

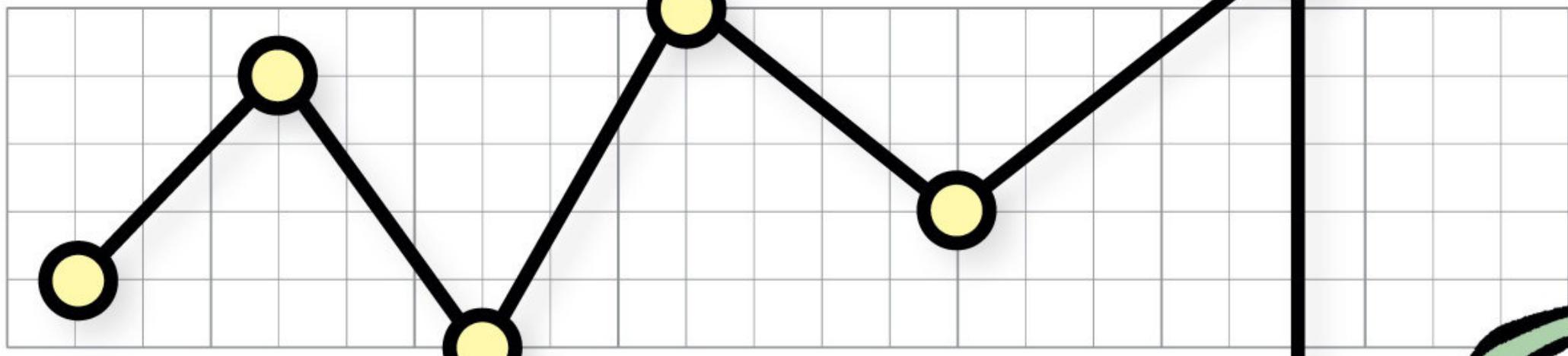
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September-
October
2019



Are **METRICS** Undermining Your Business?

Too many leaders
confuse numbers
with strategy.

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Abeselom Zerit/500px/Getty Images

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The Tyranny of Numbers



HBR Press team members Lindsey Dietrich, Brian Galvin, and Felicia Sinusas with Adi Ignatius

METRICS ARE A FACT of business life—essential to measuring performance and executing strategy. But they can be pernicious. In “Don’t Let Metrics Undermine Your Business,” Michael Harris of Kenan-Flagler Business School and Bill Tayler of the Marriott School of Business demonstrate that performance management is frequently conflated with strategy—producing all sorts of unwelcome consequences. The problem is that business metrics are inherently imperfect; most are used to quantify an intangible goal. Even earnings, the most common measure, represents an abstract concept. As the authors say, “Your performance management system is full of metrics that are flawed proxies for what you care about.”

Consider what happens when a company makes “delighting the customer” a strategic objective. As Harris and Tayler note, the company will probably track its progress through online customer surveys. But then employees start thinking that the strategy is to maximize survey scores rather than to deliver a great customer experience. So they may begin pestering customers to give them high scores or send out constant nudges

to take the survey—pop-ups, follow-up emails, robocalls. These make for a decidedly undelightful experience.

Harris and Tayler show that we often confuse what’s being measured with the metric itself—a tendency called surrogation. This can be especially dangerous when the metric is not in fact well matched to the strategy. Consider what happened when Wells Fargo made long-term banking relationships a strategic priority and used cross-selling as its metric. Employees scrambling to meet sales goals opened up millions of deposit and credit card accounts without customer consent. The impact has been staggering. The bank has faced billions of dollars’ worth of fines, legal damages, and litigation expenses. Surrogation in this case led to prioritizing sales numbers over the long-term health of the organization and its stakeholders. That’s surely the very opposite of sound strategy.



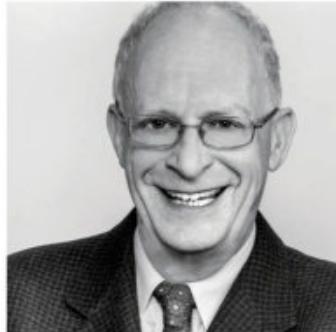
ADI IGNATIUS Editor in chief

Contributors



Like many marketing professors, Bart de Langhe studies the use of data analytics in decision making. But he focuses not so much on the data as on how people interpret it. “I am continually surprised by how often people draw the wrong conclusions,” he says. “To understand these errors and correct them, you need a psychologist’s perspective.” In this issue de Langhe—who has two degrees in psychology—and his coauthor examine how we instinctively categorize information and how that tendency can lead decision makers astray.

80 The Dangers of Categorical Thinking



In 1983 the economist **Oliver Hart** began researching a problem: Contracts are inevitably incomplete, and parties to them don’t always act in a rational manner. His resulting theories earned him the 2016 Nobel Prize in economics (with Bengt Holmström). While in Stockholm to accept the prize, he met David Frydlinger. “Some of my ideas resonated with his experience as a lawyer, and we started working together to marry theory and practice,” Hart says. Their collaboration, which eventually included Kate Vitasek, produced a radically new type of “relational” contract for businesses, which they describe in this issue.

116 A New Approach to Contracts



At three o’clock one morning in 2010, **Jennifer Petriglieri** decided to give up on her career. The wife of a professor and the mother of two young children, she was moving from the corporate world to academia—and she was exhausted. When she announced her intention at breakfast, her husband replied, “That’s ridiculous!” So they worked together to overcome the challenges of dual-career life—a subject she pursued in her academic research. That led to the book *Couples at Work*, on which her article in this issue is based.

44 How Dual-Career Couples Make It Work



In the 1960s, when **Richard Boyatzis** was working as an aerospace research scientist, he recognized a big failing: Managers weren’t very good at helping their reports learn and grow. He looked into other professions and found a similar situation. In the 1980s Boyatzis joined Case Western Reserve University and began dozens of longitudinal, hormonal, and fMRI studies aimed at uncovering how effective coaching works. He and his coauthors distilled their findings in the book *Helping People Change*, from which their article in this issue is drawn.

151 Coaching for Change



Catherine Nelson began her career in the film industry, working as a visual effects designer on dozens of movies, including *Moulin Rouge!* and *Harry Potter and the Prisoner of Azkaban*. In 2008 she opened an art studio and began creating her own work. For each one of her images in this issue, she says, “I took hundreds of photos and applied my visual effects skills.” Her goal, she explains, is “to tell a lot of different stories about nature in a single image.”

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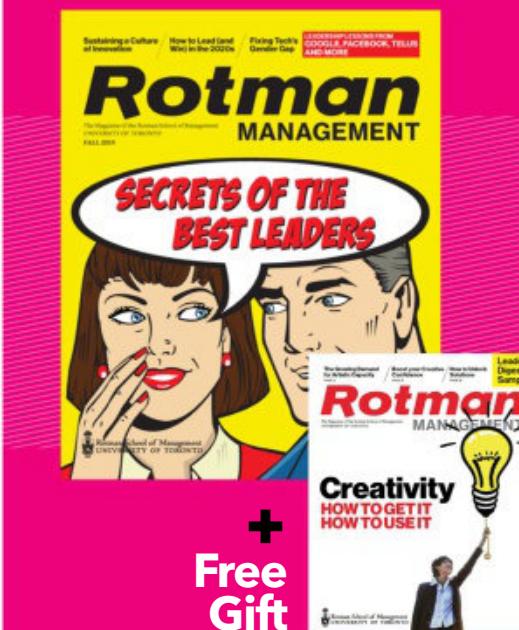
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IN THEORY

THE #MeToo BACKLASH

New data shows negative effects for women.

IN THE FALL OF 2017, when the *New York Times* and other media began reporting on widespread sexual harassment and assault by powerful male entertainment figures, many people were heartened. The conventional wisdom was that bringing the issue to light and punishing those responsible would have a deterrent effect. Leanne Atwater,

a management professor at the University of Houston, had a different response. “Most of the reaction to #MeToo was celebratory; it assumed women were really going to benefit,” she says. But she and her research colleagues were skeptical. “We said, ‘We aren’t sure this is going to go as positively as people think—there may be some fallout.’”

In early 2018 the group began a study to determine whether their fears were founded. They created two surveys—one for men and one for women—and distributed them to workers in a wide range of industries, collecting data from 152 men and 303 women in all.

First the researchers sought to understand whether men and women held different views about what constitutes sexual harassment. They took this tack because men accused of the behavior frequently claim they didn't understand how their actions were being perceived, while women who report it are sometimes deemed overly sensitive. The surveys described 19 behaviors—for instance, continuing to ask a female subordinate out after she has said no, emailing sexual jokes to a female subordinate, and commenting on a female subordinate's looks—and asked people whether they amounted to harassment. For the most part, the two genders agreed. For the three items on which they differed, men were more likely than women to label the actions harassment. "Most men

know what sexual harassment is, and most women know what it is," Atwater says. "The idea that men don't know their behavior is bad and that women are making a mountain out of a molehill is largely untrue. If anything, women are more lenient in defining harassment."

Next the researchers explored the incidence of harassment in the workplace. Sixty-three percent of women reported having been harassed, with 33% experiencing it more than once. A woman's age, the supervisor's gender, whether the woman filled a blue-collar or a white-collar role, and whether she was married had no bearing on the likelihood that she had been harassed. Just 20% of women who had been harassed reported the episode; among those who didn't, the chief deterrents were fear of negative consequences and apprehension that they would be labeled troublemakers. Five percent of men admitted to having harassed a colleague, and another 20% said that "maybe" they had done so.

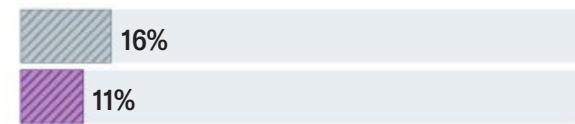
The study's biggest surprise has to do with backlash. Respondents said they

Unintended Consequences

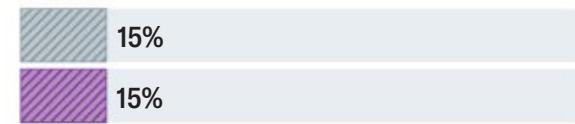
The researchers' 2018 survey results, below, showed that in the wake of #MeToo, many people expected men to become more reluctant to engage with women at work in certain ways—even though such activities can be crucial for advancement. (A follow-up survey in 2019 showed that the backlash was even worse than anticipated.)

 Men who agree  Women who agree

I will/would be more reluctant to hire attractive women.



I will be more reluctant to hire women for jobs that require close interpersonal interactions with men (for example, traveling).



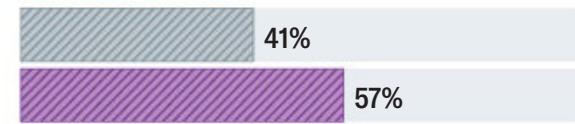
The more women who come forward about sexual harassment, the more likely it will be that men blame women for the problem.



Men in general will be more likely to exclude women from social interactions.



Men in general will be more reluctant to have one-on-one meetings with women with no others present.



expected to see some positive effects of the #MeToo movement: For instance, 74% of women said they thought they would be more willing now to speak out against harassment, and 77% of men anticipated being more careful about potentially inappropriate behavior. But more than 10% of both men and women said they thought they would be less willing than previously to hire attractive women. Twenty-two percent of men and 44% of women predicted that men would be more apt to exclude women from social interactions, such as after-work drinks; and nearly one in three men thought they would be reluctant to have a one-on-one meeting with a woman. Fifty-six percent of women said they expected that men would continue to harass but would take more precautions against getting caught, and 58% of men predicted that men in general would have greater fears of being unfairly accused.

Because the data was collected soon after the #MeToo movement gained momentum, and because much of it focused on expectations, the researchers conducted a follow-up survey (with different people) in early 2019. This revealed a bigger backlash than respondents had anticipated. For instance, 19% of men said they were reluctant to hire attractive women, 21% said they were reluctant to hire women for jobs involving close interpersonal interactions with men (jobs involving travel, say), and 27% said they avoided one-on-one meetings with female colleagues; only one of those numbers was lower in 2019 than the numbers projected the year before. The researchers say that some of the behaviors are manifestations of what is sometimes called the Mike Pence rule—a reference

to the U.S. vice president's refusal to dine with female colleagues unless his wife is present. "I'm not sure we were surprised by the numbers, but we were disappointed," says Rachel Sturm, a professor at Wright State University who worked on the project. "When men say, 'I'm not going to hire you, I'm not going to send you traveling, I'm going to exclude you from outings'—those are steps backward."

The researchers have several recommendations for organizations looking to reduce harassment, a number of which involve prevention training. Their study shows that traditional sexual harassment training has little effect, perhaps because much of it focuses on helping employees understand what constitutes harassment, and the data shows they already do. Instead, the researchers say, companies should implement training that educates employees about sexism and character. Their data shows that employees who display high levels of sexism are more likely to engage in negative behaviors, and they believe training can reduce those levels. Their data also shows that people of high character—those who display virtues such as courage—are less likely to harass and more likely to intervene when others do. "Though character building in organizations is on the cutting edge and consultants are just learning how to do this, there are training resources available," the researchers write.  **HBR Reprint** F1905A



ABOUT THE RESEARCH "Looking Ahead: How What We Know About Sexual Harassment Now Informs Us of the Future," by Leanne E. Atwater, Allison M. Tringale, Rachel E. Sturm, Scott N. Taylor, and Phillip W. Braddy (*Organizational Dynamics*, forthcoming)

IN PRACTICE

"People Are Trying to Figure Out How to Respond"

In 2015 the Canadian Armed Forces launched Operation HONOUR, aimed at preventing sexual misconduct and assault among military personnel. As part of that effort **Denise Preston**, a psychologist who has worked with victims and imprisoned sex offenders, was hired in 2017 as the executive director of the Sexual Misconduct Response Centre, which operates outside the military chain of command to support victims of sexual misconduct and lead prevention efforts. She spoke with HBR about the center's work. Edited excerpts follow.

Do you agree with one of the findings of this research—that most men and women understand what constitutes sexual harassment even though the behavior persists?

When you ask most people about sexual harassment, sexual assault, or issues around consent, they understand on a conceptual level when something is wrong. But they don't see it so clearly when it's their own behavior. On a theoretical

level, perpetrators understand what's wrong, but they have rationalizations for why it doesn't apply to them.

Then what kind of training can help? There isn't a simple solution. Basic awareness training—making sure people understand what the laws are, what their rights are, and how to access resources if they need them—is important, but it doesn't necessarily change perpetrators' behavior. We also have to teach specific skills. Create scenarios tailored to the audience—situations that will resonate. If people are comfortable, try role-playing. Talk to people about how they'd handle a given situation—why one person would respond one way and someone else another way—and discuss the best responses. That kind of training, including bystander intervention training, gives people tangible skills to practice, and those skills become an automatic reflex.

Is sexual harassment a bigger problem in the military than in the private sector? Research shows that two significant risk factors for sexual harassment are male-dominated organizations and hierarchical ones. Both descriptions apply to the military. But sexual harassment is endemic; it occurs in every industry around the world.

Are you seeing a backlash as sexual harassment gets more attention? According to anecdotes and survey data, some men in the Canadian



Armed Forces feel guilt by association—that there's a pervasive message that all men are potential perpetrators. We've heard from male senior officers who are uncomfortable meeting one-on-one with female subordinates. Women in some units report being excluded from certain social events. The reports are unfortunate but not surprising. People are trying to

figure out how they fit in, how to respond to these issues, and how to stay safe.

Is the prevention work making a difference? Statistics Canada, an independent national office, surveyed sexual misconduct in the Canadian Armed Forces in 2016 and 2018. Unfortunately, the rate of self-reported sexual assaults did not drop in that

time, consistent with national trends that have stayed steady for 20 years. But there are positive findings, including a 10% decrease in people who have witnessed or experienced sexualized or hostile behavior. There were reductions in the 15 other types of negative behavior measured. We attribute that to the training the Canadian Armed Forces has put in place. ☰

INVESTMENT

Beware Excessively Chipper CEOs

The economist John Maynard Keynes wrote of the “animal spirits” that can affect the stock market and the economy, and economists routinely monitor consumer and investor sentiment for clues about where the business cycle and markets are heading.

A new study highlights another measure of mood: manager sentiment. Drawing on transcripts of quarterly conference calls with investors and management discussions in 10-K and 10-Q filings—more than 375,000 documents in all—researchers used textual analysis tools to count the positive and negative words in all statements for each month from January 2003 to December 2014. They calculated the difference between the two types of words and divided by the total number of words to arrive at a “monthly financial statement tone.” Next they examined aggregate stock returns for the subsequent month, three months, six months, nine months, and 12 months. The more positive corporate managers were in their communications, the worse the market performed. Comparing their indicator with others, such as the consumer sentiment measures produced by the University of Michigan and the Conference Board, the researchers found that manager sentiment was a better predictor of stock price movements.

The researchers believe that high degrees of positivity signal that managers are overconfident and apt to



overinvest, causing profits to decline. “Corporate managers as a whole tend to be overly optimistic when the economy and the market peak, and the manager sentiment index is a contrarian return indicator,” they write.



ABOUT THE RESEARCH “Manager Sentiment and Stock Returns,” by Fuwei Jiang et al. (*Journal of Financial Economics*, 2019)

PERFORMANCE

If You Think You’re Multitasking, You’ll Do Better

We may pride ourselves on our ability to multitask, but cognitive scientists know that strictly speaking, there’s no such thing: Most activities requiring active attention can’t be done simultaneously, and we’re really just rapidly switching between them, generally with poor results. New research shows there’s reason not to shatter our illusions: Across 32 studies, people who perceived themselves as doing two things at once

(for example, listening to a lecture and taking notes) outperformed people primed to see the same activity as consisting of a single task (taking lecture notes). Those who identified as multitaskers took more and higher-quality notes in the scenario above; they also proved better at word-search puzzles, video transcriptions, and math problems. This happened, the researchers say, because of heightened engagement: Multitasking is viewed as challenging, so people want to demonstrate their proficiency at it. “[Although] working on more than one task is detrimental to performance...separating an activity into its components and merely creating the perception of multitasking could improve people’s performance,” the researchers write. “Furthermore, if people are already engaged in multiple tasks, making them aware that they are multitasking should increase engagement and help them perform better.”



ABOUT THE RESEARCH “The Illusion of Multitasking and Its Positive Effect on Performance,” by Shalena Srna, Rom Y. Schrift, and Gal Zauberman (*Psychological Science*, 2018)

CUSTOMER SERVICE

Does the Squeakiest Wheel Get the Most Grease?

A new study tests the common belief that the angrier people appear after a service failure, the more compensation they'll get—and shows that often the reverse is true. The effect of intense anger on service reps, the researchers found, varies according to a cultural trait known as *power distance*, or PD: a person's level of acceptance of power differences and hierarchy. Across four experiments involving simulated service interactions, participants with high PD—those who accepted power differences as natural or inevitable—gave more compensation to mildly angry customers than to intensely angry ones, while participants with low PD did just the opposite. Why? The high-PD subjects saw displays of intense anger as inappropriate and punished them, while the low-PD subjects saw the displays as threatening and rewarded them. But when the perception of threat was mitigated (participants were told that customers couldn't harm them), low-PD people, too, gave more compensation to mildly angry customers.

PD varies on both individual and societal levels, the researchers say; for example, Singapore is a high-PD culture, while Israel is a low one. Given the cultural diversity of service employees and the increasing globalization of such work, they advise, firms can benefit from

CORPORATE CONTAGION

Following public revelations that a firm has engaged in accounting misconduct, robberies and thefts in the surrounding community rise by more than 3%.

"The Local Spillover Effect of Corporate Accounting Misconduct: Evidence from City Crime Rates," by Eric Holzman, Brian P. Miller, and Brian Williams

assessing reps' PD and tailoring emotional management training accordingly; the goal is to avoid having reps over- or undercompensate customers simply because of how angry they appear.

"For low-PD service employees, managers might minimize perceptions of threat by fostering a climate of support and helping employees feel protected by the organization," the researchers write. "In contrast, training for employees in cultures with high PD might

emphasize...the need to think carefully about how best to serve customers without automatically penalizing an emotional tone considered to be inappropriate."



ABOUT THE RESEARCH "When and Why a Squeakier Wheel Gets More Grease: The Influence of Cultural Values and Anger Intensity on Customer Compensation," by Ella Glikson et al. (Journal of Service Research, 2019)

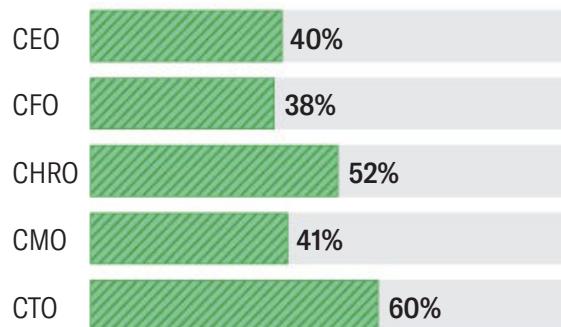


SUCCESSION

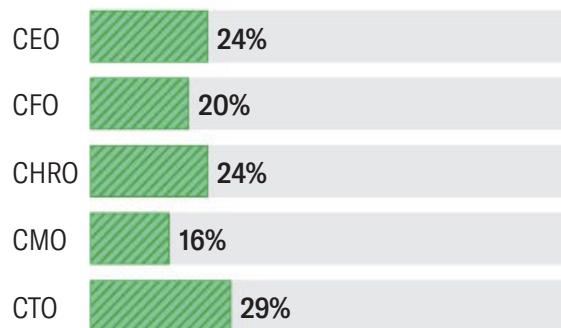
How Deep Is Your Bench?

Most boards regularly talk about who might replace the CEO and when. But a global survey of nearly 900 C-suite executives shows that many firms actually have better-developed plans for some other top functions.

Share who say their firm has a comprehensive succession plan for their role:



Share who say a suitable internal successor exists for them:



Source: "Where Are Your Next Top Executives?" by Bryan Proctor, John Petzold, and Craig Stephenson (Korn Ferry, 2019)

MOTIVATION

"Fresh Starts" Can Backfire

Performance resets are common: For example, metrics such as sales tallies and billable hours are often set back to zero at the start of a calendar cycle. This is thought to inspire people to set new goals and strive for improvement. But



what about people who were already doing well? A new study finds that for them, resets are demotivating and cause performance to decline.

The researcher analyzed archival data from Major League Baseball. When a player is traded to a team in a different league, his season-to-date statistics are reset. Examining traded players' at bats from 1975 to 2014, the researcher found that trades across leagues had a bigger effect on batting averages than trades within a league—and whether the effect was positive depended on pre-trade performance. When that was one standard deviation below the league average, an across-league trade was followed by a nine-point increase in batting average; when it was one standard deviation above the league average, an across-league trade was followed by a 13-point decline. Subsequent experiments involving word searches and anagrams found a similar pattern: Resets helped low performers but hurt high ones. This happens, the researcher says, because resets affect self-efficacy, or confidence about future

performance. When people regard their past performance as weak, a reset boosts self-efficacy and increases the motivation to continue, but the opposite occurs when people regard their past performance as strong. These findings can help companies leverage resets as a motivational tool, the researcher suggests. "Given a chance to put past performance failures behind them, employees may...recover more easily," she writes. "However, managers should be aware that performance resets affect employees differently.... [They] may consider communicating positive expectations to and instilling confidence in top performers when a reset occurs."



ABOUT THE RESEARCH "A Double-Edged Sword: How and Why Resetting Performance Metrics Affects Motivation and Performance," by Hengchen Dai (Organizational Behavior and Human Decision Processes, 2018)



IdeaWatch

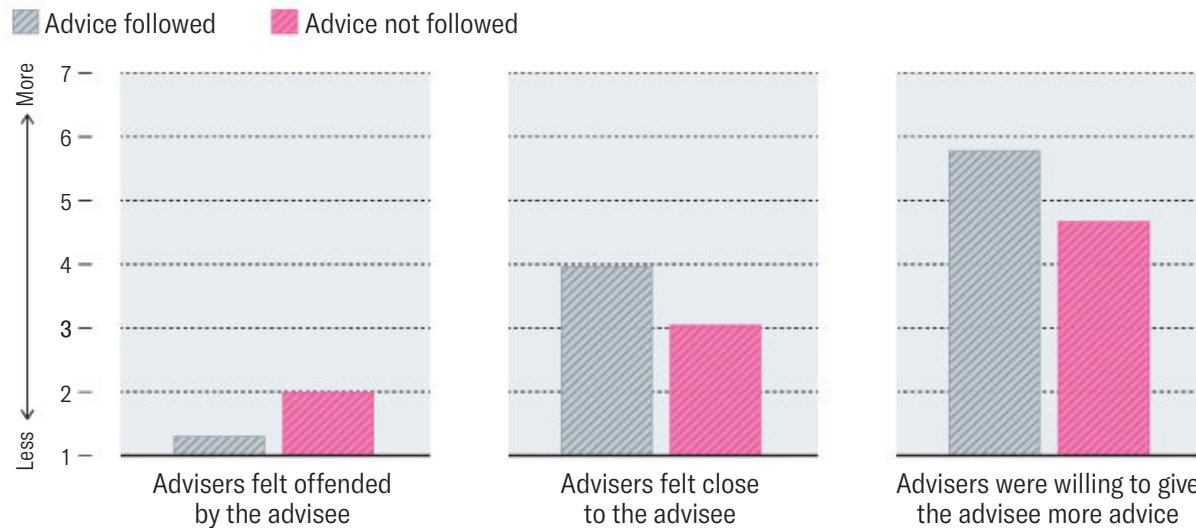
WORTH THE WAIT?

For each hour of scheduled layover time on an itinerary booked with a major U.S. airline, passenger fares decrease by an average of \$42.74 to \$47.60—and for passengers on United, the drop is \$61.89.

"Are Passengers Compensated for Incurring an Airport Layover? Estimating the Value of Layover Time in the U.S. Airline Industry," by Alexander Luttmann

DECISION MAKING

Beware the Costs of Ignoring Advice



When facing an important decision, it's natural to solicit guidance. But if you then disregard that guidance, your relationship with your adviser may suffer. New research shows that people tend to distance themselves from those who ignore the advice they'd asked for. They also do so if they discover that the advice of others was also sought. The graph above shows how 143 participants in an interactive experiment reacted, on average, to advice seekers across three interpersonal measures after learning whether or not their suggestions had been followed.

Source: "Seeker Beware: The Interpersonal Costs of Ignoring Advice," by Hayley Blunden et al. (*Organizational Behavior and Human Decision Processes*, 2019)

MARKETING

It Pays to Reveal Production Costs

Companies rarely disclose the cost of producing a good—but a new study suggests that often they should. In a field experiment with the dining service of a large U.S. university, customers saw one of two signs about the chicken soup for sale: a list of ingredients, or a list of ingredients showing the cost of each one plus the cost of labor. Over the course of five weeks and more than 50 hours of lunchtime sales, customers who saw the costs were 21% likelier than others

to buy a bowl of soup. Five subsequent experiments involving a variety of products (wallets, travel packages, T-shirts) replicated the result and provided insight into the reason for it. "Although firms typically treat their costs as tightly guarded secrets, the present research points to a potential upside of revealing them," the researchers write. "Just as when people reveal sensitive information, when firms do so, it can engender trust and deepen the relationship among companies and consumers."



ABOUT THE RESEARCH "Lifting the Veil: The Benefits of Cost Transparency," by Bhavya Mohan, Ryan W. Buell, and Leslie K. John (working paper)

ETHICS

How to Set Goals That Lessen the Temptation to Cheat

Managers have long used ambitious goals as motivational tools, but that can backfire, with employees sometimes crossing ethical lines to make their numbers. Recall Wells Fargo, where employees created millions of unapproved accounts in an effort to satisfy lofty sales targets. Yet numerous studies have shown that when goals are made less challenging or are dispensed with altogether, performance declines—creating a dilemma for managers seeking to drive results without inadvertently encouraging unethical behavior.

A new study suggests a way around the problem, relating to the *type* of goal that is set. In one experiment, 231 university students were given three rounds of anagrams to solve. In the final round they did not have to show their solutions but merely had to check a box next to each anagram they had unscrambled. One group of students was told that the task was intended to evaluate their performance—a so-called *outcome goal*. Another group was told that the task was meant to develop their skills—a *learning goal*. Sixty-one percent of the students with an outcome goal inflated their performance, versus 44% of those with a learning goal. This happened, the researchers say, because outcome goals stimulate what's known as a prevention focus: People become so intent on preventing a negative outcome

that they will go to great lengths to avoid falling short.

Experiments involving numerical problem solving yielded similar results, and the effect was heightened when the goals were especially difficult. Importantly, framing a task as a learning exercise had no negative effect on how well participants did. “Managers can motivate performance and avoid unethical behavior if they implement challenging learning goals rather than assigning ends-focused outcome goals,” the researchers write.

ABOUT THE RESEARCH

“Reconceptualizing Goal Setting’s Dark Side: The Ethical Consequences of Learning Versus Outcome Goals,” by David Welsh et al. (*Organizational Behavior and Human Decision Processes*, 2019)

RETENTION

Worried About Turnover? Ask Workers for Feedback

Unhappy employees have two basic options: speak up or quit. A new study shows that providing outlets for the former can reduce the incidence of the latter. Researchers asked 2,000 frontline workers at a large Indian manufacturer about their expectations for the next scheduled wage hike. After the company announced the raise—which was much lower than people had anticipated—they administered an employee satisfaction survey to half the group. Data collected



over subsequent months revealed that employees in the survey group were 20% less likely to quit than employees in the control group were; they were also less likely to miss work. Moreover, the researchers write, “the effects of this voice intervention were strongest among those most disappointed by the wage hike—individuals [whose] expectations for the hike...were much higher than was actually realized.” They say that SMS and app-based technologies that allow anonymous communication could be deployed to good effect, especially in low-skill manufacturing contexts.

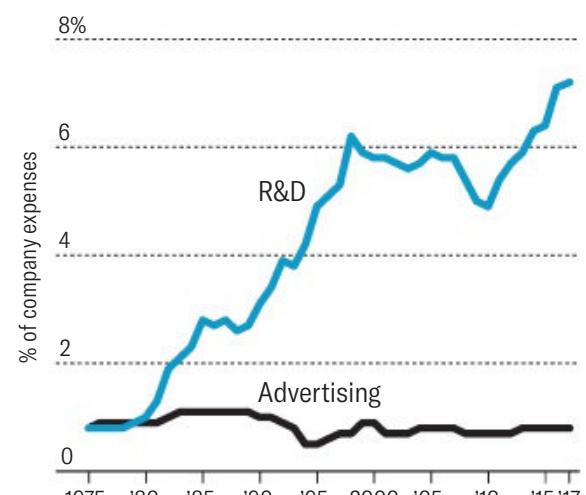
ABOUT THE RESEARCH

“Expectations, Wage Hikes, and Worker Voice: Evidence from a Field Experiment,” by Achyuta Adhvaryu, Teresa Molina, and Anant Nyshadham (working paper)

INNOVATION

More R&D, Fewer Ads

Since the 1970s R&D spending has soared relative to ad spending. Why? Digital media has lowered the price of ads; firms are acquiring rather than building brands; word of mouth and online reviews help drive sales; and tech-minded CEOs are more passionate about inventing than about marketing.



Note: Data set includes public companies listed in the United States. Source: Compustat

Chad H. Van Iddekinge of Florida State University and his colleagues reviewed 81 studies to investigate the link between an employee's prior work experience and his or her performance in a new organization. They found no significant correlation between the two. Even when people had completed tasks, held roles, or worked in functions or industries relevant to their current ones, it did not translate into better performance. **The conclusion:**

Experience Doesn't Predict a New Hire's Success



**Professor Van Iddekinge,
DEFEND YOUR RESEARCH**

VAN IDDEKINGE: We were surprised. It seems so intuitive that applicants who have general work experience or have already done the job that they're applying for would be at an advantage. But when we looked at all these studies—and we sifted through thousands to find the 81 with pertinent data—we discovered a very weak relationship between prehire experience and performance, both in training and on the job. We also found zero

correlation between work experience with earlier employers and retention, or the likelihood that a person would stick with his or her new organization.

HBR: But isn't experience the first thing companies look for when screening candidates? Absolutely. We sampled 115 Monster.com job ads and found that 82% either required or stated a strong preference for experience. Most organizations think that it's important,

even for entry-level jobs. Unfortunately, the evidence doesn't support the idea that applicants with more experience will be better or longer-tenured employees than those with less.

How did the studies measure performance? It varied, but typically in two ways: either supervisor evaluations—such as annual reviews—or more-objective, quantifiable metrics, such as sales or, in one paper on sewing-machine operators, parts produced.

What types of jobs and industries are we talking about here? The ones most represented were protective services (police, firefighters) and then sales and customer service jobs. Study participants mainly worked in frontline positions, though some were managers. None were at the senior executive level. But we captured 15 of the 23 job families listed by the U.S. Labor Department's Occupational Information Network, so we felt it was a pretty good representation of the U.S. economy.

Why on earth wouldn't people with experience—especially directly relevant experience—outperform those without it? My coauthors—John Arnold of Florida State University, Rachel Frieder of the University of North Florida, and Philip Roth of Clemson University—and I have speculated about that. One possibility is that many measures of experience are pretty basic: the number of jobs you've held, tenure at your previous employers, years of total work, whether or not you've previously worked

in a similar role. Those metrics tell us whether a candidate possesses experience but not about the quality or significance of that experience, which would probably have more bearing on performance. One of the basic premises in our area of research is that past behavior predicts future behavior. But prehire experience isn't a measure of behavior. The person might have failed or stagnated in previous jobs. So we should take experience into account but maybe do a better job of delving into prehire *performance*. We also want to know whether candidates have learned from their prior experiences. People aren't always good at that; they might forget things that have gone wrong or explain them away. And, last, we need to consider that experience in one organization might not help—and might even hurt—performance in another if they don't operate the same way or have similar cultures.

Don't interviews and reference checks help employers figure all that out?

Yes, especially when you ask behavioral questions like "How have you previously handled difficult clients? Tell me about a specific situation, what you did, and what the outcome was." But not all employers evaluate candidates that way. And it's possible that applicants who could answer well have already been screened out due to their lack of traditional work experience.

What factors beyond experience should we consider? Well, another reason employers look for hires with experience is that they think previous jobs have helped those people build up knowledge and skills. They might even think that candidates who have done certain types of work have particularly desirable personality traits. But we'd recommend focusing on the knowledge, skills, and traits directly rather than using experience or even education as a proxy.

Are there any scenarios in which experience matters? We did identify a couple of situations in which it does seem to have more of a benefit. First, we found a smaller set of studies within our data set that looked at prehire experience and performance on the job after three months, two years, and five years. Although the relationship was weak at the two- and five-year marks, it was stronger at three months, so experience appears to have helped some people as they were getting started. Maybe it's because they were accustomed to employment and organizational life and could hit the ground running. Or perhaps managers gave the employees who came in with experience better ratings at first. But over time employees' prehire experience became less and less important to performing their current job.

Second, again in a smaller number of studies, we saw measures of experience more at the task level. So, for example, instead of asking pilots or truck drivers how many years they'd worked in those jobs, employers would ask how many hours they'd logged flying or driving. Those metrics were better predictors of future performance.

Is it realistic to think that HR departments and hiring managers will stop screening for experience? You can understand why so many organizations do it: Experience is easy to assess. Have you worked in sales for three years? Have you managed people before? It's either a yes or a no. Past performance and existing knowledge and skills are more difficult to figure out, especially if all you have is an application or a résumé. But today, when everyone is complaining about the skills shortage and the war for talent, companies can't afford to knock out candidates who would do really well but don't have the experience that someone has chosen to put in the job

description. You want to expand the pool of people you're considering.

Are there any other simple screens we could use instead? Probably, but they would vary by organization and job. The key thing is evidence of correlation with job performance. Let's say there's a role you need to fill in the sales department and you see over time that people who majored in marketing tend to stay longer and get better customer reviews than those who studied other subjects. That could be a viable screen. For another job it could be having some certification; the data might show that employees who have it outperform their peers, so you look for it when hiring. Companies could consider using other screening tools, too, like job-relevant tests. The problem is that most organizations don't take those steps. They use data to make decisions about products, marketing, and finance, but they don't use it to make decisions about people—at least not effectively.

Does experience within an organization matter? We didn't look at posthire experience, but other research suggests that there is a link between how long someone has been in the job or working at a company and how well they perform. It's not a superstrong relationship, but it's something companies might consider when deciding on promotions and transfers. Is experience more important for managers? That's something we're looking at now. If, say, a sales rep wants to be a sales manager, how much does his or her experience in that lower-level job predict success in the more senior one?

I've been a senior editor at HBR for nine years and a professional journalist for two decades. Do you think I'll do a good job on this piece? I have no idea. ☺

Interview by Alison Beard
HBR Reprint F1905B

HOW I DID IT

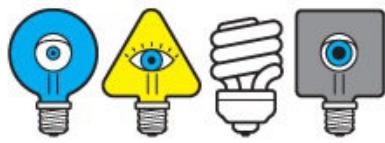


THE CEO OF CANADA GOOSE ON CREATING A HOMEGROWN LUXURY BRAND

by Dani Reiss

I CLEARLY REMEMBER the exact day in 2001 when I decided that Canada Goose, the small family business I'd recently taken over from my parents, would commit to always making our signature parkas in Canada. I was sitting at my desk, upstairs from our Toronto

factory (the only one we had at the time), reading that morning's newspaper headlines, and I saw that two North American apparel companies were moving their manufacturing abroad. Their leaders gave two reasons: First, the high cost of domestic labor had been



IdeaWatch

squeezing their margins, so it was just good business to pursue higher profits elsewhere. Second, they didn't believe that customers cared where products were made so long as the brand and the quality remained the same.

I thought to myself, *They're wrong.*

I believed, as I still do today, that achieving mass distribution by competing on price is not the way to succeed; that's how you build commodity brands. I knew that to create a sustainable global business, we would have to grow from a foundation of undeniable core values that prioritized quality over quantity.

I'd also learned from my early days at international trade shows that many customers in Europe and Asia do indeed care where goods are produced, especially high-value ones. I saw firsthand that they had a passion for authentic, high-quality, Canadian-made outerwear (after all, who knows cold better than Canadians?), and I suspected that over time, people would come to care about provenance even more deeply. If "Made in Canada" did become important, and we stuck around while all these other companies left, we would eventually have a huge competitive advantage.

Today Canada Goose is arguably one of the country's best-known apparel brands, selling a range of high-quality outerwear and other clothing at prices ranging from \$295 to \$1,695 in our own stores and e-commerce channels and with retail partners around the world. With three factories in Winnipeg, three in Toronto, and another two in Quebec, and training schools for sewers in each of those cities, we are also recognized



as a leader in building and rebuilding Canada's apparel manufacturing infrastructure. With our recent acquisition of Baffin, a respected Canadian footwear maker, we're now doubling down on that bet I placed years ago: that a "Made in Canada" company could become a global luxury business.

A FAMILY ENTERPRISE

In 1957 my maternal grandfather, a Polish immigrant, started the company that would eventually become Canada Goose. His Metro Sportswear was a small industrial-apparel factory with a handful of employees, some of whom still work for us today. (They like being here so much that they don't want to retire.)

In the 1970s my dad got involved in the business and soon became the president. He invented a down-filling

machine, which allowed us to be more efficient and expand our product line, and he created the in-house brand, Snow Goose, which supplied coats to tactical units across the province of Ontario and developed a cult following in the high Arctic for its extreme warmth. But most of our revenue at the time came from private-label commissions: making outerwear on which other companies put their names.

Those relationships could be unpredictable. Orders weren't always as large or as frequent as my parents would have liked, but they wanted to keep their workers employed year-round. So they sometimes accepted less-profitable orders to keep the factory running. It was not a career they wanted me to pursue: "You should be a professional and make a predictable income," they would tell me. "Running a factory is too hard."



I wholeheartedly agreed. I had no interest in the parka business or in having a job that people would think my mom and dad had given me. I didn't exactly follow their "professional, predictable" advice, however: I got a degree in English literature and set out to be a short-story writer. But first I wanted to do some traveling after graduation in 1996.

That meant I needed to earn some money, so I asked if I could work in the factory for three months, making \$12 an hour. I had zero intention of staying and certainly didn't think I'd eventually take it on as my life's work. But I liked earning an income, and I realized later that this wasn't just a "parka business"—we were making something real. Our products had meaning that resonated with customers.

While working at the company, I also had some ideas about how the business

could be improved. For example, this was in the early days of email and the internet, and we didn't use either of them—so I set up an email account and built our company's first website. My three-month stay turned into six months and then into a few years; it's now been more than two decades since I started.

As early as 1998 I began attending trade shows around the world. I discovered that in Japan and Europe, where we used the name Canada Goose (because Snow Goose was already trademarked), our little in-house label really meant something. Consumers recognized that people who lived and worked in the coldest places in the world wore our coats. I realized that our authentic reputation was the foundation for an iconic brand.

If we were to build on that foundation, though, we would have to get out

Inside a manufacturing facility in Toronto—one of seven that Canada Goose operates in Canada, which together make it the country's leading employer of cut-and-sew workers.

of the private-label business, eliminate the Snow Goose name, and focus exclusively on Canada Goose.

BUILDING THE BRAND

In 2001 I told my parents I was ready to run the company if they were willing to let me, which meant making some big changes. My dad was an industrial guy, but he understood the branding push I wanted to make. (He may also have found it ironic, because as a kid, I hated labels so much that I cut the alligators off my Lacoste shirts.) To his credit, he let me take the reins and pursue



We couldn't afford glossy ad campaigns, so we focused on word of mouth and telling real stories.

my own vision for what Canada Goose could become.

Slowly but steadily, I got out of our private-label deals and focused solely on the Canada Goose brand. I continued to travel extensively through Europe and Asia to better understand what consumers valued. Quality, of course, was key. People wanted a well-constructed, perfectly stitched, exceptionally warm coat made from the best materials. That's something else I learned from my parents. They always saved their money to invest in high-quality products that lasted a long time, rather than buying cheaper, disposable things. Our country of origin was also critical. To many people, owning a Canada Goose jacket is like owning a little piece of Canada, and for that they're willing to pay a premium.

That's another part of what persuaded me to commit to being a "Made in Canada" brand, even as other companies were fleeing the country. I realized that although we couldn't sustain the cost of domestic manufacturing in a world where people bought one \$299 coat and kept it for a decade, we could do so in a new environment where outerwear was treated as a luxury, coveted and collected, just like high-end watches or cars. The Swiss had Rolex, the British had Range Rover—Canada could have Canada Goose.

As a still-small company, we couldn't afford glossy ad campaigns to drive consumer awareness or demand, so we focused on a different, and arguably more powerful, kind of marketing: word of mouth and telling real stories. When an expedition team traveled to the North Pole and was featured in

National Geographic, we made sure the team members were wearing our jackets. We also outfitted TV and film crews that were shooting in remote cold-weather locations where temperatures could fall well below freezing. We protected people who lived and worked in the coldest environments on earth and then shared their stories.

CREATING A NEW WORKFORCE

As awareness grew and sales began to spike, we needed to increase production capacity. We moved to a much larger manufacturing facility in Toronto and later expanded into the eight factories we now own.

We also needed a bigger talent pool. To many people's surprise, a huge amount of human craftsmanship continues to go into each of our garments. Whereas previous generations of Canadians, especially immigrants to our country, included many expert sewers, those skills are much harder to find in today's labor market. So what can you do when the workforce you need doesn't exist? You can build your own. In our training schools people learn to operate an industrial sewing machine, set a zipper, and more. In Winnipeg we've partnered with local government and employment agencies that funnel students into our programs: We've taught and hired more than 770 people in Manitoba over the past year, adding to the previously existing workforce of 1,250 in Winnipeg. Across the country we now employ more than 3,500.

Our Canadian heritage and commitment to manufacturing our parkas domestically are at the heart of our

business and brand. Many companies in our industry outsource to offshore manufacturers, but we will keep aggressively investing in producing premium products in Canada, the country from which we draw our inspiration. Wages in Canada are up to five times as high as those in factories overseas, and we believe that our production facilities and craftspeople have set us apart on the international stage and in the minds of our customers.

