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MARCH 2016

MARKETING IN THE AGE OF SOCIAL MEDIA

PAGE 40


BOTTEGA VENETA


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CHRIS GLOAG; TAMARA SHOPSIN; ANGUS GREIG


TO BREAK THE RULES, YOU MUST FIRST MASTER THEM.
THE VALLÉE DE JOUX. FOR MILLENNIA A HARSH, UNYIELDING ENVIRONMENT; AND SINCE 1875 THE HOME OF AUDEMARS PIGUET, IN THE VILLAGE OF LE BRASSUS. THE EARLY WATCHMAKERS WERE SHAPED HERE, IN AWE OF THE FORCE OF NATURE YET DRIVEN TO MASTER ITS MYSTERIES THROUGH THE COMPLEX MECHANICS OF THEIR CRAFT. STILL TODAY THIS PIONEERING SPIRIT INSPIRES US TO CONSTANTLY CHALLENGE THE CONVENTIONS OF FINE WATCHMAKING.
AUDEMARS PIGUET
AUTOMATIC
AUDEMARS PIGUET
Le Brassus
ROYAL OAK
CHRONOGRAPH
IN YELLOW GOLD

From the Editor
Making Start-Ups More Resilient

Being a start-up isn't easy. Sure, occasional "unicorns" such as Uber and Airbnb capture our imagination, raise huge amounts of money, and set a path for rapid growth. But most start-ups fail, even those with customers, cash, and a promising business model. In many cases they simply can't scale. And the standard response—bringing in "grown-ups" to professionalize the organization—usually doesn't work.

This month's Spotlight suggests better ways. In "Start-Ups That Last," Harvard Business School's Ranjay Gulati and coauthor Alicia DeSantola provide a framework for how start-ups can evolve. The goal isn't just to increase capacity and efficiency, but to adapt to complexity while seeking *different* opportunities for growth.

In "Reigniting Growth," Bain & Company partners Chris Zook and James Allen tackle what they call "stall-out"—a sudden plunge in revenue and profit growth that often hits as companies become larger and more complex. They show how revitalizing the "founder's mentality" can restart the engines of growth.

Rounding out the package, HBS's David Collis argues in "Lean Strategy" that strategy and entrepreneurship, often seen as polar opposites, in fact need each other. He urges companies to integrate the bottom-up workings of a lean start-up with the top-down orientation of strategic management.

None of these approaches guarantees survival, of course. But they should increase your odds of enduring success.

Adi Ignatius, Editor in Chief

JOHN VON PAMER

Contributors

As a teenager, **Ranjay Gulati** worked during summers for his family's business in India. It sold high-end women's fashion that featured ethnic colors and patterns before they became commonplace. He watched the business grow from five employees to more than 1,000 in a very short time and then come crashing down. Despite a solid business model and increasingly eager customers, the company had failed to scale up. So his article in this issue, "Start-Ups That Last" (page 54), is a very personal one.

In this issue's Spotlight (page 53) we feature the abstract paintings of **Margaret Neill**, who says she is "inspired by analogies to nature... weather, music, and sound waves." She sees her work as "a metaphysical exploration of real time space in response to velocity, momentum, and movement through deeply layered intersecting geometries."

Joshua Gans's interest in the economics of innovation dates back to the early 1990s, when the subject was essentially ignored. But it soon assumed a new prominence, thanks largely to two Harvard academics, Clay Christensen and Rebecca Henderson, who looked at the impact of new technologies on competition and whose work deeply informs Gans's own, including his article on page 78.

When **Adam Grant** was the publicity director for the Let's Go travel guides, he pitched an unusual proposal for product placement in a film to the board of directors, which decided to invest in another project instead. That project flopped—whereas the movie, *EuroTrip,* was a hit. Grant decided to figure out how leaders can spot potential in the unfamiliar. He now helps organizations build cultures in which new ideas can flourish—the topic of his article on page 86.

Erika Andersen has built a career helping other people learn how to be better leaders, managers, and strategic operators. Drawing on her experience as a consultant and coach and on research in neurology, sociology, and psychology, her article on page 98 describes four attributes executives need to turbocharge their development.

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Forward-thinking strategy and innovative technology. When the first is enabled by the second, your business is equipped with a competitive edge. Our unique approach helps you react quicker, scale easier and capitalize on rapidly emerging opportunities. With strategy enabled by technology, your business is positioned to adapt and grow — today and tomorrow. That's high performance, delivered.
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The Disruption Debate

HBR article by **Clayton M. Christensen, Michael Raynor,** and **Rory McDonald,** December

The theory of disruptive innovation has been a powerful tool for predicting which industry entrants would succeed. But the "disruptive" label has often been applied incorrectly, simply because a newcomer shakes up a market. In December, the theory's architect, Clay Christensen, and his coauthors tried to correct the misunderstanding. Readers, however, kept arguing for a broader classification:

According to the article, disruptive innovations originate only in low-end or new-market footholds. Zipcar, the company I cofounded, qualifies because it launched a market for cars rented by the hour. But the authors claim Uber is not disruptive because it neither offered a low-end service nor created a new market. Using that lens, I'd agree: Uber is basically a taxi service. But the authors failed to appreciate a third possibility for disruption: the leveraging of excess capacity. Uber helped people make use of their downtime and cars they already owned. Leveraging excess capacity is disruptive. Just ask hotels how they feel about Airbnb. Or TomTom about Waze. Or Western Union about TransferWise. These efforts are part of a new collaboration in which platforms harness excess capacity and invite peers to help fulfill service delivery.
Robin Chase, cofounder, Zipcar and Veniam; author, *Peers Inc*

Christensen made a seminal contribution to management strategy when he introduced the concept of disruptive innovation. But he and his coauthors have perhaps lost sight of the benefit of their core contributions and are defending their limited definition with a tenuous argument. In our perhaps less academically pure but more practical experience, we have come to define disruptive innovation somewhat more comprehensively: as discontinuously changing the business definition, the customer value proposition, and the structure and cost of the value chain. We are less worried about how these changes are introduced. We regard any introductory niche as acceptable, even a broadly based assault. We respectfully believe that a more expansive view of allowable entry characteristics would provide greater insight.
Bill Achtmeyer, founder and senior managing director, Parthenon-EY

The authors respond: *Our position is that understanding the processes by which innovations achieve material market impact is key to managing innovation effectively. We'd argue that there's merit in reserving the label "disruptive innovation" for a specific pathway to success. This does not preclude—and indeed, it encourages—understanding other pathways.*

I'd argue that Uber can be described as disruptive. But it's disrupting the auto industry, not taxis. It wants to end car ownership by making it cheaper and easier to summon a car via an app than to buy and maintain one. Uber began as an inferior alternative to owning a car; its service wasn't always available when you needed it. However, it's now cheaper than owning a car.
James Lewis, head of product, DigitalBridge

The authors respond: *Excellent point. Uber might well be disruptive to some other incumbent. This is why "X is [or is not] disruptive" is an incomplete statement; to make it precise enough to be useful, it might be better as "X is [or is not] on a disruptive path with respect*

RECENTLY TRENDING ON HBR.ORG

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to Y incumbent or industry." Whether Uber is on a path to disrupting car ownership is a question worth exploring.

This article seems to ignore Uber's origins as a car service. One of its founders explicitly said he wanted his own car and driver but didn't want to pay for one and found existing car services to be a hassle; it was a pain to make several bookings a day. So Uber actually was a low-end disrupter of traditional livery services.
Scott Kirsner, cofounder, Innovation Leader

The authors respond: *This is also a good point and a reminder that disruption is relative. In our article we did note that the limousine or "black car" business is a different story from the taxi business, and here Uber is more likely to be on a disruptive path.*

I disagree with another example, Netflix. Netflix initially offered a product for the low end but hasn't moved up. All its streaming service has done is make a cheap, accessible product cheaper and more accessible. It hasn't offered Blockbuster's high-end product of new movies. But another company, Redbox, has found a way to provide new releases cheaply and more efficiently. Blockbuster is a story not of disruption but of two companies that through sustaining innovations were able to each steal one of the incumbent's primary customer segments. Netflix stole the low end and Redbox the high end.
Ben Hansen, data analyst, Nautilus Insurance Group

The authors respond: *This highlights an important distinction about disruptive innovation: New entrants do not need to catch up entirely to the offerings of incumbents to disrupt them; entrants must only meet the needs of enough of the mainstream market to steal a sufficient chunk of customers. It seems to us that Netflix has easily done well enough to justify the "disrupter" label.*

Interaction

Rules for Negotiating Across Cultures

HBR article by **Erin Meyer,** December

To be effective, a negotiator must recognize subtle messages being sent across the table. In international interactions, however, it's much harder to interpret unspoken signals. Meyer identifies some helpful rules of thumb, such as adapt the way you express disagreement.

If I'm driving my business by adding value for my clients, I should not have a problem negotiating with anyone, regardless of nationality. For example, a football coach as effective as Vince Lombardi would not have a problem mentoring and motivating players from different cultural backgrounds. If you make the persistent pursuit of any goal itself the culture, the actual cultural differences should not matter.

Chris M. Jayachandran, director, sales and business development, Vknotec

A coach is dealing with people who all represent the same entity—their team—so their goals are easier to align. When you're negotiating with other businesses, cultural differences seem exacerbated, and goals may not be aligned.

Michael A. Massetti, executive partner, supply chain, Gartner

Additional complexity arises (mostly in multinational companies) when a team consists of many culture-oriented individuals who are dealing with a more homogeneous group. In my experience in the Middle East, after a lot of misfires, we held rehearsal meetings within the multicultural group prior to actual meetings in order to avoid pitfalls.

Dinesh Jain, founder and CEO, IndianMaze Consulting

Meyer responds: *This type of situation is so common in countries like the UAE, which are some of the most culturally complicated!*

The chart comparing the countries' approach to conflict and emotional expression was interesting. I've always thought that the Italians and Japanese might have cultural differences that would make doing business together difficult.

Tony Reiss, founding principal, Sherwood PSF Consulting

Meyer responds: *On that chart the Italians and Japanese are very far apart, but on some other dimensions, they're not so different. For example, both Italians and Japanese put a lot of value on emotional trust.*

HBR SURVEY

How curious are our readers?
A recent assessment shows that:

When it comes to new experiences

12%	play it safe
41%	adapt to new situations
47%	seek new experiences and relationships

When it comes to conventionality

7%	are traditional thinkers
19%	are flexible thinkers
74%	are unconventional thinkers

SOURCE "ASSESSMENT: WHAT'S YOUR CURIOSITY PROFILE?" BY TOMAS CHAMORRO-PREMUZIC

Control the Negotiation Before It Begins

HBR article by **Deepak Malhotra,** December

Some of the costliest negotiation mistakes take place before people even sit down at the bargaining table. Malhotra argues that factors relating to process, relationships, and expectations can have a big impact on deal outcomes and provides guidance on how to manage them.

Negotiations can be one of the most stressful aspects of business. Going in with these tips and a plan can significantly reduce that stress, helping you maintain control (even if it's only over yourself). Here are some additional tips that I've found helpful:

1. Try to foresee the outcomes of different offers. This will help you think through (from your counterpart's perspective) what is and isn't important and to prepare to respond to counteroffers.

2. Keep a negotiation notebook. This will allow you to track the progress of the negotiation and give you the means to reflect on how things are going. At the end you can spend a bit more time learning from your mistakes and your counterpart's, and be in a position to negotiate more powerfully in the future.

Michael Mehlberg, founder, Modern da Vinci

CORRECTION

In "The Overvaluation Trap" in our December issue, we misstated the date when Lehman Brothers filed for bankruptcy. The correct date was September 2008. HBR regrets the error.

Idea Watch

Compiled by HBR editors

The power of quick wit page 28

ANGUS GREIG

If managers think about **“ideal” employees** before considering actual applicants, they may unintentionally discriminate against minorities.

“NARROW IMAGINATIONS: HOW IMAGINING IDEAL EMPLOYEES CAN INCREASE RACIAL BIAS,” BY JAZMIN L. BROWN-IANNUZZI, B. KEITH PAYNE, AND SOPHIE TRAWALTER

MARKETING
WINNING BACK LOST CUSTOMERS

How to target and appeal to the most likely returnees

For any service company that bills on a recurring basis, a key variable is the rate of churn: How many customers cancel? In many competitive industries, churn can be substantial—some wireless carriers, for instance, lose 3% of subscribers each month. (Other businesses plagued by churn include insurance companies, gyms, and online streaming services.) Companies with high churn typically spend vast sums on marketing to try to replace all those defectors. New research shows that they might be better served by smart strategies aimed at getting lost customers to come back to the fold.

V. Kumar, a marketing professor at Georgia State University who studies “win back” strategies, cites three reasons companies should focus more energy on lapsed customers. First, these people have demonstrated a need for the service, making them far better prospects than random names on a cold-call list. Second, they are familiar with the company, eliminating the need to create brand awareness and educate them about the offering and thus reducing the cost of marketing to them. Third and most important, recent technology, particularly more-sophisticated customer databases, allows companies to draw on information about how people used their service the first time around to craft more-successful win-back offers and to identify and go after the most profitable defectors.

Kumar and two colleagues studied data on more than 53,000 customers who left a telecom company over a seven-year period. To help focus the firm’s ongoing efforts to win such people back, they examined how each lost customer behaved before canceling, why each canceled (many companies ask departing customers this question), how each responded to various win-back offers, and how profitable each one who signed on again subsequently became. As they parsed the data, they sought to answer four questions.

How likely is a given customer to come back? Many companies try to regain every lost customer, but this can sap marketing dollars; firms will be more efficient if they focus on people whose prior behavior suggests a predisposition to return. The researchers found that customers who have referred others, who have never complained, or who have had complaints that were satisfactorily resolved are the best bets. Reasons for leaving are also predictive: Customers who canceled because of price are more likely to come back than those who left because of poor service, and people who cited both reasons for quitting are the least likely of all to return.

Kumar visited telecom companies around the world to explore their win-back strategies and found that many are experimenting with “propensity models” like this one. But few are investigating which customers would be most valuable to win back—the issue addressed by the following questions.

How long will a reacquired customer stay, and how much will he or she spend? There’s little point in wooing back someone who will depart again a few months later, so it’s useful to predict how long a returnee will stay on board. The researchers expected that consumers who bolted once would depart quickly during their second stint. In fact they generally stayed longer, and customers who defected because of price—behavior suggestive of fickle deal seekers—stayed the longest of all. Second-time customers in the study had an average lifetime value of $1,410, versus just $1,262 during their initial run with the service—highlighting an important upside of win-back strategies.

Which people should get which offers? Many firms have one-size-fits-all incentives. The telecom firm targeted 40,000 lapsed customers whose prior behavior indicated they were likely to return and, with help from the researchers, tested four inducements on them. One group was offered a discount. One could get a service upgrade, such as a free premium cable channel. One could get a discount *and* an upgrade. And members of one received offers tailored to their reasons for leaving—a customer who defected because of

Pitching the Right Offer

A telecom firm tested four win-back offers with 40,000 customers, looking not only at which offer lured back the most people but also at which was the most profitable.

Strategy	Per-Person Cost	Success Rate	ROI
DISCOUNT OFFER: $20 off for 6 months	$120	45%	668%
UPGRADE OFFER: A $35 movie channel free for 3 months	$105	41%	793%
BUNDLED OFFER: $20 off for 6 months, plus a $35 movie channel free for 3 months	$225	47%	302%
TAILORED OFFER: Customers who left over price get the discount; customers who left over service get the upgrade.	$120/$105	45%	596%

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price was offered a discount, while someone who canceled because of poor service was offered an upgrade. The bundled offer yielded the highest win-back rate (47%), followed by the tailored offer and the stand-alone discount offer (both 45%). The stand-alone upgrade offer yielded a 41% win-back rate.

Which win-back strategy is the most profitable? Knowing what kinds of offers lure back the most customers isn't enough; the costs and returns of each are important too. Although a service upgrade has the lowest success rate, it's the cheapest strategy and has the highest return on investment. And while the bundled offer has the highest success rate, it also has the highest cost and the lowest ROI. Kumar notes that companies don't always choose the strategy that will maximize profit, because many are in industries where market share is paramount. For most companies with subscription models, he says, "Wall Street rewards the acquisition rate—how many customers did you add this quarter?—rather than how much money you made from those customers." Kumar sees this as shortsighted, but it explains why firms might utilize the strategy most likely to attract the largest number of returning customers, even at the expense of profit.

Many companies have a lot to learn about bringing back lost customers. Simply identifying those who are the most likely to sign up again, rather than appealing to every defector, can increase win-back rates eightfold. And a large company with multiple product lines, such as a telecom providing landline, cable, wireless, and home security services, can benefit from more-sophisticated ways of analyzing customer behavior to offer enticing bundles. "Too many companies go after whoever they've lost, throwing all these offers at them, hoping something will work," Kumar says. "I hope this study helps change the way they operate."