As we've added new apparel categories, however, we have chosen to make them where we can get the highest-quality products at the scale we need, regardless of labor costs; we're not chasing margins. When we introduced Knitwear—our first non-outerwear category—we decided after extensive research to manufacture in Italy and Romania. Building our capacity and infrastructure to meet global demand while maintaining our commitment to manufacture all our core down-filled goods on Canadian soil has easily been one of our best investments.

SWIMMING UPSTREAM

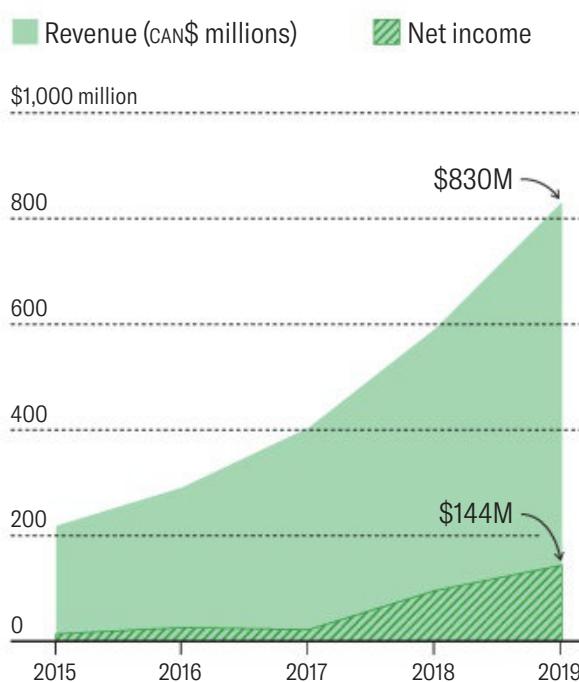
For many years I dreamed of opening our own store. Although we're fortunate to work with some of the best retailers in the world, we wanted to create a place where we could showcase our heritage and full product line and really immerse shoppers in the Canada Goose story, unfiltered.

In 2016 that dream became a reality when we opened our first stores in Toronto and New York City. We had already launched e-commerce in North America by then, so the shift from pure

FACTS & FINANCIALS

Canada Goose

Founded 1957
Headquarters Toronto, Ontario
No. of employees 3,900



Note: Fiscal year ends March 31
Source: Canada Goose

manufacturer to retailer wasn't new. But our expansion into brick-and-mortar shops, especially at a time when so many other companies were closing them, caused us to shift our thinking about the business and its operations across every department. Today we have Canada Goose stores in 12 cities around the world, and we run an international e-commerce business.

Our focus on function first and delivering an exceptional experience recently inspired us to create "cold rooms" in our stores where shoppers can test our products in temperatures as low as -25 Celsius before they make a purchase. It's

a creative—and authentic—way for us to help ensure that a customer buys the perfect jacket.

In 2017 we took the company public, which I saw as another storytelling opportunity—perhaps our biggest. This was a chance for people around the world to own a part of Canada Goose and join us on our journey. Many people warned me that being publicly listed would change us, putting pressure on the company to do whatever it takes to keep investors happy. But that's not a formula that works for us, and we made that very clear from day one. I continue to run this business with the same long-term vision I had back when I became CEO.

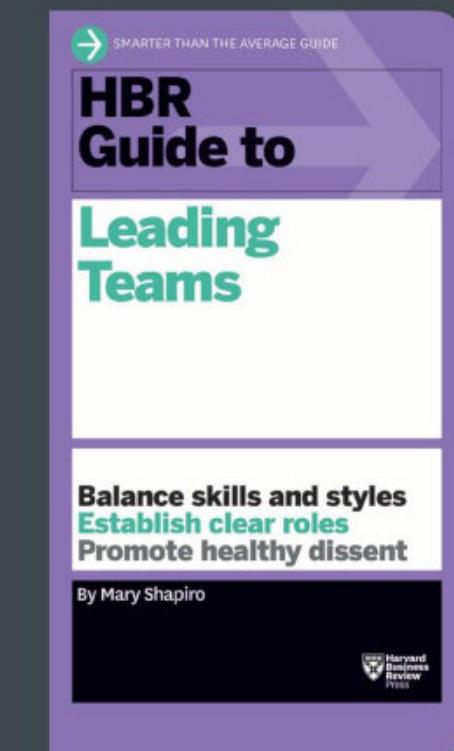
During the IPO road show we fielded questions about whether Canada Goose was a fad and whether we were worried about becoming too popular. I've heard such questions probably every year I've been at the company, yet they still make me smile. Our brand is 60+ years old, and we've been growing every year for at least the past 15 years, but in so many ways we're just getting started. I hear stories regularly from people who are only now discovering us about how much they love our products. Young, old, local, international, outdoor explorers or fashionistas, they all respond to our commitment to quality, authenticity, and staying true to our DNA. That's how we remain relevant as we grow and build an enduring brand.

And as we do, I've made it clear that one aspect of our business is nonnegotiable. Canada Goose will forever be a champion for "Made in Canada." There is simply no better way for us to remain timeless. ☰

HBR Reprint R1905A

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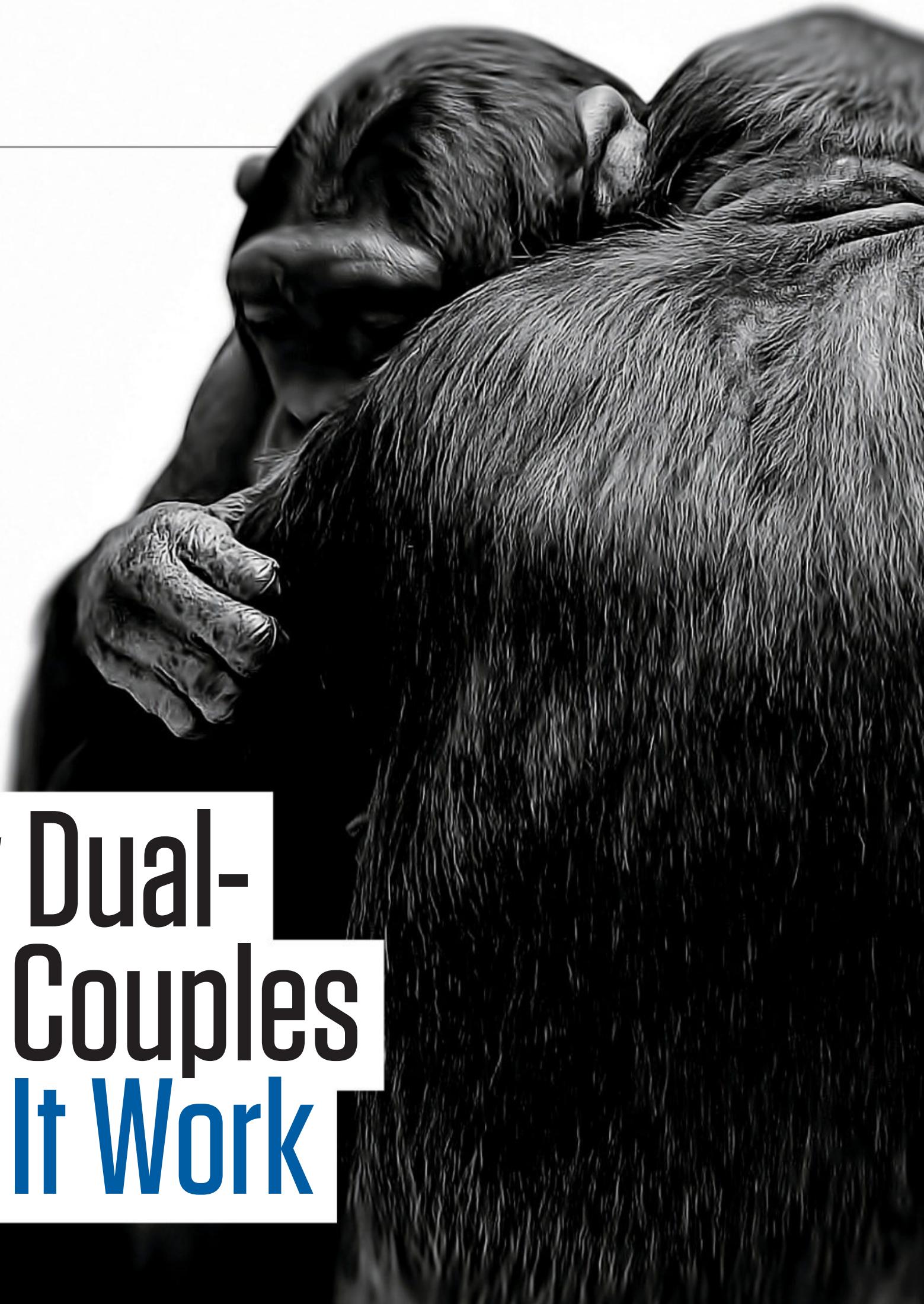
spotlight

Power Couples



Laurent Dambreville/Eyeem/Getty Images

Successful partnerships sidestep predictable traps and master three challenging transitions.



How Dual-Career Couples Make It Work

C

amille and Pierre met in their early forties after each one's marriage had ended. Both were deeply committed to their careers and to their new relationship. Camille, an accountant, had felt pressured by her ex-husband to slow her progress toward partnership at her firm. Pierre, a production manager at an automotive company, was embroiled in a bitter divorce from his wife, who had given up her career to accommodate the geographic moves that his required. (As with the other couples I've profiled in this article, these aren't their real names.) Bruised by their past experiences, they agreed to place their careers on an equal footing. Initially things went smoothly, but two years in, Camille began to feel trapped on a professional path that she realized she had chosen because "that was what the smart kids did."

Mindful of their pact, Pierre calmly listened to her doubts and encouraged her to explore alternatives. But as the months wore on, he began to feel

weighed down as he juggled providing emotional support to Camille, navigating their complex family logistics (both had children from their former marriages), and succeeding in his demanding job. When he began to question his own career direction, he wondered how the two of them could manage to change course. They couldn't afford to take time out from work, nor could they take much time to reflect and keep their family and relationship afloat. Frustrated and exhausted, both wondered how they could continue to find meaning and fulfillment in their lives.

Dual-earner couples are on the rise. According to Pew Research, in 63% of couples with children in the United States, for example, both partners work (this figure is slightly higher in the EU). Many of these are *dual-career couples*: Both partners are highly educated, work full-time in demanding professional or managerial jobs, and see themselves on an upward path in their roles. For these couples, as for Pierre and Camille, work is a primary source of identity and a primary channel for ambition. Evidence is mounting from sociological research that when both partners dedicate themselves to work and to home life, they reap benefits such as increased economic freedom, a more satisfying relationship, and a lower-than-average chance of divorce.

Because their working lives and personal lives are deeply intertwined, however, dual-career couples face unique challenges. How do they decide whose job to relocate for, when it's OK for one partner to make a risky career change, or who will leave work early to

pick up a sick child from school? How can they give family commitments—and each other—their full attention while both of them are working in demanding roles? And when one of them wants to undertake a professional reinvention, what does that mean for the other? They must work out these questions together, in a way that lets both thrive in love and work. If they don't, regrets and imbalances quickly build up, threatening to hinder their careers, dissolve their relationship, or both.

Many of these challenges are well recognized, and I've previously written in HBR about how companies can adapt their talent strategies to account for some of them ("Talent Management and the Dual-Career Couple," May-June 2018). But for the couples themselves, little guidance is available. Most advice treats major career decisions as if one is flying solo, without a partner, children, or aging parents to consider. When it's for couples, it focuses on their relationship, not how that intersects with their professional dreams, or it addresses how to balance particular trade-offs, such as careers versus family, or how to prioritize partners' work travel. What couples need is a more comprehensive approach for managing the moments when commitments and aspirations clash.

My personal experience in a dual-career couple, and my realization that little systematic academic research had been done in this area, prompted a six-year investigation into the lives of more than 100 dual-career couples, resulting in my forthcoming book, *Couples That Work*. The people I studied come from around the world, range in age from mid-twenties to mid-sixties, and represent a range of professions, from corporate executive to entrepreneur to worker in the nonprofit sector. (See the sidebar "About the Research.") My research revealed that dual-career couples overcome their challenges by directly addressing deeper psychological and social forces—such as struggles for power and control; personal hopes, fears, and losses; and assumptions and cultural expectations about the roles partners should play in each other's lives and what it means to have a good relationship or career.

I also discovered that three transition points typically occur during dual-career couples' working and love lives, when those forces are particularly strong. It is during these transitions, I found, that some couples craft a way to thrive in love and work, while others are plagued by conflict and regret. By understanding each transition and knowing what questions to ask each other and what traps to avoid, dual-career couples can emerge

stronger, fulfilled in their relationships and in their careers.

TRANSITION 1

Working as a Couple

When Jamal and Emily met, in their late twenties, trade-offs were the last thing on their minds. They were full of energy, optimistic, and determined to live life to the fullest. Jamal, a project manager in a civil engineering firm, traveled extensively for work and was given increasingly complex projects to lead, while Emily, who worked at a clothing company, had just been promoted to her first management role. They saw each other mostly on weekends, which they often spent on wilderness hiking adventures. They married 18 months after their first date.

Then, in the space of three months, their world changed dramatically. While Emily was pregnant with their first child, Jamal's boss asked him to run a critical infrastructure project in Mexico. Jamal agreed to spend three weeks out of every month in Mexico City; designating some of his pay raise to extra child care would allow Emily to keep working in Houston, where they lived. But when their daughter, Aisha, was born two weeks early, Jamal was stuck in the Mexico City airport waiting for a flight home. Soon Emily, who

Idea in Brief

THE PROBLEM

When both members of a couple have demanding careers, their work and personal lives are deeply intertwined—and often at odds.

THE TRANSITIONS

Dual-career couples tend to go through three phases of being particularly vulnerable: when they first learn to work together as a couple; when they experience a midlife reinvention; and in the final stages of their working lives.

THE SOLUTION

Couples who communicate at each transition about values, boundaries, and fears have a good chance of being fulfilled both in their relationships and in their careers.



In the first transition that dual-career couples face, they must move from having parallel, independent careers and lives to having interdependent ones.

was single-handedly managing Aisha, her job, and their home, discovered that the additional child care wasn't enough; she felt overburdened and unappreciated. Jamal was exhausted by the relentless travel and the stress of the giant new project; he felt isolated, incompetent, and guilty.

After many arguments, they settled on what they hoped was a practical solution: Because Jamal earned more, Emily took a smaller project role that she could manage remotely, and she and Aisha joined him in Mexico. But Emily felt disconnected from her company's head office and was passed over for a promotion, and eventually she grew resentful of the arrangement. By the time Jamal's boss began talking about his next assignment, their fighting had become intense.

The first transition that dual-career couples must navigate often comes as a response to the first major life event they face together—typically a big career opportunity, the arrival of a child, or the merger of families from previous relationships. To adapt, the partners must negotiate how to prioritize their careers and divide family commitments. Doing so in a way that lets them both thrive requires an underlying shift: They must move from having parallel, independent careers and lives to having interdependent ones.

My research shows two common traps for couples negotiating their way through their first transition:

Concentrating exclusively on the practical. In the first transition in particular, couples often look for logistical solutions to their challenges, as Jamal and Emily did when they arranged for

extra child care and negotiated how many weekends Jamal would be home. This focus is understandable—such problems are tangible, and the underlying psychological and social tensions are murky and anxiety provoking—but it prolongs the struggle, because those tensions remain unresolved.

Instead of simply negotiating over calendars and to-do lists, couples must understand, share, and discuss the emotions, values, and fears underlying their decisions. Talking about feelings as well as practicalities can help them mitigate and manage them.

Basing decisions primarily on money. Many couples focus on economic gain as they decide where to live, whose career to prioritize, and who will do the majority of the child care. But as sensible (and sometimes unavoidable) as this is, it often means that their decisions end up at odds with their other values and desires.

Few people live for financial gain alone. In their careers they are also motivated by continual learning and being given greater responsibilities. Outside work, they want to spend time with their children and pursue personal interests. Couples may be attracted to a location because of proximity to extended family, the quality of life it affords, or their ability to build a strong community. Basing the decision to move to Mexico on Jamal's higher salary meant that he and Emily ignored their other interests, feeding their discontent.

Couples who are successful discuss the foundations and the structure of their joint path forward. First, they must come to some agreement on

about the research

I studied 113 dual-career couples. They ranged in age from 26 to 63, with an even distribution among age groups. The majority of couples—76—were in their first significant partnership. Participants in the study came from 32 countries on four continents, and their ethnic and religious backgrounds reflected this diversity. At the time of the study, roughly 35% resided in North America, 40% in Europe, and 25% in the rest of the world. In 68 of the couples at least one partner had children. Eleven of the couples identified as gay, and the rest as straight. Just under 60% of the participants were pursuing careers in the corporate world. The others were spread roughly equally among the professions (such as medicine, law, and academia), entrepreneurship, government, and the nonprofit sector.

I interviewed the members of each couple separately, asking them about the development of their relationships, their career paths, their interactions as a couple, and their family and friend networks.

core aspects of their relationship: their values, boundaries, and fears. (See the sidebar “A Guide to Couple Contracting.”) Negotiating and finding common ground in these areas helps them navigate difficult decisions because they can agree on criteria in advance. Doing this together is important; couples that make this arrangement work, I found, make choices openly and jointly, rather than implicitly and for each other. The ones I studied who had never addressed their core criteria struggled in later transitions, because those criteria never go away.

Next, couples must discuss how to prioritize their careers and divide family commitments. Striving for 50/50 is not always the best option; neither

must one decide to always give the other's career priority.

There are three basic models to consider: (1) In *primary-secondary*, one partner's career takes priority over the other's for the duration of their working lives. The primary person dedicates more time to work and less to the family, and his or her professional commitments (and geographic requirements) usually come before the secondary person's. (2) In *turn taking*, the partners agree to periodically swap the primary and secondary positions. (3) In *double-primary*, they continually juggle two primary careers.

My research shows that couples can feel fulfilled in their careers and relationships whichever model they pursue, as long as it aligns with their values and they openly discuss and explicitly agree on their options. Couples who pursue the third option are often the most successful, although it's arguably the most difficult, precisely because they are forced to address conflicts most frequently.

To work past their deadlock, Emily and Jamal finally discussed what really mattered to them beyond financial success. They identified pursuit of their chosen careers, proximity to nature, and a stable home for Aisha where they could both actively parent her. They admitted their fears of growing apart, and in response agreed to an important restriction: They would live in the same city and would limit work travel to 25% of their time. They agreed to place their geographic boundaries around North America, and Jamal suggested that they both draw circles on a map around the cities where they

felt they could make a home and have two careers. Their conversations and mapping exercise eventually brought them to a resolution—and a new start in Atlanta, where they would pursue a double-primary model. Three years later they are progressing in their careers, happy in their family life, and expecting a second child.

TRANSITION 2

Reinventing Themselves

Psychological theory holds that early in life many people follow career and personal paths that conform to the expectations of their parents, friends, peers, and society, whereas in their middle years many feel a pressing need for *individuation*, or breaking free of those expectations to become authors of their own lives. This tends to happen in people's forties, regardless of their relationship status, and is part of a process colloquially known as the midlife crisis.

We tend to think of a midlife crisis mostly in personal terms (a husband leaves his wife, for example, and buys a sports car), but in dual-career couples, the intense focus on professional success means that the partners' job tracks come under scrutiny as well. This combined personal and professional crisis forms the basis of the second transition. Camille and Pierre, whose story began this article, were in the midst of it.

As each partner wrestles with self-redefinition, the two often bump up against long-settled arrangements they have made and the identities, relationship, and careers they have crafted together. Some of those

arrangements—whose career takes precedence, for example—may need to be reconsidered to allow one partner to quit a job and explore alternatives. It may be painful to question the choices they made together during the previous transition and have since built their lives around. This can be threatening to a relationship; it's not uncommon for one partner to interpret the other's desire to rethink past career choices as an inclination to rethink the relationship as well, or even to potentially end it. Couples who handle this transition well find ways to connect with and support each other through what can feel like a very solitary process.

The second transition often begins—as it did for Camille and Pierre—when one partner reexamines a career or life path. That person must reflect on questions such as: What led me to this impasse? Why did I make the choices I made? Who am I? What do I desire from life? Whom do I want to become? He or she should also take time to explore alternative paths, through networking events, job shadowing, secondments, volunteer work, and so forth. Such individual reflection and exploration can lead couples to the first trap of the second transition:

Mistrust and defensiveness. Living with a partner who is absorbed in exploring new paths can feel threatening. Painful questions surface: Why is my partner not satisfied? Is this a career problem or a relationship problem? Am I to blame? Why does he or she need new people? Am I no longer enough? These doubts can lead to mistrust and defensiveness, which may push the exploring partner to withdraw further



from the relationship, making the other even more mistrustful and defensive, until eventually the relationship itself becomes an obstacle to individuation, rather than a space for it.

In such a situation, people should first be open about their concerns and let their partners reassure them that the angst is not about them or the relationship. Next, they should adopt what literary critics call *suspension of disbelief*—that is, faith that the things they have doubts about will unfold in interesting ways and are worth paying attention to. This attitude will both enrich their own lives and make their partners' exploration easier.

Finally, they should understand their role as supporters. Psychologists call this role in a relationship the *secure base* and see it as vital to the other partner's growth. Originally identified and described by the psychologist John Bowlby, the secure base allows us to stretch ourselves by stepping outside our comfort zone while someone by our side soothes our anxieties about doing so. Without overly interfering, supporters should encourage their partners' exploration and reflection, even if it means moving away from the comfortable relationship they've already established.

Being a secure base for a partner presents its own trap, however:

Asymmetric support. In some couples one partner consistently supports the other without receiving support in return. That's what happened to Camille and Pierre. Pierre's experience in his former marriage, in which his wife gave up her career for his, made him determined to support Camille,

and he initially stepped up to be a secure base for her. Their lives were so packed, however, that Camille had trouble finding the energy to return the favor. The result was that her exploration and reflection became an impediment to Pierre's, creating a developmental and relationship deadlock. It is important to remember that acting as a secure base does not mean annihilating your own wishes, atoning for past selfishness, or being perfect. You can be a wonderful supporter for your partner while requesting support in return and taking time for yourself. In fact, that will most likely make you a far better (and less resentful) supporter.

In my research I found that couples who make it through their second transition are those in which the partners encourage each other to do this work—even if it means that one of them is exploring and providing support at the same time.

Once the exploring partner has had a chance to determine what he or she wants in a career, a life, or a relationship, the next step is to make it happen—as a couple. Couples need to renegotiate the roles they play in each other's lives. Take Matthew and James, another pair I spoke with, who had risen through the professional ranks in their 18 years together. When Matthew realized that he wanted to get off what he called the success train—on which he felt like a mere passenger—both he and James had to let go of their identity as a power couple and revisit the career-prioritization agreement they had forged during their first transition. Initially Matthew was reluctant to talk to James about his doubts, because he

questioned whether James would still love him if he changed direction. When they started discussing this, however, they realized that their identity as a power couple had trapped them in a dynamic in which both needed to succeed but neither could outshine the other. Acknowledging and renegotiating this unspoken arrangement allowed James to shoot for his first senior executive position and Matthew to transition into the nonprofit sector. The time and care they took to answer their existential questions and renegotiate the roles they played in each other's lives set them up for a renewed period of growth in their careers and in their relationship.

TRANSITION 3

Loss and Opportunity

Attending her mother's funeral was one of the most difficult experiences of Norah's life. It was the culmination of two years of immense change for her and her husband, Jeremy, who were in their late fifties. The change began when their fathers unexpectedly passed away within five weeks of each other, and they became caregivers for Norah's ailing mother just as their children were leaving the nest and their own careers were in flux.

Jeremy is a digital visual artist. His studio's main projects were ending because a big client was moving on. Though he was sad, he had become confident enough to feel excited about whatever might come next. Norah had been working for the same small agricultural machinery business for 26 years; she had once wanted to change careers

a guide to couple contracting

Drawing on my research, I've developed a systematic tool to help dual-career couples who are facing any of the three transitions described in this article. I call it *couple contracting*, because to shape their joint path, partners must address three areas—values, boundaries, and fears—and find common ground in each. Values define the direction of your path, boundaries set its borders, and fears reveal the potential cliffs to avoid on either side. Sharing a clear view in these three domains will make it easier to negotiate and overcome the challenges you encounter together.

First, take some time on your own to write down your thoughts about each of the three areas. Then share your reflections with each other. Listen to and acknowledge each other's responses,

resisting any temptation to diminish or discount your partner's fears. Next, note where you have common ground and where your values and boundaries diverge. No couple has perfect overlap in those two areas, but if they are too divergent, negotiate a middle ground. If, for example, one of you could tolerate living apart for a period but the other could not, you'll need to shape a boundary that works for both of you.



values

When our choices and actions align with our values, we feel content; when they don't, we feel stressed and unhappy. Openly discussing your values will make it easier to make choices that align with them. For example, if

you and your partner know you both greatly value family time, you'll be clear that neither of you should take a job requiring 70-hour workweeks.

Questions to ask each other: What makes you happy and proud? What gives you satisfaction? What makes for a good life?



boundaries

Setting clear boundaries together allows you to make big decisions more easily. Consider three types of boundaries: place, time, and presence.

Questions to ask each other: Are there places where you'd love to work and live at some point in your life? Are there places you'd prefer to avoid? Understanding that we

may sometimes have to put in more hours than we'd like, how much work is too much? How would you feel about our taking jobs in different cities and living apart for a period? For how long? How much work travel is too much, and how will we juggle travel between us?



fears

Monitoring each other's fears can help you spot trouble and take preventive action before your relationship enters dangerous territory. Many fears are endemic to relationships and careers: You may worry that your partner's family will encroach on your relationship, that over time the two of you will grow apart, that your partner will have an affair, that you will have to sacrifice your

career for your partner's, or that you may not be able to have children. But sharing these fears allows you to build greater empathy and support. If you know that your partner is worried about the role of your parents in your lives, for example, you are more likely to manage the boundary between them and your partnership sensitively.

Likewise, if you are interested in a risky career transition but worried that financial commitments would prevent it, you might agree to cut back on family spending in order to build a buffer.

Questions to ask each other

other: What are your concerns for the future? What's your biggest fear about how our relationship and careers interact? What do you dread might happen in our lives?

but felt that she couldn't do so while Jeremy was relying on her for emotional and logistical support. Now she was being asked to take an early retirement deal. She felt thrown on the scrap heap despite her long commitment to the company. No career, no parents, no children to care for—who was she now? She felt disoriented and adrift.

The third transition is typically triggered by shifting roles later in life, which often create a profound sense of loss. Careers plateau or decline; bodies are no longer what they once were; children, if there are any, leave home. Sometimes one partner's career is going strong while the other's begins to ebb. Having raced through decades of career growth and child-rearing, couples wake up with someone who may have changed since the time they fell in love.

They may both feel that way. These changes again raise fundamental questions of identity: Who am I now? Who do I want to be for the rest of my life?

Although loss usually triggers it, the third transition heralds opportunity. Chances for late-in-life reinvention abound, especially in today's world. Life expectancy is rising across the globe, and older couples may have several decades of reasonably good health and freedom from intensive parenting responsibilities. As careers and work become more flexible, especially for those with experience, people can engage in multiple activities more easily than previous generations could—combining advisory or consulting work with board service, for example. Their activities often include giving back to the community, leaving some kind

of legacy, mentoring younger generations, rediscovering passions of their youth, or dedicating themselves more to friendships.

Their task in the third transition is to again reinvent themselves—this time in a way that is both grounded in past accomplishments and optimistic about possibilities for the future. They must mourn the old, welcome the new, figure out how the two fit together, and adjust their life path to support who they want to become.

One thing that struck me when I spoke to couples in their third transition is that it's most powerful when partners reinvent themselves together—not just reflecting jointly, as in the other transitions, but actually taking on a new activity or project side by side. When one is curious about a



Because previous generations retired earlier, didn't live as long, and didn't have access to the gig economy, many couples lack role models for what reinvention can look like.

partner's life and work as well as one's own, an immense capacity for mutual revitalization is unlocked. I met many couples who were charting new paths out of this transition that involved a merging of their work—launching a new business together, for example.

The third transition also has its traps:

Unfinished business. For better or for worse, earlier relational patterns, approaches, decisions, and assumptions will influence how a couple's third transition unfolds. I found that the most common challenge in managing this transition was overcoming regret about perceived failures in the way the partners had "worked" as a couple—how they had prioritized their careers, or how each partner had supported the other's development (or not).

To move through the third transition, couples must acknowledge how they got where they are and commit to playing new roles for each other in the future. For example, Norah and Jeremy had become stuck in a pattern in which Norah was Jeremy's supporter. By recognizing this—and both their roles in cementing it—they were able to become more mutually supportive.

Narrow horizons. By the time a couple reaches the third transition, they will probably have suffered their fair share of disappointments and setbacks. They may be tired from years of taking care of others, or just from staying on the treadmill. As their roles shift and doubts about their identities grow, reinvention may be beyond consideration. In addition, because previous generations retired earlier, didn't live as long, and didn't have access to the gig economy, many couples lack role models for what

reinvention can look like at this stage of life. If they don't deliberately broaden their horizons, they miss opportunities to discover themselves anew.

So couples must explore again. Even more than in the second transition, they need to flirt with multiple possibilities. Like healthy children, who are curious about the world, themselves, and those around them, they can actively seek new experiences and experiment, avoid taking things for granted, and constantly ask "Why?" Most of us suppress our childhood curiosity as life progresses and responsibilities pile up. But it is vital to overcome the fear of leaving behind a cherished self and allow ambitions and priorities to diversify. Exploring at this stage is rejuvenating.

Shifts in people's roles and identities offer a perfect excuse to question their current work, life, and loves. Many people associate exploring with looking for new options, which is surely important. But it's also about questioning assumptions and approaches and asking, "Is this really how things need to be?"

Having rebalanced their support for each other, Norah and Jeremy could open up to new possibilities. Having earned financial security from their previous work, they sought reinvention not only in their careers but also in their wider roles in the world. Encouraging each other, they both transitioned to portfolio working lives. Jeremy became a freelance digital visual artist, took a part-time role teaching young art students at a local college, and dedicated more time to his passion of dinghy sailing. Norah retrained to be a counselor working with distressed families and began

volunteering at a local agricultural museum. With these new opportunities and more time for each other and their friends, they felt newfound satisfaction with their work and with their relationship.

THE CHALLENGES COUPLES face at each transition are different but linked. In their first transition, the partners accommodate to a major life event by negotiating the roles they will play in each other's lives. Over time those roles become constraining and spark the restlessness and questioning that lead to the second transition. To successfully navigate the third transition, couples must address regrets and developmental asymmetries left over from their first two transitions.

No one right path or solution exists for meeting these challenges. Although the 50/50 marriage—in which housework and child care are divided equally between the partners, and their careers are perfectly synched—may seem like a noble ideal, my research suggests that instead of obsessively trying to maintain an even "score," dual-career couples are better off being relentlessly curious, communicative, and proactive in making choices about combining their lives. ☰

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One Couple's Perspective

DISCUSSIONS ABOUT dual-career couples tend to focus on challenges and conflicts. But couples who are juggling two ambitious careers and family life also enjoy advantages—ones that go beyond having two incomes. Tamar Dane Dor-Ner and Dan Krockmalnic

illustrate this mix. Dor-Ner has spent 20 years at the consulting firm Bain, where she is a managing partner and the head of its Boston office. Since the two married, in 2009, Krockmalnic, a lawyer, has worked for two large law firms, as an assistant attorney general

for Massachusetts, and, starting in 2017, as general counsel for the *Boston Globe*. The couple—she is 42, he is 39—have two boys, ages eight and six. They spoke with HBR about the professional upsides of being a dual-career couple. Edited excerpts follow.

How do your professional lives help you support each other at home?

TAMAR: We both come at work assuming that we will really enjoy, care about, and bring some measure of ambition to our jobs. That's a shared value—we take it for granted, so it's not a source of tension. If one of us has a bad day at work on Friday and is still preoccupied about it on Saturday, the other one isn't going to be annoyed or surprised. Hopefully we will be compassionate. We try to be present, but we don't get upset if the other one can't turn it off immediately. The only thing worse than having work stress spill into personal time is to go home and be punished for it.

DAN: A corollary is that neither of us is overinvested in the other's career. She has her job, I have my job. We're there for each other to help when needed, but it's not core to my being that I'm the spouse of a Bain partner, nor is it core to her being that she's the spouse of a *Boston Globe* employee. I don't think that would be healthy for us.

How has your dual-career status come into play as Dan has made job changes?

DAN: Tamar's career gives me the freedom to do what I want to do. I can choose [to take a pay cut] to go work for the attorney general's office for



"The stuff we argue about is how much we should try to jam into life, how complicated we should make it."

two years without our having to worry about paying the mortgage.

TAMAR: I really love my job, and I have for a long time. I've wanted that for Dan, and my job has allowed me to encourage him to move to find it. He has that now, and we're all better for it.

Was balancing two demanding careers a big challenge before you had children?

TAMAR: When we were first married, before we became parents, our professional lives were indistinguishable from when we were single. The changes all came after the kids. I was really lucky in a number of ways: I didn't leave Bain to go back to business school, as many consultants do, and I became a partner fairly young.

DAN: Let me interrupt to brag about her: She became a partner at 28, and she was the youngest person to become partner that year.

TAMAR: Making partner before I had kids gave me a ton more autonomy, flexibility, and security than I would have had otherwise. Even so, I assumed I'd leave Bain when I had kids. I didn't think it would be possible to stay. I had been traveling all the time. I carry emotional baggage around parents who travel—my mom died when I was pretty young, my dad traveled a lot, and I didn't want to do that. I thought I would come back from maternity leave and work for as long as I could before leaving. It was a happy surprise that I was able to navigate it—to find creative ways to not have to travel. I focused on local clients and did a lot with private equity, where much of the work can be done

remotely. My current job running the Boston office is the latest version of that strategy.

How do you decide who's responsible for housework and child-related demands?

TAMAR: We have to acknowledge that the first thing we do is throw a lot of money at it. We have an amazing au pair who gets the kids ready for school, picks them up, takes them to activities. We have a house manager who does the laundry, shopping, and some of the cooking. Dan and I divide up what's left. I deal with summer camps. He deals with the boys' sports. I deal with doctors. He deals with insurance. We're past the point of thinking it has to be equal or identically sized time commitments. That's not possible. When new things come up—our eight-year-old needs systematic homework help for the first time—we sort it out.

DAN: It's all dynamic, but there's no shortage of talking about it—what's working and what's not.

TAMAR: And whenever we talk about juggling responsibilities, we try to remember that we are lucky as hell. We don't think our choices are at all representative of the choices most people are making. Most couples are both working because they have to—financially, they don't have a choice. One of our shared concerns is that economic and political trends in this country are actually eliminating choices for families.

What are some other benefits of having a spouse with a big job?

TAMAR: We have almost entirely non-overlapping networks. We know very different kinds of people. My network isn't built geographically—it's more by industry. Dan is well connected in Boston, and now that I'm playing a bigger role in our Boston office, that has been useful to me. Also, my new role involves more HR issues than my previous jobs did. I talk to Dan a lot about personnel situations, so I understand the legal perspective. And he's a very good writer, so I ask him to review things I write.

DAN: Tamar has much more experience and skill than I do in navigating interpersonal relationships. I lean on her for advice in that area quite a bit. At a more basic level, before I began working at the *Globe*, every place I'd worked had been a law firm. (The attorney general's office is effectively a law firm.) Making the transition to a media company, with P&Ls and budgets, has been a big change for me. Tamar has been, and continues to be, very helpful with that piece of it.

TAMAR: Dan is also a great recruiter for me. When he meets or reconnects with someone he thinks would be a good fit for Bain, he sends that person to me. When I'm recruiting people who have working spouses, and they're worried about how they will manage the consulting lifestyle, I often have them talk to Dan.

DAN: Those conversations are usually pretty informal ones, and we have them over dinner. Despite Tamar's having the kind of career she has, we have a very full life together. It's a way to show people that's possible, rather than just telling them.

You're managing the balance well right now; what conflicts do you fear in the future?

DAN: What I fear is a shock to the system. That could happen any number of ways—for example, a health issue.

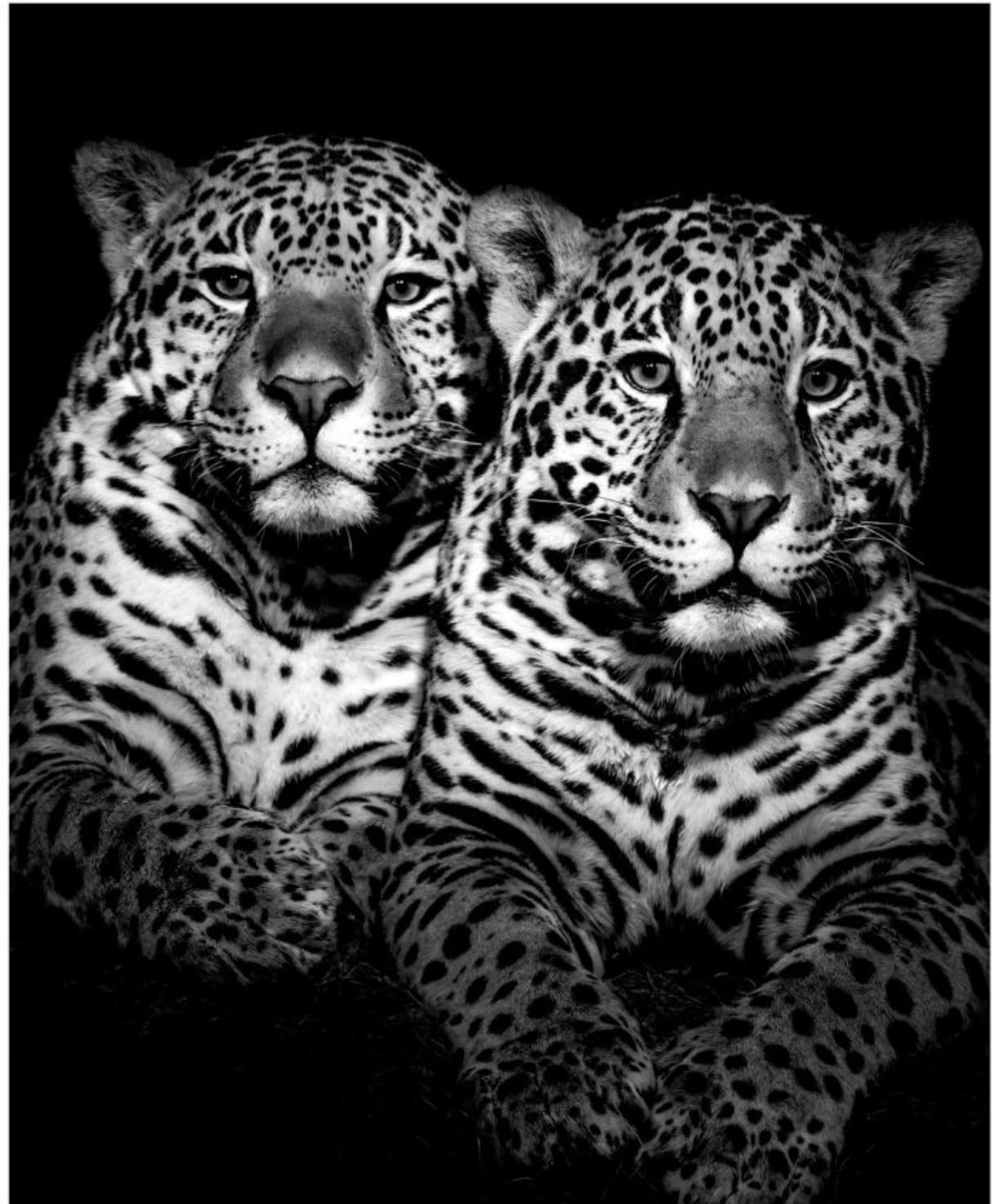
TAMAR: The piece we have the most conflict about is in our social lives. There are moments I feel like we're attempting to do too much socially. The stuff we argue about is how much we should try to jam into life, how complicated we should make it. For example, I'm concerned that as the kids get older, their sports activities are going to take over our weekends. We have different natural equilibria on activities. Dan is restless and wants to do more, and I tend to feel exhausted and want to do less.

Do you worry that your spouse's career might prevent you from taking the next big step in your own?

TAMAR: We both took on bigger jobs in late 2017, and that was an implicit recognition that we had a better handle on things at home and more room to maneuver. The role I'm in now typically lasts six years. At some point, as the kids get older, I'll feel different constraints and liberties, and I'm sure we'll change it up again.

DAN: Because our careers are different, our pictures of the future are too. Tamar's new job is different from her previous one, but she's still a partner at Bain. Whatever happens next, she'll probably be a partner at Bain. I'm less than two years into what I strongly suspect will be the most interesting job I'll ever have, so I'm not putting any thought into next steps now. ☺

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The Spouse Factor

A recruiter's view of how couples balance their career ambitions



Jane Stevenson

Global leader, CEO succession, Korn Ferry

PERFORMING WELL AS a high-level recruiter requires understanding what makes your candidates tick—and not just at work. That's especially true if I'm asking them to consider a job that requires relocation. In many cases I already know something about a candidate's family life—including the spouse or partner's professional status, the ages of their kids (if any), and whether they have elderly parents living nearby. In cases where I don't know, I find a way to ask, "Is there anything in your family situation we should be sensitive to?" If there is, it's important to know early on,



"Choosing a spouse may be one of the most important career decisions you'll ever make. So choose wisely."

especially if these issues could become "blockers."

In my 34 years of experience, the most difficult factor to overcome when recruiting a candidate who has to relocate for a new job has been children, especially those in high school or with special needs. (This is often true whether the candidate is married or divorced; moving can be especially hard for someone who shares custody with an ex.) Spouses are the second most frequent reason a candidate will be reluctant to relocate, especially if he or she is part of a couple in which both are pursuing ambitious professional paths.

When I'm trying to recruit one member of a dual-career couple, it's important to fully understand the other's career, and also the city to which I hope to relocate them. For so-called trailing spouses, the most challenging careers are physician or lawyer in private practice or owner of a business that isn't portable. People in these situations have often spent years building a client base and a local reputation, and it's difficult to reproduce those in a new region. The size of the destination city is also a factor. If the candidate's partner works in a traditional corporate function, he or she will have an easier time finding a similar (or better) position in a big market like Los Angeles or New York than in a smaller city. If the trailing spouse travels frequently for work, being near a major airport is also vital.

If the candidate's partner won't or can't move, I'll often ask whether the couple would consider a "commuter marriage." [See page 58.] Companies

today are increasingly willing to let high-performing leaders commute or work remotely. However, they are much more willing to allow an existing employee to do so, because they know the person's track record; the risk feels higher with a new employee.

Sometimes we have to think creatively. A few years ago a colleague and I were recruiting a female candidate who was based in Europe for a job in Asia. She had a long-term partner who had a great job and was unwilling to move to Asia. So we looked at the likely career path of the candidate (if she took the new role) and concluded that if she did a great job in Asia, she'd most likely be promoted to a position at headquarters in the United States, where her partner *was* willing to move. So the two commuted for a couple of years, and then the woman I'd recruited did get a top job at headquarters; her partner moved to the United States, bringing them back together.

My work gives me a unique window onto how couples manage these situations, but my views are also informed by a research project I led at Korn Ferry on the careers of female CEOs. We interviewed 57 current or former CEOs about their paths to the corner office, and the most striking takeaway was the importance of strong spousal support for women who aspire to top jobs. When discussing the factors that led to their success, most of the women spontaneously brought up their husbands' support. About half the CEOs had spouses with substantial careers; managing their dual careers involved complex calendar negotiations, turn taking, weighing of career

decisions, a willingness to relocate, and significant help from housekeepers, nannies, and so forth. About a third had spouses or partners who, by the time the women became CEOs, were assuming primary responsibility for home and children; some were househusbands, and others were retired or worked part-time.

Each of us has only so much energy to utilize, and dealing with a partner who isn't truly rooting for you professionally saps that energy, limiting your potential. A few of the CEOs we interviewed said they had previously had unsupportive husbands or partners but ultimately went on to connect with more-supportive ones. They speculated that they wouldn't have attained the top job if they hadn't received the support they needed. (Most male CEOs I've worked with say the same thing.) My children are now 24 and 21, and I tell them very bluntly: Choosing a spouse may be one of the most important career decisions you'll ever make, because that person will be either a support or a hindrance to your professional ambitions. So choose wisely.

I empathize with couples who struggle with these issues, because I've faced them myself. My husband is a pathologist. We've been married 37 years. For roughly the first two decades, his career took priority. We moved several times to accommodate his medical school training, residency, fellowships, and stint with the U.S. Air Force. I believe a sturdy flower can bloom anywhere, so I tried to look at those moves as opportunities: When we moved from California to



Philadelphia, my job search led me to executive recruiting. When we moved to Texas, where my then employer had no office, I opened a new one, which was great experience. As my career has evolved, we've made changes. My travel schedule is insane. In 2007, when our children were much younger, my husband left his hospital job and started consulting to have more flexibility and to be more available for the kids. Since then we've considered my career the priority.

Having experienced this push and pull, I recognize that it's typically a phone call from someone like me—followed by a great job offer—that

Courtesy of Getty Images

causes a couple to rethink their coequal arrangement. Very often, the resulting conversation will focus on the upside opportunity. It's natural for partners to compare the potential of their careers and decide to prioritize the one with the higher ROI. In the past that was typically the man's, but today it's frequently the woman's.

At such moments, many dual-career couples will decide that one career has to take a backseat, or that the lesser-earning partner will make a leap of faith and hope that he or she can find (or create) a great job in a new city. When couples face this prospect, I remind them that choosing to

prioritize one partner's career doesn't mean it will be that way forever. Careers are long. The partner who's stepping back right now may be able to step forward in the future. I like to think I have credibility when I make this argument, because I've experienced that shift myself. ☺

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Spotlight



Living Apart for Work

When spouses are offered career opportunities in different locations, they may choose to live apart. Some evidence suggests that this is happening more than ever before. HBR executive editor Ania Wieckowski talked with Danielle Lindemann, a sociologist at Lehigh University and the author of *Commuter Spouses* (ILR Press, 2019), to find out how these couples manage. Edited excerpts follow.

HBR: What types of people are most likely to try a commuter marriage?

LINDEMANN: Many of them are highly educated. It's counterintuitive, but when you're in a high-level job, employment possibilities become more limited, because only a few roles will make sense for you. One recent study, for instance, has shown that couples with graduate degrees are more likely to live apart than are couples with just college degrees.

What factors determine whether a couple can make this work?

According to the people I interviewed, the most crucial factor is life stage—especially whether you have kids. People who don't have children at home experience fewer complications. Personality also plays a role: You need a certain self-sufficiency and independence to make this work. Take into account how flexible your job is. If your company allows you to telecommute, or your career has built-in rhythms (such as slower summers in academia), it will be easier to live apart. Consider how far apart you'll be. One couple I studied was living a two-hour drive apart and seeing each other every weekend; they experienced fewer complications than the guy who was in a time zone 12 hours different from the one his wife was in—they had trouble figuring out when to even call each other. Finally, take the temperature of your relationship. If it's new, or if you're struggling a bit, living apart can exacerbate the problems.

Is technology making this easier?

Yes. Many professionals can stay in semiconstant contact with their spouses, texting throughout the day. Frequency of contact is important: One study of workers on oil rigs who were out of touch with their families for days at a time found it was really tough on their relationships. For most couples now, phone and texting are the most important channels of communication—even more than video chat.

Jonathan Kirn/Getty Images (left); David Lewis Taylor/Getty Images (right)



"Some couples say that their communication improves when they're apart because their distance becomes a forcing function."

Couples who communicate effectively think about which channel to use depending on the kind of information they're sharing. If they're making plans and need to get details across, they send an email, but if it's a more emotional conversation, they'll get on the phone. Many modern communication tools are what my colleague Raelene Wilding has called *sunny-day technologies*, because they work well when your relationship is going well but can do more harm than good for unsteady relationships.

Should couples go into these arrangements with an endgame?

Most do anticipate living with their spouses again. Some have a specific date in mind, often tied to a career milestone such as the end of a medical residency or retirement. They view having an end goal as a positive thing. Those with a hazier end date tend to experience more anxiety.

What happens when these couples move back in together?

There's an adjustment period. They're used to having their own space, and suddenly there are turf wars; they're used to doing things in a certain way, and suddenly that creates friction. This is similar to what's been found in research about military spouses coming home from deployments.

Are there any benefits to living apart from your spouse—other than being able to take the job you want?

Yes! Some people find that they're recharged with the excitement they felt when dating. Others appreciate the absence of all the little tensions



that arise from sharing a space. This is particularly important for women, who cherish their newfound independence—having their own space and their own time. Some couples say that their communication improves when they're apart because their distance becomes a forcing function. If you have a call scheduled with each other every night at 8:00, you have to talk about your day. Finally, the amount of work they can get done is one of the biggest benefits—they can work evenings when they want to without fear of impinging on family time. This is again particularly pronounced among women,

unless they have children. One woman I interviewed said she didn't think she would have gotten tenure if she had been living with her husband.

How should employers be thinking about this?

I'd encourage managers with employees in commuter marriages to consider more flexibility for people whose jobs don't depend on being in the office five days a week. That's in the employer's best interest—it may make it less likely that people will look for another job that might allow them to spend more time with a spouse. ☺ **HBR Reprint R1905B**

Features



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PERFORMANCE
MEASUREMENT

Don't Let *Metrics* Undermine Your Business

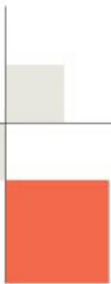
AN OBSESSION WITH THE NUMBERS
CAN SINK YOUR STRATEGY.

ILLUSTRATOR MIKE MCQUADE





PERFORMANCE
MEASUREMENT



Tying performance *metrics* to *strategy* has become an accepted best practice over the past few decades.

Strategy is abstract by definition, but metrics give strategy form, allowing our minds to grasp it more readily. With metrics, Ford Motor Company's onetime strategy "Quality is job one" could be translated into Six Sigma performance standards. Apple's "Think different" and Samsung's "Create the future" could be linked to the amount of sales from new products. If strategy is the blueprint for building an organization, metrics are the concrete, wood, drywall, and bricks.

But there's a hidden trap in this organizational architecture: A company can easily lose sight of its strategy and instead focus strictly on the metrics that are meant to *represent* it. For an extreme example of this problem, look to Wells Fargo, where employees opened 3.5 million deposit and credit card accounts without customers' consent in an effort to implement its now-infamous "cross-selling" strategy.

The costs from that debacle were enormous, and the bank has yet to see the end of the financial carnage. In

addition to paying initial fines (\$185 million), reimbursing customers for fees (\$6.1 million), and eventually settling a class-action lawsuit to cover damages as far back as 2002 (\$142 million), Wells Fargo has faced strong headwinds in attracting new retail customers. In April 2017, it reported that first-quarter credit card applications were down 42% year over year, with new checking-account openings down 35%. Meanwhile, more revelations about unauthorized mortgage modifications and fees, improper auto loan practices, and other missteps surfaced throughout 2017. In the fourth quarter the bank had to set aside a \$3.25 billion accrual for future litigation expenses. In February 2018 the Federal Reserve prohibited Wells Fargo from growing its assets any further until it strengthened its governance and risk management. This was followed in April by a joint \$1 billion fine from the Consumer Financial Protection Bureau (CFPB) and the Office of the Comptroller of the Currency (OCC), which led Wells Fargo to increase its litigation

IDEA IN BRIEF

THE PROBLEM

Companies that work hard on their strategies and carefully monitor their progress often run into spectacular trouble.

WHY IT HAPPENS

People have a behavioral tendency—known as *surrogation*—to confuse what's being measured with the metric being used.

HOW TO FIX IT

To reduce the risk of *surrogation*, make sure that the people executing your strategy had a role in formulating it, don't link incentives too tightly to strategy metrics, and use multiple metrics to assess performance.





accrual by \$800 million. While press releases from the CFPB and the OCC tie the agencies' action only to mortgage fees and auto loan problems, the political context suggests that the penalty's severity stems in part from public outrage over the original fake-accounts scandal. In the face of the bank's prolonged difficulties, the CEO who'd taken the helm after the scandal, Timothy Sloan, resigned in March 2019.

Were these devastating outcomes simply the natural consequences of having a bad strategy? Closer examination suggests that Wells Fargo never actually had a cross-selling *strategy*. It had a cross-selling *metric*. In its third quarter 2016 earnings report, the bank mentions an effort to "best align our cross-sell *metric* with our *strategic focus* of long-term retail banking relationships" [emphasis added]. In other words, Wells Fargo had—and still has—a strategy of building long-term customer relationships, and management intended to track the degree to which it was accomplishing that goal by measuring cross-selling. With brutal irony, a focus on the metric unraveled many of the bank's valuable long-term relationships.

Every day, across almost every organization, strategy is being hijacked by numbers, just as it was at Wells Fargo. It turns out that the tendency to mentally replace strategy with metrics—called *surrogation*—is quite pervasive. And it can destroy company value.

The Surrogation Snare

Of course, we all know that metrics are inherently imperfect at some level. In business the intent behind metrics is usually to capture some underlying intangible goal—and they almost always fail to do this as well as we would like. Your performance management system is full of metrics that are flawed proxies for what you care about.

Here's a common scenario: A company selects "delighting the customer" as a strategic objective and decides to track progress on it using customer survey scores. The surveys do tell managers something about how well the firm is pleasing customers, but somehow employees start thinking the strategy is to maximize survey scores, rather than to deliver a great customer experience.

It's easy to see how this could quickly become a problem, because there are plenty of ways to boost scores while actually displeasing customers. For example, what happened the last time you were urged to rate your experience a 10 on a satisfaction survey "because anything but a 10 is considered a failure"? That request may have turned negative feedback into a nonresponse or an artificially high score, and the pressure was probably off-putting. And think about all the pop-up windows, follow-up emails, and robocalls that pester you with surveys you would rather ignore. Such tactics tend to lower a customer's satisfaction with a company, but surrogation can lead those charged with delighting the customer to use them *despite* the strategy.

Surrogation is especially harmful when the metric and the strategy are poorly aligned. The greater the mismatch, the larger the potential damage. When a production manager's success at achieving the strategic objective "make high-quality products" is measured by using very precise quality standards (such as "ball bearings must be 10 millimeters in diameter, plus or minus 0.0001 millimeters"), surrogation might not be a problem. However, if success at the objective is measured by the number of customer returns, the production manager might find creative ways to avoid returns. For example, he or she might connect directly with the purchasing departments of clientele, offering to personally handle any product concerns so that returns are registered as rework rather than returns. Or the manager might be willing to gamble a bit, pushing beyond acceptable (or even safe) quality standards, knowing that while the lower quality will increase the likelihood of a return, it may not actually trigger one. Furthermore, when a single metric is used more widely—for example, to gauge the performance of multiple managers overseeing various components of a complex product—surrogation can have a far bigger impact and do much greater harm.

What Happened at Wells Fargo

Several explanations have been provided for how things went awry at Wells Fargo. The most widely accepted theory lays the blame on the company's incentive system. In the



The tendency to mentally replace strategy with metrics is quite pervasive. And it can destroy company value.

words of Richard Cordray, the former CFPB director involved in imposing an early fine on the bank: “What happened here...is that Wells Fargo built an incentive-compensation program that made it possible for its employees to pursue underhanded sales practices.”

But was the compensation approach actually the root of Wells Fargo’s problems—or was it simply a symptom of a more insidious ailment? Another culprit might have been the combination of challenging sales quotas and relentless pressure to meet them. Indeed, employees under investigation cited pressure more often than incentives as a cause for misconduct. Another possible cause was a permissive sales culture. A key finding of an internal investigation was that management espoused the philosophy that “it was acceptable to sell 10 low-quality accounts to realize one good one.” The investigation found that managers referred to products that the customer did not need (or want) as “slippage” and that a certain amount of slippage was deemed “the cost of doing business in any retail environment.” But again, sales pressure and questionable culture could merely have been symptoms of a more pervasive and pernicious problem.

Incentives, pressure to meet quotas, and sales culture were all tied to a system employed throughout Wells Fargo at the time. In fact, it’s one found at almost every company. It’s the performance measurement system, used to monitor everyday business activities, from the organizational level on down to the individual-employee level. There could be no sales incentives at Wells Fargo without rigorous *tracking* of sales numbers. There would have been no accounts-per-household goals, pressure to meet them, or culture surrounding them if customers’ accounts were never *counted*. Ex-CEO John Stumpf’s now-infamous mantra, “Eight is great” (the goal was to have eight Wells Fargo products per customer), was based on this common denominator.

The real source of Wells Fargo’s problems was measurement. When the bank decided to actively track daily cross-sales numbers, employees rationally responded by working to maximize them. Throw in financial incentives, a permissive culture, and intense demands for performance, and they might even illegally open some unauthorized accounts, all in the name of advancing the “strategy” of cross-selling.

Don’t get us wrong. We’re not suggesting that measurement is a bad thing. It’s not, and there’s a reason it’s

ubiquitous in business: It’s the only way we can make sense of our environment, our results, and our strategic objectives, which we must do if we are to succeed. Metrics provide clearly defined direction where strategy may otherwise seem too amorphous to have an impact. Because they can coordinate behaviors and actions, metrics are crucial. But as the Wells Fargo case shows, unless the inherent distortions of metrics are understood, they can be dangerous—and the distortions can be amplified precisely because the flawed metrics coordinate behaviors.



Guarding Against Surrogation

To prevent surrogation, we must first understand how it happens. Two recent studies on surrogation—one using fMRI machines to measure blood flow in the brain to better understand how people make decisions, and the other using video games to examine surrogation in a nonbusiness setting—suggest that surrogation is a common subconscious bias: Whenever metrics are present, people tend to surrogate. Nobel prize winner Daniel Kahneman and Yale professor Shane Frederick postulate that three conditions are necessary to produce the type of substitution we see with surrogation:

1. The objective or strategy is fairly abstract.
2. The metric of the strategy is concrete and conspicuous.
3. The employee accepts, at least subconsciously, the substitution of the metric for the strategy.

Multiple research studies have helped demonstrate how these conditions combine to produce surrogation. Knowledge of them supplies us with the means to combat the problem. Just as fire is stifled when the heat, fuel, or oxygen necessary for combustion is removed, surrogation can be suppressed by cutting off one or more of its key ingredients. Here’s how to do that:

Get the people responsible for implementing strategy to help formulate it. This helps reduce surrogation because those involved in executing the strategy will then be better able to grasp it, despite its abstract nature—and to avoid replacing it with metrics. It’s particularly crucial to bring



the executives and senior managers who are charged with communicating strategy into this process. Research that one of us, Bill, did with Willie Choi of the University of Wisconsin and Gary Hecht of the University of Illinois, Urbana-Champaign, suggests that simply *talking* about strategy with people is not sufficient. In other words you can't just invite them to boardroom briefings and hang signs around the building promoting the strategy—you need to involve people in its development.

Consider the experiences of one organization Bill advised, Intermountain Healthcare. Its goal is to provide high-quality, low-cost care. One of the battlegrounds for this type of “value-based care” is the treatment of lower back pain. It turns out that most lower back pain goes away on its own in a few weeks. Medication and surgery can help, but they can also hurt—and they can be very costly. The data suggests that once a patient presents with lower back pain, the ideal response is to wait. So, with the involvement and advice of practicing physicians, Intermountain recently formulated a strategy aimed at reducing unnecessary interventions. To measure performance on the strategy, Intermountain began tracking whether doctors waited at least four weeks after meeting with a patient with lower back pain to recommend an X-ray, MRI, or another, more invasive diagnosis or treatment method.

The danger with this metric, of course, is that doctors could begin to see “make patients wait” as the objective rather than providing high-quality care at low cost. But because Intermountain doctors helped develop the strategy, this type of surrogation was far less likely to happen. And because the physicians were also heavily involved in the rollout and training for the strategy and its metrics, they could help others avoid surrogation as well. Indeed, Nick Bassett, executive director of population health at Intermountain, says that “without question, when physicians are involved in designing objectives, they better understand those objectives, and when they understand the objectives, they have proven time and time again their ability to determine the right course of action, often in spite of a particular metric.”

Brett Muse, a doctor at Intermountain who played a large part in the strategy’s development and rollout, agrees. “When I get in front of physicians and throw data at them,

they get glassy-eyed,” he says. Instead, he gets in front of the group and says, “Here’s a problem involving quality of care. Let’s try to solve this problem—and by the way, here’s some data we can look at to see how we’re doing.”

Loosen the link between metrics and incentives. Tying compensation to a metric-based target tends to increase surrogation—an unfortunate side effect of pay for performance. Besides tapping into any monetary motivations people might have, this approach makes the metric much more visible, which means employees are more likely to focus on it at the expense of the strategy.

To think about how to get around this problem, let’s look again at Intermountain’s lower-back-pain metric. If management had done the obvious and just informed physicians that they would be paid a small bonus each time they required a patient to wait four weeks before receiving any costly tests or treatments, it probably would have driven even the most well-meaning doctors away from the true strategy of reducing unnecessary interventions and toward maximization of the metric. But the people overseeing the program didn’t tie compensation to the metric, because they recognized that most doctors are already intrinsically motivated to provide high-value care. In addition, they set the target for the percentage of patients who waited four weeks before medical intervention at 80%. This served as a reminder to doctors that high-quality, low-cost care for *most* patients meant waiting for lower back pain to resolve itself, but for some patients—for example, those who waited a month before seeing the doctor in the first place—immediate treatment was warranted. The target reflected the imperfect nature of the metric and drew physicians’ attention back to the underlying strategy.

Use multiple metrics. Another study Bill did with Choi and Hecht shows that people surrogate less when they’re compensated for meeting targets on multiple metrics of a strategy rather than just one. This approach highlights the fact that no single metric completely captures the strategy, which makes people more likely to consciously reject substituting it for the strategy. At Intermountain overall physician performance is assessed with a myriad of metrics, including patient satisfaction, condition-specific quality metrics (such as average A1C levels of diabetes patients), health outcomes (such as hospital readmittance), preventive efforts (such

as appropriately timed mammograms), and total cost of care. No lone metric is used to quantify the competence or contribution of the medical staff. Multiple yardsticks do add complexity to the task of performance evaluation, but they're essential to keeping people focused on the true strategy and avoiding surrogation.

Wells Fargo Revisited

To see if Wells Fargo remains vulnerable to surrogation, let's look at the actions it has taken in the wake of its crisis. As far as we can tell, the bank is heading in the right direction with its damage-control efforts.

First, the new management's emphasis on rebuilding trust with customers after the scandal has made the long-term relationship strategy much more clear and prominent. Second, the bank has stopped paying employees to cross-sell and has eliminated all sales goals. That may sound extreme, but it was appropriate for Wells Fargo because an obsession with sales quotas had become so entrenched at the bank. To address that issue, the cross-selling metric and everything related to it needed to go. Finally, Wells Fargo now gauges strategic success using at least a dozen metrics related to its customer focus, emphasizing that no single number tells the whole story and encouraging employees to consciously reject surrogation.

That progress notwithstanding, this episode in Wells Fargo's history was devastating in terms of both quantifiable out-of-pocket costs and less measurable (but truly colossal) reputational costs, and there's no indication yet that the bank is close to full recovery. However, at the very least, the new steps Wells Fargo has taken seem likely to remind tomorrow's managers and employees that performance metrics are mere representations of strategy, not the strategy itself.

MANY MANAGERS LEARN the hard way that surrogation can spoil strategy, and if you don't take action to protect against it, it's very likely that sooner or later personal experience will lead you to the same realization. If you're using performance metrics, surrogation is probably already happening—the mere presence of a metric, even absent

THE BIGGEST SURROGATION OF ALL?

If you stop to think about it, the surrogation trap is everywhere. Even the most common performance metric—earnings—was conceived as a proxy for something bigger and more abstract: Hicksian income.

Don't remember learning about Hicksian income in your accounting class? That's probably because you didn't take accounting in the mid-1900s, when our ideas about measuring value began to congeal. John Hicks described this fairly abstract metric as the amount of money that can be distributed to shareholders while still leaving the company's value unchanged. In contemporary terms, it's the value added by a company's operations. Earnings were a clearly defined proxy for

that value and were intended to make an abstract concept more concrete. But generating accounting earnings isn't necessarily the same thing as creating value. After all, financial statements don't present a complete picture of what's happening in companies, especially if the numbers in them are manipulated. And investors who surrogate may support financial decisions that do not create value, such as cost cuts that undermine customer service and long-term financial performance.

While there is no formal evidence that investors surrogate, the outsize market reactions we see when a company misses an earnings target by a penny suggest that many are falling into the trap.

any compensation, is enough to induce some level of the behavior. So it's time to take a hard look internally to see which metrics might be most prone to surrogation and consider where it might cause the most damage. As the Wells Fargo case illustrates, preventing the disease is far preferable to treating its symptoms. ☐

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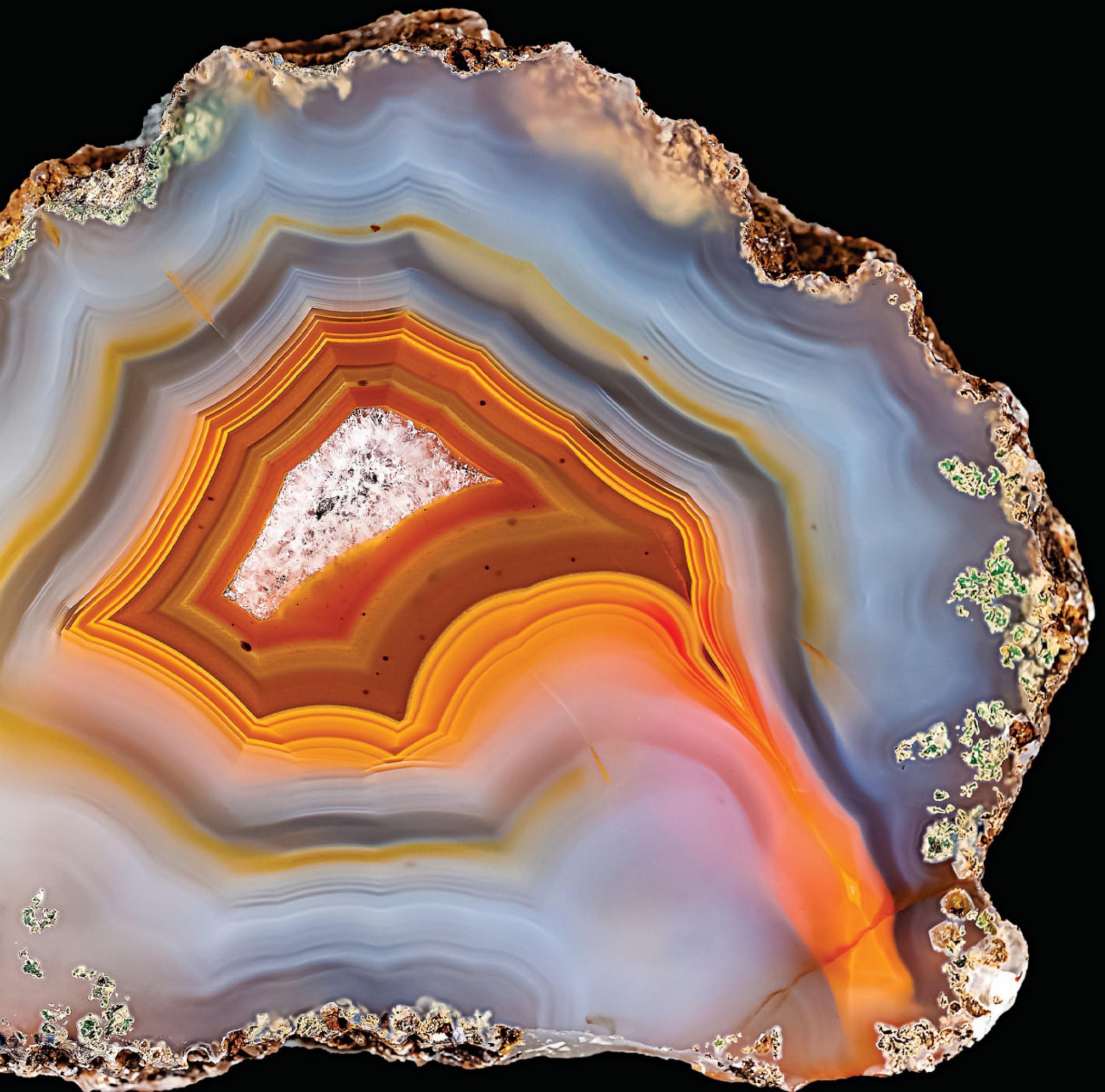
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Put Purpose *at the* **CORE** of Your Strategy.



It's how successful companies
redefine their businesses.







Eight years ago we launched a global study of high growth in companies, investigating the importance of three strategies known to drive it: creating new markets, serving broader stakeholder needs, and changing the rules of the game. What we found surprised us. Although each of those approaches did boost growth at the organizations we studied, there was a fourth driver we hadn't considered at all:

purpose.





Many high-growth companies use purpose to generate sustained profitable growth, stay relevant in a rapidly changing world, and deepen ties with their stakeholders.

Companies have long been encouraged to build purpose into what they do. But usually it's talked about as an add-on—a way to create shared value, improve employee morale and commitment, give back to the community, and help the environment. But as we worked with the high-growth companies in our study and beyond, we began to recognize that many of them had moved purpose from the periphery of their strategy to its core—where, with committed leadership and financial investment, they had used it to generate sustained profitable growth, stay relevant in a rapidly changing world, and deepen ties with their stakeholders.

Two Critical Roles

In the course of our research, we talked to scores of C-level executives. They worked at 28 companies—in the United States, Europe, and India—that had had an average compound annual growth rate of 30% or more in the previous five years. What we learned from those conversations was that purpose played two important strategic roles: It helped companies *redefine the playing field*, and it allowed them to *reshape the value proposition*. And that, in turn, enabled them to overcome the challenges of slowing growth and declining profitability.

ROLE 1: Redefining the playing field. What's a key difference between low-growth and high-growth companies? The former spend most of their time fighting for market share on one playing field, which naturally restricts their growth potential. And because most aggressive battles take place in industries that are slowing down, gains in market share come

at a high cost, often eroding profits and competitive advantage as offerings become commoditized.

High-growth companies, by contrast, don't feel limited to their current playing field. Instead, they think about whole ecosystems, where connected interests and relationships among multiple stakeholders create more opportunities. But these firms don't approach ecosystems haphazardly. They let purpose be their guide.

Consider the different strategies adopted by the two leading companies in the pet-food industry: Nestlé Purina PetCare, the largest player in North America; and Mars Petcare, the global leader. The companies have defined very similar purposes for themselves—“Better with pets” (Purina) and “A better world for pets” (Mars Petcare)—and both want to develop new products that will help customers improve their pets’ health. But Purina has continued to focus on the pet-food playing field and is applying purpose in some inspiring social initiatives, whereas Mars Petcare is using purpose to propel its expansion in the broader field of pet health.

Mars Petcare, which had established a foothold in pet health with the acquisition of Banfield Pet Hospital in 2007, decided to build its presence in that arena by buying two other veterinary services: BluePearl in 2015 and VCA in 2017. Then in 2018 Mars Petcare entered the European veterinary market, buying the Swedish company AniCura, which has operations in seven European countries, and the British company Linnaeus. Those acquisitions helped Mars Petcare become Mars Inc.’s largest and fastest-growing business division.

IDEA IN BRIEF

THE CHALLENGE

Companies pursuing high growth tend to follow three well-known strategies: creating new markets, serving broader stakeholder needs, and changing the rules of the game. But there's another critical growth driver: purpose.

THE INSIGHT

Many companies consider purpose merely an add-on to their strategy, but the most successful companies put it at the core, using it to redefine the playing field and reshape their value propositions.

THE BENEFITS

A purpose-driven strategy helps companies overcome the challenges of slowing growth and declining profits. It also helps with the soft side of management: the people-related aspects of running a business, which so often prove to be the undoing of leaders.



STRATEGY

In moving deeper into this larger ecosystem, Mars Petcare did more than just capitalize on a burgeoning industry. It also shifted its orientation beyond products to services, a radical change for an asset-heavy company that for 75 years had relied on the production and sale of goods. To succeed, the company had to build completely different core competencies and devise a new organizational structure. Many companies in this dangerously open-ended situation might have flailed, but Mars Petcare did not. It was able to pull off a transformation because it ensured that every move it made was aligned with the same core purpose. And it's not done yet: The company is now bringing that sense of purpose to efforts to expand into pet-activity monitoring with "smart" collars.

Another company that has used purpose to redefine the playing field, this time in the industrial sector, is the Finnish oil-refining firm Neste. For more than six decades Neste, founded in 1948, operated a business focused almost entirely on crude oil, but by 2009 it was struggling. The market was glutted, oil prices had dropped sharply, margins were falling, and the EU had passed new carbon-emissions legislation. During the previous two years the company's market value had shrunk by 50%.

Fighting those headwinds, the executive team, led by Neste's new CEO, Matti Lievonen, realized that the company could no longer survive on its traditional playing field. It would have to look for new opportunities in the larger ecosystem. Renewable energy could be a key driver of growth, they realized. Their purpose, they decided, should be to develop sustainable sources of energy that would help reduce emissions, and everything they did would be guided by a simple idea: "Creating responsible choices every day."

It's common for major oil companies to nod to sustainability in some way, but Lievonen quickly proved that Neste meant business, launching a bold transformation that would become a seven-year journey. Employees, customers, and investors all initially resisted the change, but Lievonen and his team were undaunted. They made major investments in infrastructure, innovated renewable technologies, focused on converting customers to green energy solutions, and, most important, engineered a fundamental change in the company's culture.

The process wasn't easy. When Lievonen was just three months into his tenure, a leading economic magazine in Finland published an article saying that he should be fired. He soldiered on, however, and by 2015 Neste had established itself as the world's largest producer of renewable fuels derived from waste and residues. A year later its comparable operating profits from renewables would surpass those of its oil-products business. In 2017 the company took yet another step by actively researching and promoting the use of waste feedstock from new sources such as algae oil, microbial oil, and tall oil pitch.

ROLE 2: Reshaping the value proposition. When confronted with eroding margins in a rapidly commodifying world, companies often enhance their value propositions by innovating products, services, or business models. That can bring some quick wins, but it's a transactional approach geared toward prevailing in the current arena. Because a purpose-driven approach facilitates growth in new ecosystems, it allows companies to broaden their mission, create a holistic value proposition, and deliver lifetime benefits to customers.

Companies can make this shift in three main ways: by responding to trends, building on trust, and focusing on pain points.

> **Responding to trends.** In line with its purpose of "contributing to a safer society," Sweden's Securitas AB, a security company with 370,000 employees, has traditionally offered physical guarding services. But in the early 2010s its CEO at the time, Alf Göransson, saw that globalization, urbanization, and the increasingly networked business landscape were all changing the nature of risk—for people, operations, and business continuity. At the same time, labor was becoming more expensive, and new technologies were becoming cheaper. Given those developments, Göransson decided that Securitas could no longer "simply sell man-hours." Instead, the company had to explore new ways of using electronics to provide security. This shift, Göransson understood, was not a threat to the existing business but an opportunity to grow—as indeed it has proved to be.

In 2018 the company decided to go a step further and reshape its value proposition from reactive to predictive security, a plan that once again built on the company's core purpose. Under the leadership of Göransson's successor, Magnus Ahlqvist, the firm strengthened its electronic security business by acquiring a number of companies, investing heavily in modernizing and integrating back-office systems, and training its guards in remote surveillance, digital reporting, and efficient response. That allowed Securitas to offer bundled, customized security solutions—encompassing physical guarding, electronic security, and risk management—that provided a much-enhanced level of protection at an optimized cost. By expanding its value



proposition in this way, Securitas has been able to strengthen client relationships and significantly increase its margins for the solutions business. From 2012 to 2018 the company's sales of security solutions and electronic security also increased, from 6% of total revenue to 20%.

➤ **Building on trust.** When Mahindra Finance, the financial services arm of the Mahindra Group, a \$20 billion Indian conglomerate, wanted to define its value proposition, it looked to its parent company's longtime purpose-driven strategy of improving customers' lives—encapsulated in 2010 by the simple motto "Rise." It's a word that the company's third-generation leader, Anand Mahindra, expects will

inspire employees to accept no limits, think alternatively, and drive positive change.

In keeping with that strategy, Mahindra Finance decided to target its core offering, vehicle financing, to rural areas, where it could—as Rajeev Dubey, the group head of HR, put it to us—"address the unmet needs of underserved customers in an underpenetrated market."

That meant that the company had to figure out how to determine the creditworthiness of customers who were mostly poor, illiterate, and unbanked, with no identity documents, no collateral, and cash flows that were often impacted by monsoons. To do that, the company had



STRATEGY

to develop completely new ways to handle loan design, repayment terms, customer approval, branch locations, and disbursement and collection in cash. Not only that, but it had to figure out how to recruit workers who could speak local dialects, assess local situations, and operate under a decentralized model of decision making.

Remarkably, the company managed to do all those things and established a preliminary level of trust with its customers. It then stretched its value proposition to help farmers and other customers obtain insurance for their tractors, lives, and health. In a country where insurance penetration is abysmally low (about 3.5%), this was no small feat, especially since rural residents didn't easily part with any minuscule monthly surplus they had, even if it was to secure their livelihood.

Then Mahindra Finance extended its purpose-driven efforts to housing finance, another arena in which it recognized that it could help its rural customers rise above their circumstances. For most of those people, securing loans for housing was difficult in the extreme. Banks offered loans at an interest rate of about 10% but demanded documentation most rural residents couldn't provide. Moneylenders offered instant financing but charged interest rates of about 40%. Recognizing an opportunity, Mahindra Finance decided to play at the intermediate level, offering customized home loans at rates of about 14%, an option that appealed to its growing base of customers. And when some of those customers developed successful small agribusinesses, they began looking for working-capital loans, equipment loans, project finance, and so on—more unmet needs that Mahindra Finance could address. So it extended its value proposition again, into the small-to-medium-enterprise arena, offering finance and asset-management services.

Throughout its expansion, Mahindra Finance was guided by its goal of helping rural citizens improve their lives. The company identified and committed itself to value propositions that allowed it to deepen its relationship with its customers, which in turn created additional streams of revenue and profits. Today Mahindra Finance is India's largest rural nonbanking financial company, serving 50% of villages and 6 million customers.

> Focusing on pain points. We've already seen how Mars Petcare's health care value proposition led to direct

IS PURPOSE AT THE CORE OF YOUR STRATEGY?

Not unless you answer yes to all five questions below.

- | | Y | N |
|---|-----------------------|-----------------------|
| 1 Does purpose contribute to increasing your company's growth and profitability today? | <input type="radio"/> | <input type="radio"/> |
| 2 Does purpose significantly influence your strategic decisions and investment choices? | <input type="radio"/> | <input type="radio"/> |
| 3 Does purpose shape your core value proposition? | <input type="radio"/> | <input type="radio"/> |
| 4 Does purpose affect how you build and manage your organizational capabilities? | <input type="radio"/> | <input type="radio"/> |
| 5 Is purpose on the agenda of your leadership team every time you meet? | <input type="radio"/> | <input type="radio"/> |

connections with pet owners at multiple touchpoints. Having established them, the company looked for other ways to create "a better world for pets." How could it come up with a value proposition that would make pet ownership a seamless, convenient, and attractive experience?

The answer was by investing in technology to help address one of the biggest concerns of pet owners: *preventing* health problems. In 2016 the company acquired Whistle, the San Francisco-based maker of a connected collar for activity monitoring and location tracking—a kind of Fitbit for dogs. Teaming the device up with its Banfield Pet Hospital unit, the company launched the Pet Insight Project, a three-year longitudinal study that aims to enroll 200,000 dogs in the United States. By combining machine learning, data science, and deep veterinary expertise, the project seeks to understand when behavior may signal a change in a pet's health and how owners can partner with their veterinarians on individualized diagnostics and treatments for their pets.

Developing a Purpose

Leaders and companies that have effectively defined corporate purpose typically have done so with one of two approaches: *retrospective* or *prospective*.

The retrospective approach builds on a firm's existing reason for being. It requires that you look back, codify



The focus of the discovery process is internal: Where have we come from? What makes us unique? Where does our DNA open up future opportunities we believe in?

organizational and cultural DNA, and make sense of the firm's past. The focus of the discovery process is internal. Where have we come from? How did we get here? What makes us unique to all stakeholders? Where does our DNA open up future opportunities we believe in? These are the kinds of questions leaders have to ask.

Anand Mahindra very successfully employed this tactic at the Mahindra Group. First he looked back at his 30 years at the company and at the values that had guided him as its leader. Then he delved into the psyche of the organization by conducting internal surveys of managers at all levels. He also did ethnographic research in seven countries to identify themes that resonated with his company's multinational, cross-cultural employee base. The process took three years, but ultimately Mahindra arrived at "Rise," which, he realized, had been fundamental to the company from its inception. "'Rise' is not a clever tagline," he has said. "We were already living and operating this way."

The prospective approach, on the other hand, reshapes your reason for being. It requires you to look forward, take stock of the broader ecosystem in which you want to work, and assess your potential for impact in it. The idea is to make sense of the future and then start gearing your organization for it. The focus is external, and leaders have to ask a different set of questions: Where can we go? Which trends affect our business? What new needs, opportunities, and challenges lie ahead? What role can we play that will open up future opportunities for ourselves that we believe in?

The prospective approach can be particularly useful for new CEOs. In 2018, when Magnus Ahlqvist took charge at Securitas, he spearheaded a "purpose workstream" to capture aspirations for the company from the ground up. He asked all his business-unit leaders to run "listening workshops" (with groups of employees from diverse functions, levels, age groups, genders, and backgrounds), which were held over six months. At the end of that period, the findings were collated and analyzed. Among the discoveries: Employees had a vision of transforming the company from a *service provider* to a *trusted adviser*. That shift would require anticipating and responding to security issues instead of relying on the legacy methods of observing and reporting. So employee input helped executives refine the firm's predictive-security strategy.

Implementing a Purpose-Driven Strategy

Our research shows that a compelling purpose clarifies what a company stands for, provides an impetus for action, and is aspirational. But some purpose statements are so generic that they could apply to any company (like Nissan's, "Enriching people's lives"), while others provide only a narrow description of the company's existing businesses (like Well Fargo's, "We want to satisfy our customers' financial needs and help them succeed financially"). Even if organizations do manage to define their purpose well, they often don't properly translate it into action—or do anything at all to fulfill it. In those cases the purpose becomes nothing more than nice-sounding words on a wall.

Leaders need to think hard about how to make purpose central to their strategy. The two best tactics for doing that are to *transform the leadership agenda* and to *disseminate purpose throughout the organization*.

Consider Mars Petcare again. In 2015 its president, Poul Weihrauch, significantly altered the composition and focus of the leadership team. Its new collective agenda, he declared, would go beyond the performance of individual businesses; it would include generating "multiplier effects" among the businesses (such as between pet food and pet health) and increasing their contributions to creating a better world for pets.

In keeping with that principle, Weihrauch had the company adopt an "outside-in" approach to meeting stakeholder needs. As part of this effort, in 2018 Mars Petcare launched two new programs to support start-ups innovating in pet care: Leap Venture Studio, a business accelerator formed in partnership with Michelson Found Animals and R/GA; and Companion Fund, a \$100 million venture-capital fund in partnership with Digitalis Ventures. In announcing these initiatives the company declared that its ambition was "to become a partner of choice for everyone willing to change the rules of the game in pet care."

Revising a leadership agenda and restructuring an organization are arguably easier at a privately held company like Mars Petcare than at a publicly held one. But Finland's Neste is public, with a major stake held by the government, and it has managed to do both things very effectively.



Neste faced an uphill battle when it decided to move into renewables. The company had to build new capabilities while confronting strong opposition from many employees who didn't buy into the change in direction. About 10% of them left during the first year of the strategy's implementation. Painful as it was, it proved to be a positive development, since the company could not have forged ahead with people who didn't believe in its new purpose.

And forge ahead it did. Neste put in place a new top management team, mobilized its 1,500 R&D engineers, innovated patented renewable technology, and invested €2 billion in building new refineries.

The shift also raised a big question for Neste. How could it change its organizational mindset from *volume* to *value* selling—which entailed convincing customers that its clean fuels would be better for them in the long run? That shift meant going beyond wholesalers to work directly with the distributors and even the distributors' customers. The new leadership team realized that a much higher level of collaboration among business segments and functions was imperative. Winning deals was no longer the sole responsibility of the sales department. The expertise of the whole organization—product knowledge, marketing, finance, taxation—would be required to understand the specific needs of customers like airlines and bus fleets. So Neste engineered a major reorganization and created a matrix structure, in the process rotating about 25% of senior managers and about 50% of upper professionals into new positions. Targets and incentive plans became cross-functional, designed to build capabilities both within and across businesses. And at every step, purpose helped everybody in the company understand the “why” (the business environment’s increasing emphasis on sustainability), the “what” (value-creation programs offering renewable solutions to customers, which in turn generated higher margins for Neste), and the “how” (changing from a sales organization to a key-account management model with dedicated people responsible for strategic customers).

The process worked. Neste is now a leader in the renewables industry, and the world is starting to pay attention. In 2015, for example, Google and UPS began partnering with the company to reduce their carbon emissions, as did several cities in California, among them San Francisco and Oakland. In 2018, *Forbes* ranked Neste second on its Global 100 list of the world’s most-sustainable companies.

Benefits on the Soft Side

Purpose can also help with the soft side of management—the people-related aspects of running a business, which so often prove to be the undoing of leaders. By putting purpose at the core of strategy, firms can realize three specific benefits:



more-unified organizations, more-motivated stakeholders, and a broader positive impact on society.

Unifying the organization. When companies pursue dramatic change and move into larger ecosystems, as both Mars Petcare and Securitas have done, it’s unsettling for employees. Why does a pet-food company need to develop a platform to support technology start-ups? Why does an on-site guarding company want to provide electronic security services that could, over time, make the physical presence of guards redundant? Purpose helps employees understand the whys and get on board with the new direction.

Motivating stakeholders. According to the Edelman trust barometer, distrust of government, businesses, the media, and NGOs is now pervasive. At the same time, more than ever, employees, especially Millennials, want to work for organizations that can be trusted to contribute to a higher cause. And when customers, suppliers, and other stakeholders see that a company has a strong higher purpose, they are more likely to trust it and more motivated to interact with it.

Broadening impact. Strategy involves exploring some fundamental questions. Why are we in this business? What value can we bring? What role does my unit play within the bigger portfolio? Purpose creates a basis for answering those questions and defining how each unit will contribute to the organization and to society as a whole. This focus on collective objectives, in turn, opens up many more opportunities to improve growth and profitability today and in the future.

THE APPROACH TO purpose that we’re recommending cannot be a one-off effort. Leaders need to constantly assess how purpose can guide strategy, and they need to be willing to adjust or redefine this relationship as conditions change. That demands a new kind of sustained focus, but the advantages it can confer are legion. ☐

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PSYCHOLOGY

The Dangers of Categorical Thinking

We're hardwired to sort information into buckets—and that can hamper our ability to make good decisions.



PHOTOGRAPHER BRUNO FONTANA



Say *ta*. Say *da*. Now repeat the sounds, in each case paying attention to how you're making them in your mouth. What's the difference?

Trick question! There isn't one. It's not what's happening in your mouth that makes these sounds different. It's the "voice onset time"—the time between when you start moving your tongue and when you start vibrating your vocal cords. If that time is greater than roughly 40 milliseconds, English-speakers will hear *ta*. If it's less than 40 milliseconds, they'll hear *da*.