Reprint F1603A

ABOUT THE RESEARCH "Regaining 'Lost' Customers: The Predictive Power of First-Lifetime Behavior, the Reason for Defection, and the Nature of the Win-Back Offer," by V. Kumar, Yashoda Bhagwat, and Xi (Alan) Zhang (*Journal of Marketing*, July 2015)

THE IDEA IN PRACTICE

"THERE'S AN ART AND A SCIENCE TO THIS"

Cox Communications, the third-largest U.S. cable provider, plays in a high-churn industry where win-back strategies are vital. HBR recently spoke with Mark Greatrex, Cox's chief marketing and sales officer, about the company's evolving efforts to woo back defectors. Edited excerpts follow.

How have your win-back strategies changed? There's more sophistication in the analytics we're doing around individual customers and what their experience was with us the first time around. We can now do personalized marketing at scale—customizing the message, the offer, the pricing. And we have new services, such as one-gigabit internet speeds and home automation and security systems, that give lost customers a reason to take a second look. People are more likely to come back if we improve the value proposition. Win-back is definitely becoming more important—and we're getting better at it.

How do you decide what to offer lost customers? By understanding why a particular household left us, we can pick up the thread and respond. This doesn't just help with win-back—we also have a pretty sophisticated retention program, and as we capture information about why customers intend to leave, we use real-time decision engines to inform the conversation and try to keep them with us. There's an art and a science to this—it's not just math. It requires inventiveness and creative flair.

Has this work changed how you deal with customers who haven't left? Yes. The analytics that guide our win-back efforts have helped us better understand the customer experience. For instance, we're more mindful of certain trigger points in a customer's first life with us—such as the time when someone rolls off an introductory discount. We pay very close attention during those moments, because we're aware of the economics of retaining customers versus having to win them back.

1969

FROM THE ARCHIVE

"Many companies view their computer installations as showplaces, welcoming visitors with relatively little supervision and failing to provide even minimum security precautions. These companies apparently have not considered the possible losses."

"PLUGGING THE LEAKS IN COMPUTER SECURITY," BY JOSEPH J. WASSERMAN (HBR, SEPTEMBER–OCTOBER 1969)

PRICING
ONLINE DISCOUNTING: WHO'S LEADING THE RACE TO THE BOTTOM?

"Minimum advertised pricing" guidelines—policies setting the lowest price at which retailers should market a product—are common in industries from electronics and video games to housewares and plumbing. They help manufacturers coordinate and control retail channels, maintain brand image, and prevent products from being used as loss leaders. Cooperating retailers may be rewarded with advertising money or preferential product access. But enforcement is spotty: By some estimates, roughly 30% of prices for products sold online in the U.S. fall beneath MAP floors, and monitoring sellers is one of the most complicated issues many manufacturers face.

A new study may simplify their task by shedding light on where and how often violations occur and how much discounting is taking place. In the first large-scale empirical analysis of MAP, researchers examined data on hundreds of products sold through hundreds of online U.S. dealers—more than a million product observations in all. They compared compliance rates among authorized and unauthorized sellers and assessed variables including the breadth of retailers' product lines and whether shipping was free.

Some of their findings align with prevailing managerial beliefs. Violations are far less common among authorized retailers (15%) than unauthorized ones (54%), and when discounting does occur, it's not as deep among the former (9% versus 16%). Also as expected, violations appear to have a cascading effect, spreading from one retailer to another.

Other findings upend conventional wisdom: First, although managers tend to think that MAP violations by unauthorized sellers inspire authorized retailers to follow suit, the study revealed no clear association; contagion seems to occur mainly *within* groups. That's important, because firms often try to solve problems with authorized sellers by cracking down on unauthorized ones. Second, although managers often blame Amazon and eBay for harboring discounters, the analysis showed that most infractions take place on sellers' own websites.

Several other results can help manufacturers focus their search for violators. Among authorized retailers, those carrying a broad assortment of a manufacturer's products are less likely to undercut the price on any single item, presumably because they have more to lose if manufacturers respond by restricting access to products. Among unauthorized retailers, those with physical showrooms commit fewer violations than those selling exclusively online. And compliance rates for all retailers are higher among top sellers and those offering a given product for a relatively long period of time.

Finally, violations are more numerous among sellers that don't offer free shipping. Those merchants, the researchers say, may use shipping charges to offset deep discounts while maintaining the *appearance* of rock-bottom prices.

The fact that any unauthorized sellers, let alone more than 50%, cooperate with MAP guidelines—given that manufacturers have no direct authority over them—surprised the study's authors. "One might expect these retailers to violate on 100% of their prices," they say. "What [causes them] to comply with MAP remains an open question."

ABOUT THE RESEARCH "Minimum Advertised Pricing: Patterns of Violation in Competitive Retail Markets," by Ayelet Israeli, Eric T. Anderson, and Anne T. Coughlan (*Marketing Science,* forthcoming)

TEAMS
WHEN AUTHORITY TRUMPS COMPETENCE

When we choose leaders, are we too willing to give the reins to people who project confidence and authority? Should we pay more attention to technical expertise—to the specialized knowledge needed to actually deliver the goods?

A new study suggests that the answer is yes. In a lab experiment, researchers randomly divided 294 students into teams of three to five people to work on a stranded-in-the-desert survival scenario. Half the teams were told to work together but were not instructed to choose a leader. The rest were told to select a leader to manage discussions and to make decisions when disagreements arose. Singly and as a group, the members of each team were asked to rank 12 items, including a knife, a first aid kit, and a map, in order of importance. Ten minutes into the task, the teams with leaders got feedback on how closely their individual and group lists aligned with the choices of wilderness experts, and they were then allowed to pick new leaders.

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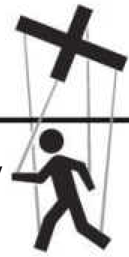
Interim CEOs engage in 37% more earnings manipulation than permanent CEOs, and those who manipulate earnings significantly increase their odds of gaining the permanent position by 6%.

"PASSING PROBATION: EARNINGS MANAGEMENT BY INTERIM CEOS AND ITS EFFECT ON THEIR PROMOTION PROSPECTS," BY GUOLI CHEN, SHUQING LUO, YI TANG, AND JAMIE Y. TONG



When the teams' final lists were scored, the groups with the most-capable leaders (the leaders whose individual rankings most closely matched the experts') performed the best, followed by the leaderless teams. The least successful teams were those headed by people whose rankings had little in common with the experts' choices. Those results aren't surprising. But when choosing new leaders after getting feedback on everyone's preliminary list, only 55% of the groups picked the most competent members of their teams. The rest opted for people who were taller or louder or who projected more confidence than their teammates—that is, people who *appeared* authoritative.

The study also looked at the relationship between leadership qualities and performance in teams working on fraud investigations at a Danish financial firm. The field results supported the lab experiment: Teams with leaders who were deemed highly competent tended to do better work.

The researchers say that their findings show an alarming disregard for expertise when choosing leaders. Their study builds on work by Cornell University's David Dunning and Justin Kruger, who found that undergraduates shown to be incompetent on various tests (such as logical reasoning and grammar) dramatically overestimated their own expertise, whereas the most competent students underestimated theirs. The sobering lesson: Those who see themselves as experts and project the most confidence may be the people whose expertise we should question most.

"Don't get snowed by persuasiveness or the appearance of authority," advises one of the researchers, Stanford professor Lindred Greer. "Some of those things can be useful, but competence comes first."

ABOUT THE RESEARCH "When Does Power Disparity Help or Hurt Group Performance?" by Murat Tarakci, Lindred L. Greer, and Patrick J.F. Groenen (*Journal of Applied Psychology,* November 2015)

Some of these articles previously appeared in different form on HBR.org.

SALES
WHAT TYPE OF FORECASTER ARE YOU?

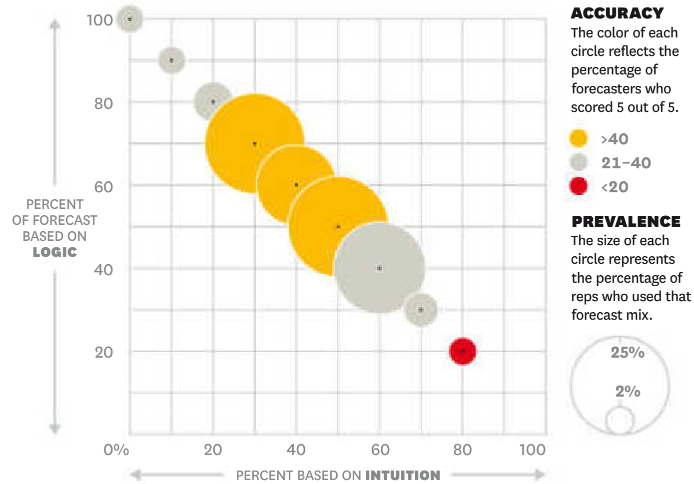
Predicting revenue is one of the most basic tasks salespeople perform, but it can be difficult to master. To learn how top forecasters combine metrics, qualitative information, and intuition, Steve W. Martin, a lecturer at the University of Southern California, surveyed more than 350 B2B sales reps and managers, whom he divided into three groups.

56%
HEAVY HITTERS
The best forecasters constantly reassess and share their estimates.

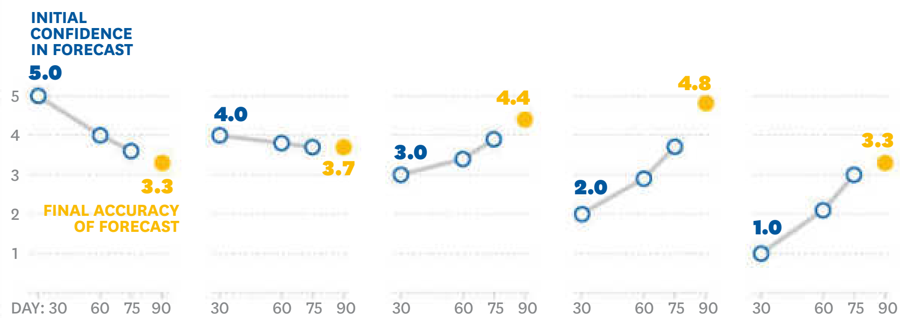
25%
SANDBAGGERS
This group hoards data to keep bosses from realizing that they're aiming too low.

19%
EXAGGERATORS
Overly optimistic by nature, they misread buyer signals and overestimate sales.

LEFT BRAIN, RIGHT BRAIN
The most accurate forecasters depend on both logic and intuition. The least accurate forecasters rely overwhelmingly on intuition.



A MOVING TARGET
The researcher asked salespeople to rate their confidence in their forecasts (on a scale of 1 to 5) at intervals throughout a quarter and to assess how well their forecasts held up once revenue results were in. The most surprising finding: The reps who'd initially rated themselves a 5 (most confident) did poorly, achieving the same accuracy as those who'd rated themselves a 1 (least confident). The most accurate forecasters were those with middling initial confidence.



DEFEND YOUR RESEARCH

FAST THINKERS ARE MORE CHARISMATIC

The research: William von Hippel of the University of Queensland and a team of researchers recruited dozens of small groups of friends for a study. They gave participants intelligence and personality tests and then asked each subject to answer 30 common-knowledge questions—such as "What's the name of a precious gem?"—as rapidly as possible. Participants also rated their friends' charisma and social skills. The researchers found that individuals who answered the questions more quickly were perceived to be more charismatic—regardless of their IQ, knowledge, or personality.

The challenge: Does the speed at which you think predict how appealing people will find you? Is charisma nothing more than a quick brain? **Professor von Hippel, defend your research.**

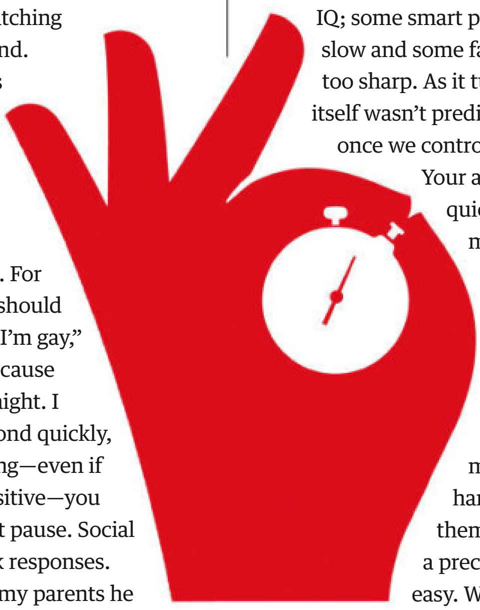
Von Hippel: We were expecting to see that fast thinkers were charismatic, and we did. I think we all sense that charismatic people tend to be quick on their feet. They say things that you find compelling but that you don't expect. They come back with an entertaining answer or a surprising association, and you never quite know what will happen next. They're interesting. It's sort of like humor. You say something, and then I make a joke that connects it to an idea you hadn't thought of. If I can do that quickly, it makes all the difference. What surprised us, however, was that mental speed didn't seem to correlate to social skills overall. Just to charisma.

HBR: How fast did you have to be to be considered a quick wit? The fast thinkers in our study could name a precious gem in 400 milliseconds; the slow ones took more than 900 milliseconds.

That seems like a tiny difference. Nearly everyone can respond to an easy question or pattern-matching task in less than a second. Though the differences may be small here, your mental speed on a really simple task can speak to what it might be on a much more complicated task. For example, if you say, "I should probably let you know I'm gay," I might be surprised because I thought you were straight. I have to be able to respond quickly, because if I take too long—even if I don't care or I feel positive—you might misinterpret that pause. Social pressure requires quick responses. When my brother told my parents he was getting married, they thought he was too young, and there was this long pause on the phone before they said congratulations. You can't undo that. Everybody knows what it means when nothing comes out of your mouth for a second and a half.

But aren't those situations more about social interaction than about recalling facts? Yes, but we think that mental speed might have evolved partly as a way for us to impress each other. It doesn't seem as if our brain got to be as big as it is just so we could deal with facts. Many people have argued that our brain evolved to deal with a complex social environment. Therefore, it's probably the case that many of the mental abilities we use to solve abstract problems didn't actually evolve for that purpose. Rather, they evolved so that we could deal with each other more effectively.

Aren't smart people just more charismatic in general? Wouldn't IQ predict charisma too? Mental speed is one of the most reliable predictors of actual IQ, so we expected IQ would be an important predictor of charisma—that how much you know would affect how quickly you made associations. But it's important to note that mental speed is not the same thing as IQ; some smart people are pretty slow and some fast people aren't too sharp. As it turned out, IQ itself wasn't predictive of charisma once we controlled for speed. Your ability to respond quickly was much more important for charisma than your IQ was.



ANGUS GREIG

What if someone gave the wrong answers? It didn't matter. And people hardly ever got them wrong. "Name a precious gem" is pretty easy. We didn't want to test how smart they were; we wanted to see how fast they were.

I thought of the last question in about 200 milliseconds. Pretty smooth, right? Slick, but I'd be more impressed if you thought of the answer that fast!

It seems as if a fast brain would help with other social skills, too. But you didn't find that. We ran the study twice because we also expected quick thinking would predict general social skills, like how comfortable people were in various social settings, how good they were at making others feel better, and so on. It didn't predict that at all in the first study. And even when we used a slightly larger version of the social skills scale in a second study, it still didn't predict it. I don't know why.

In the first study the charisma scale had three questions: How charismatic are they? How quick-witted are they? How funny are they? The social skills scale asked, How good are they at handling conflict? How comfortable are they in a wide range of social settings? And how good are they at interpreting other people's feelings? The second study added three more questions about social skills: How good are they at putting people at ease? How socially skilled are they? And do they get along with everybody?

How do you actually define charisma? Charisma is a bit like pornography—not very easy to describe, but you know it when you see it. From my perspective, you can be charismatic—but also an asshole. For example, Donald Trump is almost entirely devoid of social grace, but he's charismatic. People find him fascinating; they don't know what he's going to say next. Jeb Bush, in contrast, is a snoozer. You not only know what he's going to say but also know it's not going to be very interesting. But I'd bet he's a lot more pleasant at a dinner party or across a negotiation table. I think a lot of our political leaders are very charismatic, but they're not necessarily socially skilled.

So fast-thinking, smooth-talking managers are actually good for a company even if they lack other social skills? Charismatic leaders are engaging. They can get companies to change direction, they can get people to believe in them, and they can get people to see things in new ways. While there's not much people can do to enhance their mental speed, it does tell you something about which people have the capacity to inspire your organization and which don't. If you want to make big changes, you may want to bring in a charismatic leader.

If I wanted to appear charismatic to convince my boss of something, how could I do that? Here's the thing: There's a bit of risk involved in trying to do that. I think what impresses us about people who are fast is that they're not just fast, they have quick—what I would call parallel—access to multiple ways of interpreting an idea. The only way to demonstrate that is to respond differently from everybody else and to do so rapidly. But if you do that, you're taking a risk, because what you say may be stupid or may offend people. There's a cost. I don't like to keep using Trump as an example, since there are many charismatic people who are lovely. But there's a big chance it could backfire.

How can I avoid that? I think that being charismatic and wrong is a disaster. Being charismatic and right is a good thing.

Interview by **Nicole Torres**
HBR Reprint F1603B

STRATEGIC HUMOR

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HOW I DID IT...
THE CEO OF RIO TINTO ON MANAGING IN A HYPERCYCLICAL INDUSTRY

by Sam Walsh

The Idea

Sam Walsh called on lessons he learned as a boy to bring financial discipline back to the mining giant Rio Tinto.

CHRIS GLOAG

My appointment as chief executive of Rio Tinto, the Anglo-Australian metals and mining company, had a definite tropical flavor. I was on vacation with my wife in Singapore in January 2013 when I received an e-mail from Rio Tinto's chairman, Jan du Plessis, asking me to travel immediately to London for an emergency board meeting. The chairman understood that I was away from home, so the e-mail told me to drop everything and "come as you are."

I had joined Rio Tinto in 1991 and had risen to lead the iron ore operation, the largest product group in the company. I'd also been on the board since 2009. So I knew enough about the 140-year-old firm's culture to understand that if you want to be taken seriously, you don't show up to a board meeting in a Hawaiian shirt. But I had few other options in my suitcase. So I frantically searched for a 24-hour tailor, had a suit made, and boarded a plane.

Though I had earned a reputation for managing my product group with discipline and accountability, some were surprised when the board asked me to take over as chief executive. I was 63 at the time, a bit beyond the job profile in terms of age.

In addition, Rio Tinto—which is the second-biggest mining company in the world, with a market cap of around $50 billion—did not have a reputation for removing chief executives. But the directors recognized that the company had lost its way. In the 2000s it had been caught up in one of the largest commodities booms in history, fueled primarily by China's rapid development. Almost all the major mining companies made mistakes in the mad rush for growth; but at Rio Tinto the smart allocation of capital had traditionally been a strength, so our recklessness was particularly painful. We suffered multibillion-dollar write-downs of two of our boom-time acquisitions, and in 2012 the company reported a net loss for the first time in 25 years. We had been spending as if we had an open checkbook. Quite frankly, we were living beyond our means. I knew that had to change.

Three Initiatives

From a macro perspective, I took the helm at an interesting time. In the coming decades, hundreds of millions of people across the globe will move from rural to urban environments in search of a better life. They will rely on extracted minerals and metals for their smartphones, cars, buildings, and other comforts. International development cannot move forward without the mining industry. But I believe that our business will be even more competitive in the future. Sudden demand shifts and price fluctuations will become more frequent. Industries will be hypercyclical. Xi Jinping, the president of China, calls this "the new normal," and everyone should be preparing for it.

To ensure that Rio Tinto would succeed in such a turbulent environment, I needed to reconnect it with its core balance-sheet discipline and put it back on a path of measured, sustainable growth. Fiscal discipline and responsible risk management are sound business principles in any market environment—but they're absolutely essential in a hypercyclical market, where prices have a tendency to soar and plummet.

My chief financial officer, Chris Lynch, and I decided to focus on three initiatives: First, I would tighten up our investment decisions so that only the best projects received funding. Second, I would run the entire organization for cash—a highly unusual step for a company of our size and complexity—and elevate shareholder value above all else. Third, I would drive efficiency through the organization by cutting costs, exiting businesses, and rationalizing our workforce. But I would also continue to invest in innovation—pulling best practices from other industries and fully harnessing the efficiency gains made possible by new technology.

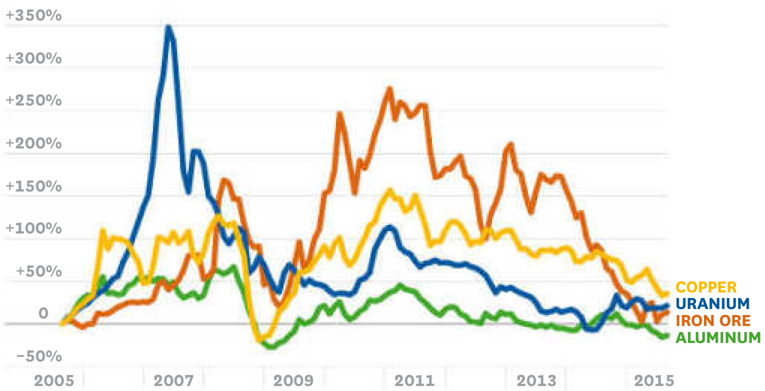
Investment Checks and Balances

This wasn't the first time I stepped in to lead during times of hardship. My father, a former postmaster, and later a director of the commonwealth government in Australia, died when I was 15, so I had to manage the family finances from a young age. In the 1980s I led the team that overhauled the Australian division of General Motors, which at the time was struggling with huge debt, lost market share, and overcapacity. I learned more than just fortitude during my time in the automotive industry. (I also worked for Nissan.) I learned how to operate systems effectively, how to be truly competitive, how supply chains work, how to foster innovation, and that the customer (not the product) must always come first.

My first meeting on the day I was appointed CEO was with the investment committee, which would decide whether and how to spend hundreds of millions—perhaps billions—of dollars. This committee was supposed to evaluate all projects, and it was signing off on almost everything at the time. But the subject matter experts—the people in the middle of our organization—were the ones who actually understood how things worked. They knew about geology and hydrology, geotech, marketing, financing, joint venture relationships, and so on. These vital managers were being passed over.

Boom, Bust, and Beyond

With continuing volatility in commodity prices, Rio Tinto's CEO worked to instill fiscal discipline that would help the mining giant profit in any market.



I saw immediately that I needed to reinforce the system of checks and balances that had once been a core competency for Rio Tinto. The first thing I did was stop the upward flood of delegation. I wanted people who were closer to projects to make more decisions; the investment committee should act as a final safeguard, not the only one. And I decided to raise the hurdle for new investments—dramatically. During the boom years, almost every project with a positive net present value had been given the green light. We made a bold announcement: Only projects that met or exceeded an internal rate of return of 15% would move forward under my leadership.

My thinking was: Good projects are always good projects. The problem with marginal projects is that people work to pull them over the line. They stretch assumptions. High prices during a bubble can hide a lot of sins, but when this bubble burst, we were left exposed. Chris and I felt that by setting an IRR of 15%, we could cull the marginal projects and focus on the good ones. So our spending on new projects went from $17.6 billion at our peak to $5 billion in 2015.

Cash Doesn't Lie

I then turned to Rio Tinto's accounting practices. For years before my appointment, the company was focused on earnings. I'm a believer in the adage that cash doesn't lie. It's either there or it's not. God bless accountants, but there have been so many changes to accounting rules that earnings no longer track performance. I was told that managing for cash wasn't possible for a business as large and complex as ours, but I held my ground. Drawing on my early experience with managing the family finances, I made a home economics analogy: If you find a hole in your roof, you move money around. You don't buy a new suit, and you use the money you didn't spend to fix the roof.

At our annual meeting in 2015, a shareholder commented that cash was mentioned in the annual report 24 times. Now that is what I call success!

I also decided to change how we issue forecasts, from quarterly to monthly. What we'd been doing before was the equivalent of driving while looking in the rearview mirror. The same naysayers claimed there were too many variables. I took them on again directly and went through various input costs line by line. We're now forecasting monthly with a 5% margin of error, which is plenty accurate enough.

A renewed emphasis on accountability requires more than a focus on the balance sheet. It requires that all 60,000 of Rio Tinto's employees adopt an "owner's mindset" in order to align their interests with those of our shareholders. Instilling that mindset at Rio Tinto was made easier by the fact that about 38% of our employees already own shares in the company.

I'm quite clear with our people that shareholder returns are Rio Tinto's number one focus. I'm sometimes asked why I don't make safety or the environment number one. Safety is a top priority. It is widely acknowledged that a strong safety and sustainability record is essential to achieving returns. But I want our employees to know that it's not embarrassing to say we're here to make money. That is our purpose as a business! It sounds like a pretty simple cultural change, but for a huge company like Rio Tinto it required a major shift in thinking.

Of course, like all mining companies, we are watched closely by NGOs, unions, and other stakeholders, who sometimes raise concerns about Rio Tinto's environmental impact, the safety of its workers, its community relations, and other issues. We welcome their scrutiny for the same reason we foster a culture of protecting internal whistle-blowers. We can—and must—do better. At the same time, our safety record is the best it's been in our 140-year history. We've reduced greenhouse gas emissions by 21% in the past five years. We've barely reduced our community spending around the world, even as we've made enormous cuts throughout the rest of the business. We're always working to make mining safer, cleaner, and more sustainable.

A Drive for Efficiency

As I was instituting these changes, I met with two of our former chairmen to ask them about the historical context in which Rio Tinto had risen—to understand how and why the company's accounting and capital expenditure procedures had been set up and to make sure that I was staying true to the principles underlying its run of success. These informal mentors gave me confidence that I was on the right track.

I've had to make some difficult decisions in my drive for efficiency. We've substantially reduced our head count, including at corporate headquarters, where we cut the staff by more than half, and we've taken costs out of every aspect of the business. Many of these decisions were painful, but all were necessary. When I took over, our target was a $3 billion reduction in costs. We recently announced that we have hit $5.5 billion in savings, and we're still going.

Given the imperative to restore discipline to the business, I've had to be careful to continue investing in the innovations that will keep our long-term prospects bright. And I'm not shut off to inorganic growth opportunities. But what excites me most is using technology to increase our productivity.

"Mine of the Future"

I try to focus the senior leadership team on the wide world around us, to ensure that we are pulling best practices from outside mining. In 2005, when I was running the iron ore product group, I took my team on a U.S. road trip. We deliberately did not visit a single mining company.

At Stanford we saw R&D programs for driverless tractors in farming. I knew from experience in the car industry what can be achieved with automation. Rio Tinto now has a "mine of the future" program that includes 66 driverless trucks that have moved some 400 million tons of material. Each truck weighs 350 tons and is the size of a house—the tires alone are more than six feet high. These trucks allow us to run the operation much more efficiently. In fact, our autonomous fleet outperformed the manned trucks by an average of 12%, primarily by eliminating required breaks, absenteeism, and shift changes. As they trundle back and forth from our mines, they are unmistakable harbingers of what the future holds.

At Schlumberger we saw oil and gas platforms being remotely managed. Today we manage 15 iron ore mines, 1,700 kilometers of rail, four ports, three power stations, and various other facilities in real time from a remote operations center in Perth, Australia, which resembles an air traffic control center (except it's much larger). The center helps us recruit talented people who might not want to live in remote mining areas. But more important, it helps us optimize operations. If we see a mine slowing down because of heavy rain, for example, we can increase production elsewhere, maintain the consistency of our iron ore blend, and keep the whole show running. We can analyze variations in plant and mine performance and tweak as necessary. We have captured the IP, and our competitors are now a decade behind us.

Three years after my appointment, these changes are starting to bear fruit. We now have one of the strongest balance sheets in the sector. Crucially, we reduced our net debt from $22.1 billion in June 2013 to $12.5 billion in December 2014. Demand from China and other developing countries remains softer than in the recent past, but scale and efficiency allow us to compete as a low-cost producer, helping us sustain or even gain market share during periods of deflationary pressure. Our underlying earnings were the highest of any mining company's for the six months leading up to June 30, 2015.

Of course, you can't actually turn around a company in just three years. A lot remains to be done. I think the big secret of my job is how completely the chief executive relies on his or her team. I don't shovel in a mine. I don't produce aluminum in a smelter. I sit at my desk, spend time across the business, and lead the company. My executive committee is composed of bright people who make decisions every day that create value for this business. Strong leadership extends right through to the teams on the ground.

Rio Tinto provides the building blocks for the global economy. The materials we dig out of the earth have helped unleash untold value since the end of agrarianism, and they will continue to do so. My hope is that when I leave Rio Tinto, I will pass on an even stronger company to my successor.

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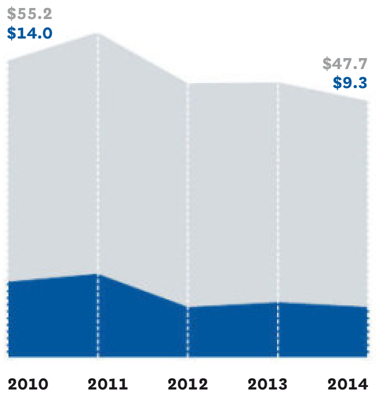
Rio Tinto Facts & Financials

FOUNDED 1873
HEADQUARTERS London; Melbourne
EMPLOYEES 60,000

CONSOLIDATED SALES REVENUE (IN US$ BILLIONS)
UNDERLYING EARNINGS



THE GLOBAL DIGITAL ECONOMY

THE DIGITIZATION OF BUSINESS is transforming industries and reshaping the competitive landscape. To compete and win, you have to understand how the new dynamics will play out.

In this Insight Center, we will take a closer look at how the digital economy is changing around the world and how companies can respond. Topics include the "next billion" online consumers, strategies for global growth, how the shift to mobile is changing consumer behavior and enabling new business models, the role of government and regulation, and entrepreneurial ecosystems.

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BY BHASKAR CHAKRAVORTI, CHRISTOPHER TUNNARD, RAVI SHANKAR CHATURVEDI

The current state of digital development in 50 countries.

2 The Future and How to Survive It

BY RICHARD DOBBS,TIM KOLLER, SREE RAMASWAMY

Corporate profits are beginning a long slide. Prepare for leaner times.

3 How Local Context Shapes Digital Business Abroad

BY WILLIAM R. KERR

It's often the nondigital components that are most important for creating value.

4 7 Traits of Companies on the Fast Track to International Growth

BY NATALY KELLY

Position your company for global success.

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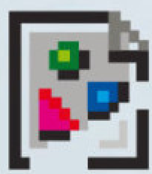

Douglas Holt is the founder and president of the Cultural Strategy Group and was formerly a professor at Harvard Business School and the University of Oxford. He is the author of *How Brands Become Icons: The Principles of Cultural Branding* (Harvard Business School Press, 2004).

Branding in the Age of Social Media

BY DOUGLAS HOLT

In the era of Facebook and YouTube, brand building has become a vexing challenge. This is not how things were supposed to turn out. A decade ago most companies were heralding the arrival of a new golden age of branding. They hired creative agencies and armies of technologists to insert brands throughout the digital universe. *Viral, buzz, memes, stickiness,* and *form factor* became the lingua franca of branding. But despite all the hoopla, such efforts have had very little payoff.

As a central feature of their digital strategy, companies made huge bets on what is often called *branded content*. The thinking went like this: Social media would allow your company to leapfrog traditional media and forge relationships directly with customers. If you told them great stories and connected with them in real time, your brand would become a hub for a community of consumers. Businesses have invested billions pursuing this vision. Yet few brands have generated meaningful consumer interest online. In fact, social media seems to have made brands *less* significant. What has gone wrong?

Once audiences could opt out of ads, it became much harder for brands to buy fame.

To solve this puzzle, we need to remember that brands succeed when they break through in culture. And branding is a set of techniques designed to generate cultural relevance. Digital technologies have not only created potent new social networks but also dramatically altered how culture works. Digital crowds now serve as very effective and prolific innovators of culture—a phenomenon I call *crowdculture*. Crowdculture changes the rules of branding—which techniques work and which do not. If we understand crowdculture, then, we can figure out why branded-content strategies have fallen flat—and what alternative branding methods are empowered by social media.

Why Branded Content and Sponsorships Used to Work

While promoters insist that branded content is a hot new thing, it's actually a relic of the mass media age that has been repackaged as a digital concept. In the early days of that era, companies borrowed approaches from popular entertainment to make their brands famous, using short-form storytelling, cinematic tricks, songs, and empathetic characters to win over audiences. Classic ads like Alka-Seltzer's "I Can't Believe I Ate the Whole Thing," Frito-Lay's "Frito Bandito," and Farrah Fawcett "creaming" Joe Namath with Noxema all snuck into popular culture by amusing audiences.

This early form of branded content worked well because the entertainment media were oligopolies, so cultural competition was limited. In the United States, three networks produced television programming for 30 weeks or so every year and then went into reruns. Films were distributed only through local movie theaters; similarly, magazine competition was restricted to what fit on the shelves at drugstores. Consumer marketing companies could buy their way to fame by paying to place their brands in this tightly controlled cultural arena.

Brands also infiltrated culture by sponsoring TV shows and events, attaching themselves to successful content. Since fans had limited access to their favorite entertainers, brands could act as intermediaries. For decades, we were accustomed to fast food chains' sponsoring new blockbuster films, luxury autos' bringing us golf and tennis competitions, and youth brands' underwriting bands and festivals.

The rise of new technologies that allowed audiences to opt out of ads—from cable networks to DVRs and then the internet—made it much harder for brands to buy fame. Now they had to compete directly with real entertainment. So companies upped the ante. BMW pioneered the practice of creating short films for the internet. Soon corporations were hiring top film directors (Michael Bay, Spike Jonze, Michel Gondry, Wes Anderson, David Lynch) and pushing for ever-more-spectacular special effects and production values.

These early (pre-social-media) digital efforts led companies to believe that if they delivered Hollywood-level creative at internet speed, they could gather huge engaged audiences around their brands. Thus was born the great push toward branded content. But its champions weren't counting on new competition. And this time it came not from big media companies but from the crowd.

The Rise of Crowdculture

Historically, cultural innovation flowed from the margins of society—from fringe groups, social movements, and artistic circles that challenged mainstream norms and conventions. Companies

Idea in Brief

CONTEXT
Companies have sunk billions of dollars into producing content on social media, hoping to build audiences around their brands. But consumers haven't shown up.