What's amazing is that you never hear anything other than *ta* or *da*. If two speakers fall on the same side of the

40-millisecond dividing line, it doesn't matter if their voice onset times differ dramatically. One person's time might be 80 milliseconds, and the other's might be only 50 milliseconds, but in both cases you'll hear *ta*. If their times fall on opposite sides of the divide, however, a difference of just 10 milliseconds can be transformative. If one person's voice onset time is 45 milliseconds, you'll hear *ta*. If the other person's time is 35 milliseconds, you'll hear *da*. Strange but true.

People have had a lot of fun on the internet recently with the tricks our either-or minds play on us. Think of the audio clip of the word that people hear as either *Yanni* or *Laurel*. Or the dress that people see as either black-and-blue or white-and-gold. In these cases, as with *ta* and *da*, people fall on one side or the other of the categorical dividing line, and they're practically willing to stake their lives on the idea that their perception is "right."

Your mind is a categorization machine, busy all the time taking in voluminous amounts of messy data and then simplifying and structuring it so that you can make sense of the world. This is one of the mind's most important capabilities; it's incredibly valuable to be able to tell at a glance whether something is a snake or a stick.

For a categorization to have value, two things must be true: First, it must be *valid*. You can't just arbitrarily divide a homogeneous group. As Plato put it, valid categories "carve nature at its joints"—as with snakes and sticks. Second, it must be *useful*. The categories must behave differently in some way you care about. It's useful to differentiate snakes from sticks, because that will help you survive a walk in the woods.

IDEA IN BRIEF

THE PROBLEM

We all think categorically, and for good reason: It helps us make sense of the world. But in business, categorical thinking can lead to major errors in decision making.

THE FALLOUT

When we categorize, we compress category members, treating them as if they're more alike than they are; we amplify differences across categories; we discriminate, favoring certain categories over others; and we fossilize, acting as if the structures we've imposed are static.

THE SOLUTION

Thoughtful leaders can avoid the harm that comes from categorical thinking in four ways: by ensuring that everybody understands the dangers of categorization, by developing ways to analyze data continuously, by questioning decision-making criteria, and by actively "de-fossilizing" categories.



ABOUT THE ART

Bruno Fontana is drawn to the mosaic of identical homes and cookie-cutter modern architecture often found in suburbia. In his photography he seeks to both categorize infinite repetitions of form and highlight the touches of customization and decorative embellishments that make these structures unique.





So far, so good. But in business we often create and rely on categories that are invalid, not useful, or both—and this can lead to major errors in decision making.

Consider the Myers-Briggs Type Indicator, a personality assessment tool that, according to its publisher, informs HR decision making at more than 80% of *Fortune 500* companies. It asks employees to answer 93 questions that have two possible responses and then, on the basis of their answers, places them in one of 16 personality categories. The problem is that these questions demand complex, continual assessment. Do you go more by facts or by intuition? Most of us would probably answer, “Well, it depends”—but that’s not an option on the test. So respondents have to choose one camp or the other, making choices they might not reproduce if they were to take the test again. Answers to the questions are summed up, and the respondent is labeled, say, an “extravert” rather than an “introvert” or a “judger” rather than a “perceiver.” These categorizations simply aren’t valid. The test isn’t useful either: Personality type does not predict outcomes such as job success and satisfaction.

Why, then, is Myers-Briggs so popular? Because categorical thinking generates powerful illusions.

Categorical thinking can be dangerous in four important ways. It can lead you to *compress* the members of a category, treating them as if they were more alike than they are; *amplify* differences between members of different categories; *discriminate*, favoring certain categories over others; and *fossilize*, treating the categorical structure you’ve imposed as if it were static.

Compression

When you categorize, you think in terms of prototypes. But that makes it easy to forget the multitude of variations that exist within the category you’ve established.

The myth of the target customer. According to a story that Todd Rose tells in his book *The End of Average*, a newspaper in Cleveland ran a contest in 1945 to find the anatomically prototypical woman. Not long before, a study had determined the average values for a variety of anatomical measurements, and the paper’s editors used those measurements to define their prototype. A total

of 3,864 women submitted their measurements. Want to guess how many of them were close to the average on every dimension?

None. People vary on so many dimensions that it’s highly unlikely that any single person will be close to the average on every one of them.

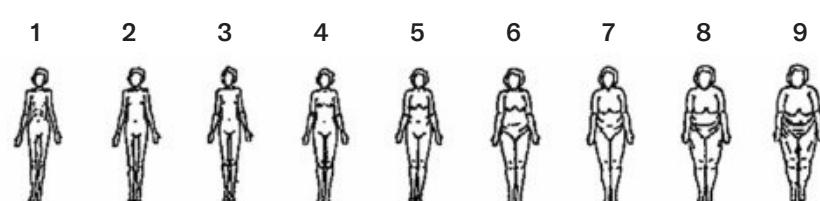
The same holds true for customers. Consider what happens in segmentation studies—one of the most common tools used by marketing departments. The goal of a segmentation study is to separate customers into categories and then identify target customers—that is, the category that deserves special attention and strategic focus.

Segmentation studies typically begin by asking customers about their behavior, desires, and demographic characteristics. A clustering algorithm then divides respondents into groups according to similarities in how they answered. This kind of analysis rarely yields highly differentiated categories. But instead of seriously evaluating whether the clusters are valid, marketers just move on to the next steps in the segmentation process: determining average values, profiling, and creating personas.

This is how “minivan moms” and other such categories are born. After conducting a survey, somebody in marketing identifies an interesting-looking cluster in which, say, 60% of the respondents are female, with an average age in the early 40s and an average of 2.75 kids. Looking at those averages, it’s easy to drift away from the data and start dreaming of a prototypical customer with those very attributes: the minivan mom.

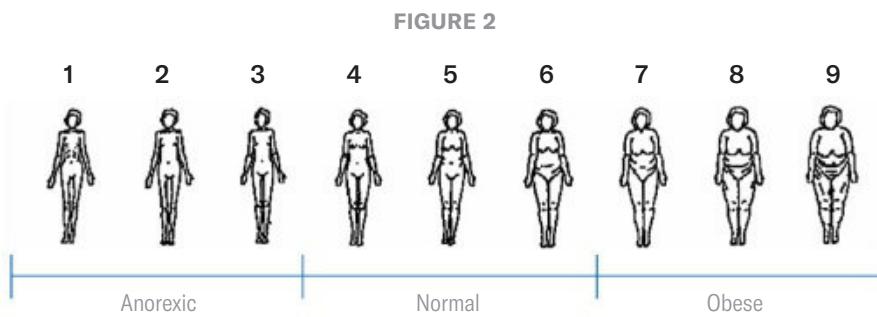
Such labels blind us to the variation that exists within categories. Researchers in a 2011 study, for example, presented participants with an image of women’s silhouettes at nine equidistant points along the spectrum of the body mass index. The participants were shown the silhouettes twice—once just as they appear in Figure 1, below, and once with the labels “anorexic,” “normal,” and “obese.” (See Figure 2 on the facing page.)

FIGURE 1





The segments that most businesses work with are not as clear-cut as they seem. Customers in a segment often behave very differently.



Adapted from Foroni and Rothbart, "Category Boundaries and Category Labels," *Social Cognition* 2011

At each viewing, the participants were asked to rate the images on various dimensions. They saw the women differently when they were labeled than when they were not—even though nothing about the women themselves had changed. For instance, participants assumed that the personality and lifestyle of woman 7 was more like that of woman 9 when the two were labeled obese. Similarly, women 4 and 6 were seen as more alike when they were labeled normal.

As with body types, the segments that most businesses work with are not as clear-cut as they seem. Customers in a segment often behave very differently. To resist the effects of compression, analysts and managers might ask, How likely is it that two customers from different clusters are more similar than two customers from the same cluster? For instance, what is the probability that a minivan mom's favorite clothing brand is more like that of a maverick mom than like that of another minivan mom? That probability is often closer to 50% than to 0%.

The screening effect. Compression can also distort recruiting decisions. Imagine that you're responsible for hiring at your company. You recently posted a job announcement, and 20 people applied. You do a first screening, ranking candidates in terms of their technical skills, and invite the five highest-ranked candidates in for an interview.

Even though technical skills vary considerably among the five, you're not much influenced by that now in deciding whom to hire. Once you've screened candidates on the basis of technical skill, those who made it to the next stage all seem similar to you on that dimension. Affected in this way by categorical thinking, you'll decide primarily on the basis of the soft skills the candidates demonstrate in interviews: how personable they are, how effectively they communicate, and so on. Those skills are important, of course, but the top

requirement for many jobs is the highest possible technical skills, and the screening effect hampers your ability to pinpoint them.

Anomalies in financial investments. Compression also occurs in financial markets. Investors roughly categorize assets according to size (small-cap or large-cap stocks), industry (energy, say, or health care), geography, and so on. Those classifications help investors sift through the vast number of available investment options, and that's important. But they also lead investors to allocate capital inefficiently in terms of risk and return. During the internet bubble of the late 1990s, for example, people invested heavily and almost immediately in companies that had adopted dot-com names, even when nothing else had changed about those businesses. That mistake cost many investors dearly. Another example: When a company's stock is added to the S&P 500, it starts moving more closely with the stock prices of other companies in the index, even if nothing about the company or its stock has actually changed.

Amplification

Categorical thinking encourages you to exaggerate differences across category boundaries. That can lead you to stereotype people from other groups, set arbitrary thresholds for decisions, and draw inaccurate conclusions.

Group dynamics. Amplification can have serious consequences when it affects how you think about members of social or political groups. Studies show that people affiliated with opposing political parties tend to overestimate the extremity of each other's views.

Who do you think cares more about social equality: liberals or conservatives? If you answered liberals, you're correct. On average, liberals rate social equality as more important than conservatives do. But some conservatives care more about social equality than some liberals do. Suppose we take two random people on the street—first somebody who votes conservative, and then somebody who votes liberal. What's the probability that the first person rates social equality as more important than the second does? Much closer to 50% than you might think. Averages mask the overlap between groups, amplifying perceived differences. Despite the average in this case,





many conservatives actually care more about social equality than many liberals do.

If you're a liberal in the United States, you're likely to assume that all conservatives oppose abortion, gun control, and the social safety net. If you're a conservative, you're likely to assume that all liberals want open borders and government-run universal health care. The reality, of course, is that ideologies and policy positions exist on a spectrum.

Amplification due to categorical thinking is especially worrisome in today's age of big data and customer profiling. Facebook, for example, is known to assign political labels to its users according to their browsing history ("moderate," "conservative," or "liberal") and to provide that information to advertisers. That can lead advertisers to assume that differences among Facebook's categories of users are bigger than they actually are—which, ironically, can widen the true differences, by giving advertisers an incentive to deliver a highly tailored message to each group. That's what seems to have happened in 2016, during the U.S. presidential election and the Brexit campaign, when Facebook fed "conservatives" and "liberals" thousands of divisive communications.

Many companies struggle internally with similar amplification dynamics. Success often hinges on creating inter-departmental synergies. But categorical thinking may cause you to seriously underestimate how well your teams can do cross-silo work together. If, say, you assume that your data scientists have lots of technical expertise but little understanding of how the business works, and that your marketing managers have the domain knowledge but can't wrangle data, you might rarely think about having them team up. That's one reason so many analytics initiatives fail.

Decision making. Amplification also has subtler consequences for managerial decisions. Consider that NBA coaches are 17% more likely to change their starting lineup in a game following a close loss (100–101) than they are following a close win (100–99), even though the difference in the other team's scores is only two points. But few coaches would change a lineup because their team lost 100–106 rather than 100–108, even though the difference is still only two points. A loss feels qualitatively different from a win, because you don't think about sports outcomes as being on a continuum.



Marketers tend to get obsessed with their target customers, ignoring the value that can be extracted from everyone else.

Whenever you make a decision using a cutoff along some continuous dimension, you're likely to amplify small differences. After the financial crisis in 2008, the Belgian government bailed out Fortis, a subsidiary of BNP Paribas. As a result, the government owned millions of shares of BNP Paribas. According to the Belgian newspaper *De Standaard*, at the end of January 2018, when the stock price was a little over €67, the government decided that it would sell its shares if they reached €68 again. But they never did; instead the price plummeted, and those shares are now worth only €44.

Nobody in the Belgian government could have predicted that the stock price would fall so much. But the government's mistake was to make selling its shares an all-or-nothing affair. A better approach would have been to sell some of the stock at one price, some at a second price, and so on.

Statistical significance. With the rising influence of behavioral economics and data science, companies increasingly rely on A/B testing to evaluate effectiveness. In part that's because A/B tests are easy to implement and analyze: You create two versions of the world that are identical except for one factor; you assign one group of participants to experience version A and one to experience version B; and then you measure whether behavior differs substantially between the groups. There will always be some difference between the groups due simply to chance, even if your manipulation had no effect. So, to determine whether the difference is large enough to indicate that the manipulation did have an effect, you apply a statistical test. The outcome of the test is the probability that you would have observed a difference of that magnitude if the manipulation had no effect. This probability is known as the p-value. The closer a p-value is to zero, the more comfortably you can conclude that any difference can be attributed to the factor you manipulated, not just to chance. But how close to zero is close enough?

In 1925 Sir Ronald Fisher, a British statistician and geneticist, decided arbitrarily that .05 was a convenient threshold. Fisher might just as easily have picked .03, and in fact he recommended that the p-value threshold be dependent on the specifics of whatever study was being conducted. But few people paid attention to that. Instead, in the decades that followed, entire scientific disciplines blindly adopted .05 as the magical boundary that separates signal from noise, and it has become the norm in business practice.

That's a problem. When an A/B test yields a p-value of .04, an intervention might be adopted, but at .06 it might be skipped—even though the difference between $p=.04$ and $p=.06$ is not in itself meaningful. Making matters worse, many experimenters peek at the data regularly to test for statistical significance, stopping data collection when they see a p-value below .05. This practice greatly increases the likelihood of concluding that an intervention is effective when in fact it isn't. A recent study examining the practices of experimenters who use a popular online platform for A/B testing found that the majority engage in such "p-hacking," increasing false discovery rates from 33% to 42%.

Discrimination

Once you've imposed a categorical structure, you tend to favor certain categories over others. But insufficiently attending to other categories can be harmful.

Overtargeting. Imagine that you're the digital marketing director for an online retailer that sells home furnishings with unique and creative designs. You've done a segmentation study and identified a target customer segment with the following characteristics: male professionals aged 18 to 34 with creative jobs in fashion, marketing, or media and with medium disposable income. You have \$10,000 to spend on digital ads, and you're considering three plans: (1) No targeting. The ad is served with equal probability to all Facebook users and will cost 40 cents per click. (2) Full targeting. The ad is served only to your target segment and will cost 60 cents per click. (3) Partial targeting. You invest half your budget in marketing to your target segment and the other half in mass marketing, which will cost 48 cents per click.

Which plan should you choose? Probably B or C, because it allows you to narrow your target—right?

Wrong. The best option is probably A, the broadest target. Why? Because targeting broadly often yields a higher ROI than targeting narrowly. Researchers have found that online ads tend to increase purchase probability by only a small fraction of a percent. If the chance that someone will buy your product without seeing an ad is 0.10%, exposure to an ad might move the probability up to 0.13%. The positive impact of the ad may be a bit greater for target customers,

but in many cases it won't compensate for the additional cost per click. Marketers, however, get obsessed with their target customers, ignoring the value that can be extracted from everyone else.

Facebook has been engaged in a concerted effort to teach its advertising customers about the importance of reach relative to narrow targeting. It cites the case of a beer brand that traditionally focused on men. When the brand moved onto digital media platforms, it was able to narrow its targeting, which seemed like a good thing. But in fact that severely limited the reach of its campaigns, and the brand started performing poorly. After some investigation the company realized that a significant proportion of people consuming its product were women. Once it broadened its targeting and creative messaging, it saw immediate positive results.

Net Promoter Score. Discrimination can distort how data is interpreted. When we teach classes on data analytics, we often ask our students whether they've heard of the Net Promoter Score (NPS) and whether their companies use the metric in some way. Invariably most hands go up, and for good reason. After Frederick F. Reichheld introduced the concept, in this magazine ("The One Number You Need to Grow," December 2003), it quickly became one of the most important key performance indicators in business, and it still is.

What is NPS, and how does it work? Companies ask customers (or employees) to indicate on a 0–10 scale how likely they are to recommend the company to relatives or friends. Zero means "not at all likely," and 10 means "extremely likely." After responding, customers are grouped into three categories—*detractors* (0–6), *passives* (7–8), and *promoters* (9–10). The NPS is arrived at by determining the percentage of customers in each category and then subtracting the percentage of detractors from the percentage of promoters. If 60% of your customers are promoters and 10% are detractors, your NPS is 50.

There are good reasons to use NPS. It's straightforward and easy to understand. Also, it helps avoid the amplification bias that comes with categorical thinking—or, as Reichheld put it in his article, "the 'grade inflation' that often infects traditional customer-satisfaction assessments, in which someone a molecule north of neutral is considered 'satisfied.'"

That's helpful. But the NPS system actually exhibits the sort of amplification bias that it's supposed to help companies avoid. Customers who score a 6, for example, are much closer to a 7 than a 0, but nonetheless they get lumped in with the detractors rather than the passives. Small differences across category boundaries matter in determining the score, in other words—whereas the same or larger differences within a category don't.

NPS has another categorical-thinking problem: It disregards the number of passives it finds. Consider two extreme



survey results: One company has 0% detractors and 0% promoters. Another company has 50% detractors and 50% promoters. The NPS for both is the same, but clearly their customer bases are very different and should be managed in different ways.

Biased interpretation of correlations. Categorical thinking can also distort how you interpret data. Imagine that you're responsible for managing a service desk. You believe that the satisfaction of your agents may have an effect on customer satisfaction, so you commission a study. A few weeks later a team from HR analytics sends you the data, visualized in a scatterplot that looks like Figure 1.



How would you evaluate the strength of the relationship between agent satisfaction and customer satisfaction? Most people see a moderately strong relationship.

But what if the results were different, and you were sent the scatterplot in Figure 2? How would you evaluate the strength of the relationship now?

Most people see a much weaker relationship or none at all. But the strength of the relationship is actually about the same. The scatterplots are identical except for eight data points that have moved from the upper-right quadrant in the first one to the lower-left quadrant in the second.

So why do people see a stronger relationship in the first graph? Because they tend to privilege the upper-right quadrant. In the first scatterplot they see many satisfied agents with satisfied customers, so they conclude that the correlation is fairly strong. In the second scatterplot they see few satisfied agents with satisfied customers, so they conclude that the correlation is weaker. There's a lesson here: Failing



to attend equally to all categories harms your ability to accurately uncover relationships between variables.

Fossilization

Categories lead to a fixed worldview. They give us a sense that this is how things are, rather than how someone decided to organize the world. John Maynard Keynes articulated the point beautifully. “The difficulty lies, not in the new ideas,” he wrote, “but in escaping from the old ones.”

In the 1950s the Schwinn Bicycle Company dominated the U.S. bicycle market. Schwinn focused on the youth market, building heavy, chrome-encrusted, large-tired bicycles for kids to pedal around the neighborhood. But the market changed markedly from the 1950s to the 1970s. Many adults took up cycling for sport and sought lighter, higher-performance bikes. Schwinn failed to adapt, and U.S. consumers gravitated toward European and Japanese bicycle makers. This was the beginning of Schwinn’s grinding and painful decline into obsolescence. The company’s view of the consumer landscape had fossilized from decades of success selling bikes to children, blinding Schwinn to the tectonic changes under way.

Innovation. Innovation is about breaking the tendency to think categorically. Many businesses aim to increase the efficiency of their operations through categorization. They assign tasks to people, people to departments, and so on. Such disciplinary boundaries serve a purpose, but they also come at a cost. Future business problems don’t fall neatly within the boundaries that were created to help solve past problems. And thinking only within existing categories can slow down the creation of knowledge, because it interferes with people’s ability to combine elements in new ways.

Consider what researchers from the University of Toronto discovered in 2016, when they asked about 200 participants to build an alien with Legos. Some participants were asked to use blocks that had been organized into groups, and others were asked to use blocks in a random assortment. A third group was then asked to rate the creativity of the solutions—and declared the aliens made using uncategorized blocks to be more creative.

When categories fossilize, they can impede innovation in another way, by making it hard to think about using objects

(or ideas) in atypical ways. This is the problem of *functional fixedness*. If you were given a screw and a wrench and asked to insert the screw in a wall, what would you do? You might try to clamp the head of the screw with the wrench and twist the screw into the wall—with predictably awkward and ineffective results. The most effective approach—using the wrench to hammer the screw in like a nail—might not occur to you.

Limiting the Dangers of Categorical Thinking

So how can a thoughtful leader avoid the harm that comes from categorical thinking? We propose a four-step process:

1. Increase awareness. We all think categorically, and for good reason. But anybody who makes decisions needs to be aware of the alluring oversimplifications and distortions that categorical thinking encourages, the sense of easy understanding it invites, and the invisible biases it creates. The companies that best avoid those pitfalls will be the ones that help their employees be more comfortable with uncertainty, nuance, and complexity. Is a categorization valid? and Is it useful? are questions that should be part of the decision-making mantra.

2. Develop capabilities to analyze data continuously.

To avoid the decision-making errors that stem from categorical thinking, good continuous analytics are key. But many companies lack the know-how. When it comes to segmentation, for example, they outsource the analytics to specialized companies but then improperly interpret the information they’ve bought. That’s relatively easy to fix. Well-established metrics for evaluating the validity of a defined segment can be applied with a little bit of training. Any company that uses segmentation studies as a major part of its marketing research or strategic planning should employ such metrics and do such trainings; they represent a golden opportunity for smart organizations to develop in-house expertise and reap competitive advantage.

3. Audit decision criteria. Many companies decide they will act only after they pass some arbitrary threshold on a continuum. This has two drawbacks.

First, it increases risk. Imagine that a company is doing market research to determine whether a new product is likely to succeed. It might move forward with a launch if consumer evaluations hit a predetermined threshold during a large-scale survey or if the results of an experiment yield a p-value smaller than the magic number .05. But because the difference between just hitting and just missing the threshold is minuscule, the company may have crossed it simply because of random variation in the sample or some small



bias in the data collection method. A tiny and fundamentally meaningless difference can thus lead to a dramatically different decision—and, as the Belgian government learned when it failed to reach its stock-sale threshold, possibly the wrong one. In such a situation, a staged approach is far sounder. The Belgians could have scaled the amount of investment to the weight of the evidence instead of using a binary cutoff.

Second, an arbitrary threshold can impede learning. Consider a company that plans to make organizational changes if it doesn't hit a certain revenue target. If it just barely fails to hit that target, it assumes that something is wrong and so makes the changes. But if the company just barely *makes* its target, it assumes that things are OK and carries on with business as usual, even though the two cases' numbers are almost identical.

To avoid these problems, we recommend that you perform an audit of decision-making criteria throughout your organization. You'll probably be surprised at how many decisions are made according to go/no-go criteria. Sometimes that's unavoidable. But usually alternatives exist, and they represent another opportunity to reap competitive advantage.

4. Schedule regular “defossilization” meetings. Even if you follow the three steps above, fossilization is still a danger. To avoid it, hold regular brainstorming meetings at which you scrutinize your most basic beliefs about what is happening in your industry. Is your model of the customer landscape still relevant? Are customer needs and desires changing?

One way to innovate is to reflect on the individual components that make up existing categories and imagine new functions for them. For instance, cars transport *people* from A to B, and postal workers transport *mail* from A to B, right?

Well, yes—but if you think that way, you're probably overlooking interesting opportunities. Amazon recognized this. When the company questioned the function of cars, it realized that they could be used to receive packages, so in the United States it began to deliver mail to the trunks of cars belonging to Prime members. Similarly, in the Netherlands, when PostNL considered the function of its postal workers, it recognized that while walking their routes they could regularly photograph weeds to better assess the effectiveness of herbicidal treatments—a valuable new function that categorical thinking would never have allowed the company to see.

CATEGORIES ARE HOW we make sense of the world and communicate our ideas to others. But we are such categorization machines that we often see categories where none exist. That warps our view of the world, and our decision making suffers. In the old days, businesses might have been able to get by despite these errors. But today, as the data revolution progresses, a key to success will be learning to mitigate the consequences of categorical thinking. ☰ **HBR Reprint R1905E**

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CAN CHINA AVOID A GROWTH CRISIS?

YES—IF ITS COMPANIES GLOBALIZE THEIR CULTURES AND STRATEGIES.



**J. Stewart
Black**

Professor, INSEAD

Allen J. Morrison
Professor, Thunderbird
School of Global
Management



PHOTOGRAPHER RICHARD JOHN SEYMOUR

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THERE'S NO QUESTION THAT CHINA IS ON THE RISE.

In 2018, *Fortune's* Global 500 ranking included 111 firms headquartered in China—just a handful fewer than the United States' 126. In 1995, only three Chinese firms made the list; in 2018, three were in the top 10. No wonder some observers predict that China will soon overtake the U.S. as the home to the highest number of *Fortune* 500 firms.

It's entirely possible that this could happen, but the triumph would likely be fleeting. Our skepticism is rooted in Japan's example: In 1995, Japan was second only to the United States on the *Fortune* 500 list, with just four fewer companies. It had achieved that position thanks to several decades of soaring growth in the domestic economy—an astounding 1,171% from 1973 to 1995, a growth factor of 12. The China story is almost identical: Since 1995, the domestic economy has grown by a factor of 16.6, from just \$735 billion to \$12.2 trillion today, and the correlation between the rise of Chinese GDP and the ascent of Chinese firms onto the Global 500 list is 99%.

In our view, China's share of global business is predicated, as was Japan's, on a dynamic domestic economy. The top three Chinese companies on the *Fortune* list in 2018—State Grid Corporation of China, China Petrochemical Corporation,

and China National Petroleum Corporation—generated more than 85% of their revenue domestically. They, along with 84 others out of China's 111, are state-owned enterprises, or SOEs; you would expect such companies to be reliant on domestic revenue for growth. But many of the privately owned enterprises (POEs) on the list also generate the bulk of their revenue from domestic customers. The numbers for tech giants Alibaba and Tencent, for example, are 74% and 80%, respectively. The implication is clear: With a few exceptions—notably Huawei and Lenovo, which generate 50% and 75%, respectively, from sales in foreign markets—the great majority of the Chinese companies on the Global 500 would be vulnerable to a major slowdown in the domestic economy.

And a slowdown is inevitable, we believe. Demographic data shows that China's working-age population is shrinking. In the absence of drastic improvements in labor productivity, a smaller workforce means a lower GDP growth rate. Japan has experienced a similar decline in working-age population, and it has been unable to achieve the productivity gains necessary to maintain growth. It is unlikely that China's firms will succeed where Japan's have failed, primarily because the factors that have driven China's spectacular growth over the past 20 years—a low baseline of productivity to begin with, an excess supply of rural workers, and easy access to foreign technology—have significantly weakened.

China's other option for averting an economic slowdown—boosting international sales and exports—also faces headwinds: China's penchant for debt could hamstring attempts to innovate by reducing the capital available for investment in international sales and dampening the country's export competitiveness. And Chinese management style is antithetical to fostering innovation. For these reasons, we believe that after a meteoric rise, China's giants could face a rocky future. Let's begin with a review of the demographics.

THE DEMOGRAPHIC DISASTER

The demographic parallels between China and Japan are striking. China's working population (people aged 15 to 64) is estimated to fall by 9% from 2015 to 2035, and by 20% in 2050 (see the exhibit "The Rise and Fall of Working-Age Populations"). That's a loss of 200 million people—more than the total working-age populations of Germany, France, the UK,



As Japan's working-age population fell, domestic consumption faltered, and Japanese firms started sliding off the Global 500 list. China faces the same situation.

Italy, Belgium, the Netherlands, and Switzerland combined. Japan has experienced a similar decline over the past two decades: Its working population fell 13.4% from 1997 to 2017.

China's infamous one-child policy, implemented in 1979, is often seen as the reason the birth rate fell from 2.9 children per family to 1.6 in 1995. But demographic data suggests that the policy only accelerated a decline that China was already experiencing. The country's birth rate began falling a decade earlier, reflecting a nearly universal pattern of economic development in which birth rates fall as standards of living rise. In Japan, the birth rate fell from 2.1 in 1965 to 1.6 in 1989 without the help of a one-child policy.

A country's workers are its most powerful consumers; when the working-age population shrinks, so do revenues. That has already happened to Japan's global giants. As the country's working-age population fell, domestic consumption faltered, and Japanese firms started sliding off the Global 500 list. The correlation between the decline in the working-age population and Japanese firms' leaving the Global 500 was 94%. China faces the same situation.

Two key ways a country can compensate for a shrinking workforce are by boosting the number of workers through immigration and by boosting the productivity of the remaining workers. Immigration as a countervailing force to a falling birth rate seems unlikely for China, which, like Japan, is not known for welcoming foreign workers. According to World Bank data, in 2015 less than one-tenth of one percent of the people living in China were foreigners. During Japan's heyday, that country's rate was somewhat higher, but still

only 1.7% of people living in Japan in 2015 were registered foreigners. By contrast, the number of registered foreigners in both the United States and Germany that year was about 15% of the total population.

Countries can also offset a shrinking working age population through dramatic improvements in labor productivity. With increased productivity, companies can pay fewer workers more money and still remain profitable, and the higher pay translates into higher domestic consumption per worker. In Japan's case, the improvements didn't happen. The country averaged 13% per year in productivity gains for the 20 years leading up to its peak working-age population in 1997. But in the two decades that followed, during which the workforce shrank, productivity growth averaged less than 1% per year. And the vast majority of those gains came from the manufacturing sector, not the service sector, which now represents 70% of Japan's economy.

China seems to be following a similar path. Although its productivity growth averaged 15.5% from 1995 to 2013, when its working-age population reached its peak, productivity growth slowed to an average of just 5.7% from 2014 to 2018. In other words, China's productivity growth rate is decelerating just when it needs to speed up. This gloomy scenario is especially problematic for China's SOEs. Although they have larger revenues than POEs, on average, they also have significantly higher numbers of employees (a median of 143,927 versus 77,073) and lower profits (a median of \$746 million versus \$1.7 billion). That means they are heading into the slowdown with a productivity growth rate significantly

IDEA IN BRIEF

THE PROBLEM

Although it is very likely that China will soon overtake the United States as the home to the highest number of Fortune 500 firms, that triumph could be short-lived.

WHY IT'S HAPPENING

China's Fortune 500 firms are heavily reliant on domestic revenues, and a rapidly falling working-age population will severely reduce domestic GDP growth in the absence of improvements in labor productivity (which are unlikely to occur). Japan provides an uncomfortable precedent for the consequences of this demographic shift.

THE SOLUTION

To keep their places on the Fortune 500, China's domestic giants will have to develop a global mindset more characteristic of multinationals from small countries like Switzerland—a transformation that has to date eluded most of Japan's businesses.



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lower, on average, than that of the POEs, as measured by revenue per employee (\$326,338 versus \$496,172) and profits per employee (\$5,355 versus \$22,507).

Can China correct or compensate for its falling productivity? That will depend on the long-term outlook for the main drivers of its labor productivity and on the ability of its firms to replace falling domestic revenues with exports (producing in China and selling abroad) and international sales (producing abroad and selling abroad).

THE OUTLOOK FOR CHINA'S PRODUCTIVITY

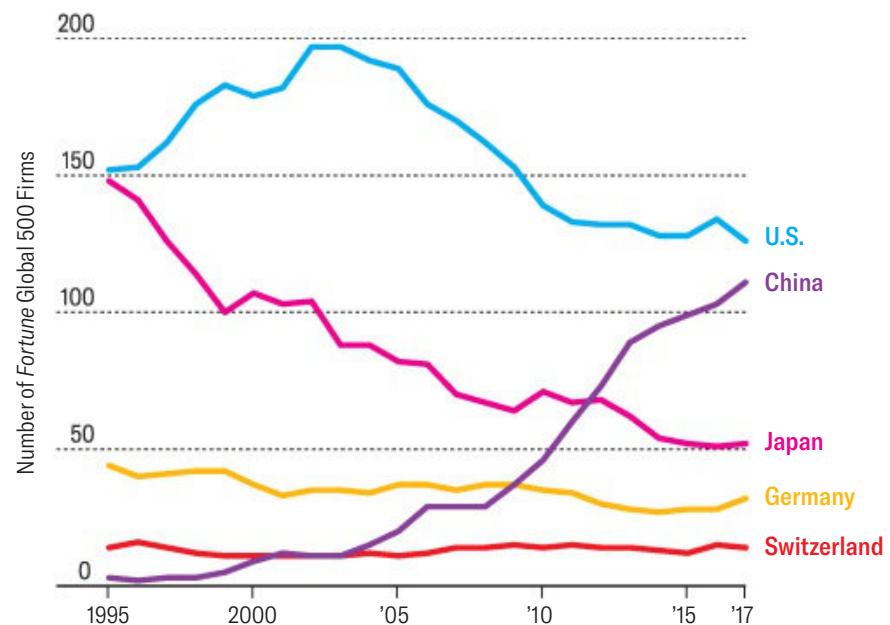
To assess the outlook for Chinese productivity, we have to determine whether the factors contributing to its impressive growth to date are likely to improve, stay the same, or decline. Economists and business strategists point to three drivers of China's growth: the fact that the country started with a very low productivity level, an excess of rural workers available to migrate to more-productive city jobs, and firms' ability to trade market access for productivity-enhancing foreign technology.

A low productivity baseline. In 1994 China's GDP was just \$564 billion, and its GDP per capita was only \$473. In 2014, GDP topped \$10 trillion. The economic reality is that the larger GDP gets, the harder it becomes to maintain the same rate of growth. A falling number of workers compounds the challenge. Suppose a country is growing at a rate of 6%. If its workforce falls by 3%, productivity growth from that smaller workforce has to increase to 9.3% just to sustain the baseline. The difficulty of achieving this over a long periods is obvious.

An excess supply of labor. Most experts acknowledge that the migration of people from rural areas devoid of modern machinery and technology to industrialized urban areas plays a big role in driving productivity in a developing economy. It certainly did in Japan's recovery after World War II and in China over the past 25 years. But internal migration happens only if a country has an excess supply of rural labor. That no longer appears to be the case in China. Over the past 10 years, migration from rural to urban areas has dropped precipitously, with just 0.3% of the population leaving the

Will China Follow Japan's Path?

Powered by meteoric growth in the domestic economy, China is poised to overtake the United States as the home of the most Fortune Global 500 companies. But it faces the same challenges that reversed Japan's trajectory in the late 1990s.



Source: Fortune Global 500 List, 1995–2017

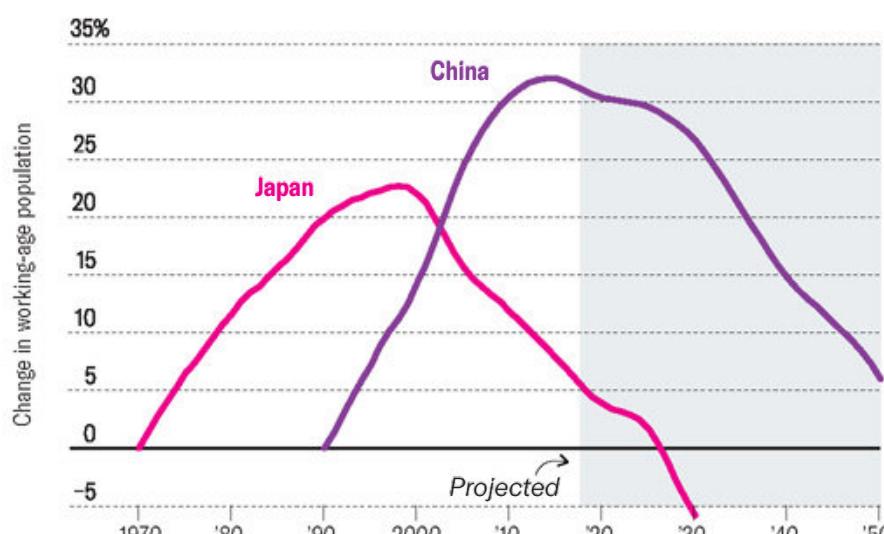
countryside in 2016, according to the Chinese government. In the 10 years prior to that, more than 280 million workers migrated from the countryside to the city. This slowdown is starting to be reflected in higher pay: Wages for migrant workers in the eastern urban regions of the country rose by 7.4% in 2016.

These indicators suggest that China is reaching what's called the Lewis turning point (LTP)—that is, when migration from country to town effectively stops. Many economists believe that China reached its LTP prior to 2018. Many of the residential areas built in major cities over the past 10 years to accommodate expected internal migration remain vacant. Some reports put the number of unoccupied apartments, almost all located in urban areas, at more than 64 million. Based on this evidence, China's recent announcement that it plans to move another 250 million people from rural to urban areas by 2025 may be wishful thinking.

Easy technology expropriation. Foreign firms increasingly recognize that giving away proprietary technology in return for market access makes little sense in China's mature, increasingly competitive business landscape. UNCTAD data reveals that FDI flows into China—a reasonable proxy for investment in local technological capabilities—grew by an average of only 2% per year from 2012 to 2017, down from the 10% annual average from 2002 to 2012. Companies such as GoPro, Panasonic, Sony, Hasbro, Revlon, and L'Oréal have

The Rise and Fall of Working-Age Populations

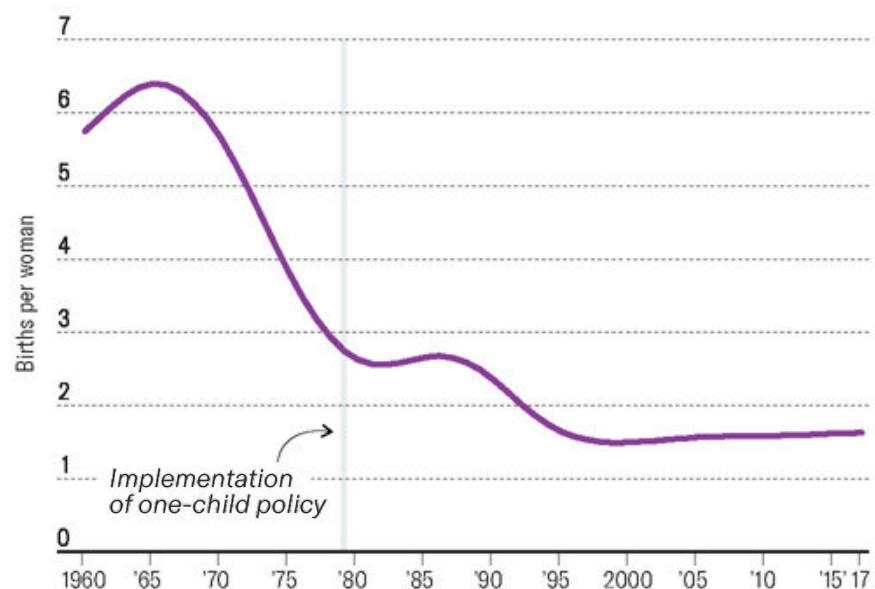
The steep decline in China's working-age population is likely to be accompanied by a sizeable drop in GDP in the absence of dramatic gains in labor productivity. Japan experienced a similar decline in its working-age population and was unable to boost productivity enough to maintain GDP growth.



Source: UN Population Project

China's Declining Birth Rate

Many observers point to China's infamous one-child policy as the catalyst for its declining birth rate. However, World Bank data shows that the birth rate had already begun to slow more than a decade earlier. The drop is most likely associated with the near-universal pattern whereby birth rates fall as standards of living rise.



Source: World Bank

recently closed shop or significantly reduced investments in the country. And many more multinationals are reconsidering expansion plans because of an unwillingness to trade technology for market access along with concerns about tariffs, political pressure, and rising wages.

Chinese companies' activities abroad are also coming under scrutiny. Foreign governments and companies increasingly see Chinese tech giants as security threats, as reflected in the recent high-profile arrests of executives from Huawei and the restriction of business with that company imposed by governments in the United States, Canada, and the UK. Western companies and agencies have accelerated their efforts to protect databases and proprietary technologies from Chinese hackers, which we can assume will further slow the transfer of foreign technology into China.

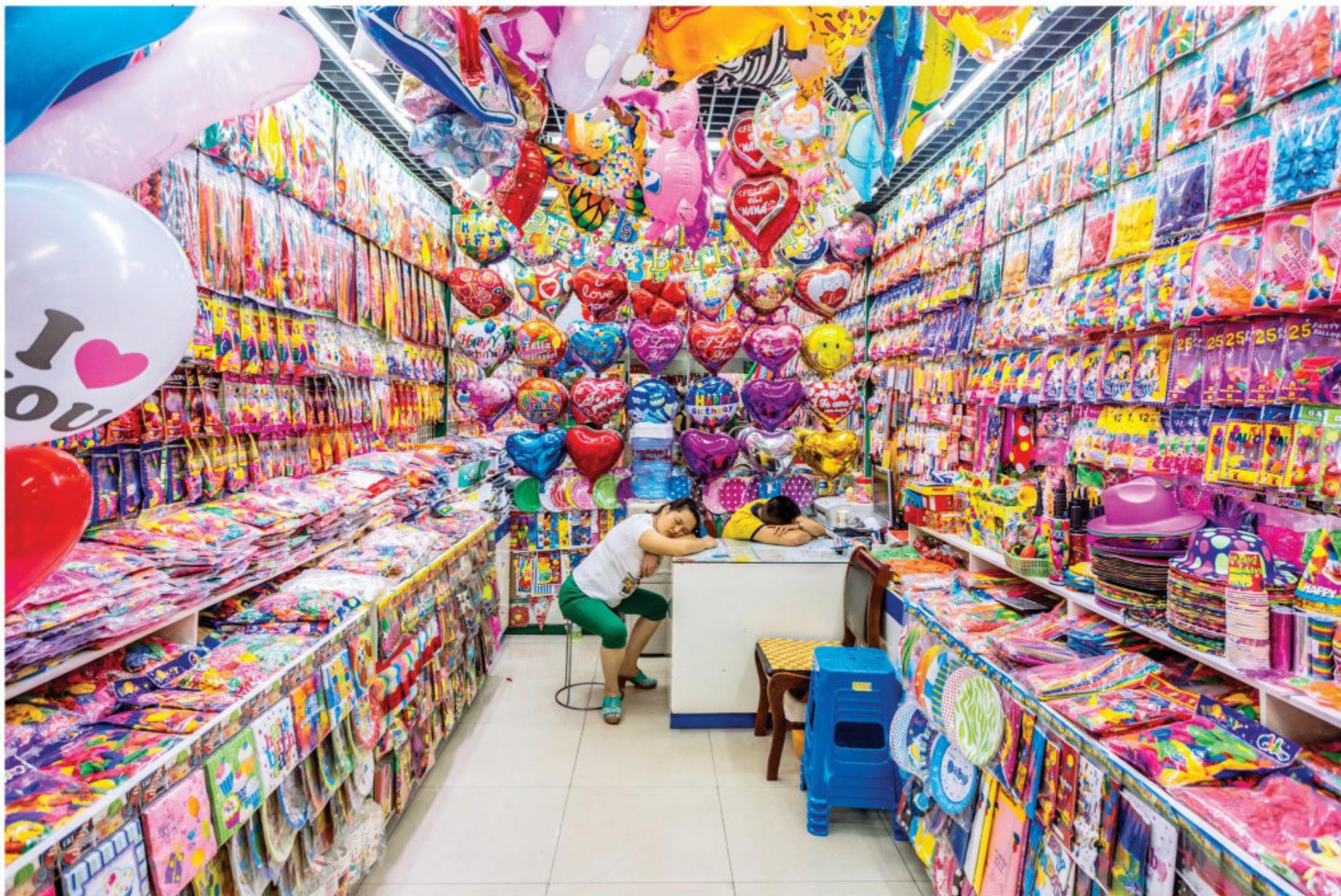
The Chinese government recognizes that the days of easy productivity gains via technology expropriation are over. In 2015 it released its Made in China 2025 plan, which calls for transforming 10 strategic industries into world leaders through homegrown technology innovation. But successfully shifting from strategies based on imitation and expropriation to ones focused on creation and innovation requires changes in organizational culture so large that the majority of companies from all countries fail in such attempts. To think that Chinese companies will fare better defies the odds, despite all the government support they get. What's

more, many Chinese companies favor top-down, autocratic approaches to management, which is inconsistent with a culture of innovation. And Chinese companies face another uniquely Chinese hurdle: All companies with more than 50 employees must have a Communist Party representative on-site. This muddies decision making, skews rewards, and bureaucratizes the innovation process.