WHAT WENT WRONG
Social media has transformed how culture works. Digital crowds have become powerful cultural innovators—a new phenomenon called *crowdculture*. They're now so effective at producing creative entertainment that it's impossible for companies to compete.

THE WAY FORWARD
While crowdculture has deflated conventional branding models, it actually makes an alternative model—*cultural branding*—even more powerful. In this approach, brands collaborate with crowdcultures and champion their ideologies in the marketplace.

and the mass media acted as intermediaries, diffusing these new ideas into the mass market. But social media has changed everything.

Social media binds together communities that once were geographically isolated, greatly increasing the pace and intensity of collaboration. Now that these once-remote communities are densely networked, their cultural influence has become direct and substantial. These new crowdcultures come in two flavors: subcultures, which incubate new ideologies and practices, and art worlds, which break new ground in entertainment

Amplified subcultures. Today you'll find a flourishing crowdculture around almost any topic: espresso, the demise of the American Dream, Victorian novels, arts-and-crafts furniture, libertarianism, new urbanism, 3-D printing, anime, bird-watching, homeschooling, barbecue. Back in the day, these subculturalists had to gather physically and had very limited ways to communicate collectively: magazines and, later, primitive Usenet groups and meet-ups.

Social media has expanded and democratized these subcultures. With a few clicks, you can jump into the center of any subculture, and participants' intensive interactions move seamlessly among the web, physical spaces, and traditional media. Together members are pushing forward new ideas, products, practices, and aesthetics—bypassing mass-culture gatekeepers. With the rise of crowdculture, cultural innovators and their early adopter markets have become one and the same.

Turbocharged art worlds. Producing innovative popular entertainment requires a distinctive mode of organization—what sociologists call an art world. In art worlds, artists (musicians, filmmakers, writers, designers, cartoonists, and so on) gather in inspired collaborative competition: They work together, learn from one another, play off ideas, and push one another. The collective efforts of participants in these "scenes" often generate major creative breakthroughs. Before the rise of social media, the mass-culture industries (film, television, print media, fashion) thrived by pilfering and repurposing their innovations.

Crowdculture has turbocharged art worlds, vastly increasing the number of participants and the speed and quality of their interactions. No longer do you need to be part of a local scene; no longer do you need to work for a year to get funding and distribution for your short film. Now millions of nimble cultural entrepreneurs come together online to hone their craft, exchange ideas, fine-tune their content, and compete to produce hits. The net effect is a new mode of rapid cultural prototyping, in which you can get instant data on the market's reception of ideas, have them critiqued, and then rework them so that the most resonant content quickly surfaces. In the process, new talent emerges and new genres form. Squeezing into every nook and cranny of pop culture, the new content is highly attuned to audiences and produced on the cheap. These art-world crowdcultures are the main reason why branded content has failed.

Beyond Branded Content

While companies have put their faith in branded content for the past decade, brute empirical evidence is now forcing them to reconsider. In YouTube or Instagram rankings of channels by number of subscribers, corporate brands barely appear. Only three have cracked the YouTube Top 500. Instead you'll find entertainers you've never heard of, appearing as if from nowhere.

YouTube's greatest success by far is PewDiePie, a Swede who posts barely edited films with snarky voice-over commentary on the video games he plays. By January 2016 he had racked up nearly 11 billion views, and his YouTube channel had more than 41 million subscribers.

How did this happen? The story begins with the youth subcultures that formed around video games. When they landed on social media, they became a force. The once-oddball video-gaming-as-entertainment subculture of South Korea went global, producing a massive spectator sport, now known as E-Sports, with a fan base approaching 100 million people. (Amazon recently bought the E-Sports network Twitch for $970 million.)

In E-Sports, broadcasters provide play-by-play narration of video games. PewDiePie and his comrades riffed on this commentary, turning it into a potty-mouthed new form of sophomoric comedy. Other gamers who film themselves, such as VanossGaming (YouTube rank #19, 15.6 million subscribers), elrubiusOMG (#20, 15.6 million), CaptainSparklez (#60, 9 million), and Ali-A (#94, 7.4 million), are also influential members of this tribe. The crowdculture was initially organized by specialized media platforms that disseminated this content and by insider fans who gathered around and critiqued it, hyping some efforts and dissing others. PewDiePie became the star of this digital art world—just as Jean-Michel Basquiat and Patti Smith had done in urban art worlds back in the analog days. The main difference is that the power of crowdculture propelled him to global fame and influence in record time.

Gaming comedy is just one of hundreds of new genres that crowdculture has created. Those genres fill every imaginable entertainment gap in popular culture, from girls' fashion advice to gross-out indulgent foods to fanboy sports criticism. Brands can't compete, despite their investments. Compare PewDiePie, who cranks out inexpensive videos in his house, to McDonald's, one of the world's biggest spenders on social media. The McDonald's channel (#9,414) has 204,000 YouTube subscribers. PewDiePie is 200 times as popular, for a minuscule fraction of the cost.

Or consider Red Bull, the most lauded branded-content success story. It has become a new-media hub producing extreme- and alternative-sports content. While Red Bull spends much of its $2 billion annual marketing budget on branded content, its YouTube channel (rank #184, 4.9 million subscribers) is lapped by dozens of crowdculture start-ups with production budgets under $100,000. Indeed, Dude Perfect (#81, 8 million subscribers), the brainchild of five college jocks from Texas who make videos of trick shots and goofy improvised athletic feats, does far better.

Coca-Cola offers another cautionary tale. In 2011 the company announced a new marketing strategy—called Liquid & Linked—with great fanfare. Going all in, it shifted its emphasis from "creative excellence" (the old mass-media approach) to "content excellence" (branded content in social media). Coke's Jonathan Mildenhall claimed that Coke would continually produce "the world's most compelling content," which would capture "a disproportionate share of popular culture," doubling sales by 2020.

The following year, Coca-Cola launched its first big bet, transforming the static corporate website into a digital magazine, *Coca-Cola Journey*. It runs stories on virtually every pop culture topic—from sports and food to sustainability and travel. It's the epitome of a branded-content strategy.

On social media, what works for Shakira backfires for Crest and Clorox.

Journey has now been live for over three years, and it barely registers views. It hasn't cracked the top 10,000 sites in the United States or the top 20,000 worldwide. Likewise, the company's YouTube channel (ranked #2,749) has only 676,000 subscribers.

It turns out that consumers have little interest in the content that brands churn out. Very few people want it in their feed. Most view it as clutter—as brand spam. When Facebook realized this, it began charging companies to get "sponsored" content into the feeds of people who were supposed to be their fans.

The problem companies face is structural, not creative. Big companies organize their marketing efforts as the antithesis of art worlds, in what I have termed *brand bureaucracies*. They excel at coordinating and executing complex marketing programs across

How One Brand Uses Celebrities to Break Through

NOT WHAT YOU'D EXPECT
Videos of Bündchen and Copeland challenged assumptions about women.

Under Armour's recent campaign "I Will What I Want" shows how to combine celebrity sponsorships and cultural branding to create content with impact.

Under Armour originally became an iconic brand by swiping Nike's cultural strategy—then doing it one better.

Nike's approach, launched in the 1970s and perfected in the 1990s, was to tell stories of athletes who overcame societal barriers through sheer willpower. But a decade ago Nike abandoned its competitive-underdog ideology to go all in on branded content, using famous athletes to make entertaining sports films. Under Armour stepped into the void, producing arresting new ads, such as "Protect This House," that championed the same ideology and took off on social media.

Under Armour also followed Nike in dramatizing how übercompetitiveness, traditionally associated with masculinity, applied equally to women, broadcasting spots that showcased female athletes. The latest effort, "I Will What I Want," pushed gender boundaries even further, challenging conventions in arenas where traditional ideals of femininity still reign.

Ballet star Misty Copeland—who grew up in poverty with a single parent—is an athletic, muscular dancer in a profession that celebrates waifish, reed-thin women. Under Armour made a video about how she rose above adversity (the voice-over is from a rejection letter saying that her body was completely wrong for ballet), showing her dancing in a formfitting sports bra and pants that reveal her curvier physique.

A Gisele Bündchen film followed the same convention-breaking formula but mashed up incongruous crowdcultures to provoke a social media response. The former Victoria's Secret star is usually portrayed within the glamorous world of runways and celebrity hobnobbing. Under Armour broke the frame by placing her in what was essentially an old Nike ad: a backstage video of Gisele in an intense kickboxing workout. The company announced the partnership ahead of filming. It immediately stirred up the crowdculture: Sports fans were cynical, Gisele fans were curious, fashionistas were puzzled, and feminists simply loved it. Under Armour's agency scraped all this commentary from the web and projected quotes from the digital discussion on the walls behind her. The resulting video shows Gisele sweating and kicking the bag, ignoring the litany of digs surrounding her: "Is posing now a sport?" "She's not even pretty." "What's her sport, smiling?" "Stick to modeling, sweetie."

Under Armour succeeded because it innovated with ideology—using female celebrities to provocatively push against gender norms. The company aimed its communiqués directly at the crowdcultures that held those norms, which set off a firestorm of debate.

multiple markets around the world. But this organizational model leads to mediocrity when it comes to cultural innovation.

Brand Sponsors Are Disintermediated

Entertainment "properties"—performers, athletes, sports teams, films, television programs, and video games—are also hugely popular on social media. Across all the big platforms you'll find the usual A-list of celebrities dominating. On YouTube musicians Rihanna, One Direction, Katy Perry, Eminem, Justin Bieber, and Taylor Swift have built massive audiences. On Twitter you'll find a similar cast of singers, along with media stars like Ellen DeGeneres, Jimmy Fallon, Oprah, Bill Gates, and the pope. Fans gather around the tweets of sports stars Cristiano Ronaldo, LeBron James, Neymar, and Kaká, and teams such as FC Barcelona and Real Madrid (which are far more popular than the two dominant sports brands, Nike and Adidas). On Instagram you'll find more of the same.

These celebrities are all garnering the super-engaged community that pundits have long promised social media would deliver. But it's not available to companies and their branded goods and services. In retrospect, that shouldn't be surprising: Interacting with a favored entertainer is different from interacting with a brand of rental car or orange juice. What works for Shakira backfires for Crest and Clorox. The idea that consumers could possibly want

How Cultural Branding Builds Icons

Iconic brands are cultural innovators: They leapfrog the conventions of their categories to champion new ideologies that are meaningful to customers.

As a result, they enjoy intense customer loyalty and superior sales and profits, and garner loads of free media coverage. In business, few achievements are more prized than creating an iconic brand. Yet the two dominant branding models are not designed to do the job.

The first model, *mindshare branding,* is one that companies have long relied on. It treats a brand as a set of psychological associations (benefits, emotions, personality). The second model, *purpose branding,* has become popular in the past decade. In it, a brand espouses values or ideals its customers share. Over the past 15 years I've developed an alternative approach—*cultural branding*—to turn what was once serendipity into a rigorous discipline. Let me illustrate how it works, using the transformation of Jack Daniel's from a near-bankrupt regional distiller to the maker of the leading premium American whiskey.

Whiskies compete to be perceived as upscale and masculine. In the 1950s the major brands sought to align themselves with the male ideal of the day: the sophisticated modern corporate executive. Jack Daniel's, a small whiskey targeted to upper-middle-class men, was being trounced by the national competitors. How could it break through?

Mindshare-branding experts would advise the company to convey, very consistently, the key brand associations: masculine, sophisticated, smooth-tasting, classic. But that was precisely what Jack Daniel's was doing—its ads mimicked the national brands', showing alpha executives drinking smooth whiskey. And they didn't work. Purpose-branding experts would encourage the firm to champion its core values. With that approach, the focus wouldn't be much different: Those values had to do with producing classic charcoal-filtered whiskey for a sophisticated drinker.

Instead, the firm (tacitly) pursued a cultural-branding approach. Because masculine ideals are shaped by society, they change over time. The Cold War had dramatically affected Americans' perceptions of masculinity. In the face of a nuclear threat, the corporate executive seemed too sedentary. Instead, the public was drawn to what had only recently been viewed as an anachronism: the gunslinging rugged individualist of the Old West, who, in the American mythos, had helped forge the country's success. The enormous popularity of Western films was one indication of this shift. This massive cultural opportunity, which Marlboro and Levi's leveraged as well, is obvious when analyzed through a cultural-branding framework—but invisible without one.

The Jack Daniel's distillery was in a rural region of Tennessee that the postwar mass media portrayed as an impoverished land of hillbillies. Yet in the American imagination, the area was also one of the last authentic pockets of the frontier, where Davy Crockett and Daniel Boone had gotten their start. So when American men yearned to revive the ideology of the frontier, the whiskey offered great potential as a symbol. This theme was first hit upon by men's magazines (*Fortune, True*), which published stories romanticizing the distillery as a place run by frontiersmen, little changed since the 19th century. The company's print-ad campaign simply emulated those stories, adding some folksy copy.

Jack Daniel's quickly became the aspirational whiskey among urban upper-middle-class men; the branding converted its once-stigmatized location into a place where men were really men. Conventional models would never build a strategy centered on such a downscale version of masculinity. But in cultural branding, inverting marginal ideologies is one of the tricks of the trade.

to talk about Corona or Coors in the same way that they debate the talents of Ronaldo and Messi is silly.

Social media allows fans to create rich communities around entertainers, who interact directly with them in a barrage of tweets, pins, and posts. Sports teams now hire social media ambassadors to reach out to fans in real time during games, and once the game is over, the players send along insider photos and hold locker-room chats. Beyond the major platforms, new media sites like Vevo, SoundCloud, and Apple Music are spurring even more direct digital connections.

Of course, entertainers are still more than happy to take sponsors' money, but the cultural value that's supposed to rub off on the brand is fading.

Cultural Branding

While the rise of crowdculture diminishes the impact of branded content and sponsorships, it has greased the wheels for an alternative approach that I call *cultural branding.* (See the sidebar "How Cultural Branding Builds Icons.") The dramatic breakthrough of the fast-casual Mexican food chain Chipotle from 2011 to 2013 (before recent outbreaks of foodborne illness) demonstrates the power of this approach.

Chipotle took advantage of an enormous cultural opportunity created when the once-marginal movements that had challenged America's dominant industrial food culture became a force to be reckoned with on social media. The chain jumped into the fray as a champion of this crowdculture's ideology. By applying cultural branding, Chipotle became one of America's most compelling and talked-about brands (though recent food-safety difficulties have dented its image). Specifically, Chipotle succeeded by following these five principles:

1. Map the cultural orthodoxy. In cultural branding, the brand promotes an innovative ideology that breaks with category conventions. To do that, it first needs to identify which conventions to leapfrog—what I call the *cultural orthodoxy.* America's industrial food ideology was invented in the early 20th century by food-marketing companies. Americans had come to believe that, through dazzling scientific discoveries (margarine, instant coffee, Tang) and standardized production processes, big companies, overseen by the Food and Drug Administration, would ensure bountiful, healthful, and tasty food. Those assumptions have undergirded the fast food category since McDonald's took off in the 1960s.

2. Locate the cultural opportunity. As time passes, disruptions in society cause an orthodoxy to lose traction. Consumers begin searching for alternatives, which opens up an opportunity for innovative brands to push forward a new ideology in their categories.

For industrial food, the tipping point came in 2001, when Eric Schlosser's book *Fast Food Nation* powerfully challenged it. This was followed in 2004 by Morgan Spurlock's film *Super Size Me* and in 2006 by Michael Pollan's influential book *The Omnivore's Dilemma*. These critiques dramatically affected the upper middle class, quickly spreading concerns about industrial food and providing huge momentum to Whole Foods Market, Trader Joe's, and a host of other upmarket food purveyors. The same transformation is unfolding in other countries dominated by industrial food ideology. For instance, in the United Kingdom the celebrity chefs Jamie Oliver and Hugh Fearnley-Whittingstall have played a similar role.

Before social media, the influence of these works would have remained locked within this small fraction of society. Instead, crowdcultures grabbed the critiques and blew them up, pushing industrial food anxiety into the mainstream. News about every major problem linked to industrial food production—processed foods loaded with sugar, carcinogenic preservatives, rBGH in milk, bisphenol A leaching from plastics, GMOs, and so on—began to circulate at internet speed. Videos of the meatlike substance "pink slime" went viral. Parents worried endlessly about what they were feeding their kids. Crowdculture converted an elite concern into a national social trauma that galvanized a broad public challenge.

3. Target the crowdculture. Challengers to the industrial food ideology had lurked at the margins for more than 40 years but had been easily pushed aside as crazy Luddites. Small subcultures had evolved around organic farming and pastured livestock, eking out a living at the fringes of the market in community-supported agriculture and farmers' markets. But as social media took off, an influential and diverse cluster of overlapping subcultures pushed hard for food innovations. They included advocates of evolutionary nutrition and paleo diets, sustainable ranchers, a new generation of environmental activists, urban gardeners, and farm-to-table restaurants. In short order, a massive cultural movement had organized around the revival of preindustrial foods. Chipotle succeeded because it jumped into this crowdculture and took on its cause.