For these reasons, we believe that Chinese corporations will have a hard time achieving the productivity gains that will be required in the future. That leaves only one way for them to keep their places on the Global 500: by boosting exports and international sales. But two serious obstacles stand in the way: high levels of debt and a conservative, inward-focused management culture.

CHINA'S DEBT CRISIS

China's government debt is about \$34 trillion—266% of GDP—and is growing fast. Corporate debt is also on the rise. According to July 2018 data provided by the Ministry of Finance, total debt among China's state-owned firms amounted to more than \$16 trillion, up 8.8% from the previous year. That's about 15% more than the debt of all U.S. nonfinancial corporations combined. China's indebtedness has quadrupled in the past seven years, and it grew 14% in 2017 alone.



So far China has been able to sustain this level of borrowing, largely thanks to robust internal rates of savings; that allows it to avoid the high interest rates that outside lenders might charge. It continues to run a large current-account surplus—that is, it exports a greater value of goods and services than it imports—which has enabled it to be a net lender to other nations. It still has the potential to simply grow its way out of the problem, even as the economy slows down—provided debt does not continue to mount at current rates. That, however, is a big proviso. China has long had a penchant for borrowing in order to stimulate the economy. If, as we predict, a shrinking workforce and lower productivity growth cause the economy to slow further, the government will be likely to double-down on borrowing, particularly through SOEs. That will only reduce the capital available for investment in international sales and do little to improve the country's export competitiveness.

But even if Chinese firms had plenty of capital to invest in international sales capabilities, they would still face a more fundamental challenge: their management culture.

A CRISIS OF LEADERSHIP

Like China's firms today, Japan's *Fortune* 500 companies in 1995 derived 85% of their revenues from domestic sales. When Japan's working population began to shrink and domestic productivity stalled, executives were unable to compensate for the hit to their revenues through exports and international sales. Why?

From our first-hand experience working with Japanese firms at the time, we found that, with the exception of a handful of firms (such as Sony, Toshiba, and Toyota) that were already international in outlook, most management teams refused to accept that the domestic economy was not going to revive until they simply couldn't deny the reality any longer. It took until about 2002 before Japan's 1995 giants had fully refocused their strategies on international growth.

Unfortunately in Japanese firms, Japanese leaders who understood both their domestic markets and international ones were in short supply, while internationally experienced non-Japanese top executives were virtually nonexistent. The reason was perfectly understandable: Why would



ABOUT THE ART

In his project, "Yiwu Commodity City," photographer Richard John Seymour explores the largest small-commodity wholesale market in the world. Located in Yiwu, China, thousands of stalls exhibit slight variations on particular items.

companies put significant focus on developing leaders for markets representing only 15% of revenues? And why would rising Japanese leaders risk their careers by taking expatriate assignments away from the main action?

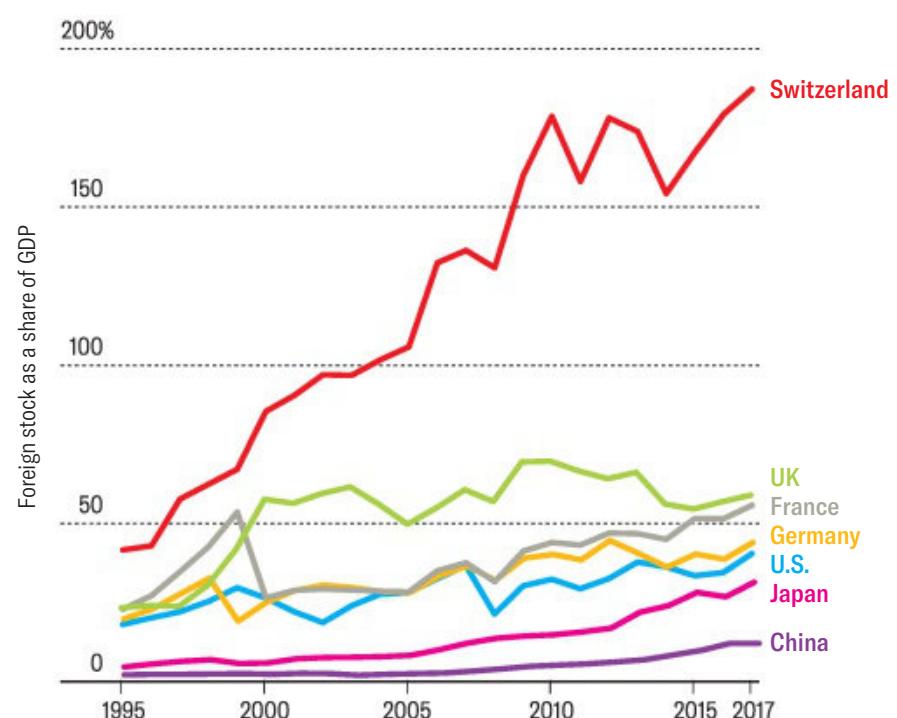
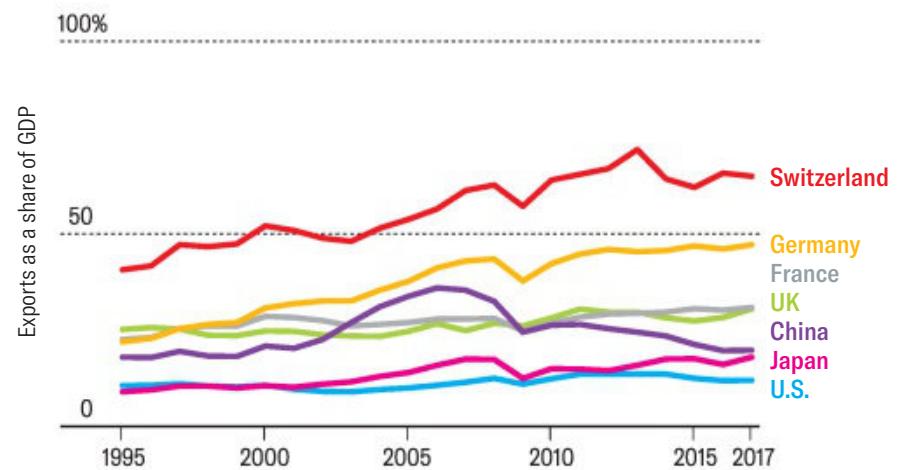
Moreover, Japanese firms were not attractive to foreign talent, because the path to advancement lay through achievement in the domestic market. Our research found that from 2005 to 2010 essentially all the top executives and board members of Japanese firms were Japanese nationals. Also, nearly 100% were male. Recognizing this, non-Japanese leaders who had international experience and savvy were hesitant to join Japanese firms. The lack of diversity at the top has not changed. We examined a random sample of 20 of the 52 Japanese companies on the 2018 Global 500 list and found that nearly 97% of all executives and more than 98% of all board members were Japanese nationals, and more than 90% were male.

Following their shift in strategic focus, Japanese firms finally started to see a boost from international business—just when the financial crisis erupted. The ensuing recession hit Japanese exports hard: They slumped by 25.4% in 2009 and didn't recover for three years. International sales were less affected by the recession as the investments in overseas operations began to pay off. But even so, Japanese firms significantly lagged their global rivals on this front, with dramatically lower levels of investment in foreign assets as a percentage of GDP. (See the exhibit “Can Exports and International Sales Make the Difference?”) The underperformance was actually larger than the graphic suggests, because some of the increase in the rate came from a flat denominator (GDP) rather than from increases in the numerator (overseas investments). As a consequence, Japanese firms lost 65% of their peak share of the Global 500 list in less than a generation. Given the persistent lack of global leadership at the top, we do not predict a major recovery in the near future.

The parallels with Chinese firms are worrying. We also looked at a random sample of 20 Chinese firms on the 2018 Global 500 list and found that just over 97% of board members and just under 97% of executives were Chinese nationals. Thirteen of the 20 firms were SOEs (65%), similar to the share on the list overall (71%). The seven POE firms in our sample demonstrated similarly low levels of diversity, with

Can Exports and International Sales Make the Difference?

Companies can compensate for a declining working-age population, even in the absence of productivity gains, by increasing exports and international sales. China leads the world in exports in absolute numbers, but as a percentage of GDP, it lags other nations—suggesting its largest firms risk losing their Global 500 rankings in a domestic slowdown.



Source: World Bank; UNCTAD World Investment Report 2018

one, notable exception—AIA, a major insurance company. We then examined an additional 10 randomly chosen POEs from the Global 500 list. Here we found a somewhat higher level of leadership diversity than in SOEs, but it was hardly convincing: Over 80% of the board members and 87.3% of the senior managers were Chinese nationals. So although we do anticipate that leadership diversity will increase somewhat in the years ahead, we don't expect the composition of top teams in Chinese firms to resemble those of successful Western multinationals any time soon.

China's Diversity Challenge

Leadership diversity correlates with strong international sales and exports, research shows. Our analysis reveals that Chinese firms are headed almost entirely by Chinese nationals, indicating that they will likely struggle, as Japanese firms did, to compensate for a slowdown in domestic growth with exports and sales abroad. Switzerland leads the developed world in both leadership diversity and in exports and foreign assets as a share of GDP.

Composition of Top Leadership



Note: Numbers are based on a random sample of Chinese and Japanese firms on the 2018 Global 500 and on the 20 largest Swiss firms in 2018.

There is little that CEOs and executives can do to change China's demographic realities and the macroeconomic forces behind the productivity slowdown. But the leadership crisis we have described is a cultural challenge that is within their capabilities to manage, as are many of the other innovation challenges they face. Chinese firms must learn to rely less on an inward-looking, hierarchical approach to management and more on the innovativeness and agility that characterize the world's most successful multinationals.

BUILDING GLOBAL LEADERSHIP CAPABILITIES

Many Western multinationals are known for agility, adaptiveness, and innovation. These sources of competitive advantage don't happen by accident; they are the consequences of a management culture and capabilities that firms deliberately adopt, acquire, and develop. The Swiss giant Nestlé, for example, is competitive globally because it has deliberately diversified its leadership pipeline and created an outward-looking management culture. Chinese firms could theoretically do the same. But their management style would have to change in five important ways. Specifically, China's corporate leaders must:

Show respect. In our work, we hear two complaints about Chinese businesses and executives. The first is best captured by a government official in a country in which a number of important Chinese firms have made significant investments over the past few years: "Maybe it's because China is so big and has been growing so fast for so long, but Chinese executives come in and are a bit arrogant and think they can manipulate suppliers, ignore communities, and discount the environment like they do back home." We heard similar complaints about American and to a lesser extent European executives 30 years ago. All have learned through bitter experience that what works at home does not necessarily work abroad. This is a lesson that more Chinese executives will need to absorb if their efforts to boost international sales are to succeed.

The second complaint relates to a mindset that we call international business for China. "Every company has a degree of self-interest," one executive told us, "but Chinese companies [operating] here seem to care only about how to suck out value for their own benefit and to help China

overall." Stakeholders increasingly demand that foreign businesses create value for, and not simply extract value from, the countries and communities in which they operate. These common complaints reflect a China-centric mindset that is out of step with today's global business environment.

Promote inpatriation. Chinese firms need to accelerate their efforts to bring global leaders together, not just via email or teleconference but in person. Nestlé has about 2,600 employees at its headquarters and offices in Vevey, Switzerland. An estimated 800 of them are foreigners.

This level of inpatriation, or bringing people into the center for international assignments, is viewed as necessary to develop leaders, bring diversity and breadth of perspective to the company, and build networks and trust. In our work with Chinese companies over the past 30-plus years, we have yet to see one that supports any serious inpatriation. Japanese firms have also failed in this regard. Chinese leaders' reluctance to fully integrate international leaders stymies innovation, creates barriers to local responsiveness, and sends powerful messages of exclusion to talented leaders outside the country.

Fix expatriation. It is natural for globalizing firms to send expatriates from the mother ship out to foreign satellites. Although there are benefits in terms of ease of communication, research has documented the serious limitations of this approach. Learning from experience, American and European multinationals have significantly added "third-country nationals" to international assignments. Nestlé, for example, has over 2,000 expatriates around the world, but more than 85% of them are not Swiss. Potential leaders typically get foreign postings early in their careers to test and develop their global perspective and potential.

Unfortunately, Chinese firms look much more like Japanese firms than like Swiss firms. Decades of research have shown that Japanese firms proportionately send nearly twice as many "home-country nationals" to foreign outposts as do firms from most other developed countries. Chinese firms are headed down the same path. They will need to break the pattern if they are to avoid the long-term liabilities of this approach, not the least of which is difficulty attracting and retaining the best and brightest foreign leaders.

Invest in leadership development. Filling the global leadership pipeline requires not only expat assignments

LEARNING FROM SWITZERLAND'S EXAMPLE

The Swiss economy is one-twelfth the size of China's, which means that Swiss firms have no choice but to focus on international sales and exports if they are to grow fast enough to hold their own in the global economy. And hold their own they have: Relative to the size of their economies, Switzerland exports 2.3 times as many goods and holds 10.7 times as many foreign assets than China does.

What is the secret to Switzerland's outsize performance? To answer this question, we conducted structured interviews with more than three dozen executives in Switzerland and found that nearly 70% of them ascribed Swiss firms' international success to one thing: leadership diversity. As one executive put it, "If you are going after sales across many different

countries, political systems, regulatory bodies, and customer preferences, you need people with broad experience. This is not possible if [leaders] all come from one country and have spent their working lives in that country. Global revenues require global leaders." The numbers back this up. On average, 62% of nonexecutive board members of large

Swiss companies are non-Swiss. In the 20 largest Swiss companies, 55% of the CEOs are foreigners. At banking giant UBS, the 13-member Group Executive Board is composed of four Swiss nationals, two dual nationals, and seven non-Swiss. The board of directors is even more diverse. Of its 15 members, two are Swiss, three are dual nationals, and eight are non-Swiss.

Although no exact threshold of optimal diversity has been established, research shows that when the international composition of leaders is misaligned with international revenues, growth slows and profits lag. Swiss firms recognize this and take a "passport blind" approach to recruiting, developing, and deploying executives.

but also formal training programs. In many cases, these programs include multiple learning modules that bring participants together more than once and have projects and other activities that keep people connected even while they are back home and physically separated. UBS, Nestlé, and ABB all run customized programs in conjunction with major business schools that are required for advancement. The exposure to people and best practices outside the company are particularly valuable.

Chinese firms tend to regard leadership development as a training function—so while they often spend heavily on technical training and basic business skills, their commitment to developing global leaders is frequently lacking. They pay little attention to program content or participant engagement, sticking with a dated education model that emphasizes mass lectures in huge auditoriums filled with participants who never put down their smartphones.

In fairness, a few Chinese companies have begun embracing the development of global executives. In 2018, Alibaba set up a leadership academy comprising a 16-month, all-English program in China. The participants are required to rotate across three business units. Other Chinese firms should pay close attention.

Innovate outside of China. The government's Made in China 2025 initiative faces many challenges, especially if it insists that innovation can only happen at home. A number of leading global firms, including Japanese firms such as

Takeda Pharmaceutical, have established strategic innovation centers in foreign countries. Many wisely choose to locate them in geographic hotbeds of innovation, including Tel Aviv, Berlin, Austin, Boston, and Vancouver. Of course, success requires more than just investing in facilities or even hiring top people. The right culture is also essential for the success of these investments. That means that the China-centric mentality will have to change. The good news is that all the previous recommendations mentioned here will help this fifth one succeed.

ALTHOUGH MOST CHINESE firms are well positioned to use their size and ecosystems for domestic advantage, they are ill-prepared for the global expansion they will need to undertake if they are to maintain their newly acquired global rankings. Absent a major pivot in thinking and approach, they will be unable to deliver the productivity gains needed to offset the consequences of the steepening decline in the country's working-age population. If the current leadership composition continues, we predict that like Japanese firms before them, Chinese companies will begin to slide off the Global 500. ☰

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GOVERNANCE



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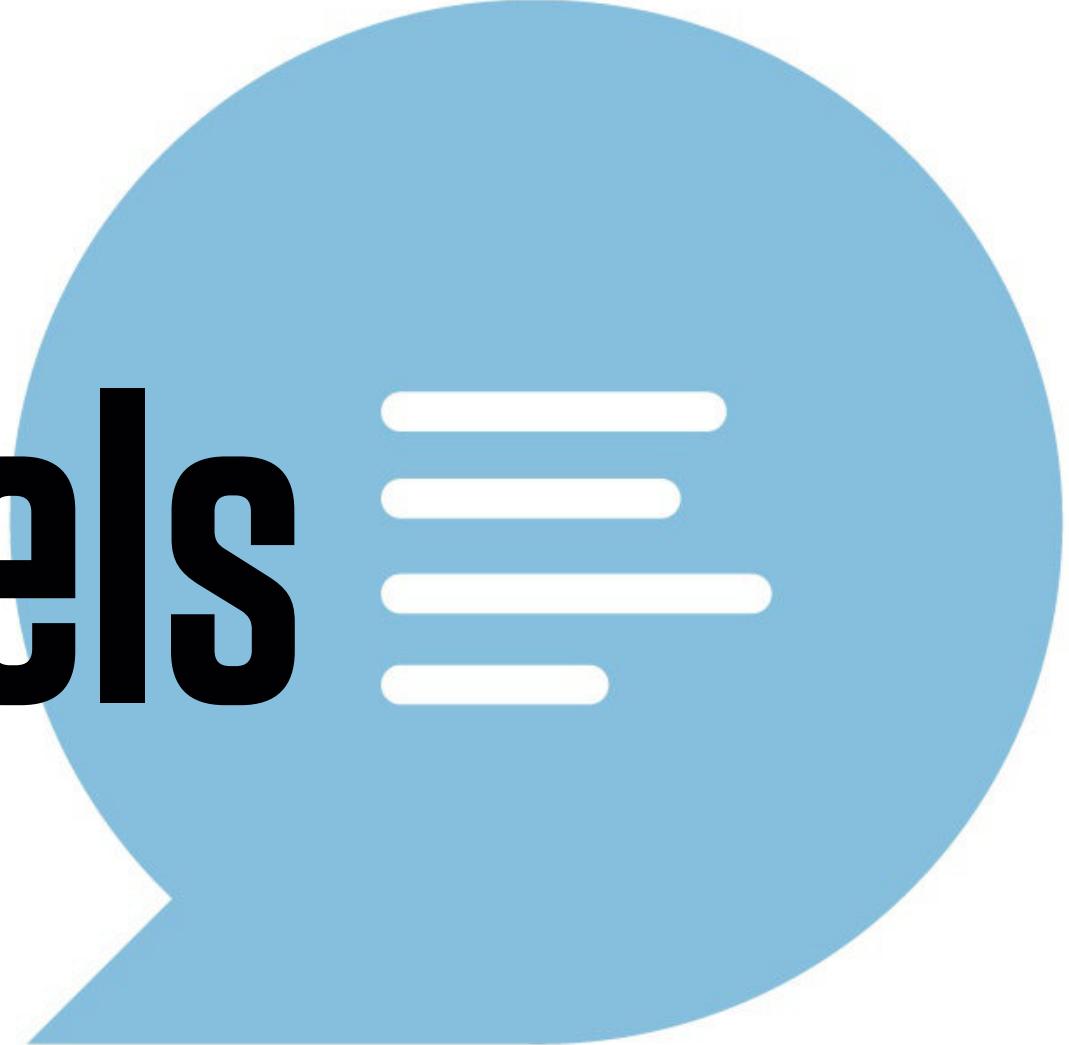


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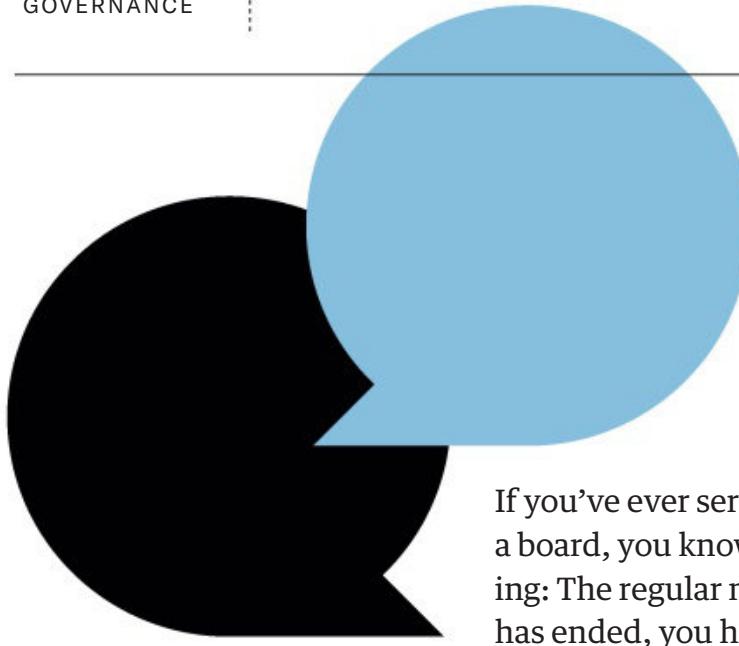
Back Channels in the Boardroom



How to prevent side conversations
between directors from blocking progress



GOVERNANCE



If you've ever served on a board, you know the feeling: The regular meeting has ended, you have lots you still need to talk about,

but the next meeting isn't for months. Maybe you've got questions about a complex technical issue there wasn't time to dig into during the meeting. Maybe you need to discuss sensitive information that can't be shared with the whole board. Maybe you just want a reality check on something. Whatever it is, you feel it can't wait, so you do what members of a team always do in this situation: You start having conversations on the side.

Side conversations can be enormously valuable. Conducted properly, they allow teams to work together smoothly and efficiently—to trade opinions, exchange information, and exert influence. But if you've served on a board, you also know that such discussions can cause trouble. Conducted improperly, they can encourage political maneuvering, marginalize members with key expertise, foster inappropriate alliances, and lead to poor decisions. Instead of making the team better, they can make it dysfunctional.

Given how dramatically side conversations can affect team performance, you might imagine they've been studied a lot, especially at the board level, where the stakes are so high. But when we began looking at them three years ago as part of a larger study of board dynamics in dozens of organizations, we realized that no one had paid side conversations much attention. We were also struck by how they hampered diversity efforts—preventing women and people from other underrepresented groups from making full contributions. Last, we were intrigued by the way almost everyone just seemed to accept them as the cost of doing business with high-powered, busy people. So we decided to examine them, combining large-scale surveys with in-depth interviews. In

the process we learned a terrific amount about how boards—or any team, for that matter—should handle these important back channels of communication.

The Challenge of Managing Side Conversations

Many board chairs and members fail to appreciate the subtler drawbacks of off-line conversations and, as a result, don't proactively mitigate them. The downsides include the following:

Side conversations almost always leave some directors with incomplete information. That hinders good decision making. Here's an example: At one nonprofit, an employee privately raised concerns about the CEO's behavior toward the staff with the board's nonexecutive chair. Before bringing up the matter formally, the chair wanted to canvass the directors to see whether any had sensed something was amiss. So he called each one. But because his own understanding of the problem evolved over the course of the conversations, each director heard a slightly different version of the story from him. At the next meeting things blew up when it became clear that the directors the chair had spoken to first hadn't gotten all the facts. Some felt misled and questioned the chair's leadership and integrity, and several resigned. Ultimately, the fractured board failed to reach a timely decision about how to address the CEO's alleged misbehavior, the employee lodged a formal complaint, the CEO resigned, and the organization's reputation suffered.

Side conversations can make boards vulnerable to biases. When a board chair tries to share information through a round-robin of one-on-one conversations, it's likely to distort everyone's understanding of a problem and the possible solutions, especially the chairman's own. One reason is that people remember later conversations more clearly than earlier ones—a tendency psychologists call *recency bias*. Consequently, the chair may place more weight on the opinion of whomever he or she talked to last, regardless of whether that input was backed up by expertise.

In addition, the first person to speak on a topic can have a disproportionate impact in shaping the discussion—a bias that behavioral economists call an *anchoring effect*. One senior nonexecutive director explained how this problem led him astray when he was assessing a proposed acquisition: "The first board member whose opinion I sought in a phone call had been the CEO of a massive global company, and I knew it had closed dozens of major deals during his tenure. He put out a number that he thought we should offer. I talked to every other director, but I realize now that I weighed each piece of successive advice against his,



New board members are often left out of side conversations. Then, when they raise issues the other directors have discussed off-line, their comments are treated as a nuisance.

rather than considering it at face value. Turns out his figure was way off for a fast-growing company like ours, which was a fraction of the size of his old company and in a completely different competitive space. We lost time and ultimately the bid.”

When board members feel left out, it undermines trust. It’s easy for directors who are not seen as part of the “inner circle” to be excluded from informal side conversations. Not surprisingly, women get shut out most often. In one study led by Boris Groysberg of Harvard Business School, a fifth of the nearly 300 female directors surveyed reported that not being part of the “in” group was a barrier to their effectiveness, and a third of male directors said that women have limited acceptance on boards because of the old boys’ club. Of course, the inability or unwillingness to draw on all members’ expertise defies the logic of having highly capable people on the board.

New board members also can be marginalized. Because they lack strong relationships with veteran directors, it’s not uncommon for both male and female newcomers to be left out of side conversations. Then, when they raise issues at meetings that the established directors have already discussed off-line, their comments are often treated as a nuisance or even an attack.

Consider the experience of a financial services executive we’ll call Victor, who had joined the board of a growing multi-billion-dollar public company. He brought valuable expertise and industry knowledge, but from the start, the other directors would brush off his questions during meetings or

respond in a perfunctory fashion. He could feel the tension rising month by month, and it came to a head at a meeting about a year and a half into his tenure, when he politely challenged what he saw as the board’s premature consensus on a major strategic acquisition. The visibly frustrated chair called for a break, and one of the directors pulled Victor aside and asked him, “Why revisit decisions that we’ve already cleared through the normal channels?” Victor was stunned. If the board meeting wasn’t the normal channel, what was?

Directors tend to justify side conversations by touting improved coordination, timely input between formal meetings, and the ability to explore the severity of confidential issues before bringing them into the open. But even efficient mechanisms may be rejected by some directors if they come across as secretive or manipulative. One board member at a private company believed that the founder-CEO, who was also the board’s chair, used one-on-one conversations to undercut potential criticism of his leadership. “Through backroom dealings with a small group of cronies on the board, the CEO avoided boardroom discussion of all issues where we should have had a debate,” the director said.

One of the most destructive kinds of off-line conversation happens after a decision has been made but hasn’t worked out. These almost always involve venting by members who disagreed with the decision, and they serve no constructive purpose. As one director told us, “The sidebar after the decision is really poisonous. If we’re going to have a post-mortem, it absolutely must be collective, where we all hear the same thing.”

IDEA IN BRIEF

THE CHALLENGE

Private discussions between individual directors can help a board function more smoothly and efficiently. But if conducted improperly, side conversations can encourage political maneuvering, marginalize members, and lead to poor decision making.

THE CAUSE

Boards just seem to accept side conversations as the cost of doing business with high-powered, busy people and don’t proactively try to make sure they stay constructive.

THE SOLUTION

Boards need to establish clear rules of engagement and regularly review whether members are adhering to them, set up an onboarding process for new members, foster personal relationships among directors, and implement measures to maintain trust during rounds of side conversations.

Interactions among board members are already complicated enough. Say a board is contemplating the impact of possible trade sanctions on a company's manufacturing footprint, supply chain, and long-term global growth. Tackling that issue requires expertise in general management, operations, strategy, regulatory law, macro- and microeconomics, political forecasting, public relations, and more. Such complexity, along with the demographic diversity that is a goal (or mandate) for many corporate boards, means boards must integrate more types of perspectives than ever before. When a board is large and meets infrequently, this is extremely difficult to do. So many boards form committees to tackle a specific area, such as government relations or compliance; create panels of experts in particular domains who advise directors, typically outside formal meetings; and add specialists to the main board itself. As a result side conversations have proliferated. They can occur within committees, among members of the committees or advisory panels and the other directors, and between an expert director and her nonexpert counterparts—all creating the potential for problems.

One nonexecutive board chair explained how a decision on a complicated issue in one committee could lead to a large round of side conversations. “If I don’t understand the ramifications of, say, a new kind of equity-based incentive program on executives’ likely behaviors *and* on shareholder perceptions, I will contact both compensation committee members and other directors to get a better sense of the possible outcomes before I bring it to the full board,” this chair said. “But it means I get a whole series of one-sided opinions.”

Despite the challenges that side conversations present, eliminating them is neither realistic nor desirable. By studying high-functioning boards, we’ve uncovered a number of techniques that can maximize the positives and minimize the negatives. These approaches are compatible with the findings of much of the organizational behavior research on how high-performance teams collaborate.

We’ve organized these suggestions into three groups: actions that prepare boards for constructive off-line conversations, ways to protect or build trust during them, and what to do after they’ve occurred.

Preparing Boards

Boards that use side conversations productively create formal onboarding processes, regularly review whether they’re adhering to standards for interacting, and continually strengthen bonds between directors. Specifically, they:

Involve a range of board members in onboarding. Many chairs take it upon themselves to brief incoming directors

about the board’s structure, operating procedures, and major agenda items, but the best approaches involve a broader set of board members. Some boards have the chair of each committee introduce the newcomer to the issues it handles and provide a rundown on the other directors involved. Ideally, those meetings should happen in person, but if that’s not possible, phone discussions are OK.

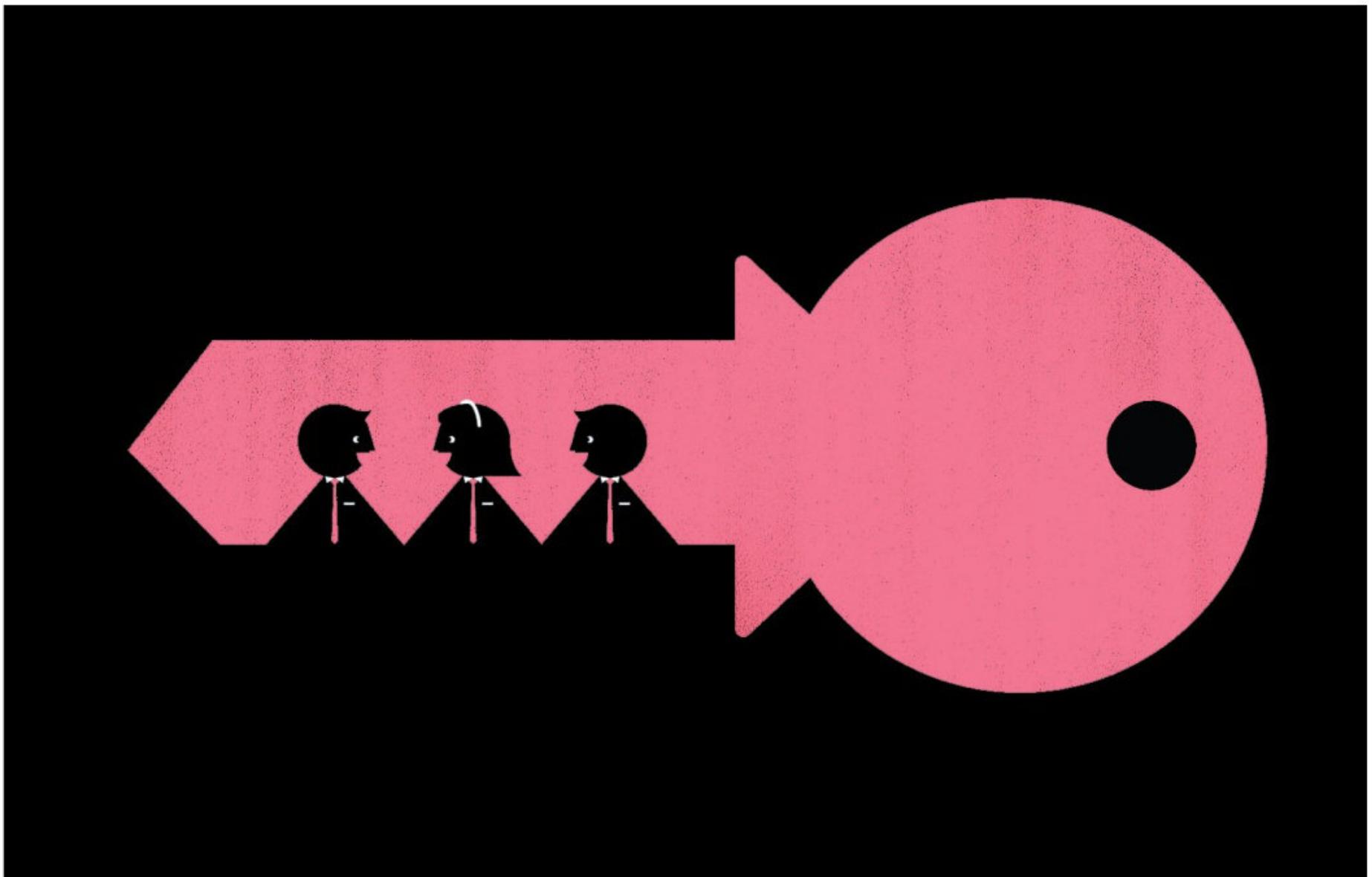
This level of contact helps new members forge relationships with their peers and makes it less likely that they’ll face a situation like Victor’s. New directors will also feel more comfortable speaking at the full board meeting and become more likely to be included in constructive side conversations.

Focus on what the new directors bring to the role.

Recent research on onboarding by London Business School’s Dan Cable and colleagues shows that focusing on the unique perspectives and strengths of new employees makes them more apt to ask questions and share their thoughts. That in turn makes them more effective. We found that the same holds true for new directors. When they have a clear understanding of how their expertise contributes to the group and how the board will rely on them, they feel they have the legitimacy and responsibility to raise issues in the full board meetings, which lowers their need to start side conversations.

Establish clear rules of engagement. Too many chairs assume that people who have been invited to serve on a board are accomplished and therefore can just take care of themselves when they become members. But even the most experienced directors have told us they appreciate hearing exactly what’s expected of them. Accordingly, when welcoming newcomers, the chair should explain not only their governance responsibilities but also how to raise issues in informal discussions. It might seem like common sense to suggest listening sensitively, questioning others respectfully, debating constructively, challenging rigorously, and deciding dispassionately. But the reality is, lots of high-powered people who are individual stars aren’t accustomed to acting in this manner. Rather than merely discussing these rules, one board chair we interviewed insists on spelling them out in a letter to newcomers.

Regularly review whether the board is adhering to its norms. When a new member joins the board, it’s an excellent time to refresh everyone’s commitment to the standards for interacting. In addition, boards should periodically assess whether they’re following their stated principles and, if not, discuss how to get back on track. The best time to do this is during an annual review, when the group evaluates how it’s handling its other core work, such as routine risk assessment, communication with executives, and reporting requirements.



Forge personal relationships. The agendas of off-site board meetings are typically packed with high-priority matters such as the company's strategy, leaving little to no time for building personal ties. That's why it's important to organize other off-sites or field trips whose main purpose is to help board members get to know one another. At those gatherings directors can build the trust they'll need to communicate effectively when stressful or sensitive issues arise. So the next time you convene the directors, adopt the "less is more" philosophy and give them time to have deeper discussions and socialize.

For one off-site, the chair took a novel approach: He asked board members to submit their favorite songs and then played them at various breaks during the day. The person whose song was playing had to tell a quick story about why he or she had chosen it. Initially, members grumbled about this, but they left saying that it was the best off-site they'd had—not only because they learned more about one another from each story but also because it gave them ways to start personal discussions that had previously seemed awkward.

Relaxed field trips can serve the same function. One director of a food manufacturer enthusiastically told us

how much he'd learned by visiting the transportation lab of a major university to see how transit innovations might change eating habits. But he admitted that an even bigger benefit was the personal conversations he'd had with fellow board members in the van on the way to and from the lab.

Maintaining Trust While Side Conversations Happen

Here are some ways that chairs and individual directors can ensure that side conversations remain constructive and build—rather than weaken—trust among members of the board:

Discourage griping. One chair we interviewed described how another director consistently "vents with me about the CEO but then calms down." Letting off steam may seem like a legitimate reason for a side conversation, but research involving corporate executives shows that it actually increases negative emotions, harms relationships, and ultimately undermines individual and team performance.

Directors should not only resist grousing about colleagues but also actively redirect the conversation when



others vent to them. A good tack is to ask questions that help colleagues take the perspective of the person they're complaining about. For instance, why might that person have acted that way—was it because of situational pressures? Dialing down the venting will help the group focus on its tasks in a positive fashion.

Be inclusive. Whether you're a chair or an ordinary director who spots the need for a side conversation, make sure directors are not left out—except by design. For example, it's legitimate for a smaller task force of directors to have its own cluster of side conversations to address issues within its purview. But the head of the task force and the board chair need to stay updated on the discussions so that they can bring in all the other directors when appropriate.

If you're the chair or the lead director and the chatter about a general board issue has already begun among directors, figure out who has spoken to whom about which angles of it and work to bring everyone's knowledge up to the same level. To the extent possible, be strategic about off-line discussions. For example, before a meeting about a controversial acquisition, a chair might ask the director with the most credibility in that industry to call each board member to elicit his or her concerns and to offer some perspective. If you're the one delegating, let other members know the delegate is acting on your behalf rather than politicking behind your back, but stay informed about any issues raised. And be as transparent as possible in any kind of side conversation so that no one feels games are being played. Make sure all directors know it's completely appropriate to share who has spoken to whom about what.

The more sensitive the topic, the more planning matters. One nonexecutive chair told us a story about a struggling CEO who was “trying to pick off enough individual directors to either stay in control or at the very least maintain a few good references from the board.” The chair needed to keep tabs on the off-line conversations. After several rounds of sidebars, he called an extraordinary meeting of the non-executive directors so that everyone could hear the same information at once and have a cohesive discussion. By then, all the directors had participated in at least one side conversation with the chair, and he knew what concerns each wanted to bring up. Ultimately, the chair held the board together, and the CEO was asked to resign.

Track the content of your conversations. If you're the chair or the lead independent director, it can be challenging to remember what happened in the side conversations you've had. But it's critical to be aware of how your own thinking has evolved over the course of your discussions so that you can circle back to people to explain why your opinions shifted and brief them on pieces of the puzzle gathered after you spoke with them. That will prevent you from looking disingenuous.

We suggest keeping a record of what you gleaned during each off-line discussion and how your views have changed. Another benefit of this is that it will help you avoid giving too much weight to more-recent information. One director of a major pharmaceutical company swears by this approach. “We are bombarded by information,” he told us. “On important issues, you think you'll remember what's happened, what someone said—but it's really impossible. You've got to be able to, every now and then, step back, look down, and think, ‘What does all this mean?’ And good reflection demands good records.”

Integrating Views After Side Conversations Happen

When the full board convenes, action-oriented directors will be itching to get down to business, and some directors may arrive with entrenched positions on issues. But board members need to reach a shared understanding of any problem so that they can have a fully informed, constructive conversation about possible solutions. Here are some tips that can help boards create an integrated picture:

Create common ground. This should be the first step whenever the board meets. Making sure everyone is up to speed can feel like a waste of time to some people, so the chair needs to explain why it's necessary—how information disparities are likely to lead to clashing assumptions about the problem and appropriate solutions. Classic studies on decision making show that teams find it difficult to solve an otherwise easy logic problem if the relevant pieces of information are distributed among individual members rather than known by all. Compounding this, people have a tendency to confirm the dominant understanding of an issue rather than share unique or challenging information. So it's vital to probe individual directors' varying assumptions.

Draw out expertise. When people are working on important issues with prominent people they want to impress—as is typical in boardrooms—they're rightly cautious about how their contributions to a discussion will be perceived. It's all too easy for directors to hear unusual or unexpected questions coming from their colleagues and jump to the unhelpful conclusion that the “newbies” or “techies” just don't get

the problem at hand. And let's face it, some leaders use their position to intimidate others. As one director recalled, "If you arrived on United 462, and the rest came on their private jets, it can be daunting. When the CEO asked me at the start of a meeting whether I'd flown commercial, it was clearly a status play."

If the board grapples with a sensitive or high-stakes issue, power dynamics will probably become stronger. (See "Coming Through When It Matters Most," HBR, April 2012.) Under pressure, groups tend to defer to people of higher status and may ignore or fail to solicit the expertise of some members. They tend to become risk averse and aren't open to new ideas. Members then become less apt to speak up (especially about thorny matters) or to challenge the group's general thinking. Feeling threatened also makes people rely more on people they've known and trusted for a long time, which means that ideas presented by newcomers or directors who aren't insiders often are dismissed.

Effective chairs and directors resist status games, actively solicit input from a broad range of members, and encourage quieter colleagues to open up. This might entail privately explaining to them how to present their expertise without jargon and with context that will make its relevance easy to grasp. It's also useful for a leader in the midst of a stressful situation to acknowledge the tension in the room; that will help lower the emotional temperature, get high-powered members to soften ego-driven hard positions, and refocus attention on what matters.

BOARDS WILL NEED more off-line discussions as they deal with increasingly complicated problems and draw in more specialists to help them. At the same time they must ensure that those side conversations don't undermine their ability to make effective decisions. Every chair or senior independent director should be aware of the conversations that are going on and take steps to keep them constructive and see that everyone has all the critical information. But the chair cannot do everything. It's the responsibility of every board member to use side conversations to promote better understanding and make sure they don't become a vehicle for backroom deals that produce poor decisions. ☰

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BENEFITS OF PRODUCTIVE SIDE CONVERSATIONS

1. They help directors who might not otherwise have time to digest all the background reading get fully briefed before board meetings.
2. They allow directors to understand why each has a particular point of view and to make compromises without losing face.
3. They save time by enabling directors to see where they agree and disagree so that
- they can focus on the areas that need debate at the full meeting.
4. They allow directors to share sensitive information that may have legal or reputational risk for the company (such as accusations of illegal behavior) without prematurely disclosing it.
5. In them directors get feedback that can help improve their individual performance and, as a result, the board's.

DANGERS OF POORLY MANAGED SIDE CONVERSATIONS

1. They exclude input from experts who aren't in them.
2. They give too much weight to the opinions of some directors—for example, higher-status or veteran board members—who may not necessarily be experts on a specific issue.
3. They stifle open, frank discussion at the main board meeting because solutions have already been agreed upon through back channels.
4. They allow directors to selectively speak to other directors who see the world in the same way instead of being appropriately challenged.
5. They undermine buy-in to proposed solutions when some directors are left out of the reasoning behind them.
6. They dampen the engagement and organizational commitment of board members who feel their voices aren't being heard.
7. They marginalize directors who are not part of the "in" crowd and block diverse input into important decisions.
8. They allow operators to manipulate people out of plain view.
9. They waste time and distract executives and non-executives alike when having one full-group discussion around the board table would be more productive.