4. Diffuse the new ideology. Chipotle promoted preindustrial food ideology with two films. In 2011 the company launched *Back to the Start,* an animated film with simple wooden figures. In it, an old-fashioned farm is transformed into a parody of a hyper-rationalized industrial farm: The pigs are stuffed together inside a concrete barn, then enter an assembly line where they are injected with chemicals that fatten them into blimps, and then are pressed into cubes and deposited in a fleet of semis. The farmer is haunted by this transformation and decides to convert his farm back to its original pastoral version.

Crowdculture converted an elite concern into a national social trauma.

The second film, *The Scarecrow,* parodied an industrial food company that branded its products using natural farm imagery. The company is actually a factory in which animals are injected with drugs and treated inhumanely. It cranks out premade meals stamped "100% beef-ish" that kids, oblivious to the real process, eagerly gobble up. A scarecrow who works at the factory is depressed by what he witnesses until he gets an idea. He picks a bunch of produce from his garden, takes it to the city, and opens up a little taqueria—a facsimile of a Chipotle.

The films were launched with tiny media buys and then seeded out on social media platforms. Both were extremely influential, were watched by tens of millions, generated huge media hits, and helped drive impressive sales and profit gains. Each won the Grand Prix at the Cannes advertising festival.

Chipotle's films are wrongly understood simply as great examples of branded content. They worked because they went beyond mere entertainment. The films were artful, but so are many thousands of films that don't cut through. Their stories weren't particularly original; they had been repeated over and over with creative vigor for the previous decade or so. But they exploded on social media because they were myths that passionately captured the ideology of the burgeoning preindustrial food crowdculture. Chipotle painted an inspired vision of America returning to bucolic agricultural and food production traditions and reversing many problems in the dominant food system.

The bête noire of the preindustrial food movement is fast food, so the idea that a major fast food company would promote that story was particularly potent with the crowd. Chipotle was taking on pink slime! Moreover, boutique locavore food was expensive, but at Chipotle people could now assuage their worries with a $7 burrito. Because they tapped into anxieties percolating in the crowdculture, Chipotle's films never had to compete as great entertainment.

5. Innovate continually, using cultural flashpoints. A brand can sustain its cultural relevance by playing off particularly intriguing or contentious issues that dominate the media discourse related to an ideology. That's what Ben & Jerry's did so well in championing its sustainable business philosophy. The company used new-product introductions to playfully spar with the Reagan administration on timely issues such as nuclear weapons, the destruction of the rain forests, and the war on drugs.

To thrive, Chipotle must continue to lead on flashpoint issues with products and communiqués. The company has been less successful in this respect: It followed up with a Hulu series that had little social media impact because it simply mimicked the prior films rather than staking out new flashpoints. Then Chipotle moved on to a new issue, championing food without GMOs. Aside from the fact that this claim challenged its credibility (after all, Chipotle still sold meat fed by GMO grain and soft drinks made with GMO sweeteners), GMO was a relatively weak flashpoint, a contentious issue only among the most activist consumers and already touted by many hundreds of products. These efforts failed to rally the crowdculture. A number of other flashpoints, such as sugary drinks and industrial vegetable oils, generate far more controversy and have yet to be tackled by a major food business.

Of course, leading with ideology in the mass market can be a double-edged sword. The brand has to walk the walk or it will be called out. Chipotle is a large and growing business with many industrial-scale processes, not a small farm-to-table taqueria. Delivering perishable fresh food, which the company is committed to as a preindustrial food champion, is a huge operational challenge. Chipotle's reputation has taken a painful hit with highly publicized outbreaks of E. coli and norovirus contamination. Chipotle won't win back consumer trust through ads or public relations efforts. Rather, the company has to convince the crowdculture that it's doubling down on its commitment to get preindustrial food right, and then the crowd will advocate for its brand once again.

Competing for Crowdcultures

To brand effectively with social media, companies should target crowdcultures. Today, in pursuit of relevance, most brands chase after trends. But this is a commodity approach to branding: Hundreds of companies are doing exactly the same thing with the same generic list of trends. It's no wonder consumers don't pay attention. By targeting novel ideologies flowing out of crowdcultures, brands can assert a point of view that stands out in the overstuffed media environment.

By targeting novel ideologies from crowdcultures, brands can find a way to stand out.

Take the personal care category. Three brands—Dove, Axe, and Old Spice—have generated tremendous consumer interest and identification in a historically low-involvement category, one you would never expect to get attention on social media. They succeeded by championing distinctive gender ideologies around which crowdcultures had formed.

Axe mines the lad crowd. In the 1990s feminist critiques of patriarchal culture were promulgated by academics in American universities. These attacks whipped up a conservative backlash mocking "politically correct" gender politics. It held that men

were under siege and needed to rekindle their traditional masculinity. In the UK and then the United States, this rebellion gave rise to a tongue-in-cheek form of sexism called "lad culture." New magazines like *Maxim, FHM,* and *Loaded* harked back to the *Playboy* era, featuring lewd stories with soft-porn photos. This ideology struck a chord with many young men. By the early 2000s lad culture was migrating onto the web as a vital crowdculture.

Axe (sold as Lynx in the UK and Ireland) had been marketed in Europe and Latin America since the 1980s but had become a dated, also-ran brand. That is, until the company jumped onto the lad bandwagon with "The Axe Effect," a campaign that pushed to bombastic extremes politically incorrect sexual fantasies. It spread like wildfire on the internet and instantly established Axe as the over-the-top cheerleader for the lad crowd.

Dove leads the body-positive crowd. Axe's aggressive stand set up a perfect opportunity for another brand to champion the feminist side of this "gender war." Dove was a mundane, old-fashioned brand in a category in which marketing usually rode the coattails of the beauty trends set by fashion houses and media. By the 2000s the ideal of the woman's body had been pushed to ridiculous extremes. Feminist critiques of the use of starved size 0 models began to circulate in traditional and social media. Instead of presenting an aspiration, beauty marketing had become inaccessible and alienating to many women.

Dove's "Campaign for Real Beauty" tapped into this emerging crowdculture by celebrating real women's physiques in all their normal diversity—old, young, curvy, skinny, short, tall, wrinkled, smooth. Women all over the world pitched in to produce, circulate, and cheer for images of bodies that didn't conform to the beauty myth. Throughout the past decade, Dove has continued to target cultural flashpoints—such as the use of heavily Photoshopped images in fashion magazines—to keep the brand at the center of this gender discourse.

Old Spice taps the hipster crowd. The ideological battle between the laddish view and body-positive feminism left untouched one other cultural opportunity in the personal care market. In the 2000s, a new "hipster" ideology arose in urban subcultures to define sophistication among young cosmopolitan adults. They embraced the historical bohemian ideal with gusto but also with self-referential irony. Ironic white-trash wardrobes (foam trucker hats, ugly Salvation Army sweaters) and facial hair (waxed handlebar mustaches, bushy beards) became pervasive. Brooklyn was chock-full of lumberjacks. Amplified by crowdculture, this sensibility rapidly spread across the country.

Old Spice branding piggybacked on hipster sophistication with a parody of Axe and masculine clichés. The campaign featured a chiseled, bare-chested former football player, Isaiah Mustafa, as a huckster for Old Spice—"the man your man could smell like." The films hit the hipster bull's-eye, serving up an extremely "hot" guy whose shtick is to make fun of the conventions of male attractiveness. You too can be hot if you offer your woman amazing adventures, diamonds and gold, and studly body poses, all with aggressive spraying of Old Spice.

These three brands broke through in social media because they used cultural branding—a strategy that works differently from the conventional branded-content model. Each engaged a cultural discourse about gender and sexuality in wide circulation in social media—a crowdculture—which espoused a distinctive ideology. Each acted as a proselytizer, promoting this ideology to a mass audience. Such opportunities come into view only if we use the prism of cultural branding—doing research to identify ideologies that are relevant to the category and gaining traction in crowdcultures. Companies that rely on traditional segmentation models and trend reports will always have trouble identifying those opportunities.

A DECADE IN, companies are still struggling to come up with a branding model that works in the chaotic world of social media. The big platforms—the Facebooks and YouTubes and Instagrams—seem to call the shots, while the vast majority of brands are cultural mutes, despite investing billions. Companies need to shift their focus away from the platforms themselves and toward the real locus of digital power—crowdcultures. They are creating more opportunities than ever for brands. Old Spice succeeded not with a Facebook strategy but with a strategy that leveraged the ironic hipster aesthetic. Chipotle succeeded not with a YouTube strategy but with products and communications that spoke to the preindustrial food movement. Companies can once again win the battle for cultural relevance with cultural branding, which will allow them to tap into the power of the crowd.

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SPOTLIGHT

Entrepreneurship for the Long Term

ARTWORK Margaret Neill, *Cirrus*
(detail), 2014, oil on canvas
Kenise Barnes Fine Art

SPOTLIGHT

ARTWORK
Margaret Neill, *Recruit*, 2008
Oil on linen

Start-Ups That Last

How to scale your business *BY RANJAY GULATI AND ALICIA DESANTOLA*

Ranjay Gulati is the Jaime and Josefina Chua Tiampo Professor of Business Administration at Harvard Business School.

Alicia DeSantola is a PhD student in the Organizational Behavior program at Harvard University.

Why do so many start-ups that seem to have it all—customers, cash, a promising outlook—run off the rails? Ask a venture capitalist, and you'll probably hear that they have trouble "scaling."

What does that mean, though? VCs typically describe it as a need to "professionalize the organization" and "bring in grown-ups." But those are simplistic fixes—poor substitutes for the substantive changes that need to occur. Start-ups these days grow so rapidly that it's difficult for them to correct course once they recognize missteps. They can improve their prospects by understanding the mechanics of effective scaling before they reach that moment of truth.

Venture capitalist Ben Horowitz compares scaling to a "black art." He and others have proposed useful ideas for demystifying it, but start-ups still lack a cogent framework for transitioning to mature firms. That's what this article provides. Drawing on our extensive case studies of fast-growing companies and on 75 years of organizational research, we have identified four critical activities for successfully scaling a venture. Firms must *hire functional experts* to take the enterprise to the next level, *add management structures* to accommodate increased head count while maintaining informal ties across the organization, *build planning and forecasting capabilities,* and *spell out and reinforce the cultural values* that will sustain the business.

It's easy to misconstrue these activities as replication—as merely increasing the capacity and efficiency of what you're already doing. But they're also about handling greater market and organizational complexity as you seek *different* avenues for growth. That can mean developing new products or services, entering new markets, or engaging in other forms of innovation.

Many entrepreneurs will resist these activities. They often develop strategies opportunistically, lacking a frame of reference because they are starting from scratch, and they take a similar ad hoc approach to building their organizations. Founders tend to view formal structures and processes—elements common to all four activities—as bureaucratic threats to their entrepreneurial souls. They also worry about losing speed, control, and team intimacy. When they eschew order and discipline, however, they pay a steep price: chaotic operations and unpredictable performance.

Scaling doesn't mean that ventures should disavow their start-up identities and embrace large-company dogma once they're poised for growth. But those prepared to manage that growth—and to learn new ways of operating and behaving—stand a much better chance of making it in the long term.

Defining Specialized Roles

Founders typically do a bit of everything—basically, whatever it takes to get the business off the ground. Through informal channels they hire fellow generalists, who cobble together *their* roles and responsibilities partly by pursuing their own passions and partly by looking around and seeing what needs to be done. This idiosyncratic "all hands on deck" approach can work fine in the beginning, when adrenaline is high and the company is small. But as organizations expand, they face new levels of complexity that require them to define and assign tasks more formally.

To accomplish this, they typically seek specialization in select functions, such as sales, human resources, marketing, R&D, and manufacturing. This benefits them in two ways. First, the specialists use their knowledge to tackle their functions' work more efficiently. Second, as they introduce and implement best practices within their domains, they catalyze future growth by creating slack in the rest of the firm. People who no longer have to worry about marketing, for example, are free to explore other activities.

Of course, all this can create tension between the "old guard" generalists and the domain experts. Demands for functional expertise often outstrip early employees' abilities to keep up through organic learning. As a consequence, functional leadership titles increasingly go to outsiders, and the legacy folks may grow resentful. Early employees may also chafe against the narrowing confines of their changing roles. Not every generalist can or even wants to become a specialist. Often people get frustrated and leave, taking their valuable relationships and their tacit understanding of the firm's mission and culture with them.

To keep people working together constructively, it's important to anticipate and manage these growing pains. Let's look at how one start-up, Birchbox, did so.

Birchbox experienced explosive growth within just a few years of its founding, thanks to a business model crafted around consumers' discoveries of new beauty products. Each month subscribers received a box of samples customized according to their personal profiles. They could simply pay their fees and enjoy the samples; they could also go to the Birchbox website and buy larger quantities of the products they liked most. A dedicated team generated a steady stream of digital articles and video tutorials about beauty trends to further engage customers. This model attracted a million subscribers in the first four years, inspiring dozens of copycat start-ups to pitch their businesses as "the Birchbox for X."

To keep up with demand, Birchbox grew from eight employees in 2010 to more than 300 in April 2014, when it secured $60 million in series B funding. In the process, employees' roles and responsibilities shifted. Nicole Fealey, the director of people operations and performance, recalls the excitement of being a jack-of-all-trades during the first 18 months. "That's what I love about start-ups," she says. "You never get bored." But she realizes that she and other early employees lacked the knowledge and experience to handle everything on their own as the company grew—and that they would have burned out if they'd tried.

Consider the logistics of shipping a million boxes of unique samples each month—or the job of building sales relationships with enough partner organizations to continually fill those boxes with fresh, interesting products. To manage such complex work, Birchbox divided it into specialized functions and sought out domain experts to improve the effectiveness of each one. The new hires included a CTO with a computer science PhD from Carnegie Mellon and a vice president of brand campaigns who had been a principal at Booz & Company.

Idea in Brief

THE DILEMMA
Founders often resist bringing discipline to their growing start-ups, for fear of losing agility and control. But then, ironically, operations become chaotic and performance suffers.

THE TACTICS
Manage growth for the long term by hiring functional experts, adding management structure, beefing up planning and forecasting, and continually reinforcing your organization's cultural values.

THE REWARDS
This approach to scaling won't just make your firm more efficient—though it will certainly do that. It will also help you find and exploit new opportunities.

"When I walked in and looked objectively at certain monthly processes, I saw that they had been established in a hacked-together way," says Kate Price, who served as VP of brand campaigns for about three years before becoming VP of Canada. "My consultant mind immediately went to thinking that we should fix all those things, but I learned pretty quickly to respect the people who at the age of 24 had built a process that was part of the engine keeping the company running." Cofounder Katia Beauchamp agrees about the importance of appreciating the old guard—a group the cofounders see as essential to Birchbox's "special sauce." She says, "I think we do a really good job of showing people how valuable their skill sets are and celebrating the fact that we wouldn't be here without their collective capabilities." That attitude has kept early employees feeling valued and engaged.

Even so, they have sometimes struggled to find their place in the growing organization. "It's scary for sure," Beauchamp acknowledges. "I don't think it's easy for me to this day; I don't think it's easy for anybody." Some people had to hire their own bosses to supervise activities they themselves had nurtured since the beginning, rewriting their own job descriptions accordingly. Matt Field, a former early employee who headed international operations during the big growth phase, saw that as an opportunity for personal development. "I knew I did not have the background or knowledge to take Birchbox to the level of aspiration we had," he says. "I hired someone who could teach me and empower me to get better at my job."

Cultivating a learning mindset among employees was key, as was reminding them of the challenges ahead and the ways in which experienced talent could help. Those things got Field and others focused on the greater good of the firm instead of worrying about their relevance and status in the new order. Beauchamp says that she and cofounder Hayley Barna "worked really hard to get people to believe that you can hire people better than you." Involving members of the old guard in the hiring process assured them they would still have a voice. The founders also talked with them about how the domain experts could mentor them and help them develop their niches in the growing firm.

As more outsiders have joined and settled into functional divisions, early employees have provided cohesion through their broad understanding of how the components of the business model fit together. They also serve as a cultural channel back to the time when Birchbox had no brand cachet—a time when it took great resourcefulness to grab the attention of prospective partners and customers.

"People joke that they could never have gotten their jobs now," Beauchamp remarks. "The old guard didn't come in with as much industry experience, but they are superskilled at 'Birchbox'—at our vision and practices."

Does specialization bring risks? Absolutely. Once functions have independent leaders, employees might hunker down in their silos and stop identifying

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>
> —**KATIA BEAUCHAMP,** COFOUNDER, BIRCHBOX

with the organization as a whole. Tribal instincts can prevent cross-functional idea sharing and innovation, so firms must ensure that informal interactions continue across teams and divisions. When companies are in a high-growth phase, they often forgo relationship-building activities in favor of more-immediate work demands. But over time that can lead to stasis and unoriginality. Firms are better served in the long run by fostering cross-pollination while they organize to support the work that needs to be done. The answer is not to avoid building silos but to find ways of bridging them.

Adding Management Structure

When launching their start-ups, many founders eschew hierarchy because of their egalitarian ideals. But as their firms scale, a growing number of people report to a handful of leaders. Founders may think this allows them to remain in command, because all decisions pass through them. But ironically, their organizations spin out of control as centralized authority becomes a bottleneck that hinders information flow, decision making, and execution. A couple of people at the top can't effectively supervise everyone's increasingly specialized day-to-day work; in such a system, accountability for organizational goals gets lost. And employees find it hard to remain focused and engaged when they don't have managerial guidance and processes. They may become frustrated as they struggle for access to decision makers who are juggling many other projects and people.