TITLE



NEGOTIATIONS

A New Approach to Contracts

How to build better long-term strategic partnerships

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IDEA IN BRIEF

THE PROBLEM

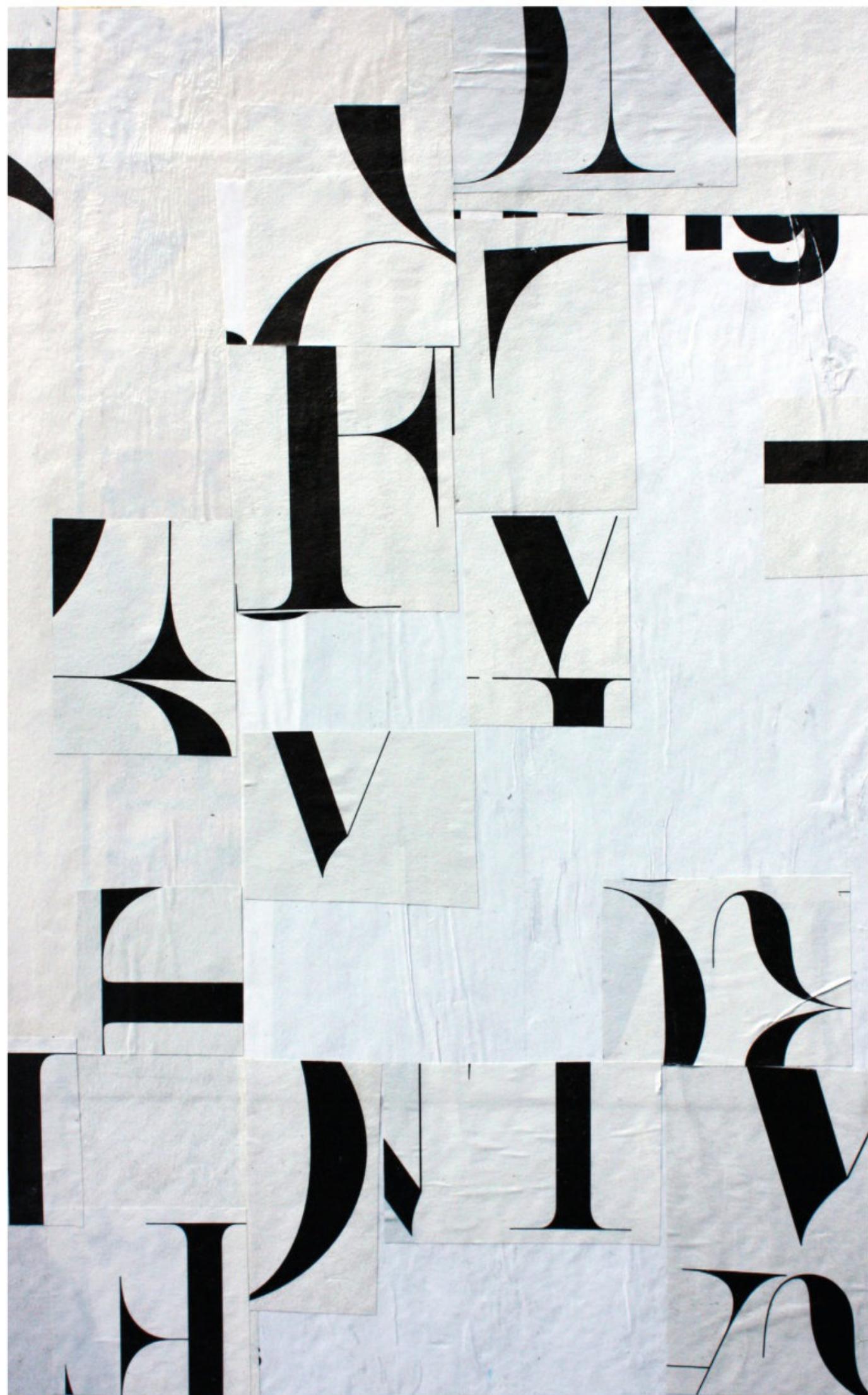
Traditional purchasing contracts don't work in complex strategic relationships where the parties are highly dependent on each other, future events can't be predicted, and flexibility and trust are required. Instead of promoting the partnership-like relationships needed to cope with uncertainty, conventional contracts undermine them.

THE CAUSE

Companies have traditionally used contracts as protection against the possibility that one party will abuse its power to extract benefits at the expense of the other. This adversarial mindset creates a downward spiral of negative tit-for-tat behaviors.

THE SOLUTION

A formal relational contract lays a foundation of trust, specifies mutual goals, and establishes governance structures to keep the parties' expectations and interests aligned over time.



Images courtesy of Sears-Peyton Gallery, New York



ABOUT THE ART

Artist Cecil Touchon's collages of sliced and rearranged letterforms create "subliteral poems." In his Typographic Abstraction series, the compositions transform letters from a symbol of written language into a kind of visual architecture.



NEGOTIATIONS

When Dell originally selected FedEx, in 2005, to handle all aspects of its hardware return-and-repair process, the companies drew up a traditional supplier contract.

The 100-page-plus document was filled with “supplier shall” statements that detailed FedEx’s obligations and outlined dozens of metrics for how Dell would measure success. For nearly a decade, FedEx met all its contractual obligations—but neither party was happy in the relationship. Dell felt that FedEx was not proactive in driving continuous improvement and innovative solutions; FedEx was frustrated by onerous requirements that wasted resources and forced it to operate within a restrictive statement of work. Dell’s attempts to lower costs, including bidding out the work three times during the eight-year relationship, ate into FedEx’s profits.

By the eighth year, the parties were at the breaking point. Each lacked trust and confidence in the other, yet neither could afford to end the relationship. Dell’s cost of switching to another company would be high, and FedEx would have trouble replacing the revenue and profits the contract generated. It was a lose-lose scenario.

Unfortunately, this story is not unique. Companies understand that their suppliers are critical partners in lowering costs, increasing quality, and driving innovation, and leaders routinely talk about the need for strategic relationships with shared goals and risks. But when contract negotiations begin, they default to an adversarial mindset and a transactional contracting approach. They agonize over every conceivable scenario and then try to put everything

in black-and-white. A variety of contractual clauses—such as “termination for convenience,” which grants one party total freedom to end the contract after a specified period—are used to try to gain the upper hand. However, these tactics not only confer a false sense of security (because both firms’ switching costs are too high to actually invoke the clauses) but also foster negative behaviors that undermine the relationship and the contract itself.

We argue that the remedy is to adopt a totally different kind of arrangement: a *formal relational contract* that specifies mutual goals and establishes governance structures to keep the parties’ expectations and interests aligned over the long term. Designed from the outset to foster trust and collaboration, this legally enforceable contract is especially useful for highly complex relationships in which it is impossible to predict every what-if scenario. These include complicated outsourcing and purchasing arrangements, strategic alliances, joint ventures, franchises, public-private partnerships, major construction projects, and collective bargaining agreements. A growing number of large organizations—such as the Canadian government, Dell, Intel, AstraZeneca, and the Swedish telecommunications firm Telia—are successfully using this approach.

In this article, we look at the theoretical underpinnings of formal relational contracts and lay out a five-step methodology for negotiating them.



Hold-Ups, Incomplete Contracts, and Shading

Companies have traditionally used contracts as protection against the possibility that one party will abuse its power to extract benefits at the expense of the other—for example, by unilaterally raising or lowering prices, changing delivery dates, or requiring more-onerous employment terms. Economists call this the *hold-up problem*: the fear that one party will be held up by the other. The fact that virtually all contracts contain gaps, omissions, and ambiguities—despite companies’ best efforts to anticipate every scenario—only exacerbates hold-up behavior.

Leaders employ a range of tactics to try to ensure that they are not taken advantage of by a powerful partner. These include contracting with multiple suppliers, forcing suppliers to lock in prices, using termination-for-convenience clauses, or obligating suppliers to cover activities that might arise after the initial contracting phase. Some companies go so far as to install a “shadow organization” to micromanage the supplier.

Early research by one of us (Oliver, who won the 2016 Nobel Prize in economics for his work on contracts) predicted that in response to the combined problems of hold-ups and incomplete contracts, companies are very likely to make distorted investments that produce poor outcomes. Using multiple suppliers instead of only one, for example, increases costs; so does operating a shadow organization. Termination-for-convenience clauses create perverse incentives for suppliers to not invest in buyer relationships. “A 60-day termination for convenience translates to a 60-day contract,” one CFO at a supplier told us. “It would be against our fiduciary responsibility to our shareholders to invest in any program for a client with a 60-day termination clause that required longer than two months to generate a return.” The implications for innovation are obvious. “Buyers are crazy to expect us to invest in innovation if they do the math.”

In 2008, Oliver, together with economic theorist John Moore, revisited his work on contracts. They realized that an equally important problem is *shading*, a retaliatory behavior in which one party stops cooperating, ceases to be proactive,



Shading happens when one party isn't getting the outcome it expected and feels the other party has not acted reasonably to mitigate the losses.



NEGOTIATIONS

or makes countermoves. Shading happens when a party isn't getting the outcome it expected from the deal and feels the other party is to blame or has not acted reasonably to mitigate the losses. The aggrieved party often cuts back on performance in subtle ways, sometimes even unconsciously, to compensate.

Imagine that a supplier of engineering services submits a proposal in a competitive bidding process and wins the contract. If demand is lower during the term of the contract than the buyer stated in the RFP or the scope expands in an unanticipated area, the supplier's profit will take a hit. If the buyer refuses to adjust the supplier's fee or the statement of work, the supplier may try to recoup losses by, for example, replacing the expensive A team it currently has on the project with its less costly C team. In long-term, complex deals, shading can be so pervasive that the tit-for-tat behavior becomes a death spiral. Oliver and Moore's expanded theory focuses on contracts as reference points, a new perspective that emphasizes the need for mechanisms to continually align expectations—or update reference points—as unanticipated events occur and needs change over time.

A New Approach

At the same time that Oliver and Moore were looking at the contracting problem from an economics perspective, University of Tennessee researchers (including two of us, Kate and David) were working with companies to come up with a new approach that would produce healthier and more sustainable partnerships. Their efforts led to the vested methodology for creating formal relational contracts—a process that establishes a “what's in it for we” partnership mentality. (It's called vested because the parties have a vested interest in each other's success.) Written contracts that are legally enforceable (which is why we call them formal), they include many components of a traditional contract but also contain relationship-building elements such as a shared vision, guiding principles, and robust governance structures to keep the parties' expectations and interests aligned.

Relational contracts that rely on parties' making choices in their mutual self-interest are nothing new, of course. The benefits of informal “handshake” deals have been studied and promoted over the decades; legal scholars Stewart

Macaulay and Ian Macneil were early advocates in the 1960s. Japanese *keiretsu*, an arrangement in which buyers form close associations with (and often own stakes in) suppliers, is a type of relational contract (see “The New, Improved Keiretsu,” HBR, September 2013).

Perhaps unsurprisingly, most companies—and their legal counsels in particular—are uncomfortable with informal handshake deals, especially when the stakes are high. In fact, many companies now believe that even the vaunted *keiretsu* model, which Toyota and Nissan, among others, used so successfully, ties up capital and limits flexibility. The formal relational contract addresses these deficiencies.

When Dell and FedEx reached their breaking point, they chose to abandon their existing contracting process and create a formal relational contract that specified desired outcomes and defined relationship-management processes at the operational, management, and executive levels. In the first two years, Dell and FedEx were able to reduce costs by 42%, scrap by 67%, and defective parts per million to record-low levels. Both companies now consider the contracting approach a best practice and have applied it in other relationships.

To date, 57 companies have employed the vested methodology. (David and Kate have consulted on many of these projects, including several mentioned in this article.) Results have not been tracked for all of them, but many have told us that they and their partners are happy with the approach and cite benefits including cost savings, improved profitability, higher levels of service, and a better relationship.

Putting It into Practice

Before jumping into a formal relational contract process, companies must determine whether it is right for them. Some relationships, such as those involving the purchase of commodity products and services, are truly transactional and only need traditional contracts. But many organizations require long-term, complex relationships for which the vested methodology is well suited. (See the exhibit “Which Type of Contract Is Right for You?”)

A case in point is Vancouver Island Health Authority and South Island Hospitalists, a partnership of administrators and doctors who work together to provide inpatient



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care for patients with the most complex medical issues in British Columbia. The entities decided to explore relational contracting in 2016, two years after their conventional contract had expired and countless hours of contentious negotiations had failed to replace it. Working with the University of Tennessee (including Kate), they embarked on the five-step process.

STEP 1 Lay the foundation. The primary goal of Step 1 is to establish a partnership mentality. Both parties must make a conscious effort to create an environment of trust—one in which they are transparent about their high-level aspirations, specific goals, and concerns. And if their previous contracting process led to distrust and a vicious cycle of shading, they should reflect on how and why that happened.

At Island Health and South Island, the parties tossed out the old contract and chartered a team of 12 administrators and 12 hospitalists to design a formal relational contract. Each individual worked with a counterpart from the other organization to establish connections in key areas. For example, Spencer Cleave, a hospitalist from South Island, and Kim Kerrone, Island Health's vice president for finance, legal, and risk, led a small group focused on rethinking the conventional fee-for-billable-service-hour payment structure.

"We were no longer interested in just developing a contract," recalled Jean Maskey, a hospitalist at South Island who coheaded the contracting team, "but in building excellent relationships at multiple levels that would allow all of us to be leaders in Canadian health care, whether as administrators or hospitalists."

STEP 2 Co-create a shared vision and objectives. To keep expectations aligned in a complex and changing environment, both parties—not just the one with greater power—need to explain their vision and goals for the relationship.

The Island Health and South Island team held a three-day off-site to craft their vision: "Together, we are a team that celebrates and advances excellence in care for our patients and ourselves through shared responsibility, collaborative innovation, mutual understanding, and the courage to act, in a safe and supportive environment." They further

established a set of four desired outcomes that flowed from the shared vision:

- Excellence in patient care (develop a formal and robust quality structure)
- A sustainable and resilient hospitalist service (strengthen recruitment, mentorship, and retention processes; create an efficient and flexible hospitalist scheduling model; clearly define hospitalist services and workload; develop stronger interdepartmental working relationships; and train and develop current and future hospitalist leaders)
- A strong partnership (continue to build a healthy relationship between Island Health and South Island)
- A best-value hospitalist service (proactively manage the budget, optimize billing, review workload, and increase operational efficiencies)

In a subsequent workshop the team delved deeper, crafting four high-level desired outcomes, seven goals, and 22 tactical and measurable objectives. One objective, for example, called for improving physicians' billing to the provincial Medical Services Plan (MSP) for cost recovery for the hospitalist fees. The parties created a joint project collaboratively working with billing support and IT technologists to develop an electronic billing program to maximize billing submissions, ultimately improving cost recovery from 87% to 100%.

STEP 3 Adopt guiding principles. Value-eroding friction and shading occur because one or both parties feel unfairly treated. This risk is highest when there are many unknowns about what will occur after the contract is signed. In Step 3, parties commit to six guiding principles that contractually prohibit opportunistic tit-for-tat moves.

The six principles—reciprocity, autonomy, honesty, loyalty, equity, and integrity—form the basis for all contracts using the vested methodology and provide a framework for resolving potential misalignments when unforeseen circumstances occur.

Island Health and South Island formally embedded their interpretations of the principles in the preamble of their contract. Each was crafted to establish a new norm for the partnership. Under "reciprocity," for example, they highlighted the need to "conduct ourselves in the spirit of achieving mutual benefit and understanding." Under "equity," they acknowledged the unavoidable imbalances that arise in contracts: "We are committed to fairness, which does not always mean equality. We will make decisions based on a balanced assessment of needs, risks, and resources."

Again, it's important to note that these guiding principles have teeth. Although the contractual language may be vague, courts are obligated to interpret it should there be a dispute. Indeed, the Canadian supreme court recently took up a case

in which a franchisee alleged that it was not being treated fairly by the franchise owner. And therein lies the beauty of the formal relational contract. Few companies will want to risk an expensive court case for breaching the guiding principles; thus the contract becomes a deterrent against counterproductive behavior.

STEP 4 Align expectations and interests. Having set the foundation for the relationship in the first three steps, parties hammer out the terms of “the deal”—for example, responsibilities, pricing, and metrics. It is crucial that all terms and conditions of the formal relational contract are aligned with the guiding principles. With the right mindset, the development of the contract becomes a joint problem-solving exercise rather than an adversarial contest.

Consider how the Island Health administrators and South Island hospitalists tackled pricing, which had always been their sticking point. Historically, the two parties had operated under a shroud of opaqueness. For example, Island Health never shared the budget with the hospitalists. And South Island’s less-than-optimal reporting processes meant inevitable bickering over billable hours.

Kim Kerrone, of Island Health, described how the vested methodology broke the impasse. “We consciously approached the economics of the relationship with full transparency and a problem-solving mentality instead of a negotiations mentality,” she told us. “We put everything on the table, and we challenged the contracting team to figure out ways to work with the money we’ve got.”

The parties ultimately came up with an alternative to the standard fee-for-billable-hours method. They designed a hybrid pricing model with a combination of fixed and variable rates, coupled with incentives to improve efficiencies. The model also gave the hospitalists autonomy in scheduling. After all, the team realized, who better to optimize the scheduling for superior patient care than the doctors on the front lines? Under the new pricing model, when the inpatient population is low, the hospitalists can opt to take time off and save Island Health money. When the population is high, they manage their hours in a way that’s within the budget and optimizes patient care. South Island has the opportunity to earn incentives if they improve efficiency and billing, which they can invest in research and quality-of-care

DRAFTING YOUR GUIDING PRINCIPLES

Formal relational contracts are built on a foundation of trust and are shaped by a shared vision and six universal guiding principles. The wording crafted by Island Health and South Island, which they embedded in the preamble of their contract, can be used by other companies as a model for drafting their own guiding principles.

SHARED VISION

- Together, we are a team that celebrates and advances excellence in care for our patients and ourselves through shared responsibility, collaborative innovation, mutual understanding, and the courage to act, in a safe and supportive environment.
- We will be recognized leaders in health care.
- We will achieve this vision by building relationships grounded in trust and respect, and anchored in the following Guiding Principles and Intended Behaviors.

GUIDING PRINCIPLES & INTENDED BEHAVIORS

- **Reciprocity:** We conduct ourselves in the spirit of achieving mutual benefit and understanding. We recognize that this requires ongoing give-and-take. We each will bring unique strengths and resources that will enable us to overcome our challenges and celebrate our successes.

- **Autonomy:** We give each other the freedom to manage and make decisions within the framework of our unique skills, training, and professional responsibilities. We individually commit to make decisions and take actions that respect and strengthen the collective interest to achieve our Shared Vision.

- **Honesty:** We will be truthful and authentic even when that makes us vulnerable or uncomfortable. This includes honesty about facts, unknowns, feelings, intentions, perceptions, and preferred outcomes.

- **Loyalty:** We are committed to our relationship. We will value each other’s interests as we value our own. Standing together through adversity, we will achieve our Shared Vision.

- **Equity:** We are committed to fairness, which does not always mean equality.

- We will make decisions based on a balanced assessment of needs,

- risks, and resources.

- **Integrity:** Our actions will be intentionally consistent with our words and agreements.

- Decisions will not be made arbitrarily but will align with our Shared Vision and Guiding Principles. Our collective words and actions will be for the greater good of the relationship and the provision of patient-centered care.

Which Type of Contract Is Right for You?

Buyers must consider three key factors when deciding what type of contracting arrangement is right for each supplier relationship. They should analyze their dependency on the particular supplier, the strategic value of its product or service, and the impact of nonperformance on a buyer's operations.

	TRANSACTIONAL CONTRACT	FORMAL RELATIONAL CONTRACT
BUYER'S DEPENDENCY ON THE SUPPLIER		
Switching costs:	—	—
Overall cost to switch suppliers	Low	Medium to high
Physical asset specificity (location, machinery, processes)	Low	Medium to high
Skill level of supplier's personnel	Unskilled to semiskilled	Skilled to professional
Level of integration required with supplier's systems or processes	None to low	Medium to high
What is the availability of substitutes in the marketplace?		
Supplier services or products	Plentiful	Moderate to scarce
Qualified and skilled personnel	Plentiful	Moderate to scarce
Technology	Off-the-shelf	Custom
STRATEGIC IMPACT		
Is the supplier's product or service a strategic differentiator for the buyer?	No	Yes
Does the buyer benefit from access to the supplier's critical systems and processes (and vice versa)?	Very little	Moderately to very much
RISKS DUE TO SUPPLIER NONPERFORMANCE		
Lost profits	None to low	Medium to high
Damage to the buyer's customer or brand experience	None to low	Medium to high
Damage to the buyer's employee experience	None to low	Medium to high
Regulatory compliance penalties	None to low	Medium to high
Impact on demand management	None	Medium to high

Note: This table is based on material presented in *Strategic Sourcing in the New Economy* (Palgrave Macmillan, 2016).



initiatives they are passionate about. Both parties felt that the new model was a win-win solution that would have been unachievable under previous contracts.

STEP 5 **Stay aligned.** In this step, contracting parties go beyond crafting the terms of the agreement and establish governance mechanisms that are formally embedded in the contract.

Island Health and South Island created four joint governance teams chartered to “live into” the relational contract:

- **The relationship team** focuses on monitoring the health of the relationship.
- **The excellence team** focuses on quality control, transformational initiatives, continuous improvement, and prioritization and tracking of innovation ideas.
- **The sustainability team** focuses on workload, scheduling, recruiting, and retention.
- **The best value team** focuses on finance, billing, workload optimization, and operational efficiencies.

Each team meets at regular intervals to review progress against the shared vision, goals, outcomes, and measures.

The contract also specifies a second governance mechanism—a “two in a box” communication approach in which an administrator is teamed with a hospitalist for each of the four governance teams. The approach encourages trust and honesty between the two sides, said Ken Smith, a hospitalist at South Island. “Before, we had no one to speak with [if concerns arose]. Now I have someone I know fairly well at a high level in administration. If I need to make an urgent decision or have a difficult issue that can’t wait for the next formal meeting, I can phone my two-in-a-box partner and ask to meet.”

Such pairings are also highly encouraged outside the governance teams to strengthen the relationship and build trust between parties at all levels. For example, Kim Kerrone and Jean Maskey, informal partners, both say that formal relational contracting was “transformational” for their respective organizations. Both point to the surveys conducted immediately before the process began and one year after the relational contract was in place: The number of people who expressed a positive attitude toward the relationship increased by 84% in just two years. Administrators and hospitalists who had called their relationship “broken,” “dysfunctional,” and “distrustful” now describe it as “collaborative,” “trusting,” and “supportive.”

Kerrone points to financial benefits as well. “For the first time, the administration and our doctors are innovating together to drive efficiencies and optimize for patient care with our limited budget,” she said. “We not only came in under budget, we also increased our revenue by improving our MSP billing process. And in a publicly funded health

care environment, that is exactly what we need to be focusing on.”

The governance structure also helped the parties surmount the tricky problem of scope creep. While the contract was being developed, in 2016 and 2017, Canada passed a law legalizing medical assistance in dying. At the time, there were too many unknowns about how it would be implemented to address the issue formally. So the sustainability team came up with a pilot project to address how to fairly add the additional scope of work and new role for health care providers to the hospitalists’ schedule and pricing model. Gone were the battles of “not in scope”; instead, there was a spirit of “how can we accommodate this new reality given our statement of intent?”

The Future: Contracting for Competitive Advantage

Formal relational contracts will never completely replace traditional transactional contracts. Nor should they. But the process we have outlined should be part of the contracting tool kit to govern highly complex relationships that demand collaboration and flexibility.

Glenn Gallins, the attorney representing South Island Hospitalists and a law professor at the University of Victoria, offers the following advice when it comes to embracing formal relational contracts: “The focus on negotiating the foundation of the relationship first is brilliant. But the real power is it threads all the way down to core decisions on how the parties would work.” In a business world where strategic, long-term relationships are critical to competitive advantage, leaders have no choice but to overturn the status quo. 

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STRATEGY

IN THE ECOSYSTEM ECONOMY, WHAT'S YOUR *Strategy?*

The five questions you need to answer



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STRATEGY



ABOUT THE ART

Blending her training as a fine artist and her expertise in cinematic visual effects, Catherine Nelson creates surreal universes by photographing and digitally fusing hundreds of images.

OU'

hen Nestlé was preparing to go mainstream with Nespresso, its single-use espresso capsule, it knew that users would need a machine specifically designed to work with the pod. So the company cultivated a network of manufacturers. It didn't tell customers to buy a Jura, a Krups, or a Braun—it just decided which manufacturers could be on the list. And because the capsule and its interface were patented, other manufacturers could not make Nespresso-compatible machines without permission.

Nespresso was creating—designing—an ecosystem: an orchestrated network spanning multiple sectors. The firms involved work to shared standards, sometimes on a shared platform, to make their products and services compatible. And they create links among themselves that make it difficult for outsiders to break in.

Designed ecosystems like Nespresso's are increasingly important, owing to the convergence of three big structural changes in our economy. The first is an unprecedented rollback of regulations protecting firms that once had the exclusive privilege of serving particular customer needs. As those protections fall, organizations in other domains are free to partner to provide more-integrated offerings, as when accountancies team up with law firms. The second change is a blurring of the separation between products and services because of regulatory changes and digitization. The latter has also led to offerings with more-modular structures whose





IDEA IN BRIEF

THE CHALLENGE

In an increasing number of contexts, the firm is no longer an independent strategic actor. Its success depends on collaboration with other firms in an ecosystem spanning multiple sectors.

WHY IT AROSE

The growing importance of ecosystems is linked to the convergence of three big structural changes: a rollback of regulatory protections, a blurring of the separation between products and services, and technology that revolutionizes how firms can serve customers.

HOW TO MEET IT

An ecosystem-focused framework can help managers answer five key questions: Can you help other firms create value? What role should you play? What should the terms be? Can your organization adapt? and How many ecosystems should you manage?

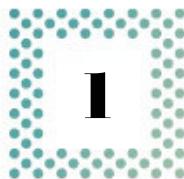


STRATEGY

components can be recombined in new ways, which in turn has encouraged the rise of product-service bundles provided by networks of interdependent suppliers. The third change involves technology that is revolutionizing how firms can serve their customers. Our dependence on mobile devices, along with the internet's influence on buying patterns, has dramatically expanded the possibilities for linking previously unrelated goods and services—reinforcing the effects of the first two changes.

Given these shifts, it is less and less likely that single firms can offer all the elements a customer needs—let alone afford to experiment with them. And so ecosystems, especially designed ones, are on the rise. In fact, in a growing number of sectors the firm and even the industry have ceased to be meaningful units of strategic analysis. We must focus instead on competition between digitally enabled designed ecosystems that span traditional industry boundaries and offer complex and customizable product-service bundles.

Traditional strategy frameworks are of little help when designing or participating in such an ecosystem. An ecosystem-focused framework, as opposed to a firm-focused one, needs to answer five questions.



CAN YOU HELP OTHER FIRMS CREATE VALUE?

In ecosystem competition, success is as much about helping other firms innovate as it is about being innovative yourself. Companies that have built a successful ecosystem have often done so incrementally, broadening the value proposition of their core offering by finding opportunities to apply one of its features or functionalities to some previously unrelated product or service.

Consider Google's Nest, which started by developing a smart digital thermostat that can be controlled remotely. It then added an alarm, thus building a bundle that controls both comfort and security. Next, capitalizing on the possibilities of digital interconnections, it created the Works with Nest ecosystem, which lets firms innovate by connecting with Nest. For instance, LIFX designed a Nest-compatible system whereby red LEDs flash if the smoke or safety alarms are activated—a literal lifesaver for the hard of hearing. Fitbit, the wearable fitness tracker, can tell Nest you're awake

so that it knows to warm your home. And Mercedes-Benz cars can use GPS to tell Nest to switch on the heat as you arrive. These extensions constitute a value proposition greater than anything Nest could have provided on its own. (Google recently announced that it will be phasing out Works with Nest and transitioning to Works with Google Assistant—an even broader and stronger ecosystem.)

That proposition rests on shared functionality. Nest may have started as a remotely controllable thermostat, but its creators realized that consumers might want to remotely control multiple services and products in multiple contexts. That understanding pointed the way to possible complementors, and Nest gradually migrated to providing remote control for a range of home systems and appliances.

Having identified a critical and shareable functionality, an ecosystem builder needs to consider the incentives and motivations of potential complementors. How will joining your ecosystem look from their point of view? Will they be content to remain complementors, or could they reasonably hope to compete with you? In Nest's case, what value proposition could it offer Mercedes—that is, how could participation improve the way Mercedes embeds itself in its customers' daily lives? How did that compare with other options Mercedes had?

If you don't focus on the needs of your partners, your ecosystem will wither on the vine, no matter how strong your brand and market position; chances are that some other ecosystem builder can offer a better alternative. Nokia's downfall provides a cautionary example. Even though the firm's Symbian operating system started out as the de facto ruler of the mobile telephony space, it was soon eclipsed because Nokia focused on its own narrow needs. Treated as dispensable supply-chain subordinates, app developers and other complementors jumped ship to Android.



WHAT ROLE SHOULD YOU PLAY?

Many firms assume they should be the focus and chief architect of any ecosystem they create. That's not necessarily the case; sometimes you are better off sharing the role or being a complementor.



In ecosystem competition, success is as much about helping other firms innovate as it is about being innovative yourself.

To be the orchestrator and prime mover of an ecosystem, you need a superior product or service that is hard to replicate. This means some combination of IP protection, a large network of users, and strong branding. Nespresso, as mentioned, patented its capsule. The apps powering Uber and Facebook are so user-friendly that those companies very quickly built large user networks. And Apple's patent protection and user base are bolstered by a strong brand and large scale, positioning the company to orchestrate pretty much any ecosystem in which it participates.

Organizational and cultural factors are also critical. Few would disagree that orchestrators need the agility to respond to new challengers, the humility to understand customer needs, and the vision to inspire complementors. But to say that isn't necessarily to state the obvious; consider the impact a single-minded focus on shareholder value and cost control can have on a company's ability to demonstrate those qualities. Firms with that focus are often, and sometimes rightly, accused of favoring the capture of short-term profits over the creation of long-term value—and given the time needed to shape an ecosystem's parts into a successful whole, that orientation could compromise a firm's ability to be an effective orchestrator. A company whose identity is deeply rooted in its technology or management system might also struggle. For example, an obsession with control could get in the way of engaging with entrepreneurial scientists, while a preference for organic, internally generated growth could lead to clashes with complementors equally protective of their turf.

If you lack the qualifications to build an ecosystem but have an IP-protected product or service that could anchor one, your best bet most likely involves attracting the interest of a large company that could buy into or license your idea. If a small-scale HVAC installer had come up with a remotely controllable thermostat, it probably could not have attracted the ecosystem of complementors that Google did. But it could have approached Google with the idea and served as a complementor while benefiting from licensing revenue. For many medium-size firms, a key strategy is to embed in many ecosystems. LIFX, for instance, connects with customers through Amazon's Alexa, Google Home, and Apple HomeKit.

Even if you bring a great product or service to the party and have the organizational and cultural capabilities to

attract complementors, it might make sense to orchestrate in partnership with another firm in order to reach critical mass. Daimler and BMW recently announced plans to jointly create a managed-mobility ecosystem combining car sharing, ride hailing, parking, and other services. Concerned about disruption from firms such as Uber and Lyft, the automakers decided to collaborate on high-end services anchored to their brands—their chief differentiator and element of value, which a wholesale migration to mobility-as-a-service (MaaS) might well erode.

A big company can also buy into an ecosystem, which can be particularly helpful if its contribution is interchangeable with other firms' offerings. Toyota recently invested \$1.5 billion in the Southeast Asian ride-hailing company Grab, reasoning that MaaS will drive demand for reliable low-cost cars. That partnership, the company hopes, will give Toyota not just a direct edge as a car supplier but also an understanding of car usage patterns that could confer an advantage over rivals such as Hyundai and Nissan.

Some notes of caution for mainstream firms: Even if you are large, you may be vulnerable to disruption from Google, Apple, or other tech giants, and participating in one of their ecosystems as a complementor may have significant advantages over trying to orchestrate your own—especially when it's hard to assess what combination of products and services will satisfy the final customer, or when the range of potential combinations is very broad. You should probably not be responsible for entrepreneurial and creative inputs; in the video game industry, for example, developers organize flexibly through video game engines to take their offerings to consumers. And even if you ultimately want to build your own ecosystem, participating in another one can help you gain experience, understand the needs of customers and complementors, and build the skills that orchestrating requires.



WHAT SHOULD THE TERMS FOR PARTICIPATION BE?

Research on ecosystem governance is still in its early days. But governance failures are easy to identify. For instance, as described earlier, Symbian failed in part because



STRATEGY

Nokia neglected to take other parties' interests into account. Contrast that with Apple's record with app developers.

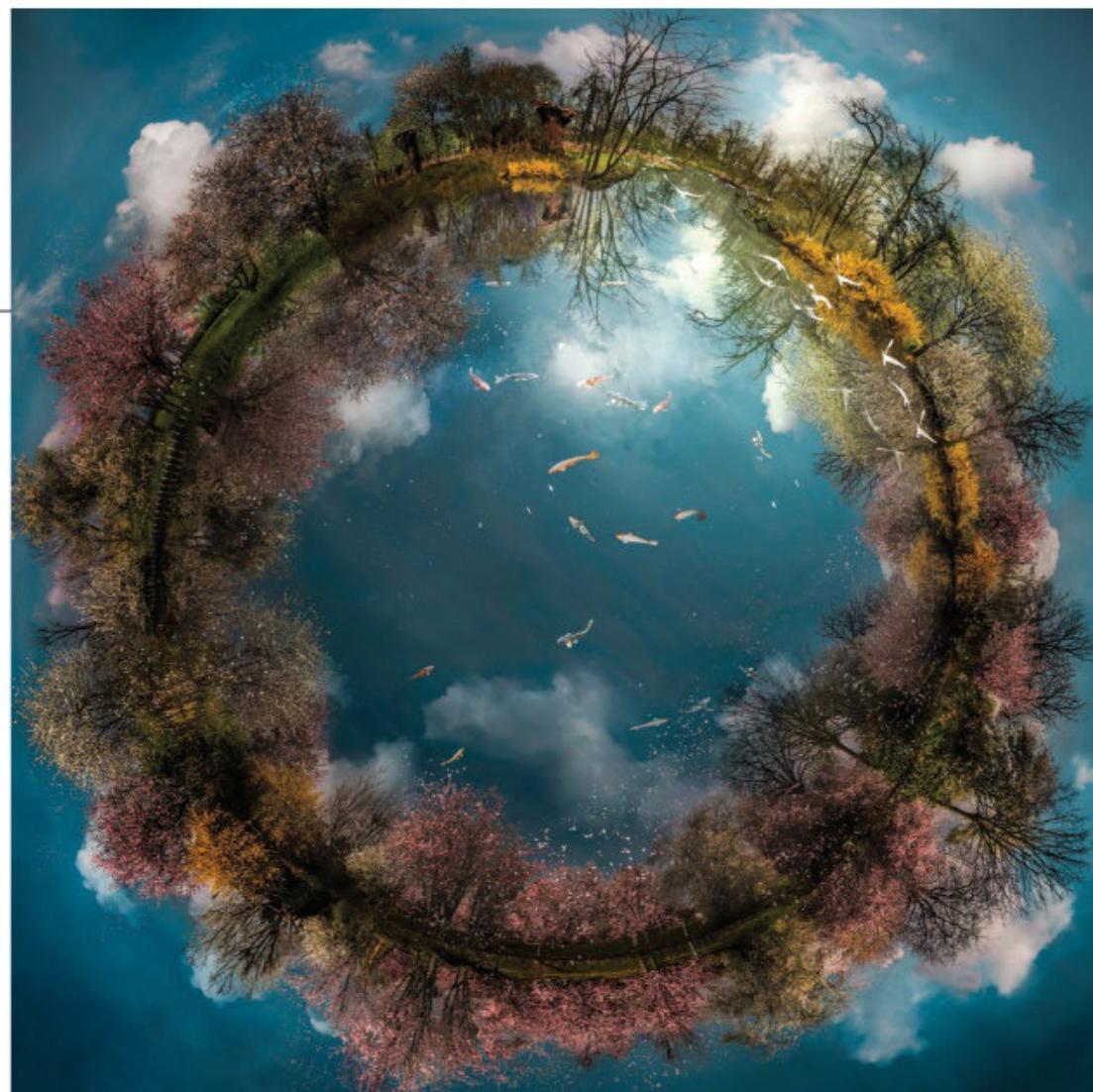
There are two key governance choices.

Access. Early in the process an ecosystem builder needs to decide whether the system should be *open, managed, or closed*. In an open ecosystem (such as Uber's drivers), complementors need only meet certain basic standards to participate. In a managed ecosystem (such as Apple's App Store), there are clear criteria for complementors and possibly some limits on their number, along with specific guidelines—on functionality and pricing, say. In a closed ecosystem (such as VW's connected cars and Philips's digital health), approval of complementors and rules of participation are tightly controlled.

In general, the more open the system, the easier it is to attract complementors and a wide range of products—but quality is more variable. The degree of openness should be determined in part by what matters most to the final customer. For a mobile app platform with a diverse customer base, for example, an open ecosystem—one offering lots of choice—might make sense. But if quality and safety concerns arise, barriers may be in order. Think of DiDi, China's largest ride-hailing company. Reeling from the 2018 murders of two passengers by drivers for its Hitch service, the firm chose to become more closed; it suspended Hitch and now rigorously vets prospective DiDi drivers.

Attachment. As you determine how accessible to make your ecosystem, you'll also need to consider how exclusively attached to it you want your complementors to be—how much they need to cospecialize with you. There will be trade-offs for all parties. If your mobile operating system forbids app developers from porting their programs to other platforms, the developers will certainly have a stake in your success. But the restriction might cause them not to join if they have opportunities elsewhere. Conversely, if you impose no barriers to redeploying an app, you'll find it far easier to recruit complementors, but they will have no particular attachment to your ecosystem.

The degree to which an orchestrator can lock in complementors generally depends on the attractiveness of that orchestrator and what alternatives are available. A hugely attractive orchestrator such as Apple, which can link an app developer to a large and loyal network, can probably require



 There aren't any default strategies for building an ecosystem. You need to decide carefully where and how to open up and then do so in a way that fits your competitive environment.

more attachment than a new entrant can. Compared with Apple, Android was easy to join; Google wanted it to gain traction before scaling up. Symbian ignored its developers' increasing alternatives and collapsed when those developers decamped to Apple and Google.

Their power and attractiveness, along with a lack of alternatives, have historically given tech giants such as Apple and Google relatively free rein to aggressively manage access and attachment to their ecosystems. But as technologies and attitudes change, less hierarchical ecosystems are growing more popular. WeWork's meteoric rise resulted from the fact that it not only provides shared office space but also builds communities: The WeWork app allows members to collaborate with and provide services to one another with little interference. Not-for-profits, too, are setting up nonhierarchical ecosystems; one example is the Ellen MacArthur Foundation's CE100 network, which supports firms that promote the so-called circular economy. Some smaller ventures have gone in a similar direction: The London-based platform upstart Common Objective matches up companies in the fashion industry without imposing its own "rules of the game."

More radically, the rapid growth of ledger technologies such as blockchain opens up new possibilities for creating sets of interconnected companies. The members of these ecosystems are linked not through a hub firm but through a distributed system—designed by one company, perhaps, but used by many. Consider Blanc Labs' Nekso, the biggest challenger to Uber in Mexico City. Instead of assembling a fleet of individual drivers who connect with customers through an app (the Uber model), it built an interface that allows taxi companies to band together in a network passengers can choose from, providing the same seamless experience Uber offers but through a decentralized ecosystem.



CAN YOUR ORGANIZATION ADAPT?

An ecosystem's members must be able to quickly adapt, because the needs of the final customer, along with the desire and ability of complementors to collaborate, can shift dramatically.

Take Nike's FuelBand, an early fitness tracker that connected with other Nike products. After the arrival of

Fitbit and other competing products, Nike discontinued production; the market could easily serve the need it had met, diminishing the value-add of a tracker tied to its own brand. The company also failed to defend its software and became a third-party app, salvaging what it could through a deal to codevelop a version of the Apple Watch. Like many other traditional, vertically integrated firms, Nike was slow to recognize the inevitable, and thus it lost its chance to orchestrate the wearables ecosystem.

Apple's success with the iPhone, in contrast, was fueled by the company's recognition, in 2008, that its original strategy of providing all the phone's apps was wrong. Steve Jobs—who was initially opposed to non-Apple app providers—made an impressive U-turn, creating the iPhone App Store. This both allowed the firm to share revenue from apps sold and encouraged others to find ways to leverage the phone.

Participating in an ecosystem requires an outward-facing culture and the ability to manage relationships with a host of complementors. Those skills don't come easily to established players, which tend to default to one of two approaches: to create a vertically integrated, tightly controlled network, as Nokia did, or to hop on the bandwagon of open innovation and production, providing only a platform and leaving ecosystem management up to users. The risk there is that without some central impetus or incentive from the host, other parties may fail to engage. That happened with Watson, IBM's AI developer platform: Initial developer enthusiasm did not translate into activity and engagement.

There really aren't any default strategies for building an ecosystem. You need to decide carefully where and how to open up and then do so in a way that fits your competitive environment. Nest got this right: Concerned that by opening up the alarm function it would compromise its ability to control the home, it made a strategic decision to engage in alarm and monitoring itself rather than link up with Alarm.com or Honeywell. It invited complementors in other, nonstrategic areas instead. For its part, when Alarm.com entered the thermostat market, it chose to enable Nest connectivity; having a smaller installed base and less muscle than Google, it placed a premium on the ability to infiltrate more houses, more effectively, even if that reduced its aspirations for control.



STRATEGY

Moving beyond strategy, to build an ecosystem you will need to manage your organization. The old part of it—that which currently generates revenue—will want to keep innovation under the firm’s control and will treat complementors with suspicion, whereas the new parts will need to be externally focused. Big firms often separate the two parts, regarding the core as a margin-preserving inertial supertanker and hoping that a small fleet of “speedboats,” some of which manage ecosystems, will pull the firm forward. Banks and insurance companies, for instance, often try to preserve their legacy structures and IT systems, hoping that a few add-ons will bring them into the digital, ecosystem-enabled age. But to succeed, ecosystems must be more closely aligned with the core.

New organizational structures are emerging that are better suited than traditional ones to these challenges. One example is the Chinese manufacturer Haier’s *rendanheyi* model. Haier is organized around independently managed “microenterprises” that it may or may not own. IT facilitates information and data flows across the microenterprise units, each of which becomes, in a sense, an internal ecosystem with relatively porous boundaries, enabling the firm as a whole to position itself in a broader ecosystem.



HOW MANY ECOSYSTEMS SHOULD YOU MANAGE?

Some successful orchestrators manage a number of synergistic ecosystems, each covering a different part of the business and leading to a different path for expansion.

The Chinese tech giant Alibaba grew by creating an expanding set of connected ecosystems, starting in one market and shifting to others as it capitalized on customer information and refined its understanding of customer needs. It began with 1688.com (a wholesale marketplace), created Taobao (a C2C marketplace), moved into TMall (a third-party-seller B2C ecosystem), and expanded to Juhuasuan (a sales and marketing platform). And it is a part owner of Ant Financial, the world’s most valuable fintech firm, which aims “to expand its ecosystem by penetrating more consumption scenarios in daily life.”

The most obvious consequence of this dynamic is the growing dominance of national e-commerce and e-services by a small number of firms. In China, the almost equally huge Tencent and Baidu compete with Alibaba, which in many ways they resemble. Their Western equivalents are Google, Apple, Facebook, Amazon, and Microsoft. Aspiring to provide a unified service, these companies are shifting into ever more sectors, often through interfaces such as voice-activated assistants that appear seamless to the consumer. Mobility firms are doing similar things. Uber’s expansion—think of Uber Eats and all the ventures of Uber Everything—demonstrates the company’s ambition to integrate multiple ecosystems and manage the customer interface. Southeast Asian mobility firms such as Grab (Singapore) and Go-Jek (Indonesia) have gotten into payments as well, aiming to make themselves indispensable to the final customer.

As Marco Iansiti and Karim Lakhani recently noted, such hub firms are becoming formidable strategic bottlenecks that can direct the lion’s share of value to themselves. But although it may seem that the future belongs to big, established firms with deep pockets and technological prowess, smaller upstarts (like Alibaba when it started, less than 20 years ago) and nontechnology firms have the potential to muscle in. The Chinese insurance and financial services conglomerate Ping An began by becoming more technologically savvy and soon ventured into adjacent areas, starting with health care and extending to lifestyle, in the process becoming the world’s most valuable insurance group. It did so by creating focused ecosystems such as Ping An Good Doctor, which combines AI with physicians to provide medical advice, and Ping An Haofang, the country’s largest online property platform. It has invested in Autohome, China’s largest used-car marketplace, and in entertainment, through an alliance with Huayi Brothers. It then combined those verticals with some of its own units, including Ping An Bank and Zhong An insurance, to create the PingOne account: an offering that seeks to capture every customer interaction.