That happened early on at CloudFlare, a San Francisco–based start-up that was founded in 2009 and quickly became an important player in content delivery and security for small to medium-size websites. By July 2012 it was serving nearly 500,000 websites, with more than 2 billion daily page views (then about 1% of total internet page views). At that time it recounted some of its growing pains to Harvard Business School's Tom Eisenmann and Alex Godden, who published a teaching case about it.

In the beginning CloudFlare's founders proudly—and vocally—proclaimed that they would build a completely flat organization, with no hierarchical titles or HR function. Like many start-up leaders, CEO Matthew Prince wanted to promote flexibility and individual achievement and believed they would be stifled by bureaucratic control. In creating a title-free organization, he also hoped to avoid future organizational chart conflicts, since the people initially heading up the small venture probably wouldn't be suited to lead a team of 250, and senior roles would inevitably change. "Either the original person gets demoted, in which case he or she will likely leave, or the new person doesn't get brought in," Prince said. "Neither is a great outcome."

> **"It's been fascinating to watch people from the engineering team look at the sales team and say, 'Hey, they actually look happy and productive. Maybe managers aren't such a bad thing.'"**
>
> —**MATTHEW PRINCE**, CEO, CLOUDFLARE

Nevertheless, problems cropped up. In the three months ending in July 2012, five of the firm's 35 employees quit, some citing the lack of a clear midlevel reporting structure and the nonexistent HR practices. They described situations in which they had no one to turn to (short of pestering the founders) if they thought certain practices, such as activities related to software or coding standards, needed to change. Without official policies, they found it difficult to navigate conversations about taking vacation and sick days, balancing work and family expectations, and expensing items. The employee backlash was similar to what Zappos experienced in 2015, when it announced that it was eliminating all titles and managers, and 14% of its workforce—210 people—consequently took buyouts and quit.

Even though CloudFlare lost fewer people than Zappos, the percentage was about the same. Soon after the departures, Prince acknowledged that the firm needed more structure. "We are under no illusion that these management practices will work forever," he told Eisenmann and Godden. "You can already see some gaps. People want feedback; they want direction. When we double our current staff, we will need more hierarchy and managers and processes." A product manager had recently joined the organization, but Prince, who still disliked the word "manager," called him a "product engineer." He preferred to think of his employees as being "assisted."

By 2015 the firm had hired additional managers, along with an HR administrator and a talent recruiter. Prince wanted the organizational chart to remain flexible enough to attract senior hires without discouraging solo contributors, but he recognized that adding management structure was helping CloudFlare grow. When building up some areas, such as enterprise sales, he added hierarchical layers. He recently commented, "It's been fascinating to watch people from the engineering team look at the sales team and say, 'Hey, they actually look happy and productive. Maybe managers aren't such a bad thing.'"

Of course, organizations can take structure too far. Having excess layers in the decision-making chain can slow things down by restricting the flow of information (top-down or bottom-up). It can also demotivate employees by signaling that they're not trusted to handle their own work. But as we saw at CloudFlare, people find *too little* guidance demotivating as well.

Firms that complement formal structures with informal mentoring and feedback can keep motivation intact. That's because those things foster a learning mindset, helping employees grow right along with the organization. Clearly delineated roles and areas of authority also enable people to make faster, smarter decisions locally. They streamline the process, rather than gum it up, and promote individuals' development. The more decisions people are empowered to make on the ground, the more they learn and the more accountable they become.

Planning and Forecasting with Discipline

Improvisation is integral to young ventures; it's how they make discoveries. However, as firms grow they need a framework of plans and goals to guide them. That way they can keep trying new things and reacting to dynamic markets, but with an eye toward larger objectives and sustaining the business. Otherwise improvisation essentially amounts to aimless riffing.

Many start-ups, including India's Micromax Informatics, have learned that the hard way. In 2010 Micromax seemed unstoppable. Having stormed the mobile handset market just a couple of years before, it was selling more than a million units a month. Its four cofounders had ambitions to make the company a global leader, and the numbers seemed to put it on that path: That year revenue more than quadrupled, and net profits more than quintupled. In September Micromax raised $45 million in private equity from Sequoia Capital and other investors, and in October it announced plans to go public.

But in July 2011 the company withdrew its IPO. Its relentless pursuit of growth had come at the expense of business hygiene, and it had lost momentum as a result. Mohit Bhatnagar, a managing director in Sequoia's New Delhi office, says, "From the outside it looked like a company that had grown exponentially, with great customer adoption of its products. However, on the inside it was chaotic."

At a board meeting later that year, Micromax committed to major organizational changes. To their credit, the founders agreed to bring in an outside CEO, along with senior leaders from blue-chip firms such as Airtel and HTC. When those leaders arrived, they were struck by the utter lack of planning. For instance, Micromax had done little to standardize market and employee information, let alone use it to inform sales, operations, or talent management decisions.

As the new CEO at the time (he has since left the firm), Deepak Mehrotra led the charge to implement strategic planning. With the founders' support, he stressed the importance of regular goal-setting and

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>
> —**SUMEET KUMAR**, COFOUNDER, MICROMAX

pacing exercises companywide to build a long-term vision. He says, "At my first meeting with my direct reports, in January 2012, I made them write their epitaphs: 'Imagine that two years hence, all 16 of you are returning from celebrating a great year, and your plane crashes. What would you want as your obituary?'" That was his way of getting managers to think more concretely about the company's future and set clearer performance targets—things the founders had avoided in their excitement to pursue new opportunities and their reluctance to admit when things weren't panning out. For example, the founders had initiated aggressive expansions to Brazil and Dubai, undeterred by their limited knowledge of customer preferences in those markets. Once systematic planning got under way, the company shut down those operations.

Micromax also began to bridge planning gaps at the operational and tactical levels. In many functions, managers lacked real-time data. Sales was a prime example: Once handsets shipped to distribution channel partners, the firm had long waits before finding out which models had sold, so placing advance orders with suppliers involved a lot of guesswork. That led to underavailability of fast-moving products and excessive returns of others. It also made it hard to know how much inventory to retain. As a result, the company experienced cash flow challenges and had a limited ability to launch new products until it reached credit and inventory settlements with suppliers.

Cofounder Sumeet Kumar designed a solution: a tool that tracked each phone from shipment by the manufacturer to activation by the user. "I now know at exactly what stage in the supply chain a device is," he explains. "I know, in the top 20 cities in the country and street by street, the models I have sold." Micromax completed the tool's rollout in November 2012. Sales and inventory planning have since become much more precise, enabling the firm to learn within 30 days whether a product "is going to be a rock star or a failure." This has reduced problems with stock-outs, returns, and cash flow.

Before Micromax applied this sort of discipline, it had an ad hoc style of pouncing on opportunities as they arose, using a combination of tacit knowledge and off-the-cuff fixes. Leaders rationalized this approach on the grounds that decisions had to be made quickly because rivals were close on the company's heels, looking to copy existing products. In the frenzy to tackle pressing challenges, the tasks of documenting solutions and analyzing how they might have been reached more efficiently often fell by the wayside. People had little interest in establishing routines to deal with repeat issues. When they came up with effective solutions, they rarely shared them companywide; each unit had to discover its own best way of doing things. And when key people left, their knowledge walked out the door with them.

As Micromax's leaders discovered, even in a fast-paced, high-growth environment, it's important to set aside time to plan and to identify and share best practices. It's easy to assume that such activities are incompatible with agility and managerial discretion. To be sure, overly rigid planning processes can provoke battles over limited resources, which may hamstring innovation. But it's possible to have freedom within a framework. Setting clear goals and guidelines, systematically gathering and sharing information to shed light on performance and enable better forecasting, and creating processes instead of relying on key individuals to craft one-off solutions—all these promote efficient, smart decisions, especially when the world around you is in flux.

With these interventions, Micromax regained its footing in the mobile market. Its 2015 fiscal year revenue was almost $2 billion.

Sustaining the Culture

Culture is typically a big part of what draws people to join start-ups—and what keeps them going. As employees battle the odds to turn a fledging business into a viable company, working late nights and weekends to make it happen, they're motivated by camaraderie and a sense of belonging to something important.

Founders recognize how powerful this is and rely on nostalgic, almost mythic, stories about the organization's first days to get everyone to embrace the culture. That can work while a venture is small and all the employees can personally relate to those stories—but as more people come aboard, leaders may struggle to maintain a strong organizational culture. That's a problem, because culture may be most important during periods of growth. As a venture starts to formalize its functions and reporting chains, identifying with the larger organization helps employees work across boundaries and engage in the spontaneous collaboration and exchange of ideas the company needs to innovate.

Although founders of fast-growing firms say they worry about losing their organizational culture, few take steps to codify and reinforce it. Their attention quickly shifts to things that feel more urgent, such as operations and marketing. As a result, employees' motivation and engagement slip and people leave, hoping to recapture the magic somewhere else.

How can entrepreneurs prevent these consequences? They can start by clearly articulating their cultural values in their mission and vision statements and in job descriptions. That makes it easier to recognize cultural drift before it goes too far. It also helps the organization keep its values alive by hiring for cultural fit and rewarding desired behaviors through recognition and compensation.

Let's look at how this played out at Practice Fusion, a San Francisco firm that makes a cloud-based platform for electronic health care records. By late 2013 it had hired nearly 200 employees within 12 months, more than doubling in size. Throughout that period, cofounder Ryan Howard made it a priority to preserve the organizational culture.

One of the firm's tenets, "Be scrappy," harked back to the days when the cofounders, spurned by VC investors, worked out of coffee shops and used insurance money from a motorcycle accident to cover payroll. So it's not surprising that early on, the leaders relied heavily on folklore—tales about their marathon workweeks and bootstrap solutions—to convey this core value. But as the business became larger and more complex, that created distance between leaders and employees. The founders' charisma and stories were no longer enough to bind everyone together.

Anticipating this problem, Howard articulated the firm's values more formally, posting them online and in the building. You'll now find them painted on the office walls—not just scrappiness (his personal favorite) but also integrity, customer focus, teamwork, fun, community giving, and "doing extraordinary things." These values have become criteria for hiring and performance evaluation. For example, leaders expect employees to be resourceful, self-motivated problem solvers. "Most of the personalities here talk a little faster," Howard says. "I tend to hire people who inherently have a bit of discontent."

The firm also instituted weekly town-hall-style meetings, where the founders encourage employees to ask tough questions about what matters most at Practice Fusion, the problems it faces, how key decisions were made, and so on. This not only ensures a regular line of communication with employees but also makes everyone insiders, privy to the leaders' thinking about critical issues.

> **"Most of the personalities here talk a little faster. I tend to hire people who inherently have a bit of discontent."**
>
> —**RYAN HOWARD**, COFOUNDER, PRACTICE FUSION

The staff also comes together once a month for "phenomenal Friday," where divisions take turns sharing updates and challenges. Sitting together and swapping stories helps weave the different groups into a unified community—an effort that requires regular care and feeding, especially in a company that extols scrappy self-starters.

AS JUST about any rapidly growing start-up will attest, scaling up is challenging. Market crashes, unreliable supply and distribution partners, fierce rivals, and plenty of other external forces can buffet firms. But that doesn't mean companies need to be chaotic on the inside. Effective internal organization frees them up to keep pursuing new opportunities and brings long-term survival within reach.

Entrepreneurs may worry that the changes we propose will be the death of spontaneity, adaptability, and speed—everything that got them up and running in the first place. Indeed, these are valuable qualities. Many large companies realize that too; that's why they often try to behave more like new ventures. We're not suggesting that start-ups abandon what made them special and innovative. But it's a lot easier to launch your rocket ship in search of new horizons when you don't have to worry that someone forgot to fill the tank.

Between the extremes of ad hoc and prescriptive organizing, there's a useful middle ground. Leaders who can find it will have an edge on their rivals—and that really matters, given how few new ventures become established players.

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SPOTLIGHT

ARTWORK
Margaret Neill, *Stream*, 2008
Acrylic on canvas

David Collis is the Thomas Henry Carroll Ford Foundation Adjunct Professor of Business Administration at Harvard Business School.

Lean Strategy

Start-ups need both agility and direction.

BY DAVID COLLIS

Strategy and entrepreneurship are often viewed as polar opposites. Strategy is seen as the pursuit of a clearly defined path—one systematically identified in advance—through a carefully chosen set of activities. Entrepreneurship is seen as the epitome of opportunism—requiring ventures to pivot in new directions continually, as information comes in and markets shift rapidly. Yet the two desperately need each other. Strategy without entrepreneurship is central planning. Entrepreneurship without strategy leads to chaos.

What many entrepreneurs fail to grasp is that rather than suppressing entrepreneurial behavior, effective strategy encourages it—by identifying the bounds within which innovation and experimentation should take place. But executives who want their established firms to be more entrepreneurial often don't fully appreciate how stage-gate processes, multiple-horizon planning, and other corporate tools for managing strategic growth initiatives can undermine innovation.

The reality is, integrating the bottom-up approach of lean start-ups with the top-down orientation of strategic management remains devilishly hard. Is there a way to get the best of both worlds?

Yes. The solution is something I call a *lean strategy process,* which guards against the extremes of both rigid planning and unrestrained experimentation.

It emerged from the more than 20 years I've spent studying and working with entrepreneurial ventures and large companies. In this framework, strategy provides overall direction and alignment. It serves as both a screen that novel ideas must pass and a yardstick for evaluating the success of experiments with them. Strategy allows—indeed, encourages—frontline employees to be creative, while ensuring that they remain on the same page with the rest of the organization and pursue only worthwhile opportunities.

The Entrepreneur's Challenge

Howard H. Stevenson of Harvard Business School defines entrepreneurship as "the pursuit of opportunity without regard to resources currently controlled." This highlights the fundamental challenge confronting entrepreneurs: They all suffer from a shortage of money, talent, intellectual property, access to distribution, and so on. While acquiring additional external resources is partly the answer, the internal challenge is to wisely shepherd, conserve, and deploy the resources the venture does possess. That is exactly what strategy is all about. Indeed, the single best piece of advice for any company builder is this: Know what *not* to do. Strategy helps you figure that out.

Much more so than leaders of established firms, entrepreneurs need to recognize these fundamental principles:

The opportunity cost of doing A is that you cannot also do B. In a resource-constrained venture, choices are mutually exclusive. If you allocate two software engineers to customize a product for a new customer, you will delay the release of version 2.0 of the product by three months. No amount of experimentation will get around this problem.

Every choice creates a unique path with a different outcome and unforeseen implications. This is why you cannot simply do A now and B later—because circumstances will almost certainly have changed. Competitors will have launched their own version 2.0. Key suppliers will have signed contracts that commit all their capacity to others. Potential customers' judgments about the service will already be clouded by their experience with a competitor's version. The employee who would have been instrumental in pursuing B will have left the company. Every choice is an irrevocable rejection of something else.

Decisions are interdependent. If John in marketing does A, it has ramifications for Peter in product development, and vice versa. Any venture needs to ensure that the scarcest resource—people's time—is spent on the tasks that are critical to the organization as a whole, not just to one department. In an established firm, operating units are subject to many organizational constraints: the brand's positioning, a shared sales force, and so on. Those constraints help ensure consistency among initiatives and innovations. A new venture, however, lacks organizational parameters; the world is its oyster. This makes it even more important for entrepreneurs to set boundaries.

Simple market tests aren't always useful. The lean start-up camp celebrates agility and adaptation through rapid testing. That may be an effective way to innovate incrementally and fine-tune an offering's fit with the market, but some ideas simply cannot be evaluated in a series of quick, cheap experiments. Though few concepts require all-or-nothing investments, as the launch of Federal Express did, many do entail substantial up-front expenditures. Innovations that bring to market truly novel products and services, like steel minimills and electric cars, often involve building complete ecosystems and require long-term investments.

While adoption rates are accelerating (Facebook achieved 100 million users in just over four years, WhatsApp in two years), some businesses will mature more slowly. Customers may need time to appreciate the value of a new product, or suppliers may need to work down a cost or experience curve to deliver at a reasonable price. Businesses such as accountable care organizations in health care and Tesla's lithium ion batteries would never have gotten off the ground had they been expected to demonstrate immediate success.

What's more, quick A/B tests that capture customer preferences may fail to account for various

The single best piece of advice for any entrepreneur is this: Know what *not* to do.

Idea in Brief

THE ISSUE
Leaders of start-ups often see strategy, the pursuit of a clearly defined path that is systematically identified in advance, as the enemy of entrepreneurship, which requires ventures to be opportunistic and quickly shift course as they learn what customers want.

THE REALITY
Entrepreneurs badly need strategies that articulate what their ventures will and will not do. Such boundaries are crucial for making the most of scarce resources, deciding which ideas to pursue, and evaluating experiments. But a rigid, fixed strategy is dangerous.

THE SOLUTION
The lean strategy process integrates the bottom-up approach of the lean start-up with the top-down orientation of strategic management. In an iterative fashion, the venture builds new capabilities and revises the original strategy in response to what it learns.

alternatives' longer-run impact on brand reputation and purchasing behavior. Such tests also focus too heavily on initial usage. Sometimes immediate traction with target customers is ephemeral: Users tire of the novelty or—like Groupon's customers—find that repeated use is uneconomical. This is one reason that consumer-packaged-goods firms are careful to distinguish trial from repeated use.

How Strategy Can Help

In a world governed by the principles discussed here, a strategy that articulates the firm's overall direction is indispensable. It helps entrepreneurs do four things:

Choose a viable opportunity. Rigorous strategic analysis can distinguish markets that promise enduring success from those that offer only the illusion of substantial, if immediate, returns. Many a new firm has failed because it pursued the latter. The archetypal example is a business with low barriers to entry. Consider Groupon again. Its innovative model of online coupons for local retailers and service providers quickly generated sales. Unfortunately, anyone and her mother could also launch such a site—and did. Demand for the service proved transitory, and no one has made any money in the business.

Yes, an entrepreneur can make a quick killing by starting such a business and then selling it to a strategic (or foolish) buyer. A classic example is Minnetonka. It brought to market a series of innovations—from Softsoap to the pump dispenser for toothpaste—that had no protection from copycats. Yet as the first mover, the company could grow rapidly before selling out to established firms: Colgate-Palmolive bought its soft-soap business, and Unilever bought the other product lines. However, this business model still reflects a strategic choice: Knowing that the business cannot be sustainable, the entrepreneur does everything possible to minimize long-term commitments and maximize the gross margin and sales while looking for the exit.

Another misstep is entering a large and growing market without analyzing whether the firm will be able to build a sustainable competitive advantage in it. Best Buy, Mattel's line of Barbie dolls, eBay, and a slew of others entered China thinking that anyone could make money there—only to fail. It may be much wiser to pursue several smaller, less risky opportunities that together could create a successful long-term business.

An initial strategic screen can save a venture from going down the wrong path: one that might be readily validated by a market test of a minimum viable product but is unlikely to support a long-term business. At Eleet, a start-up based in Providence, Rhode Island, the founders (one of whom is my son) initially developed eight possible B2B and B2C use cases for their concept, providing chauffeurs to drive you in your own car. For a few hundred thousand dollars, the team could have rapidly tested some of those use cases. But before trying out even one, the founders analyzed the target markets and recognized that a B2B version would be the most sustainable. As a result, they set aside the B2C use cases and instead ran tests that demonstrated the existence of high-volume B2B users, firms that would provide the service to their employees in lieu of limousine service. They're now in the early stages of trying to build that business. (Full disclosure: I've advised, invested in, or served as a board director for Eleet and several other companies mentioned in this article.)

Stay focused on the prize. Ventures that lack strategic bounds try to do too much and spread themselves too thin. Because they fail to concentrate their available resources, they can't win in any key market.

Sophia Amoruso, founder of Nasty Gal, initially succeeded in building a business that resold vintage clothing on eBay. Then she diversified into a variety of new activities: selling brand-name designer clothing; a magazine; an autobiography (*#GirlBoss*) and promotional book tour; retail stores; international websites; and branded products such as shoes, swimwear, lingerie, and home goods. Seduced by an overabundance of opportunities, she threw a lot of ideas against the wall to see what would stick. But with no clear focus, employees stumbled over one another, competing for resources—including Amoruso's attention—and growth stalled. She stepped down as CEO in January 2015.

In a similar manner, new ventures—driven by the need to generate cash to meet payroll—often respond to every sales inquiry, even when the customer is not in the target set. In its start-up phase, Picis, a health-care information-systems company, was pursuing two markets, operating rooms and intensive care units, winning orders in both. But in both markets the firm was struggling to get traction. After it decided to concentrate on operating rooms (and made a related acquisition), it was able to gain share and build a viable position.

Align the entire organization. In tiny start-ups, it may be possible to coordinate activities through daily personal interaction. In larger ventures, project management or a bureaucracy can help somewhat with this, but only a strategy allows a leader to empower all employees while avoiding duplicative efforts and the pursuit of conflicting agendas. A clearly articulated strategy can ensure that every aspect of an organization—the type of personnel hired, the compensation system and reward metrics employed, the IT system installed, and so on—is designed to support its distinctive value proposition.

A clarified strategy prevented staff members at Muzzy Lane Software, an educational gaming company, from continuing to pursue work-for-hire that produced one-off games. This had been an important source of funding: A single contract could cover the company's cash burn for several months. But the firm realized that its real focus should be on educational publishers, and having built a core software platform on which such firms could develop their own content, it needed to improve the suite of authoring tools. Diverting developers to customize a game would slow down that critical activity. The staff was actively discouraged from seeking such projects.

Make the necessary commitments. After deciding which opportunities to pursue, firms must make the investments needed for success. Obviously, testing should be done to minimize risk and maximize the value of each one. But, as discussed earlier, every so often an investment, like building a hospital in a new district, has to be made without a guarantee of return or the ability to be tested in phases. In those cases, it's critical to conduct a careful analysis before proceeding. And, of course, the investment must be a strategic fit.

FURTHER READING

Want to improve your firm's innovation track record? If so, you'll find many useful lessons in these HBR articles:

"Cisco's CEO on Staying Ahead of Technology Shifts"
John Chambers

"The Discipline of Business Experimentation"
Stefan Thomke and Jim Manzi

"Why the Lean Start-Up Changes Everything"
Steve Blank

"Figure It Out"
Beth Comstock

"Looking to Join the Lean Start-Up Movement?"
Scott Anthony

"Failing by Design"
Rita McGrath

"Strategies for Learning from Failure"
Amy C. Edmondson

"The Value Captor's Process: Getting the Most Out of Your New Business Ventures"
Rita McGrath and Thomas Keil

Combining Deliberate and Emergent Strategy

If strategy is to address the entrepreneur's challenge, it must also embrace entrepreneurial techniques. Entrepreneurship—empowered local experimentation—allows a firm to explore the right innovations and continually refine them to better fit the market. It's necessary no matter what a firm's size or industry is. Here's how to incorporate it effectively into strategic approaches:

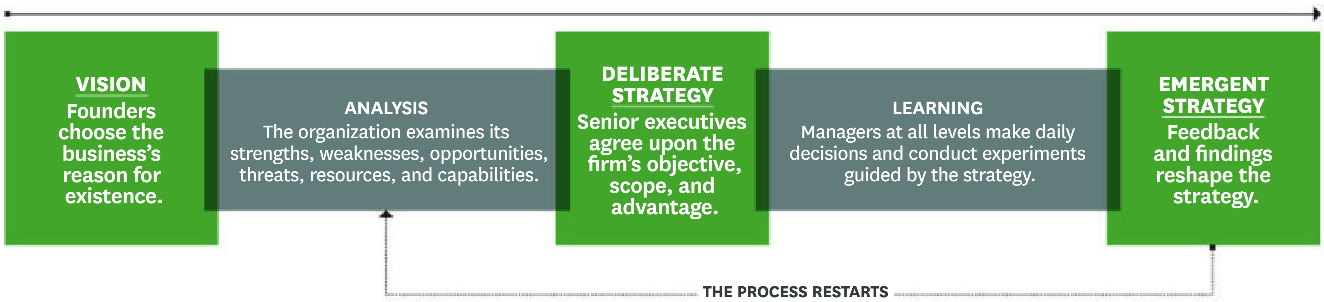
Vision. The lean strategy process begins with perhaps the only aspect of the strategy that should in any sense be permanent: the organization's vision or ultimate purpose—the reason for its existence. A vision should be compelling and motivational. It may also be aspirational and possibly even unachievable. Microsoft's original vision, for example, was to place "a personal computer on every desk." Under its founders, Ben & Jerry's strove to "make the world's best ice cream, to pursue progressive social change, and to provide fair compensation to employees and shareholders alike."

Deliberate strategy. To deliver on the entrepreneurial vision, a deliberate strategy should be agreed upon by senior executives. It should be crafted with involvement throughout the organization, from a rigorous evaluation of the firm's current strengths and weaknesses, internal resources and capabilities, and external opportunities and threats. The deliberate strategy will identify the broad market position where the firm can use its unique capabilities to satisfy customer needs in a way that no competitor can.

In my view, the three underlying elements of a strategy are objective, scope, and competitive advantage. (Though I won't go into the details here, you can find them in my April 2008 HBR article with Michael Rukstad, "Can You Say What Your Strategy Is?") Let's look briefly at how those three concepts apply to new ventures.

THE LEAN STRATEGY PROCESS

By combining traditional strategy with lean start-up practices, ventures can align employees around a common purpose, make the most of limited resources, learn from the market, and then adjust the strategy.



Objective. This is an articulation of the near-term goal that defines success in the eye of the venture's leader. If her objective is to go public within three years, that will have implications very different from those of building a sustainable business she'll still control five years out, or of selling to a strategic buyer once the business is established. For each objective, the strategy must also establish the metrics that will maximize the firm's market value when achieved. With an IPO, for instance, the metrics might include X million new customers, a Y% share of online retail, version 3.0 installed at Z key customers, and so on.

Scope. Probably the most critical strategic guide rail, scope identifies "what business we are in" and draws boundaries around what the venture will and will not do. Southwest, for instance, developed its original low-cost-airline strategy within a clearly defined domain. It decided not to compete head-to-head with the majors in big airports or on routes with flight times over a couple of hours. Instead, Southwest concentrated on building a dominant network of short-haul flights between second-tier airports. And since another premise of the strategy was that low prices had to be simple and transparent, the airline devoted no efforts to complex yield-management initiatives that would have allowed Southwest to wring the maximum fares from passengers.

Competitive advantage. Any venture needs clarity about how it will win—why customers will buy its products rather than those of competitors. That advantage should help the company satisfy an underlying customer need and, ideally, address an immediate customer pain point. It can be captured in a summary of features that are superior to those of competitors, which may also acknowledge, if not even celebrate, those aspects of the product or service that will underperform. This distinctive value proposition should align the firm's activities and shape future experiments.

One of Southwest's key advantages, for example, was rapid turnaround time, which helped it maximize its use of assets and keep prices low. The airline chose not to provide meals, because doing so would have increased costs and turnaround times. When passengers complained, customer service personnel merely responded with polite letters explaining that adding meal service would raise fares.

Emergent strategy. In implementing the strategy, managers at all levels in the organization make myriad decisions every day. The sum of all these independent choices gradually alters the company's position and determines the exact form the strategy takes over time. This is the emergent dimension of strategy.

Many frontline decisions, like daily flight departure times at Southwest, are routinized and require little or no thought. Some, like whether to hold a plane at the gate to accommodate delayed connecting passengers, require judgment and should be informed by the company's strategy. And some are conscious variations that seek to improve an existing product or practice. One incremental innovation suggested by Southwest employees, Business Select, gave passengers a free drink and early boarding for a small premium. Because it would not interfere with fast gate turns, the airline introduced it.

It is here that the notion of strategy as a filter looms large. In considering what experiments to undertake, people throughout an organization develop and test hypotheses about how to improve the strategic positioning by identifying current mismatches, gaps, or opportunities in the offering's fit with the market. Thus entrepreneurial activity in the lower levels of the organization is not random. For instance, rather than developing complex yield-management software algorithms, as other airlines did, Southwest's IT group focused on innovations in customer self-service that could be delivered on low-cost, personal-computer-based systems. Similarly, frontline personnel came up with Southwest's boarding procedures (the unique numbered stands for boarding at a Southwest gate), which contributed to the carrier's rapid turnaround time.

Once an innovation is introduced, the strategic screen again comes into play. The venture now has to evaluate the outcome of the experiment and decide whether to end, continue, or amend it (a decision that will have lasting repercussions). Without a broader orientation, wrong conclusions can be drawn from results. During the Battle of Britain, for instance, after-action reports built a picture of where damage had been inflicted by the Nazis on Spitfires returning to base. This was used to identify the areas on the planes that needed to be reinforced—that is, until a bright spark pointed out that they were not the areas that were most vulnerable. In all likelihood, the areas where there was no damage on returning planes were most problematic, since hits there meant planes never came back.

A firm evolves as the result of incremental choices made every day.

Strategy provides a framework for interpreting market feedback. It is only with a clear strategic perspective that organizations effectively learn from experiments. If the outcome of the innovation is simply a no-go decision, all the information and skills that were developed through it will be lost. But if the firm carefully digs down into where things went right or wrong—which hypotheses were validated or disproved—it can amend the strategy wisely. Instagram's original strategy was to develop a private mobile phone app, Burbn, that "enabled friends to check in to locations, make plans (future check-ins), earn points for hanging out with friends, post pictures, and much more." When users reacted negatively to an app that could do all those things, the baby was not thrown out with the bathwater. Instead, the founders decided to focus on being really good at one thing. Noticing that users posted a lot of pictures, they spent eight weeks developing a better photo-sharing app and doing a beta test. The rest, as they say, is history.

In response to environmental changes and the findings of experiments, the venture builds new internal capabilities and, if necessary, revises the original deliberate strategy. Then the process begins all over again. It is therefore true that the firm evolves as a result of the incremental choices made every day. However, this does not imply that the strategy emerges only after the fact. Rather, at every point in time there has to be clear agreement on the constraints imposed by the current strategy, even if that strategy does shift.

Nuventive, an ed-tech company, had a suite of products for assessing and improving institutional and student performance. But with limited revenue, it had to choose to invest in a focused way. As it turned out, the company's focus would change over the years as market opportunities waxed and waned, and the relative attractiveness of product lines shifted. Nevertheless, at each point in time, the strategy made clear to everyone in the firm which products had priority and which innovative ideas would have first dibs on scarce resources (the software developers). The other products were just provided enough support to keep them viable. Nuventive was, therefore, flexible enough to adjust to the changing marketplace but strategic enough to deliver against the best opportunity.

STRATEGY MATTERS even more to entrepreneurs than to established businesses. Yet lean methods for innovation also have a lot of value. The two are not in conflict; rather their reconciliation in the lean strategy process holds out hope for entrepreneurs in organizations of all sizes to become agile, effective innovators.

Any resource-constrained organization needs a strategy that defines boundaries. Clarifying what is in and what is out of bounds ensures that experimentation is not rampant and is encouraged within those parameters. It helps firms identify the long-term attractiveness of possible business models or market spaces before testing their feasibility. By combining strategy and experimentation in such a fashion, all firms can greatly increase the odds of achieving lasting success.

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SPOTLIGHT

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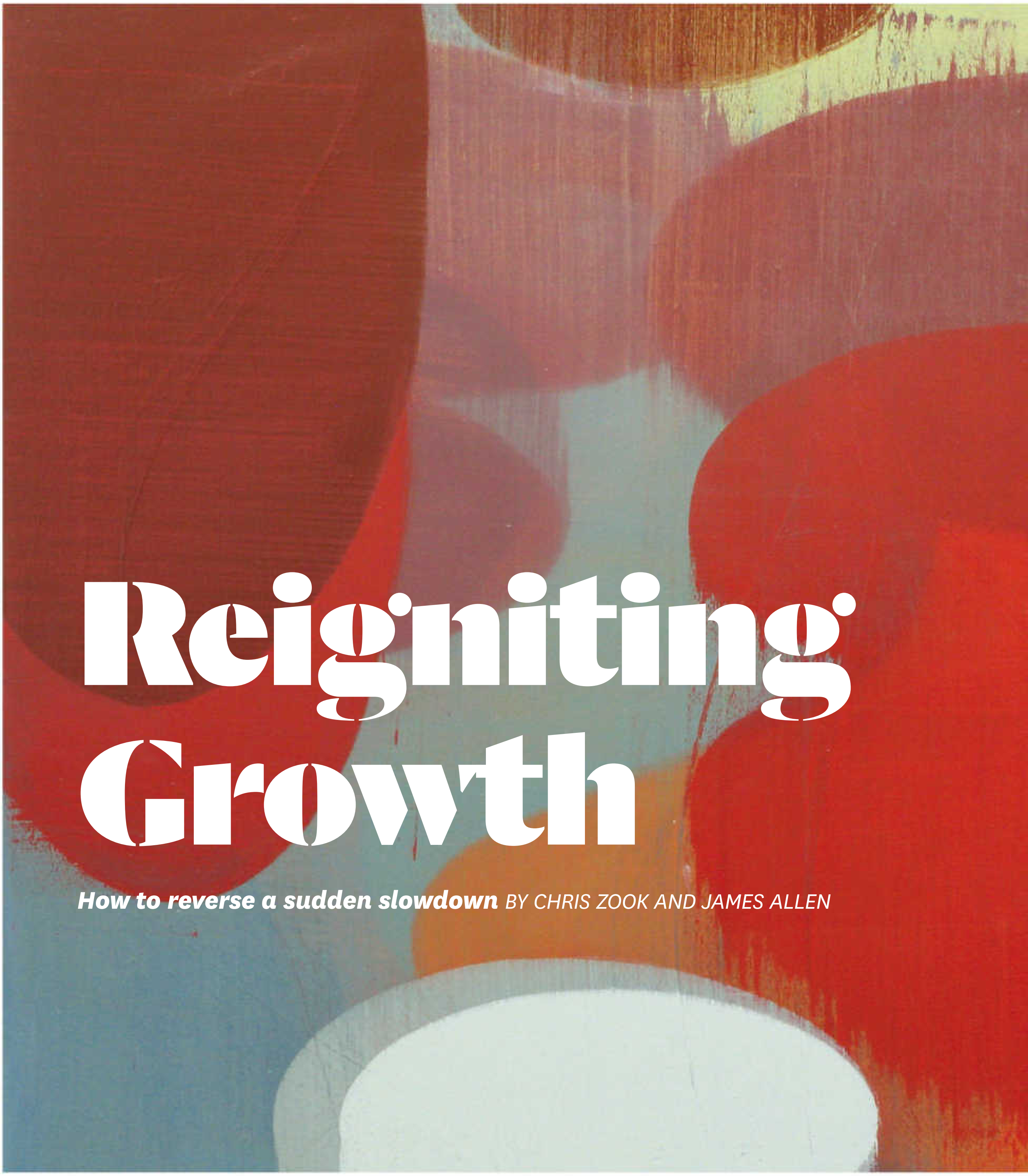
Margaret Neill, *Scout*, 2010
Oil on canvas



Reigniting Growth

How to reverse a sudden slowdown *BY CHRIS ZOOK AND JAMES ALLEN*

Chris Zook is a partner in Bain & Company's Boston office and a coleader of its global strategy practice. **James Allen** is a senior partner in Bain's London office and a coleader of its global strategy practice.