For complementors, different ecosystems represent different pathways to market—and most integrators are complementors in rivals’ ecosystems (you’ll find Microsoft Word in Android, Google Maps in Apple, Apple software in Microsoft systems, and so on). Firms choose to “multihome” according



FURTHER READING

For more on ecosystems, see these articles on HBR.org.

Alibaba and the Future of Business
Ming Zeng

Managing Our Hub Economy
Marco Iansiti and Karim R. Lakhani

Managing Multiparty Innovation
Nathan Furr, Kate O'Keeffe, and Jeffrey H. Dyer

How to Drive Value Your Way
Michael G. Jacobides and John Paul MacDuffie

Strategy Tools for a Shifting Landscape
Michael G. Jacobides

Match Your Innovation Strategy to Your Innovation Ecosystem
Ron Adner

Strategy as Ecology
Marco Iansiti and Roy Levien

to what specific ecosystems allow, the cost of redeploying in other ecosystems, and the benefits of cross-ecosystem customer reach.

A firm's role in one ecosystem may drive its participation in (or orchestration of) another, and there is plenty of room for strategizing. Samsung, the biggest user of the Android ecosystem—it sells more than 40% of Android phones—threatened to create a rival OS ecosystem if Google didn't make certain concessions. The companies reached a compromise, but they continue to compete over functions such as digital assistants, and the boundaries between Google's and Samsung's phone ecosystems continue to be hotly contested. Strategic interactions of this kind between firms and their associated ecosystems will only increase.

FROM PRIVATE BENEFIT TO PUBLIC GOOD

The rise of ecosystem-based competition not only requires a new strategic framework and organizational model; it has significant implications for policy and regulation. In particular, the increasing success of integrators and their ability to become all-powerful orchestrators across an ever-growing number of ecosystems raises serious questions about a new form of market power.

Governments must strike a balance that both keeps their business environments healthy and safeguards their societies. Little global consensus has emerged about where that balance should lie. The rapid growth of many Chinese firms has relied on their unfettered ability to access data, while Europe sets tight restrictions on that activity. Will those limit economic growth in Europe relative to China? Maybe, but Europeans may consider the price worth paying, given the social benefits of privacy protections.

Whatever social priorities they set, all countries will need to change the analytical foundations of competition law, which has long focused on managing the market shares of individual firms. As a recent report prepared for the UK Treasury argued, we need to adjust our approach to competition and regulation. In particular, we need to examine the terms of engagement in ecosystems, how orchestrators and integrators exert their power, what customer data those parties own, and how they interact with complementors. And while there

is only one Apple, there are 2 million app developers. The fate of complementors may have more far-reaching societal effects than the high-profile fortunes of an orchestrator will have, and as we contemplate regulatory action, we must consider ecosystem governance, rules of engagement, and the well-being of the myriad, de facto weaker, complementors. We must also ask whether firms' desire to expand their reach and control an increasingly broad swath of activity restricts competition. To that end, the M&A of ecosystem plays should be scrutinized.

In approaching these challenges, policy makers should avoid the trap of treating all emerging ecosystems as commercial monsters in need of control. Ecosystems can provide new ways of bridging private benefit and public good. IDEO's CoLab circular economy portfolio advises firms in the textile and food sectors on reconfiguring their ecosystems to encourage the reuse of resources and the reduction of waste. Traipse's My Local Token provides localized digital currencies for U.S. downtowns that reinforce connections between residents and tourists on one hand and local businesses on the other. Velocia is creating a rewards ecosystem that encourages the use of public transit alongside on-demand services such as carpooling and carsharing to improve people's commutes. (Disclosure: I have advised all three of these companies.).

BUSINESS IS UNDERGOING a paradigm shift as a result of digital innovation: The very nature of competition is changing. Competing is increasingly about identifying new ways to collaborate and connect rather than simply offering alternative value propositions. But as the scope of opportunity expands, so too does the confusion of executives confronted with digital ecosystems. The complexity of those systems doesn't mean we should give up trying to make sense of them; it means we need to adjust. We must shift from rigid strategies based on prescriptive frameworks to dynamic experiments based on a process of inquiry. Start by asking yourself the five questions I've just proposed. ☰

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MICHAEL G. JACOBIDES is the Sir Donald Gordon Professor of Entrepreneurship and Innovation and a professor of strategy at London Business School.

These insights can help you anticipate consumer needs during the purchase journey.

By: **Sara Kleinberg**, Head of UX Customer Insights and Strategy at Google

When it comes to spending time, everyone wants to spend it wisely. More than ever, people apply that mantra to shopping, as they look for more ways to get what they want immediately.

Mobile searches on Google for “open” + “now” + “near me” have grown by over 200% in the last two years (for example, “stores open near me right now”).¹

But “right now” isn’t just about a purchase: It applies to finding information before the sale and customer service afterward.

Find out what people want

Consumers expect brands to assist them before, during, and after a purchase.

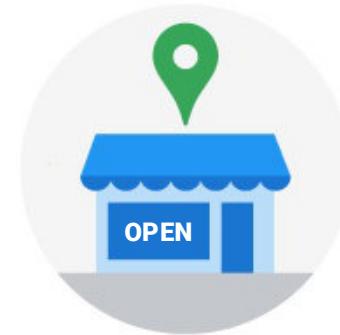
For instance, mobile searches asking about availability of products near a customer have grown 6x over the last two years. Updates on the status of shipped purchases have grown over 120%. And queries about “24/7” + “customer service” were up over 200% in that period.²

These insights allow marketers to anticipate when and where they can be most helpful. You might not be able to help every single person’s request. But you can be there with an explanation.

Three ways you can be there for customers:

1. Be immediately available

From product pages to local inventory feeds, ensure you have real-time information about where products are available and how many are in stock.



2. Be immediately relevant

Ensure you show up in the critical moments of intent throughout the purchase journey. That could be embracing automation to run ads only for products that are actually available—and pulling ads for products that aren’t.

3. Be immediately transparent

From ad copy to product and help pages, set expectations for shipping times, customer service availability, and live tracking. Post-sale, offer status updates and 24/7 assistance.

 **200%**
growth in mobile searches for **“open now” + “near me”** in the last two years

 **6X**
growth in mobile searches for **“can I/to buy” + “near me”** in the last two years

¹ Google Data, U.S., July 2015-Dec. 2015 vs. July 2017-Dec. 2017.

² Google/Greenberg, U.S., “Rising Expectations in Consumer Brand Experiences,” n=1,500, 18–64 years old, March 2018.

Learning to Work with Intelligent Machines

Companies are deploying AI and robotics in ways that disrupt traditional training techniques such as mentoring and on-the-job learning. We need to understand how to combine the old with the new.



TECHNOLOGY



AUTHOR

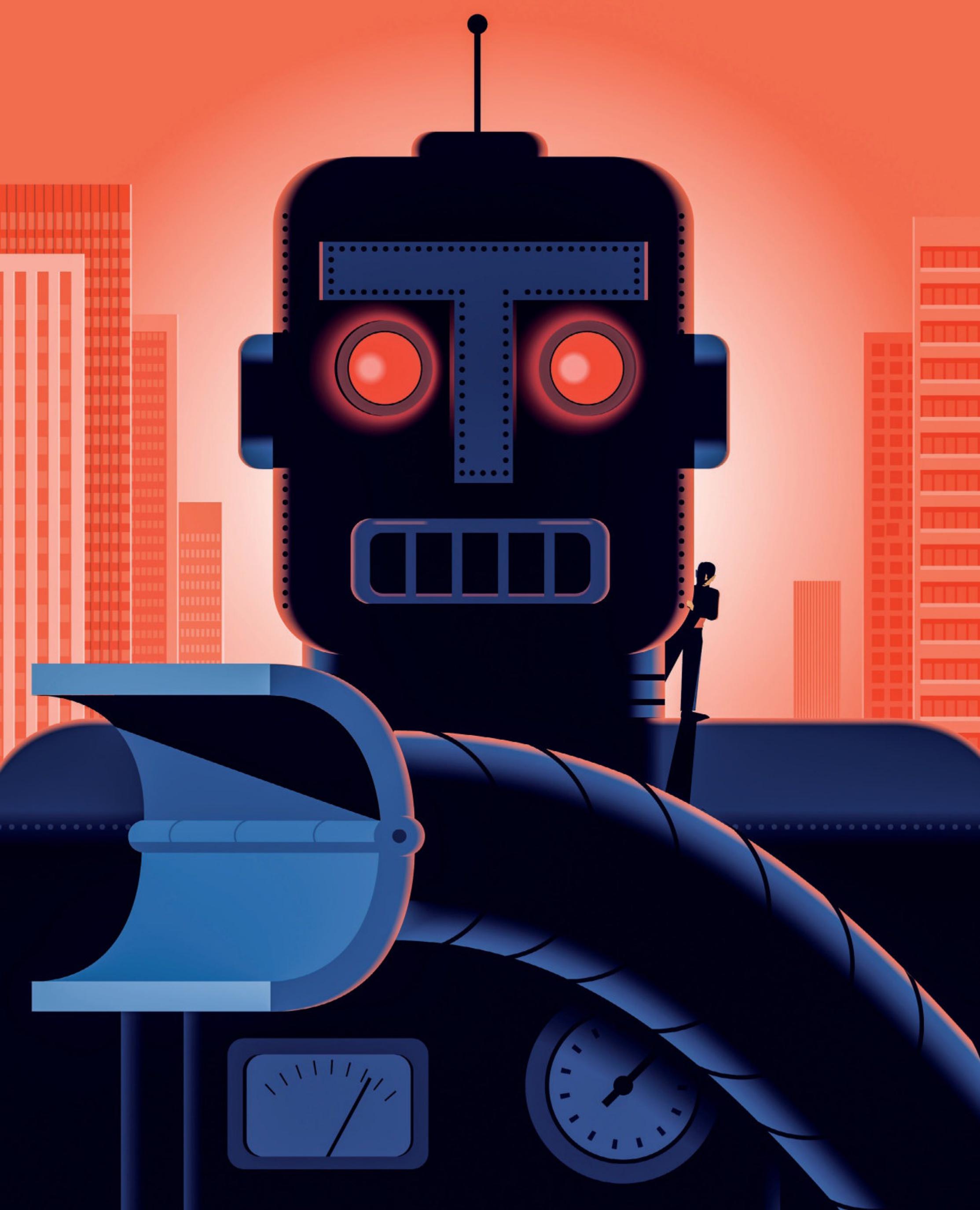
Matt Beane

Assistant professor,
UC Santa Barbara



ILLUSTRATOR

JOHN W. TOMAC



IDEA IN BRIEF

THE PROBLEM

The rush of intelligent machines and sophisticated analytics into many aspects of work means that trainees are losing opportunities to acquire skills through on-the-job learning (OJL).

THE OUTCOME

In medicine, policing, and other fields, people are finding rule-breaking ways to acquire needed expertise out of the limelight. This "shadow learning" is tolerated for the results it produces, but it can exact a personal and an organizational toll.

THE SOLUTION

In response, organizations should carefully uncover and study shadow learning; adapt practices that develop organizational, technological, and work designs that enhance OJL; and make intelligent machines part of the solution.





TECHNOLOGY

It's 6:30 in the morning, and Kristen is wheeling her prostate patient into the OR. She's a senior resident, a surgeon in training. Today she's hoping to do some of the procedure's delicate, nerve-sparing dissection herself. The attending physician is by her side, and their four hands are mostly in the patient, with Kristen leading the way under his watchful guidance. The work goes smoothly, the attending backs away, and Kristen closes the patient by 8:15, with a junior resident looking over her shoulder. She lets him do the final line of sutures. She feels great: The patient's going to be fine, and she's a better surgeon than she was at 6:30.

FAST-FORWARD SIX MONTHS. It's 6:30 AM again, and Kristen is wheeling another patient into the OR, but this time for robotic prostate surgery. The attending leads the setup of a thousand-pound robot, attaching each of its four arms to the patient. Then he and Kristen take their places at a control console 15 feet away. Their backs are to the patient, and Kristen just watches as the attending remotely manipulates the robot's arms, delicately retracting and dissecting tissue. Using the robot, he can do the entire procedure himself, and he largely does. He knows Kristen needs practice, but he also knows she'd be slower and would make more mistakes. So she'll be lucky if she operates more than 15 minutes during the four-hour surgery. And she knows that if she slips up, he'll tap a touch screen and resume control, very publicly banishing her to watch from the sidelines.

Surgery may be extreme work, but until recently surgeons in training learned their profession the same way most of

us learned how to do our jobs: We watched an expert, got involved in the easier work first, and then progressed to harder, often riskier tasks under close supervision until we became experts ourselves. This process goes by lots of names: apprenticeship, mentorship, on-the-job learning (OJL). In surgery it's called *See one, do one, teach one*.

Critical as it is, companies tend to take on-the-job learning for granted; it's almost never formally funded or managed, and little of the estimated \$366 billion companies spent globally on formal training in 2018 directly addressed it. Yet decades of research show that although employer-provided training is important, the lion's share of the skills needed to reliably perform a specific job can be learned only by doing it. Most organizations depend heavily on OJL: A 2011 Accenture survey, the most recent of its kind and scale, revealed that only one in five workers had learned any new job skills through formal training in the previous five years.



TECHNOLOGY

Today OJL is under threat. The headlong introduction of sophisticated analytics, AI, and robotics into many aspects of work is fundamentally disrupting this time-honored and effective approach. Tens of thousands of people will lose or gain jobs every year as those technologies automate work, and hundreds of millions will have to learn new skills and ways of working. Yet broad evidence demonstrates that companies' deployment of intelligent machines often blocks this critical learning pathway: My colleagues and I have found that it moves trainees away from learning opportunities and experts away from the action, and overloads both with a mandate to master old and new methods simultaneously.

How, then, will employees learn to work alongside these machines? Early indications come from observing learners engaged in norm-challenging practices that are pursued out of the limelight and tolerated for the results they produce. I call this widespread and informal process *shadow learning*.

Obstacles to Learning

MY DISCOVERY OF SHADOW learning came from two years of watching surgeons and surgical residents at 18 top-rated teaching hospitals in the United States. I studied learning and training in two settings: traditional ("open") surgery and robotic surgery. I gathered data on the challenges robotic surgery presented to senior surgeons, residents, nurses, and scrub technicians (who prep patients, help glove and gown surgeons, pass instruments, and so on), focusing particularly on the few residents who found new, rule-breaking ways to learn. Although this research concentrated on surgery, my broader purpose was to identify learning and training dynamics that would show up in many kinds of work with intelligent machines.

To this end, I connected with a small but growing group of field researchers who are studying how people work with smart machines in settings such as internet start-ups, policing organizations, investment banking, and online education. Their work reveals dynamics like those I observed in surgical training. Drawing on their disparate lines of research, I've identified four widespread obstacles to acquiring needed skills. Those obstacles drive shadow learning.

1 Trainees are being moved away from their "learning edge." Training people in any kind of work can incur costs and decrease quality, because novices move slowly and make mistakes. As organizations introduce intelligent machines, they often manage this by reducing trainees' participation in the risky and complex portions of the work, as Kristen found. Thus trainees are being kept from situations in which they struggle near the boundaries of their capabilities and recover from mistakes with limited help—a requirement for learning new skills.

The same phenomenon can be seen in investment banking. New York University's Callen Anthony found that junior analysts in one firm were increasingly being separated from senior partners as those partners interpreted algorithm-assisted company valuations in M&As. The junior analysts were tasked with simply pulling raw reports from systems that scraped the web for financial data on companies of interest and passing them to the senior partners for analysis. The implicit rationale for this division of labor? First, reduce the risk that junior people would make mistakes in doing sophisticated work close to the customer; and second, maximize senior partners' efficiency: The less time they needed to explain the work to junior staffers, the more they could focus on their higher-level analysis. This provided some short-term gains in efficiency, but it moved junior analysts away from challenging, complex work, making it harder for them to learn the entire valuation process and diminishing the firm's future capability.

2 Experts are being distanced from the work. Sometimes intelligent machines get between trainees and the job, and other times they're deployed in a way that prevents experts from doing important hands-on work. In robotic surgery, surgeons don't see the patient's body or the robot for most of the procedure, so they can't directly assess and manage critical parts of it. For example, in traditional surgery, the surgeon would be acutely aware of how devices and instruments impinged on the patient's body and would adjust accordingly; but in robotic surgery, if a robot's arm hits a patient's head or a scrub is about to swap a robotic instrument, the surgeon won't know unless someone tells her. This has two learning implications: Surgeons can't practice the skills needed to make holistic sense of the work on their own, and they must build new skills related to making sense of the work through others.

Benjamin Shestakofsky, now at the University of Pennsylvania, described a similar phenomenon at a pre-IPO start-up that used machine learning to match local laborers with jobs and that provided a platform for laborers and those hiring them to negotiate terms. At first the algorithms weren't making good matches, so managers in



Companies' deployment of intelligent machines often moves trainees away from learning opportunities and experts away from the action.

San Francisco hired people in the Philippines to manually create each match. And when laborers had difficulty with the platform—for instance, in using it to issue price quotes to those hiring, or to structure payments—the start-up managers outsourced the needed support to yet another distributed group of employees, in Las Vegas. Given their limited resources, the managers threw bodies at these problems to buy time while they sought the money and additional engineers needed to perfect the product. Delegation allowed the managers and engineers to focus on business development and writing code, but it deprived them of critical learning opportunities: It separated them from direct, regular input from customers—the laborers and the hiring contractors—about the problems they were experiencing and the features they wanted.

3

Learners are expected to master both old and new methods. Robotic surgery comprises a radically new set of techniques and technologies for accomplishing the same ends that traditional surgery seeks to achieve. Promising greater precision and ergonomics, it was simply added to the curriculum, and residents were expected to learn robotic as well as open approaches. But the curriculum didn't include enough time to learn both thoroughly, which often led to a worst-case outcome: The residents mastered neither. I call this problem *methodological overload*.

Shreeharsh Kelkar, at UC Berkeley, found that something similar happened to many professors who were using a new technology platform called edX to develop massive open online courses (MOOCs). EdX provided them with a suite of course-design tools and instructional advice based on fine-grained algorithmic analysis of students' interaction with the platform (clicks, posts, pauses in video replay, and so on). Those who wanted to develop and improve online courses had to learn a host of new skills—how to navigate the edX user interface, interpret analytics on learner behavior, compose and manage the course's project team, and more—while keeping "old school" skills sharp for teaching their traditional classes. Dealing with this tension was difficult for everyone, especially because the approaches were in constant flux: New tools, metrics, and expectations arrived almost daily, and instructors had to quickly assess and master them. The only people who handled both old and

new methods well were those who were already technically sophisticated and had significant organizational resources.

4

Standard learning methods are presumed to be effective. Decades of research and tradition hold trainees in medicine to the *See one, do one, teach one* method, but as we've seen, it doesn't adapt well to robotic surgery. Nonetheless, pressure to rely on approved learning methods is so strong that deviation is rare: Surgical-training research, standard routines, policy, and senior surgeons all continue to emphasize traditional approaches to learning, even though the method clearly needs updating for robotic surgery.

Sarah Brayne, at the University of Texas, found a similar mismatch between learning methods and needs among police chiefs and officers in Los Angeles as they tried to apply traditional policing approaches to beat assignments generated by an algorithm. Although the efficacy of such "predictive policing" is unclear, and its ethics are controversial, dozens of police forces are becoming deeply reliant on it. The LAPD's PredPol system breaks the city up into 500-foot squares, or "boxes," assigns a crime probability to each one, and directs officers to those boxes accordingly. Brayne found that it wasn't always obvious to the officers—or to the police chiefs—when and how the former should follow their AI-driven assignments. In policing, the traditional and respected model for acquiring new techniques has been to combine a little formal instruction with lots of old-fashioned learning on the beat. Many chiefs therefore presumed that officers would mostly learn how to incorporate crime forecasts on the job. This dependence on traditional OJL contributed to confusion and resistance to the tool and its guidance. Chiefs didn't want to tell officers what to do once "in the box," because they wanted them to rely on their experiential knowledge and discretion. Nor did they want to irritate the officers by overtly reducing their autonomy and coming across as micromanagers. But by relying on the traditional OJL approach, they inadvertently sabotaged learning: Many officers never understood how to use PredPol or its potential benefits, so they wholly dismissed it—yet they were still held accountable for following its assignments. This wasted time, decreased trust, and led to miscommunication and faulty data entry—all of which undermined their policing.



Close to a hundred years ago, the sociologist Robert Merton showed that when legitimate means are no longer effective for achieving a valued goal, deviance results.

Shadow Learning Responses

FACED WITH SUCH BARRIERS, shadow learners are bending or breaking the rules out of view to get the instruction and experience they need. We shouldn't be surprised. Close to a hundred years ago, the sociologist Robert Merton showed that when legitimate means are no longer effective for achieving a valued goal, deviance results. Expertise—perhaps the ultimate occupational goal—is no exception: Given the barriers I've described, we should expect people to find deviant ways to learn key skills. Their approaches are often ingenious and effective, but they can take a personal and an organizational toll: Shadow learners may be punished (for example, by losing practice opportunities and status) or cause waste and even harm. Still, people repeatedly take those risks, because their learning methods work well where approved means fail. It's almost always a bad idea to uncritically copy these deviant practices, but organizations do need to learn from them.

Following are the shadow learning practices that I and others have observed:

Seeking struggle. Recall that robotic surgical trainees often have little time on task. Shadow learners get around this by looking for opportunities to operate near the edge of their capability and with limited supervision. They know they must struggle to learn, and that many attending physicians are unlikely to let them. The subset of residents I studied who did become expert found ways to get the time on the robots they needed. One strategy was to seek collaboration with attendings who weren't themselves seasoned experts. Residents in urology—the specialty having by far the most experience with robots—would rotate into departments whose attendings were less proficient in robotic surgery, allowing the residents to leverage the halo effect of their elite (if limited) training. The attendings were less able to detect quality deviations in their robotic surgical work and knew that the urology residents were being trained by true experts in the practice; thus they were more inclined to let the residents operate, and even to ask for their advice. But few would argue that this is an optimal learning approach.

What about those junior analysts who were cut out of complex valuations? The junior and senior members of

one group engaged in shadow learning by disregarding the company's emerging standard practice and working together. Junior analysts continued to pull raw reports to produce the needed input, but they worked alongside senior partners on the analysis that followed.

In some ways this sounds like a risky business move. Indeed, it slowed down the process, and because it required the junior analysts to handle a wider range of valuation methods and calculations at a breakneck pace, it introduced mistakes that were difficult to catch. But the junior analysts developed a deeper knowledge of the multiple companies and other stakeholders involved in an M&A and of the relevant industry and learned how to manage the entire valuation process. Rather than function as a cog in a system they didn't understand, they engaged in work that positioned them to take on more-senior roles. Another benefit was the discovery that, far from being interchangeable, the software packages they'd been using to create inputs for analysis sometimes produced valuations of a given company that were billions of dollars apart. Had the analysts remained siloed, that might never have come to light.

Tapping frontline know-how. As discussed, robotic surgeons are isolated from the patient and so lack a holistic sense of the work, making it harder for residents to gain the skills they need. To understand the bigger picture, residents sometimes turn to scrub techs, who see the procedure in its totality: the patient's entire body; the position and movement of the robot's arms; the activities of the anesthesiologist, the nurse, and others around the patient; and all the instruments and supplies from start to finish. The best scrubs have paid careful attention during thousands of procedures. When residents shift from the console to the bedside, therefore, some bypass the attending and go straight to these "superscrubs" with technical questions, such as whether the intra-abdominal pressure is unusual, or when to clear the field of fluid or of smoke from cauterization. They do this despite norms and often unbeknownst to the attending.

And what about the start-up managers who were outsourcing jobs to workers in the Philippines and Las Vegas? They were expected to remain laser focused on raising capital and hiring engineers. But a few spent time with the frontline contract workers to learn how and why they made the

matches they did. This led to insights that helped the company refine its processes for acquiring and cleaning data—an essential step in creating a stable platform. Similarly, some attentive managers spent time with the customer service reps in Las Vegas as they helped workers contend with the system. These “ride alongs” led the managers to divert some resources to improving the user interface, helping to sustain the start-up as it continued to acquire new users and recruit engineers who could build the robust machine learning systems it needed to succeed.

Redesigning roles. The new work methods we create to deploy intelligent machines are driving a variety of shadow learning tactics that restructure work or alter how performance is measured and rewarded. A surgical resident may decide early on that she isn’t going to do robotic surgery as a senior physician and will therefore consciously minimize her robotic rotation. Some nurses I studied prefer the technical troubleshooting involved in robotic assignments, so they surreptitiously avoid open surgical work. Nurses who staff surgical procedures notice emerging preferences and skills and work around blanket staffing policies to accommodate them. People tacitly recognize and develop new roles that are better aligned with the work—whether or not the organization formally does so.

Consider how some police chiefs reframed expectations for beat cops who were having trouble integrating predictive analytics into their work. Brayne found that many officers assigned to patrol PredPol’s “boxes” appeared to be less productive on traditional measures such as number of arrests, citations, and FIs (field interview cards—records made by officers of their contacts with citizens, typically people who seem suspicious). FIs are particularly important in AI-assisted policing, because they provide crucial input data for predictive systems even when no arrests result. When cops went where the system directed them, they often made no arrests, wrote no tickets, and created no FIs.

Recognizing that these traditional measures discouraged beat cops from following PredPol’s recommendations, a few chiefs sidestepped standard practice and publicly and privately praised officers not for making arrests and delivering citations but for learning to work with the algorithmic assignments. As one captain said, “Good, fine, but we are telling you where the probability of a crime is at, so sit there, and if you come in with a zero [no crimes], that is a success.” These chiefs were taking a risk by encouraging what many saw as bad policing, but in doing so they were helping to move the law enforcement culture toward a future in which the police will increasingly collaborate with intelligent machines, whether or not PredPol remains in the tool kit.

Curating solutions. Trainees in robotic surgery occasionally took time away from their formal responsibilities to



create, annotate, and share play-by-play recordings of expert procedures. In addition to providing a resource for themselves and others, making the recordings helped them learn, because they had to classify phases of the work, techniques, types of failures, and responses to surprises.

Faculty members who were struggling to build online courses while maintaining their old-school skills used similar techniques to master the new technology. EdX provided tools, templates, and training materials to make things easier for instructors, but that wasn’t enough. Especially in the beginning, far-flung instructors in resource-strapped institutions took time to experiment with the platform, make notes and videos on their failures and successes, and share them informally with one another online. Establishing these connections was hard, especially when the instructors’ institutions were ambivalent about putting content and pedagogy online in the first place.

Shadow learning of a different type occurred among the original users of edX—well-funded, well-supported professors at topflight institutions who had provided early input during the development of the platform. To get the support and resources they needed from edX, they surreptitiously shared techniques for pitching desired changes in the platform, securing funding and staff support, and so on.

Learning from shadow learners. Obviously shadow learning is not the ideal solution to the problems it addresses. No one should have to risk getting fired just to master a job. But these practices are hard-won, tested paths in a world where acquiring expertise is becoming more difficult and more important.

The four classes of behavior shadow learners exhibit—seeking struggle, tapping frontline know-how, redesigning roles, and curating solutions—suggest corresponding tactical responses. To take advantage of the lessons shadow learners offer, technologists, managers, experts, and workers themselves should:

- ensure that learners get opportunities to struggle near the edge of their capacity in real (not simulated) work so that they can make and recover from mistakes
- foster clear channels through which the best frontline workers can serve as instructors and coaches
- restructure roles and incentives to help learners master new ways of working with intelligent machines



TECHNOLOGY

- build searchable, annotated, crowdsourced “skill repositories” containing tools and expert guidance that learners can tap and contribute to as needed

The specific approach to these activities depends on organizational structure, culture, resources, technological options, existing skills, and, of course, the nature of the work itself. No single best practice will apply in all circumstances. But a large body of managerial literature explores each of these, and outside consulting is readily available.

More broadly, my research, and that of my colleagues, suggests three organizational strategies that may help leverage shadow learning’s lessons:

1 Keep studying it. Shadow learning is evolving rapidly as intelligent technologies become more capable. New forms will emerge over time, offering new lessons. A cautious approach is critical. Shadow learners often realize that their practices are deviant and that they could be penalized for pursuing them. (Imagine if a surgical resident made it known that he sought out the least-skilled attendings to work with.) And middle managers often turn a blind eye to these practices because of the results they produce—as long as the shadow learning isn’t openly acknowledged. Thus learners and their managers may be less than forthcoming when an observer, particularly a senior manager, declares that he wants to study how employees are breaking the rules to build skills. A good solution is to bring in a neutral third party who can ensure strict anonymity while comparing practices across diverse cases. My informants came to know and trust me, and they were aware that I was observing work in numerous work groups and facilities, so they felt confident that their identities would be protected. That proved essential in getting them to open up.

2 Adapt the shadow learning practices you find to design organizations, work, and technology. Organizations have often handled intelligent machines in ways that make it easier for a single expert to take more control of the work, reducing dependence on trainees’ help. Robotic surgical systems allow senior surgeons to operate with less assistance, so they do. Investment banking systems allow senior partners to exclude junior analysts from complex valuations, so they do. All stakeholders should

insist on organizational, technological, and work designs that improve productivity and enhance on-the-job learning. In the LAPD, for example, this would mean moving beyond changing incentives for beat cops to efforts such as redesigning the PredPol user interface, creating new roles to bridge police officers and software engineers, and establishing a cop-curated repository for annotated best practice use cases.

3 Make intelligent machines part of the solution. AI can be built to coach learners as they struggle, coach experts on their mentorship, and connect those two groups in smart ways. For example, when Juho Kim was a doctoral student at MIT, he built ToolScape and Lecture-Scape, which allow for crowdsourced annotation of instructional videos and provide clarification and opportunities for practice where many prior users have paused to look for them. He called this *learnersourcing*. On the hardware side, augmented reality systems are beginning to bring expert instruction and annotation right into the flow of work. Existing applications use tablets or smart glasses to overlay instructions on work in real time. More-sophisticated intelligent systems are expected soon. Such systems might, for example, superimpose a recording of the best welder in the factory on an apprentice welder’s visual field to show how the job is done, record the apprentice’s attempt to match it, and connect the apprentice to the welder as needed. The growing community of engineers in these domains have mostly been focused on formal training, and the deeper crisis is in on-the-job learning. We need to redirect our efforts there.

FOR THOUSANDS OF YEARS, advances in technology have driven the redesign of work processes, and apprentices have learned necessary new skills from mentors. But as we’ve seen, intelligent machines now motivate us to peel apprentices away from masters, and masters from the work itself, all in the name of productivity. Organizations often unwittingly choose productivity over considered human involvement, and learning on the job is getting harder as a result. Shadow learners are nevertheless finding risky, rule-breaking ways to learn. Organizations that hope to compete in a world filling with increasingly intelligent machines should pay close attention to these “deviants.” Their actions provide insight into how the best work will be done in the future, when experts, apprentices, and intelligent machines work, and learn, together. ☐

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The Big Idea Expanding Women's Power and Influence by 2030

Harvard
Business
Review



September 2019
Online at hbr.org/big-ideas

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MANAGING YOURSELF

COACHING FOR CHANGE

How to help employees reach their potential

by Richard Boyatzis, Melvin Smith, and Ellen Van Oosten

CHANGE IS HARD. Ask anyone who has tried to switch careers, develop a new skill, improve a relationship, or break a bad habit. And yet for most people change will at some point be necessary—a critical step toward fulfilling their potential and achieving their goals, both at work and at home. They will need support with this process. They'll need a coach.

That's where you come in. Whether you're a boss or a colleague, a friend or a spouse, introverted or extroverted, emotional or analytic, or high or low on the totem pole, you can learn how to facilitate life-enhancing change in those around you.

All three of us work as professional coaches to executives in a variety of career stages, functions, industries, and countries. We've also spent the past two decades investigating how coaching works and training others to do it. We've conducted dozens of longitudinal studies and field experiments to identify evidence-based strategies, and we're sharing them here to ensure that more people are equipped to help others become their best selves.

In 1970 one of us (Richard) developed a theory of intentional change, which has become canon in psychology and management science. Intentional change involves envisioning the ideal self (who you wish to *be* and what you want to *do* in your work and life); exploring the real self (the gaps you need to fill and the strengths that will help you do so); developing a learning agenda (a road map for turning aspirations into reality); and then experimenting and practicing (with new behaviors and roles).

Good coaches help people through this process. Note that we used the word "help," not "guide," "lead," "push," or "pull." You're not there to tell anyone what to do. You're there to ask good questions and listen intently, to offer compassion, to explore a person's individual vision, and to build a caring relationship. Your job is to assist someone else with making a change, and how you go about it matters. You're there to help him or

her spot the learning opportunity, set the groundwork, and see things through. This framework will let you support people with challenges that range from very big (I'm unsatisfied in my career) to relatively small (I'd like to interact with others differently). Here's how it works.

SPOT THE OPPORTUNITY

If you pay attention, you'll start finding what we call "coachable moments"—opportunities to help people with their development—everywhere. Sometimes people are aware they need to shift gears: The challenge is evident. They get a promotion, are tapped to lead a significant project, or receive some feedback that their approach needs to be retooled. In other cases they experience a wake-up call: They lose their job in the latest downsizing, get a scary health diagnosis, or hit a major birthday milestone. But often they may have only a vague sense or no idea at all that things aren't quite right in their lives.

Let's look at the experiences of two executives. The first, Karen Milley, was the head of R&D at a large consumer goods company and oversaw 60 engineers and scientists. As a leader, she was driven and direct. Her focus was on solving immediate problems, and she got results. But when her manager asked her to enroll in a corporate leadership-development program, she began to wonder if her transactional, no-nonsense style was really helping her get the best performance out of her team.

The second executive, Ray Lewis, was a corporate accounts manager at his family's business, an environmental emergency response service, and on

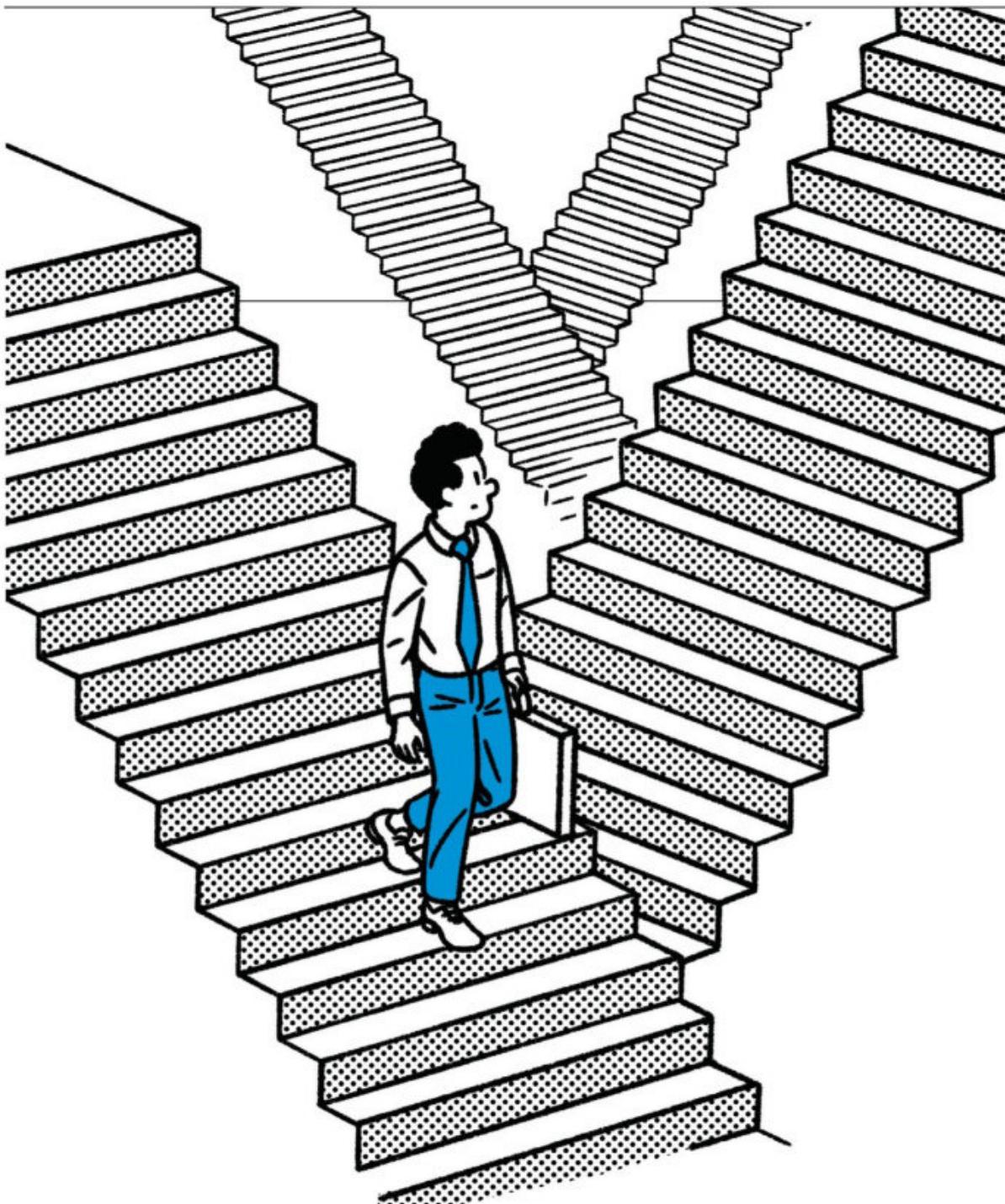
track to succeed his father as president. He'd even enrolled in an executive MBA course to hone his leadership skills. But he was feeling increasingly uneasy.

In both cases, the learning opportunity was clear. Milley was a standout manager who hoped to reach the C-suite, but she hadn't yet developed an inspiring leadership style. Lewis had never truly thought about or decided on his ideal career path. He'd just followed the one laid out for him, and if you asked him about taking over from his dad, his lack of genuine excitement came through. He needed to discover passion for his work.

Critically, Milley and Lewis were also ready to grow. Both were finally willing to look at an important aspect of their lives in new or different ways. When you're considering whether to invest in coaching someone, you need to ask yourself: Is this individual open to change? Is he or she willing to engage in the reflection and experimentation necessary to make it happen? Research by Bruce Avolio of the University of Washington's Foster School of Business and Sean Hannah of Wake Forest University shows that it's useful for companies to assess and sometimes enhance the readiness of employees they've chosen for leadership development; otherwise, it won't be as effective.

SET THE GROUNDWORK

Numerous studies have shown that people tend to achieve more, in a more sustainable way, when they're in a positive state both psychologically and physically. How can you get someone into the right mindset? By coaching with compassion. You start by showing



genuine care and concern for the other person so that the two of you can build what we call a “resonant relationship.” You also need to display curiosity—asking exploratory, open-ended questions designed to help the person realize his or her personal vision, which becomes the context for your work together.

Unfortunately, when faced with a coachable moment, most of us tend to do the opposite. We drill down into the problem and then offer advice and solutions. As an engineer-turned-marketing-executive we know once said, “When people come to me with a problem, I see the problem, not the person. Actually, I see people as problem-bearing platforms!” This is coaching for compliance, and it can be effective

in helping someone achieve a specific predetermined goal, such as earning a promotion. But when it comes to broader behavioral goals, such as becoming a dynamic leader or a great listener or finding a better work/life balance, this strategy is less successful. Indeed, as our studies and other research have shown, it can trigger a stress response that hinders rather than helps progress.

In work with our Case Western Reserve University colleague Anthony Jack, for example, we found that students who were coached for compliance—with an emphasis on targets and on challenges they needed to overcome—were left feeling “guilty and self-conscious.” Coaching that instead focused on personal dreams and how people might achieve them,

in contrast, elicited positive emotions and was deemed by study subjects to be “inspiring and caring.” What’s more, our neuroimaging studies showed that it helped activate areas of their brains associated with openness to new ideas, change, and learning.

Compassionate coaching continues with the discovery of the ideal self—getting the person you’re helping to tell you about his or her values, passions, identity, and hopes for the future. This requires you to set aside your own biases, assumptions, and experience, and engage in what MIT professor Ed Schein called “humble inquiry.” You must demonstrate sincere interest in the person, convey empathy for his or her situation, communicate your deep desire to help, and then let him or her do at least 80% of the talking.

For example, you might ask Milley: Who are you at your very best? What kind of leader do you want to be? How do you want others in the organization to see you? What does success look like to you? What position do you ultimately want to attain? You might ask Lewis: What kind of work do you feel drawn to do? What gives you the greatest energy and excitement as you think about your future? What do you really want to do, and how does that differ from what you feel you should do? Twenty years from now, what would you like to say you’ve accomplished? (And the best last question is always: What other ideas come to mind as you think about this?)

Angela Passarelli, a professor at the College of Charleston, has compared the outcomes of a coaching experience centered on this vision of a positive future with those of coaching that instead

Experience

focused on career advancement and encouraged people to work through their current problems. She discovered that participants who experienced the first kind of coaching felt happier, expressed higher aspirations, were willing to exert significantly more effort in pursuing their goals, and found more joy in doing so.

We advise everyone we coach to cap off the ideal-self discussions we've had—typically they involve multiple conversations—by crafting a personal vision statement. (Dewitt Jones, a prominent corporate trainer, goes so far as to ask that it be boiled down into a short phrase of six or so words and then memorized and repeated as a daily mantra.) This practice keeps people focused on their desire to change, rather than their obligation to. Milley's personal vision statement was "Live freely, in good health, with integrity, in a future filled with love and hope." Lewis's was "Enjoy the freedom to travel the world, meet interesting people, and pursue an exciting, passion-filled life of learning."

Next, you want to guide the person you're coaching toward an accurate assessment of his or her real self. This is not just about listing strengths and weaknesses. And it certainly doesn't involve highlighting places where the person needs improvement. Babson professor Scott Taylor, who has studied self-awareness for decades, suggests that it has two components: what people know about themselves, and their understanding of how others experience and think of them. The point here is to identify the areas where your coachee's perceptions differ from those of others and, even more critically, where his or her ideal self and real self are aligned or not.



Formal or informal 360-degree feedback can be useful here. So can additional nonleading, nonjudgmental questions, especially ones that focus on the person's best qualities and how they can be leveraged. Even when discussing areas for development, it's important to keep those being coached in that positive emotional state. As Andrew Carnegie reportedly once said, "Men are developed the same way that gold is mined. When gold is mined, several tons of dirt must be moved to get an ounce of gold, but one doesn't go into the mine looking for dirt—one goes in looking for gold."

We recommend capturing this work in a "personal balance sheet." In devising it people should consider not only their current strengths and weaknesses but also their most distinctive qualities and enduring characteristics—their traits, habits, and competencies that have held steady over time. This enables them to clarify both what is going well and what might need to change relative to their long-term vision. Milley recognized

that while she excelled at maintaining her composure in difficult times and reading power dynamics throughout the organization, she wasn't adequately demonstrating the care and empathy for others that she genuinely felt. Lewis realized that his strong suit was being a visionary and adapting easily to diverse environments—and that he didn't want to continue subordinating his own dreams to perceived obligations and the expectations of others.

Next comes the learning agenda. How, exactly, will the individual you're coaching move from point A to point B? Again, we advocate for a focus on existing strengths, passions, and values. Ask how the knowledge, skills, and traits the person already possesses can be used to close any relevant gaps, and what behavioral change he or she is most excited to try.

The learning agenda is not a performance improvement plan designed to address shortcomings; those feel like work and inhibit the development



A big part of a coach's job is to help people experiment with new behaviors, test different tactics, and then practice and perfect those that prove most effective.

process. The idea is to leave people feeling energized and empowered to improve. Milley decided that she wanted to be more of a coach and less of a commander and become more emotionally aware and mindful of others. Lewis's priorities included more fully integrating his personal passions with his professional goals, developing stronger relationships with key people within and outside the business, and making time to reflect on what was most important to him in life. That included activities like hiking, martial arts, and other sports; work with youth groups; meals and get-togethers with friends, family, and coworkers; and occasional extended breaks away from home and the office.

SEE THINGS THROUGH

Change efforts of any kind require time and energy. Even the best-laid plans sometimes fail or take a while to pan out. Research by Philippa Lally and her colleagues at University College London found that it takes 18 to 254 days to form a new habit. Skill building, relationship management, and career change require even greater commitments, with many stops and starts.

So a big part of a coach's job is to keep people progressing in the right direction—experimenting with new behaviors, testing different tactics, and then practicing and perfecting those that prove most effective.

Focused on her learning goals, Milley met regularly with her coach to review progress. She worked to shift out of her always-busy problem-solver mode and into being more approachable, kind, and playful with her team. She committed

to spending more time with her direct reports in an effort to better understand their experiences and soon established more-authentic relationships.

Lewis and his coach also continued to check in periodically to review his progress and discuss certain unreconciled issues. But it took an extended vacation abroad—that is, the time for deep reflection Lewis had deeply desired—for things to finally click. Not long after it, he left the family business and started his own successful company.

The business of learning, growth, and changing one's identity and habits is not a solo act. It's so challenging that the people you coach will need continued support not only from you but also from an extended circle of others. Kathy Kram, a professor emeritus at Boston University's Questrom School of Business, and Monica Higgins of Harvard University's Graduate School of Education call this circle "a developmental network." We recommend that coachees create a personal board of advisers made up of role models for the types of behaviors they aspire to. The idea is to identify a group of people who have a stake in an individual's ultimate success and can serve as sources of inspiration and sometimes even accountability.

If you're a team leader, peer coaching is another powerful option. If you train others in the intentional change framework, they can serve as compassionate catalysts, seeing their colleagues through the transformation they've started and perhaps even helping them identify and embark on the next one. We've found that one-on-one peer relationships work well, but so do small groups of five to 12 peers.

When Carlos De Barnola, then the director of HR for the Iberian division of Covidien, brought peer coaching to his company, he asked each person to pair up with one teammate and talk, with one of the three of us in the room to help facilitate the conversation. Very quickly, people began to show more concern, ask good questions, and build real, trusting relationships. After a while, Barnola told these pairs to find another pair. They formed quartets, and soon we, the professionals, were able to withdraw entirely while the coaching continued.

IF YOU'RE A manager, your most important job is to help those around you reach their greatest potential. Having been coached themselves, Karen Milley and Ray Lewis now bring what they've learned to their teams. "Today I give people permission to have two or three scenarios of a possible future, and I assure them that we'll figure out the path that's best for them," Milley says. "I'm seeing that compassion with each other leads to compassion with customers, constituents, and all others, which creates performance."

We agree: When you coach with compassion, it becomes contagious. ☺

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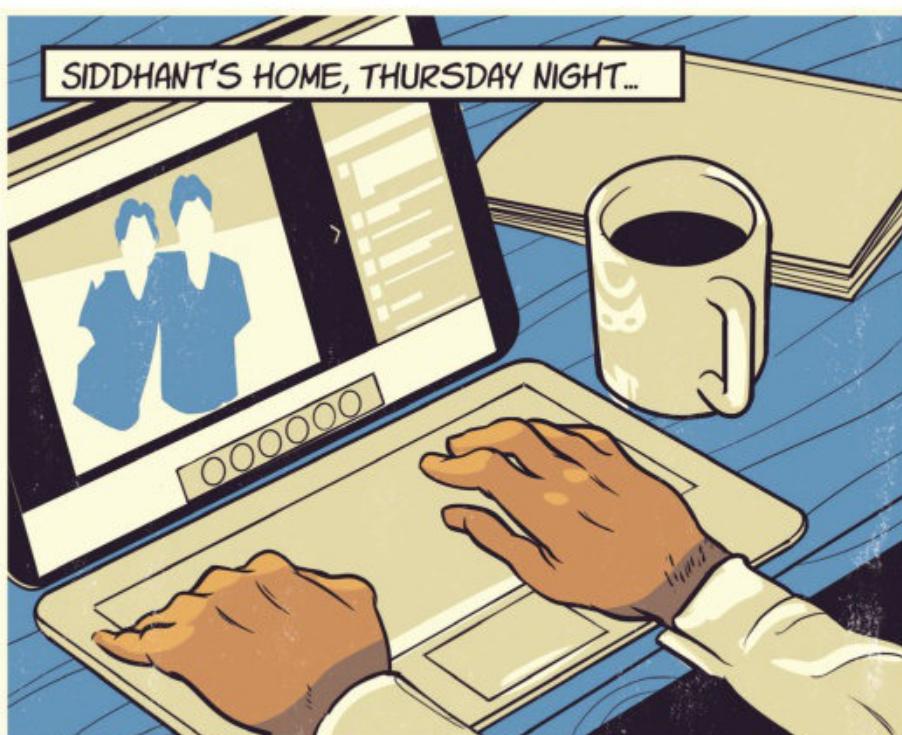


SIDDHANT, CEO

SHRADDA, SALES MANAGER

UDAY, SALES REP

BHAVNA, HR



CASE STUDY Your Star Salesperson Lied. Should He Get a Second Chance?

by Sandeep Puri

SIDDHANT'S HOME, THURSDAY NIGHT

Siddhant Kapoor rarely checked Facebook.

As CEO of one of the largest pharmaceutical-marketing firms in Western India, he didn't have time for social media. But right now, he needed to log on.

He searched for the doctor's name—Parasaran Srinivasan—and recognized the first picture that popped up. Just as he'd thought, they'd gone to university together in Mumbai.

Looking at his old classmate's page, he groaned. The pictures of Parasaran at a recent World Cup party confirmed that one of Novacib Labs' top salespeople had falsified his sales report.

Now he had to decide what to do about it.

NOVACIB HQ, THAT MORNING

SURPRISING NEWS

Everyone at Novacib knew Siddhant hated getting emails with that little red exclamation mark. So when he saw both the red mark and the word "URGENT" in his in-box, his stomach dropped. The email was from Shraddha Pillai, Novacib's regional sales manager in the Mumbai office. She'd kept her message short:

"Need your advice on a potential ethical breach."

Siddhant canceled his next meeting and called her mobile.

"Tell me what's going on," he said when she picked up.

"I'm afraid we have an issue with one of our sales reports," Shraddha said carefully.

"What kind of issue?"

"It seems that Uday may have intentionally falsified some information about his customer calls."

"Uday?" Siddhant made no attempt to hide his surprise. Uday Madhav was one of Novacib's best salespeople. He routinely exceeded his targets by 10% to 20% and had earned the company's top commission prize three times in the past five years. And he was a generous colleague. He often took new salespeople under his wing, sharing sales tactics and handing off easy customers.

There was no doubt that the company's targets were ambitious.¹ Sales reps were required to meet with a minimum of 10 physicians and four retail pharmacies a day, allocating that time according to the potential of the target: 50% to platinum-class customers, 30% to gold, and 20% to silver. The regional sales managers worked closely with the reps to coach and support them—but Uday rarely needed Shraddha's help. In fact, he often served as a mentor to his more junior colleagues.

"Could there be some mistake?" Siddhant asked.

"It's possible. But I know how seriously you take ethical issues. I wanted to bring this to your attention right away."

Five years earlier, when Siddhant had taken the helm at Novacib Labs, its founder and outgoing CEO had given him a mandate: grow the company by 40% and ensure that it remains the market leader. New competitors were popping up every day, vying to capitalize on the explosive growth in the Indian

HBR's fictionalized case studies present problems faced by leaders in real companies and offer solutions from experts.

pharma industry.² Siddhant knew that to accomplish his goals, he needed to be laser-focused on strategy. And by all accounts, he'd been successful. During his tenure, the company's portfolio had grown from 22 brands to 46, and from 10 sales territories to most of Western India.

That success, he believed, rested on Novacib's new positioning—to customers and employees—as "the ethical pharmaceutical-marketing company." Amid growing concerns that similar firms were bribing customers or overstating products' benefits, this stance distinguished Novacib.³ Siddhant and his leadership team had even changed the firm's tagline from "Health for everyone" to "Health with integrity." Behaving ethically became part of Novacib's story, and all employees were encouraged to share it, especially during sales calls. And the tagline was more than a marketing slogan to Siddhant. He'd always prided himself on leading a principled life.

Shraddha was absolutely right that he would be concerned about false reports. To protect its reputation, Novacib had a zero-tolerance policy for ethics violations. But would sacking Uday really be in the best interest of the firm, Siddhant couldn't help but wonder? He had always made or exceeded his numbers—and boosted the performance of his colleagues as well.

"Siddhant?" Shraddha asked.

"I'm still here," he said. "Tell me exactly what happened."

"SOMETHING DOESN'T FEEL RIGHT"

Shraddha recounted what she'd discovered the evening before.

"I was leaving the office last night," she began, "when I got a text from Uday that said, *Baby still sick. Need to give wife a reprieve. I'll make up the visits next week.* Of course, I felt for him. I'd been in his shoes. The baby is just a few weeks old, and neither he nor his wife have slept much. He's still been hitting his quotas, but he looks exhausted.

"I decided to stay at the office to finish up my reports in case I had to cover his sales calls. And as I was looking over his activity, one date stood out: June 21. That was the day Argentina lost to Croatia in the World Cup.

"I remember it well, because I had followed the match online. Dates don't typically stick in my mind, but that day was depressingly memorable, not just because my team lost but also because I watched the game by myself. My family—like most of Mumbai—had skipped work to watch together. I hadn't wanted to get behind, so I spent the day alone in the office.

"I had spoken with Uday the morning of the game, and he mentioned that he was going to watch it. And yet his daily report listed the names of three doctors that he supposedly saw that



Case Study Classroom Notes

1. Research from the University of Arizona shows that sales goals can cause tunnel vision, leading people to make unethical choices to achieve their targets.

2. From 2007 to 2012 the Indian pharmaceutical industry grew at a compounded annual growth rate of 15%. The rate then slowed for several years but was back up to 9.4% in 2018.

3. Harvard Business School professor Stephen A. Gheyser advises that brand identities be straightforward, authentic, and timeless.

Experience



4. Should Shraddha have kept a closer eye on her top performer?

5. What are the ethical implications of checking up on employees by tracking their activity on social media?

6. Numerous studies show that people have an ethical "blind spot" when it comes to their own behavior.

afternoon. I texted him about the discrepancy—something like *Sorry to bother you with baby sick. Can you resend your activity report for the week of June 18?*

Ten minutes later he emailed me the same information, so I texted again: *Are you sure that's accurate?* He sent back a thumbs-up emoji."

She paused. "Go on," Siddhant said grimly.

"I'm not in the habit of tracking our salespeople's whereabouts, especially in the case of Uday, who has always been a star performer.⁴ Normally, I'd give him the benefit of the doubt, but something didn't feel right. I looked him up on Twitter⁵ and scrolled back to his tweets from June 21. He'd clearly been watching the game—at home. Then I tried one of the doctors on Uday's report. Same thing: He'd been watching the game, too, not meeting with Uday. That's when I started to panic."

Siddhant was starting to panic as well. Trust was essential to the company's mission, and Uday's actions were exactly the kind of thing that could undercut Novacib's culture and reputation and breed resentment among employees. Siddhant recognized that Novacib was bound to encounter less-than-honest salespeople, but he was still having trouble believing that Uday would be the one to get into trouble first. At the same time, there was no denying his outsize contribution to the success of the firm—and how hard it would be to replace him.

Shocked and angry, Siddhant wondered to himself, *How could Uday have done this?*

NOVACIB HQ, FRIDAY MORNING

NOW WHAT?

The next day, Siddhant met with Bhavna Batra, Novacib's HR

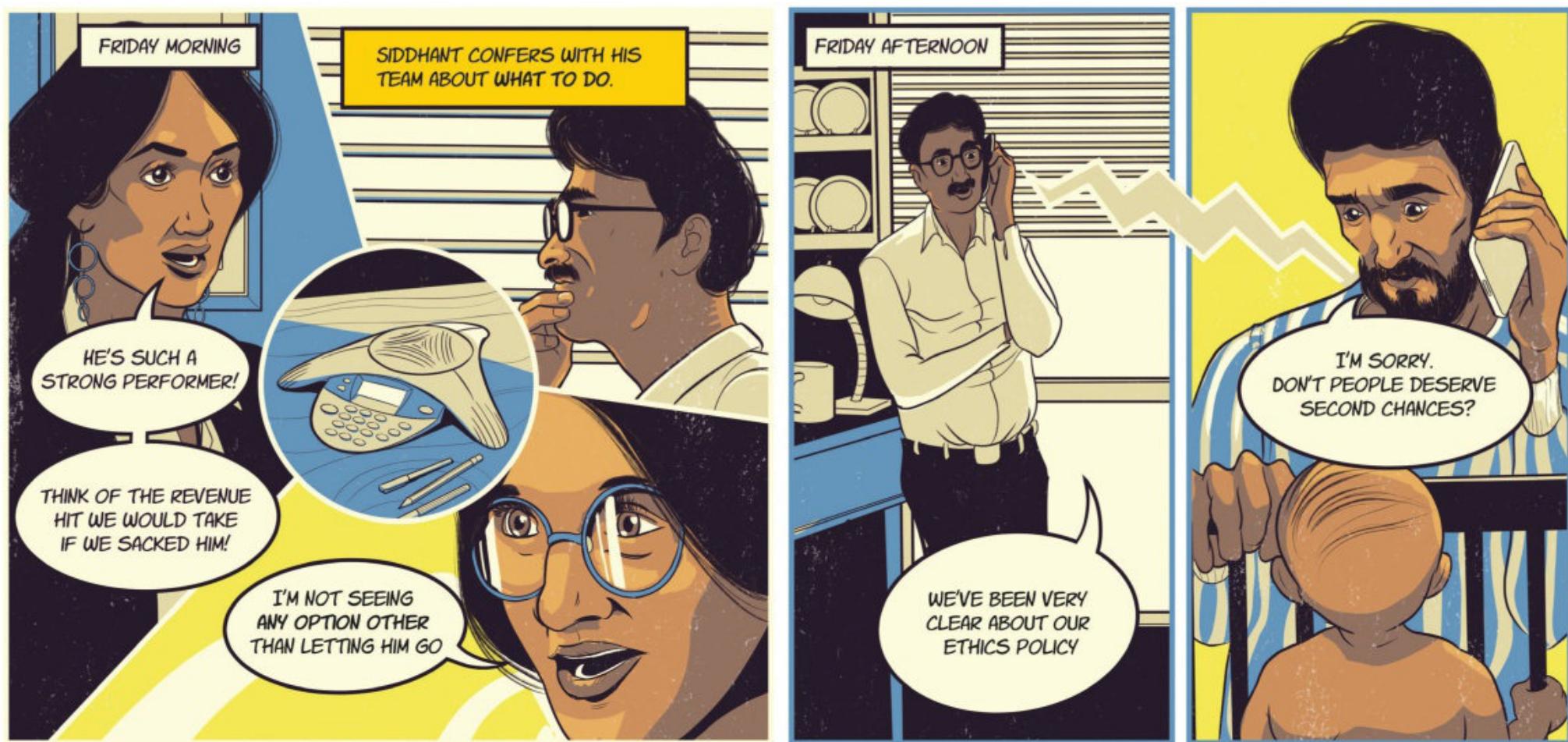
director, in his office. They dialed in Shraddha on speakerphone.

"This is bad," Siddhant began. "Last night, I confirmed another doctor listed on the report whom Uday couldn't have met with that afternoon."

"Shraddha and I had a conference call with him after she spoke with you," Bhavna said. "We asked him about the report, and he said he *had* met with the doctors he listed—but not on June 21. He all but admitted that he lied. I'm not seeing any option other than letting him go."

"I don't understand why he didn't tell anyone he was struggling," said Siddhant. "He's the first one to help his colleagues out; people would have jumped at the chance to return the favor."

"It's definitely out of character for him," Shraddha. "That's why I feel strongly that we should issue a warning—especially with his being a new father. After all, he



did meet with everyone he said he had. He wasn't fabricating that.”⁶

“But he was altering the dates to meet his daily targets,” Bhavna countered, leaning toward the speakerphone. “That’s a serious breach, and we have to consider the broader impact of merely giving him a slap on the wrist.”

She looked up at Siddhant. “When you brought me in after the rebranding, you asked me to help you build a culture of ethics and honesty. I’d be failing at my job if I advised you to let a transgression like this go. I recognize the value of Uday to our team, but our motto isn’t ‘Health with occasional integrity.’ We have to *always* do the right thing.”⁷

“I agree,” Siddhant said. “Integrity is our promise to every employee and every customer we interact with. If our people knew we tolerated this behavior after all the ethics training we’ve put them through, we’d look like

hypocrites. We’d *be* hypocrites. And if this ever got out to our customers or the press, it could destroy our reputation.”

“But how are we going to look to the rest of the team when we sack their beloved colleague with a newborn at home?” Shraddha asked. “And he’s such a strong performer! Think of the revenue hit we’d take. Are people actually going to care about three names listed for the wrong day on one weekly report?⁸ It’s not as if those call targets are tied to his compensation.”

“It’s the principle of the thing,” Bhavna retorted. “And how do we know if this is the first time he’s fudged his reports? How can we trust him going forward? Are you going to check with his customers every week to confirm his reports?”

Shraddha was silent on the line. Siddhant closed his eyes briefly. He knew she was right that the company would suffer

if they fired Uday. He brought in over \$250,000 a year, and he had built strong customer relationships that Novacib stood to lose if they sacked him.⁹ But Siddhant couldn’t shake his disappointment in Uday. Bhavna broke the silence.

“You’ve addressed this issue repeatedly in our sales offsites,” she said. “You’ve stated in no uncertain terms that you’d rather salespeople not meet their targets than fake their numbers. If you don’t take action, you’ll damage your credibility. I know it’s painful, but I think it’s time to put your money where your mouth is.”

NOVACIB HQ, FRIDAY AFTERNOON

A SECOND CHANCE?

“Thank you so much for the baby gift. Did you get the thank-you note my wife sent?” Uday’s voice sounded tentative on the phone, the small talk forced.



7. How often do zero-tolerance policies result in bad outcomes? Do they force leaders to take action when a better solution could be found?

8. Small offenses may seem harmless, but research shows that they can breed problems by desensitizing our brains to the negative emotions related to unethical behavior.

9. What options should Siddhant consider besides firing Uday or overlooking the infraction?

Siddhant had dreaded making the call, but before he reached a decision, he wanted to talk with Uday himself.

"I did. Listen, Uday, I don't want to make this any more awkward than it needs to be. I just want to hear your side of the story."

Uday repeated what he'd told Shraddha: that he had met with those doctors, just on different dates. That he shouldn't have submitted the false report. "I made a big mistake, and I'm sorry. I was feeling the pressure with the new baby. I knew I wasn't going to hit my targets, and I didn't want to disappoint anyone."

Siddhant hated to hear Uday sound so dejected. But part of him still felt betrayed. He reminded himself that Uday could easily find another job, especially since Novacib had no intention of going public with the circumstances if they let him go. But Uday would be devastated nonetheless. "We need accurate data to grow this business, and we've been very clear about our ethics policy," Siddhant said. "I wish you'd talked to Shraddha about the pressure."

"I know, and I'd understand if you have to make an example of me. But please believe me that it has never happened before and won't happen again. Don't people deserve a second chance?"

 **SANDEEP PURI** is an associate professor at the Asian Institute of Management, in the Philippines.



Should Siddhant fire Uday? THE EXPERTS RESPOND



FAIZA HUGHELL is the vice president of sales at RingCentral.

Unfortunately, leaders must sometimes fire employees who cheat.

In my 24 years of leading sales teams, I've seen plenty of people cheat to meet their targets. And I've had to fire people—even top performers like Uday—who were behaving dishonestly.

In this case, Siddhant and Shraddha appear to have fallen into a common trap: When someone is performing well, you don't always look under the

hood. I tell my sales managers that they need to "trust but verify." This means double-checking reports and looking into any outliers. In a previous company I worked at, I had a sales rep who was knocking it out of the park. He was compensated on "meaningful interactions" with customers, which meant long calls. His phone log showed steady activity, but I noticed that he'd been taking a lot of breaks. I went by his desk to check in with him. He wasn't there, but his phone was off the hook, and when I picked it up, I realized he had called roadside assistance and been on hold for close to two hours to boost his talk time. I let him go immediately even though it was hard to lose a high performer. That kind of blatant dishonesty can't be tolerated.

Siddhant's dilemma is complicated by Uday's family situation, but

Experience

it shouldn't be a consideration in his decision. I'm a mom, and my heart goes out to Uday, but a CEO's job is to protect the company. Siddhant can't let his emotions prevent him from doing his duty. That said, I would urge him to take a tempered approach and issue a formal written warning—not because it's best for Uday but because it's best for Novacib. There are two key factors he should take into account.

First, Uday's lie didn't affect his compensation. Had he earned a commission or bonus based on the false report, that would warrant termination. That is not the case here. Second, if Siddhant were to fire Uday, he might put the company at risk. Uday could pursue legal action, claiming that the company invaded his privacy by checking his social media accounts. A wrongful-termination lawsuit would damage the company's brand more than Uday's infraction could.

In my current role at RingCentral, I focus on building trust with our people. They know we have their backs, and we trust that they'll do what's in the best interest of the company. But I also do my homework. Even at my level, I block out an hour a week to look at the numbers, and if something stands out, I dig deeper.

Siddhant and Shraddha need to take a lesson from this as much as Uday does. You want to trust people and hope they'll do the right thing, but hope is not a management strategy.



MOHAMMED
ISAQUDDIN KURESHI is
the managing director
of Maha Research Labs.

Uday does deserve a second chance.

Siddhant shouldn't tolerate unethical behavior, but because Uday has acknowledged his wrongdoing and is

an excellent performer, I think there is room for a compromise: a strong warning and the understanding that any more missteps—even minor ones—will be cause for dismissal.

This case is based on my experience at Maha Research Labs, where an employee deliberately included misinformation on a sales report. At the time, I was torn about how to handle the situation. He was one of our top performers and was about to have his first child. I knew firing him would have a devastating effect on his personal life.

To better inform my decision, I called a meeting with seven regional managers and two managers from HR. I presented the case as a hypothetical and asked them what they would do.

Four of the nine said that they would sack the person with three months' severance. They felt it was essential to demonstrate that the company took ethical violations seriously. They worried that keeping the person despite the infraction would set the wrong precedent and leave the door open for this salesperson—or others—to behave unethically.

The other five managers were concerned about the impact on the company of losing a top performer. They thought the best course of action would be to give him a warning and cancel his sales incentives for six months as a punishment. They suggested crafting a legal agreement stating that if he had any further infractions, he'd lose his job, his bonus, and his retirement benefits. They also wanted to take advantage of the opportunity to ask him to sign a two-year employment contract against the risk that he might join a competitor, taking his customer relationships with him.

In the end, I went with the majority, and we issued a punishment and a written warning. In a different situation, I might have fired the person, but here I followed my heart, and I think I made the right decision. He was very grateful for the second chance and appreciated our not making an example of him. He assured me that he would be loyal to Maha Research Labs and promised to repay our faith in him during this crucial time in his life. And his performance over the past year has proved his commitment. He achieved 107% of his targets—a growth of 19% over the previous year. He has consistently ranked among the top 10 performers, and I'm planning to promote him in January.

That was not an easy decision to make, and I feel for Siddhant. He should consider consulting with other managers in the company, without divulging details about the situation. They might bring new insights to bear, and when he makes a decision—in this or future cases—he'll have their buy-in.

Perhaps more important, Siddhant should reflect on whether he's doing all he can to encourage ethical behavior. Does he include an ethics statement in job offer letters and in the employee handbook? Could he hold further trainings on ethical sales practices? And could he ask Uday to lead those? There is no doubt that Uday violated trust here, and he has to take responsibility for his actions. But Siddhant also needs to do better at setting a high ethical standard and holding people to it. ☺

HBR Reprint R1905M

Reprint Case only R1905X

Reprint Commentary only R1905Z



SYNTHESIS

IN PRAISE OF BEING UNPRODUCTIVE

Finding the off switch in an always-on world

by JM Olejarz

ARE YOU PRODUCTIVE? Efficient? Useful? More to the point, are you productive, efficient, and useful *enough*? These are the kinds of questions that arise (naturally and terrifyingly) when technology makes it easy to stay online and connected 24/7. But all this connectivity brings two unfortunate side effects. First, the expectation that we will be available at all times—from bosses, friends, the media, you name it—has increased. Second, the concepts of productivity and efficiency have been redefined according to what our devices enable. If you *could* be working, a certain line of thinking goes, then you *should* be.

Yet being able to use technology as much as we want doesn't guarantee that we're using our time well. The devices we love are full of bright, colorful distractions, tempting us to scroll just a little further, to refresh again and again. (Let's not forget: Tech companies design their products to be addictive.) And the downsides of heavy technology use, studies show, are numerous: depression, loneliness, isolation, lower empathy, and even suicidal thoughts.

In her new book, *24/6*, Tiffany Shlain, the founder of the Webby Awards, lays out a plan for surviving our "always on" culture. Taking a cue from her Jewish heritage, she suggests a "tech Shabbat": one day a week without screens or devices.

For thousands of years Shabbat has prescribed that people set



"Screens both consumed most of my time and made me lose track of it."

—Tiffany Shlain, 24/6

aside time to rest and reflect. Shlain writes that her modern interpretation benefits our mental and physical health—and she has spent the past decade practicing it. Unplugging gives us more chances to enjoy hobbies and socialize, she says, but one of its greatest gifts is perspective. When we step away from technology on a regular basis, it becomes easier to consider whether we're using it wisely.

What else can you do to resist a digital world that demands your nonstop productivity? The artist Jenny Odell has an idea: nothing. In *How to Do Nothing*, her treatise on capitalism's tendency to equate "useful" with "can make money," she argues for the value of being useless. But the nothing she favors isn't about idleness or apathy. It's about reclaiming our time and putting it toward activities whose point isn't profit.

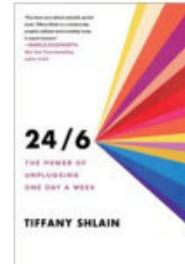
The danger of capitalist notions of value is that they're linked to economic output, a metric that misses, well, almost everything. To an algorithm, the worth of a conversation between two people might be insights into what they're likely to buy. To the two people, of course, the worth is the conversation itself. Odell contends that when our identities depend solely on what we contribute to a company's P&L statement, we're likely to end up losing who we really are.

Our sense of meaning, she writes, should instead come from our connections to the places in which we live and to the people,

plants, and animals we share them with. The digital world can't match the natural one as a source of purpose; a Saturday spent online won't make you happier, but a Saturday spent learning about local wildlife or building community in your town just might. That's why her "nothing" is anything but: Pulling back from what's efficient and profitable lets us focus on what's actually worthwhile.

Stillness Is the Key offers another take on why you should do more nothing. By the writer Ryan Holiday, it explores the virtues that helped famous figures achieve some of their greatest triumphs. John F. Kennedy (patience, solitude) resisted the urgings of advisers to pursue aggressive military action during the Cuban missile crisis, preferring to wait out the Soviets with a blockade. Napoleon (focus, prioritization) waited weeks to reply to letters, believing that most matters would resolve themselves and saving his attention for the truly important. Marina Abramović (being present) sat silent in a chair for 750 hours during her 2010 MoMA performance piece, making sustained eye contact and forming emotional connections with visitor after visitor. Holiday frames these stories as examples of "stillness," his term for the traits on display. Cultivating stillness, he says, gives us a better chance to succeed in our relentlessly kinetic world.

When I started writing this article, my editor asked me to try



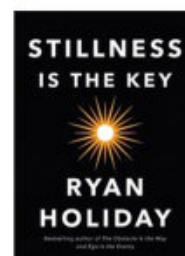
24/6: The Power of Unplugging One Day a Week

Tiffany Shlain
Gallery Books,
2019



How to Do Nothing: Resisting the Attention Economy

Jenny Odell
Melville House,
2019



Stillness Is the Key

Ryan Holiday
Portfolio,
2019

my own experiment of unplugging for 24 hours. I agreed, but honestly, I was skeptical. I've spent the past few years weaning myself off social media. I keep my phone on Do Not Disturb at work. I don't check email on weekends. I read 26 books last year. Did I really need a tech Shabbat, a day to be still and do nothing?

As it turns out, yes. My smartphone once excited me because of all the things it could do; now its absence did because of all the things I *couldn't* do. It won't surprise you to learn that my day was pretty analog: I meditated, listened to records, repotted a plant, went for a walk. What surprised me was that taking a break from screens brought an almost magical sense of being more in control of my time. Staring at people around me (most of whom were staring at their phones), I felt as though I was undercover, resisting the efficiency economy while in plain sight. I couldn't help thinking of the movie *Brazil*, that great satire on technology and the shadowy organizations that oversee our every move and what it takes to break free of them.

Even for a digital curmudgeon like me, being "unproductive" felt like a small revolution—and that's after only one day of it. I can't wait to discover what a decade of tech Shabbats feels like. ☺

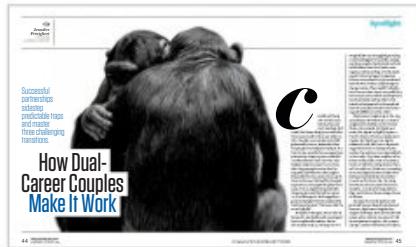
 **JM OLEJARZ** is an assistant editor at HBR.

Executive Summaries September–October 2019

SPOTLIGHT

Power Couples

When both members of a couple are focused on their careers, their personal and professional lives can become deeply intertwined. That creates unique challenges—and advantages as well. | page 43



How Dual-Career Couples Make It Work

Jennifer Petriglieri | page 44

In her study of more than 100 couples around the globe, the author found that dual-career couples tend to go through three transitions when they are particularly vulnerable: when they first learn to work together as a couple; when they go through a midcareer or a midlife reinvention; and as they reach the final stages of their careers. Those who communicate at each transition about deeper work and personal issues such as values, boundaries, and fears have a better chance of emerging stronger from each one, fulfilled both in their relationships and in their careers.



One Couple's Perspective

page 53

Tamar Dane Dor-Ner, a managing partner at Bain, and her husband, Dan Krockmalnic, general counsel for the *Boston Globe*, talk in a Q&A with HBR editors about how they support each other, how they divide child care and other domestic responsibilities, the benefits each realizes from the other's job, and what challenges the future might hold.



The Spouse Factor

Jane Stevenson | page 55

When the author, a professional recruiter with Korn Ferry, speaks with candidates about potential job opportunities, one of the first questions she asks is whether there's anything in their family situation that she should know about—meaning, Will the family make a candidate reluctant to relocate for a new job? Here she describes how candidates' spouses who have their own demanding careers can be a factor in job searches, how she approaches this challenge, and how she has managed the trade-offs in her own dual-career marriage.



Living Apart for Work

A conversation with Danielle Lindemann | page 58

In an interview with HBR executive editor Ania Wieckowski, Lindemann, a sociologist at Lehigh University and the author of *Commuter Spouses*, describes the lifestyles of "commuter couples" who choose to live apart to further their careers. She highlights the factors that go into making that choice and some ways that couples deal with their separation: how they stay in touch, manage conflict, and reunite after time apart. She also discusses the personal as well as professional benefits of their living situation.

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HOW I DID IT

HOW I DID IT

IdeaWatch

THE CEO OF CANADA GOOSE ON CREATING A HOMEGROWN LUXURY BRAND

by Dani Reiss

Photograph by MARKIAN LOZOWCHUK

Editor's Note: It was the exact day in 2010 when I decided that Canada Goose, the small family business I'd recently taken over from my father, had to move all production to Canada. I was always making our signature parkas in China, but the cost of domestic labor had been

Editor's Note: The only one who had at the time, reading the morning newspaper headlines, and I saw that two North American apparel companies had moved their manufacturing abroad. These leaders gave me the confidence that it was necessary—a critical step toward fulfilling their potential and achieving their goals, both at work and at home. They still need support with this process. They still need a coach.

Harvard Business Review Management October 2010 37

The CEO of Canada Goose on Creating a Homegrown Luxury Brand

Dani Reiss | page 37

After working at his family's coat manufacturing company for a few years, the author realized that high-end coats made in Canada could become a luxury product globally. Targeting European consumers first, he introduced the brand and then marketed it in innovative ways, including outfitting polar explorers and TV and film crews who were shooting in remote cold-weather locations. Perhaps most important, he committed to domestic manufacturing and opened factories across Canada along with training centers for sewers. This paved the way for phenomenal growth and a successful IPO.

Today the company has stores in 12 cities around the world and runs an international e-commerce business. Its focus on delivering an exceptional experience inspired the creation of "cold rooms" in the stores where shoppers can test products in temperatures as low as -25 Celsius before they make a purchase.

As Canada Goose expands organically and through acquisition, Reiss says, the company will continue to make its coats in Canada and other products wherever it can get the highest-quality products at the scale it needs.

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MANAGING YOURSELF

Experience

Advice and Inspiration

MANAGING YOURSELF COACHING FOR CHANGE How to help employees reach their potential

by Richard Boyatzis, Melvin Smith, and Ellen Van Oosten

Illustrations by JANNE IVONEN

Harvard Business Review September/October 2010 151

Coaching for Change

Richard Boyatzis, Melvin Smith, and Ellen Van Oosten | page 151

Whether you're a boss, a colleague, or a friend, you can help the people around you make important life-enhancing changes. But the way to do that isn't by setting targets for them and fixing their problems; it's by coaching with compassion, an approach that involves focusing on their dreams and how they could achieve them. Instead of doling out advice, a good coach will ask exploratory, open-ended questions and listen with genuine care and concern. The idea is to have coachees envision an ideal self (who they wish to be and what they wish to do), explore the real self (not just the gaps they need to fill but the strengths that will help them do so), set a learning agenda, and then experiment with and practice new behaviors and roles. The coach is there to provide support as they strive to spot their learning opportunities, set the groundwork to achieve change, and then see things through.

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Features

PERFORMANCE MEASUREMENT



Don't Let Metrics Undermine Your Business

Michael Harris and Bill Tayler
page 62

Every day, at almost every company, strategy is being hijacked by numbers. Because strategy is abstract, employees often mentally replace it with the hard metrics meant to assess whether the organization is succeeding at it. This tendency is called *surrogation*, and it destroys a lot of value. Take Wells Fargo. Executives there decided to track cross-sales to customers to measure performance on the bank's strategy of building long-term customer relationships. The focus on cross-selling goals led employees to open 3.5 million accounts without customer consent, which, with brutal irony, severely damaged the long-term relationships the bank sought.

Though it's easy to fall into the surrogation snare, firms can take steps to avoid it. For instance, they can involve the people who'll implement a strategy in its formulation, so they'll be more likely to grasp it and less likely to replace it with a metric. Tying financial incentives to a metric is usually a *mistake*: It only increases the focus on the numbers. Using multiple yardsticks is very helpful, however; that highlights the fact that no single metric captures the strategy and makes people less apt to surrogate.

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STRATEGY



Put Purpose at the Core of Your Strategy

Thomas W. Malnight, Ivy Buche, and Charles Dhanaraj
page 70

Eight years ago, Malnight, Buche, and Dhanaraj launched a study of high growth in companies, looking at three strategies known to drive it: creating new markets, serving broader stakeholder needs, and rewriting the rules of the game. To their surprise, they discovered a fourth driver they hadn't considered at all: purpose.

Companies have long been building purpose into what they do, but usually it's seen as an add-on—as a way to, say, give back to the community. The high-growth companies in the study, in contrast, had made purpose central to their strategies, using it to redefine playing fields and reshape value propositions. The purpose of Mars Petcare, for instance—a better world for pets—guided its expansion from pet food into the larger ecosystem of pet health. The purpose of Securitas—contributing to a safer society—led the firm to redesign its offering to include not just physical guards but electronic services and predictive solutions.

This article explains how executives can develop and implement a purpose at their organizations. It also describes the benefits they're quite likely to see once they do: a more unified organization, more-motivated stakeholders, broader impact, and more profitable growth.

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PSYCHOLOGY



The Dangers of Categorical Thinking

Bart de Langhe and Philip Fernbach | page 80

Human beings are categorization machines, taking in voluminous amounts of messy data and then simplifying and structuring it. That's how we make sense of the world and communicate our ideas to others. But according to the authors, categorization comes so naturally to us that we often see categories where none exist. That warps our view of the world and harms our ability to make sound decisions—a phenomenon that should be of special concern to any business that relies on data collection and analysis for decision making. Categorical thinking, the authors argue, creates four dangerous consequences. When we categorize, we *compress* category members, treating them as more alike than they are; we *amplify* differences between members of different categories; we *discriminate*, favoring certain categories over others; and we *fossilize*, treating the categorical structure we've imposed as static. In the years ahead, companies will have to focus attention on how best to mitigate those consequences.

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INTERNATIONAL BUSINESS



Can China Avoid a Growth Crisis?

J. Stewart Black and Allen J. Morrison | page 94

In 2018, Fortune's Global 500 ranking included 111 firms headquartered in China—just a handful fewer than the United States' 126. In 1995, only three Chinese firms made the list; in 2018, three were in the top 10. No wonder some observers predict that China will soon overtake the U.S. as the home to the highest number of Global 500 firms.

It's entirely possible that this could happen, but the triumph may be fleeting. In the late 1990s, Japanese firms came close to outnumbering U.S. companies on the list, until a combination of a graying workforce and declining productivity caused them to slide back off. Japan's experience, which is similar to that of China today, provides an uncomfortable precedent for the consequences of a slowdown in domestic growth.

To keep their places on the Global 500, Chinese companies will have to develop a global mindset more characteristic of multinationals from small countries like Switzerland, a transformation that has to date eluded most Japanese businesses.

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GOVERNANCE

Back Channels in the Boardroom

Heidi K. Gardner and Randall S. Peterson | page 106

The agendas of company boards are so packed that it's hard to get to every question and concern during regular meetings. So between meetings, directors do what members of a team always do in this situation: They start having conversations on the side.

Conducted properly, side discussions allow directors to work together efficiently—to trade opinions, share information, and exert influence. But conducted improperly, they encourage political maneuvering, marginalize members with key expertise, foster inappropriate alliances, and lead to poor decisions. They shut out diverse input, and they make boards dysfunctional.

The authors started examining side conversations three years ago as part of a larger study of board dynamics. In this article they share what they've learned about how directors should approach them. High-functioning boards, for instance, set clear rules of engagement and regularly review whether they're following them. They create onboarding processes, help directors form personal relationships, and take measures to maintain trust—such as ensuring that every member is briefed on all relevant information before formal discussions restart.

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NEGOTIATIONS

A New Approach to Contracts

David Fydlinger, Oliver Hart, and Kate Vitasek | page 116

In an era when businesses increasingly have to depend on their suppliers to lower costs, improve quality, and drive innovation, traditional contracts don't work. They often undermine the partnerlike relationships and trust needed to cope with external uncertainty.

The remedy is to adopt a totally different kind of arrangement: a *formal relational contract* that creates a flexible framework designed to foster collaboration in complex strategic relationships over the long term. These contracts, which are legally enforceable, specify mutual goals and establish governance structures to keep the parties' expectations and interests aligned.

They are especially useful for complex purchasing arrangements, outsourcing, strategic alliances, joint ventures, franchises, public-private partnerships, large construction projects, and collective bargaining agreements.

Crafting a formal relational contract involves five steps: laying the foundation, cocreating a shared vision and objectives, adopting guiding principles, aligning expectations and interests, and creating systems for staying aligned.

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PLATFORM BUSINESSES

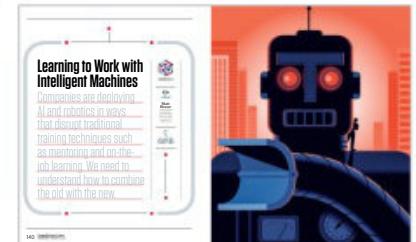
In the Ecosystem Economy, What's Your Strategy?

Michael G. Jacobides | page 128

In many contexts, the firm is no longer an independent strategic actor. Its success depends on collaboration with other firms in a designed ecosystem spanning multiple sectors. In these cases, traditional strategy frameworks are of little help. Instead, the author says, companies should focus on five questions:

- **Can you help other firms create value?** Success is as much about helping other firms innovate as it is about innovating yourself.
- **What role should you play?** You don't necessarily need to be the chief architect of your ecosystem; sometimes you're better off sharing the role or being a complementor.
- **What should the terms be?** There are two key governance choices: who can access the ecosystem, and how exclusively attached your partners must be.
- **Can your organization adapt?** Customers' needs and complementors' desire and ability to collaborate can shift dramatically, requiring changes in your allocation of resources.
- **How many ecosystems should you manage?** Some successful orchestrators head up multiple ecosystems—each covering a different part of the business, and each leading to a different path for expansion.

HBR Reprint R1905J

TECHNOLOGY

Learning to Work with Intelligent Machines

Matt Beane | page 140

Although companies spend billions on formal training for employees, most of the skills needed to perform a specific job can be learned only by doing it. This on-the-job learning (OJL) has long depended on mentorship, with experts coaching apprentices. But today OJL is under threat from the headlong introduction of sophisticated analytics, AI, and robotics into many aspects of work. These technologies are moving trainees away from learning opportunities and experts away from the action. The author describes the "deviant," rule-breaking work-arounds—"shadow learning"—that surgeons in training, police officers, M&A analysts, and others are figuring out on their own to overcome these obstacles and suggests how companies can benefit from studying them.

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"Repeating what you do everywhere is never a winning formula. We've thrived by trying new things."



DANIEL BOULUD

Born into a farming family in Lyon, France, Daniel Boulud knew at 14 that he wanted to be a chef. He trained as an apprentice, rose through the ranks of his home country's best restaurants, did a stint in Copenhagen, and then emigrated to New York City, where he was hired at the famed Le Cirque. In 1993 he struck out on his own and opened Daniel, spawning a culinary empire that now includes 16 ventures.

Interviewed by Alison Beard

HBR: Why did you opt out of the family business?

BOULUD: I had a lot of pleasure working there, cooking with my grandmother. We had goats, cows, ducks, chickens, rabbits, geese, and all sorts of vegetables. Everything on that table was 95% grown, raised, or made by us. But I would go with my father to the farmers market and meet wonderful people, including chefs coming to buy from his stall, and I liked the relationships. As the oldest boy, I was supposed to take over the farm, but that life is lonely. So I decided to cook, and family friends helped me into a restaurant.

What were the key lessons you took from the chefs you trained under?

Everyone brought me something. I worked with Georges Blanc when he was about 26 and taking over his mother's famous restaurant. I was only 17 or 18, and to see this young chef leading was inspiring. You could see the energy and willingness to make changes while respecting tradition. From Roger Vergé, I learned a real sense of hospitality. He embraced and elevated Provençal cuisine. He was demanding, but if you did well with him he was also fun—a happy man who made a lot of people happy. Michel Guérard was a poet. From him I got creativity and the need for perfection and complexity. I remember making a *salade gourmande* composed of three little salads: one with duck, one crayfish, and one foie gras and haricots verts. I once counted the ingredients and there were 35. We used tweezers before they were kitchen tools. But it was a symphony.

How do you balance artistic chef with businessman?

I have a good sense of the business, but I'm not alone in it. When I opened Daniel, my most important hire was a very good accountant. Marcel Doron became CFO; as we grew, he was a person I could trust, communicate with, and learn from. When you start, you also need a good restaurant manager; then, after you open two or three places, a director of operations. Eventually you create HR and PR and buying departments. I've seen so many talented chefs who couldn't figure out how to be in the black and so were never able to succeed. Maybe they didn't have the right people around them.

How do you find the right people?

The number one quality is trust. I need to know that the person is fully committed to excellence and has a certain discipline. Talent is also key, and in positions of responsibility, we want somebody well trained. We'll keep training them, but we want a good foundation. I also look for people with ambition and passion.

Do you still find time to cook?

I am at Daniel now. My role is maybe to cook but also to make sure that each team can produce and perform. I am connected with everything we do and close with everyone who works for me. We test dishes together. We talk about recipes. But if after 20 years you haven't given some power to others, something is wrong. My lead chefs are the decision makers. Of course, if I don't like something, they'll know.  **HBR Reprint R1905N**