They are the coauthors of several books, including *The Founder's Mentality: How to Overcome the Predictable Crises of Growth* (Harvard Business Review Press, forthcoming).

Most successful companies eventually face a predictable crisis that we call *stall-out*—a sudden large drop in revenue and profit growth or a collapse of once high shareholder returns to well below the cost of capital. Stall-out occurs when the growth engine that powered a company to success stops working. This rarely happens because the business model has suddenly become obsolete—a common misconception. Rather, our research shows that the business has almost always become too complex, most often owing to bureaucracy that slows the company's metabolism, or internal dysfunction that distorts information and hampers managers' ability to make rapid decisions and take swift action on them. When we talk to executives about the symptoms of stall-out, their words vary, but the reasons remain the same. *We've lost touch with customers. We're drowning in process and PowerPoint. We have no shortage of opportunities, but somehow we can no longer act decisively. What was once such a high-energy ride now feels like trying to pilot a plane with no thrust and unresponsive controls.*

In an analysis of 8,000 global companies, we found that two-thirds of those successful enough to reach $500 million in revenue faced stall-out over the 15 years ending in 2013—including notables such as Panasonic, Time Warner, Carrefour, Bristol-Myers Squibb, Alcatel-Lucent, Philips, Sony, and Mazda. More alarming still, for 50 large companies in prolonged stall-out, we found that the onset had usually been sudden: Momentum fell sharply over just a year or two, with growth rates dropping from double digits to low single digits or even negative numbers—a finding consistent with past research (see "When Growth Stalls," HBR, March 2008).

To be sure, external forces put pressure on incumbent companies. Strategy—the external chessboard of business—still matters. Yet competitive strategies are more similar than they used to be, more easily copied, and of shorter duration. The roots of success or failure increasingly lie in the ability of companies to remain fast, perceptive, innovative, and adaptable. Internally thriving companies can respond to shifts in their competitive environments, identifying—and executing—strategies that

When stall-out occurs, it is almost always connected to creeping complexity.

sustain their dominance. When we polled 377 business leaders, 94% of those in companies with revenue of more than $5 billion told us that internal dysfunction—not lack of opportunity or unmatchable competitor capabilities—was now the main barrier to their continued profitable growth.

Yes, stall-out may be predictable, but it can be overcome. We argue in a forthcoming book that most companies with sustainable growth share attitudes and behaviors: (1) They view themselves as business insurgents, fighting in behalf of underserved customers; (2) they have an obsession with the front line, where the business meets the customer; and (3) they foster a mindset that includes a deep sense of responsibility for how resources are used and for long-term results. Because these qualities are most vibrant in companies led by bold, ambitious founders, we call them "the founder's mentality." Since 2000, returns to shareholders in large public companies where the founder is still involved have been three times those for other companies. But any leadership team can harness the revitalizing effects of the founder's mentality. In some cases, a once-dominant mindset has been lost over time and may need to be rebuilt from a few vestiges. But these three qualities can help any company restart its growth engine by removing gunk and complexity that has built up over the years, inhibiting the clean execution of strategy.

1 Rediscover Your Insurgent Mission

When stall-out occurs, it is almost always connected to creeping complexity. "No single bad decision or tactic or person was to blame," Howard Schultz said after returning to the CEO position at Starbucks in 2008 amid shrinking revenue, collapsing margins, and a decline in stock price of more than 75%. Starbucks's stall-out was sudden and dramatic, he acknowledged, but it resulted from damage that had been "slow and quiet, incremental, like a single loose thread that unravels a sweater inch by inch."

To begin tackling stall-out, companies need to strip away complexity and excess cost in order to liberate resources, narrow focus, and harness the vigor that drove the company's early growth. We studied 10 successful rescue-and-rebirth operations and found that all of them involved reducing operating costs by at least 8% and sometimes more than 25%.

Successful attacks on complexity are led from the top down and proceed in a sequence. First the company must shed noncore assets and businesses. Next it must develop a simpler strategy for the remaining businesses. Then it can attack complexity in the core processes. Finally, it can focus on reducing product complexity in design, variations, and customization. We've seen leadership teams attempt transformation in the reverse order, only to become trapped in details and wear down the organization before getting to what really makes most transformations successful: reducing high-level complexity and cost.

We have found that as companies grow in size, internal budget processes become democratic, spreading resources evenly across businesses and opportunities. But democratic investment in the face of crisis is a sure path to mediocrity. The opposite is needed to reverse stall-out. At companies where it was avoided,

Idea in Brief

THE PROBLEM
Growing companies often face the predictable crisis of stall-out—a sudden large drop in revenue and profit growth. The culprits are usually complexity and bureaucracy.

THE SOLUTION
Leaders need to rediscover the "founder's mentality"—attitudes and behaviors that are strongly associated with founding management teams and can revitalize the business.

THE PRINCIPLES
Stalling companies should drastically reduce complexity and excess cost, refresh the mission, and configure the organization to focus obsessively on the business's front line. Finally, they should instill an owner's mindset that eschews bureaucracy and celebrates speed and accountability.

leaders had made bold investment decisions to redifferentiate the company, usually establishing a major new capability that set off waves of growth.

Once back in shape, companies must renew their view of themselves as business insurgents. This does not require promoting a martial culture or abusing the metaphor of "waging war" on competitors. Rather, companies should view their customers as underserved and their industries as setting insufficient standards, and should constantly emphasize what is special about themselves. Bold goals—not just the aim of living to fight another day—will sustain growth. As they become very large, organizations may find maintaining an insurgent mission hard, but it's not impossible. Google's mission to "organize the world's information," for example, is at once specific to Google and nearly infinite in its ambition.

A company should even be prepared to shrink significantly if that's what is needed to regroup, redeploy, and restart profitable growth. Consider the case of Perpetual, the oldest trust company in Australia, which recovered from stall-out by reducing its operating costs by 20%, stripping away noncore businesses, and rejuvenating around its founder's original mission.

Established in 1886 to manage trusts and estates for Australia's scions, Perpetual led the market for most of its history. But as it grew, it diversified into 11 new business areas, and by 2011 the company was struggling. Its share price had fallen from a high of $84 to $24 in only four years. Profits were down by nearly 70%, with no bottom in sight. Shareholders were calling publicly for a major overhaul, and the company had hired its third CEO in 12 months, Geoff Lloyd.

When he arrived, he "found an organization that was internally competitive and externally cooperative," Lloyd told us. "We had grown incredibly complex over time by entering more businesses, and we were not the leader in most of them." Lloyd concluded that to save Perpetual, he would have to return the company to its core mission: the protection of Australia's wealth. That, he realized, meant making the company "faster, more confident, and, above all, simpler."

Lloyd began by replacing 10 of the 11 members of the management team with people who had no vested interest in past decisions. With his new staff in place, he launched Transformation 2015, five initiatives designed to bring about swift complexity reduction at all levels. One was the "portfolio" initiative, which reduced the number of businesses from 11 to three (just two businesses were responsible for about 95% of profits), cut real estate holdings by half, and eliminated more than 100 legacy funding structures. Another, the "operating model" initiative, reduced the staff at headquarters by more than 50%. Lloyd and his team found that back-office support, staff functions, and redundant controls accounted for 60% of total costs. In other words, the company was putting only 40% of its money toward sales, customer service, and investment—its core activities. Furthermore, it was relying on more than 3,000 computer systems and applications.

Cutting back—on businesses, staff, computer systems, and more—was central to the transformation plan. But Lloyd and his team also crafted a plan to gain market share by investing in the company's core. He convened town hall meetings, which had never before been held at Perpetual, to discuss the company's situation and its future and to reignite enthusiasm for its core values. "We labored over the wording of our mission and strategy," Lloyd told us, explaining that he felt it was essential for employees to refocus on the founding principles of the company. In the process, he learned a remarkable thing: Perpetual's original trust business was so strong that it still had its first customer—125 years later.

His strategies brought about a stunning turnaround. Perpetual's stock price has more than doubled since Lloyd took over; employee engagement has measurably increased; the company is gaining share in its core markets; and net profits have tripled.

2 Obsess over Your Business's Front Line

Companies that sustain growth live and breathe the front line of their business. This obsession, which can often be traced back to a strong founder, shows up in three ways: an elevated status for frontline employees, a preoccupation with individual customers at all levels of the company, and an institutional curiosity about the details of the business. A frontline obsession is most obvious in "high-touch" consumer businesses such as luxury hospitality. But the trait can exist in subtler ways in a range of industries: Consider the product obsession of Steve Jobs and the legendary attention to detail of the wine pioneer Robert Mondavi, who believed in the saying "The best fertilizer for a vineyard is the owner's footsteps."

The Home Depot, the largest home-improvement retailer in the world, provides an example of how losing a frontline obsession can lead to stall-out—and how renewing it can reignite growth. The company's initial success could be traced to its remarkable founders, Bernard Marcus and Arthur Blank, who devoted themselves to building a close advisory relationship with customers. Their corporate mantra was "Whatever it takes." The founders even trained store employees in customer service themselves. Employees, in turn, offered clinics on home improvement projects for customers and were always available in stores to provide knowledgeable advice. The strategy set the company apart and generated powerful customer loyalty, and for years The Home Depot was a major success story. From its founding, in 1978, until 2000, it consistently eclipsed its 20% annual earnings growth targets. But in December 2000, after missing an earnings target and having become increasingly concerned about antiquated systems—especially IT—in a company that was approaching $50 billion in revenue, the board of directors hired Robert Nardelli, a senior executive from GE, to introduce some big-company discipline as CEO.

Nardelli created a command-and-control environment. By early 2006, 98% of the company's top 170 executives were new to their jobs, and 56% of the new managers at headquarters had come from the outside. Fresh leadership, especially in the area of systems, was probably needed, but this changing of the guard failed to build on the deep strengths that had once made the company special and beloved by its customers. Nardelli and his team neglected customer relationships and frontline enthusiasm in favor of boosting quarterly profits. Many long-serving full-time employees were replaced by lower-paid part-time workers, and customer service collapsed. "Do it yourself," some people joked, was now "Find it yourself." When the University of Michigan released its 2006 American Customer Satisfaction Index, The Home Depot had slipped to last among major U.S. retailers. The board held meetings in the field and found a consistent pattern: concern for the future, disempowerment of longtime store employees, and a feeling that the social contract between the company, its employees, and its customers was being breached.

Greg Brenneman, the longest-serving board member and a global turnaround expert, told us, "You could see the serious trouble bubbling up under the surface. Store managers were feeling shackled by dozens of financial templates and metrics that took time away from customers and running the stores. The most experienced store employees, the real experts on plumbing or electricity, had been let go and replaced with less experienced and cheaper part-time store workers. Foot traffic, the lifeblood of any retailer, was dropping. New stores were not generating good returns, leading to further staff cuts. We were stalling out and needed to change course."

The deterioration of the customer experience was at the root of the company's woes, and thus it illuminated a path back to sustainable growth. In 2007 the board replaced Nardelli with Frank Blake.

The owner's mindset focuses on the long term and has a strong bias toward speed and action.

On his very first day on the job, Blake spoke to all employees using The Home Depot's internal television station and quoted extensively from Marcus and Blank's book, *Built from Scratch*. In particular, he highlighted two of their charts. One listed their core values, and the other gave pride of place, at the top of an inverted triangle, to the company's front line: its stores, where customers and employees interact.

Many of Blake's first initiatives focused on restoring the "orange-apron cult": knowledgeable store employees, easily identifiable by their aprons, who focused on high levels of customer service. Taking advice from Marcus, Blake also began anonymously visiting stores on "undercover missions," as he called them. These proved so valuable that he instructed his senior executives to adopt a "management by walking about" approach, something most had never done before.

Like Lloyd at Perpetual, Blake then set out to reduce complexity, restructuring the businesses and closing money-losing stores—essentially, shrinking to grow. He also increased the employee bonus pool by a factor of seven, rehired some veterans, and asked store managers to return to the pre-Nardelli policy of giving out honor badges to employees who had been exceptionally attentive to customers.

Eight years ago The Home Depot had stalled out and was facing the prospect of free fall. But as of the end of 2015, thanks to Blake's renewal of the founders' mentality, the company has reenergized its employees and repersonalized its customer experience—a return to core principles that has driven the company's stock from about $25 a share in 2009 to more than $130 by December 2015.

3 Instill an Owner's Mindset

The third factor in reversing stall-out involves a management idea that first came into vogue 40 years ago: the owner's mindset. Designed to instill balance-sheet discipline and accountability by aligning employees and shareholders, this concept is frequently misunderstood. Too often, it implies an incumbent's mindset: a concern with hunkering down and extracting value from the existing business, and a loss of interest in innovating, serving customers uniquely, and fully valuing frontline employees.

At its best, the owner's mindset focuses on the long term, has a strong bias toward speed and action, and embraces personal responsibility for employees' actions and for how resources are used. The power of the owner's mindset is central to the rise of the private equity industry—a reaction against the bureaucracy, poor cost management, and complexity that beset many large companies. When we analyzed the returns of deals within several private equity funds, we found that businesses sold by large public companies in which management had seemingly lost the incentives of ownership subsequently earned nearly 50% more than the others. After private equity firms had restored the owner's mindset, these companies benefited from increased speed, reduced bureaucracy, a more critical evaluation of noncore businesses, and an improved management of costs.

A case in point is Dell, the best-performing large company of the 1990s. It began to stall out a decade later, when some of the advantages of its legendary direct sales model began to narrow, and the company saw its market value decline from $107 billion in 1999 to just under $25 billion in 2013—a 77% drop. When Michael Dell returned as CEO to renew the company he'd founded, he concluded that he could more effectively make the changes he wanted if he took the company private, which he did in partnership with Silver Lake in 2013.

"In going private," he told us, "it's amazing how we have been able to speed things up. We simplified meeting structures, went to a board of directors with just three members, and increased our appetite for risk. When big committees talk about risk, they talk about risk committees, how risk is bad, the mitigation procedures of risk, and the reaction of the analysts. For us risk is now about innovation and success. It has been very energizing to our 100,000 employees to feel the long-term focus coming back into the company."

Customer satisfaction scores have rebounded, and Dell's employee satisfaction scores are the highest in the company's history. Its core businesses are outgrowing their industry peers again, and Dell is investing heavily to redefine its model for the long term.

Going private is not for all, of course. An owner's mindset can be instilled without taking the business off the market. Companies can generate "mini-founder" experiences by, for example, creating franchises with direct ownership stakes or encouraging employees to create internal start-ups that might later be spun off. They can encourage investors

HOW TO GET STARTED

Here are some ways to prepare your team to reignite growth.

Create a "founder's mentality" scorecard. Manage it as a strategic asset. Does your mission keep you fighting in behalf of your customers? Does your company focus on the front line of the business? Do employees embrace an owner's mindset that eschews bureaucracy, is focused on speed, and demands personal accountability?

Benchmark against your most successful upstart competitors. Are they winning on speed and cost? Commit as a leadership team to closing the gap.

Launch a campaign against bureaucracy. Look for management layers and processes that have outlived their usefulness. Eliminate them.

Get the leadership team out of the office. The front line is where the answer to a growth stall-out is most likely to reside.

Reexamine the precepts and practices of your founders or early leaders. When was the company at its best? What has been lost along the way that needs to be restored?

Look outside for help inside. You might reach out to retired founders or acquire fast-growing, founder-led young companies.

with a more long-term focus and link executive pay more closely to long-term performance measures. They can change the timing of internal meetings to increase the speed of decision making. (Some leadership teams, for instance, hold Monday meetings and Tuesday follow-ups with the aim of removing blockages to important decisions and actions.) They can reach outside the company to partner with insurgents and perhaps eventually acquire them. Or they can bring founders into the company through acquisition and work to retain them and their entrepreneurial energy. This has been the approach of companies such as Cisco, Google, and eBay.

Initially a huge success story, and one of the first dot-coms to radically scale up, eBay stalled out in the late 2000s—a victim of Amazon and other online retail competitors and of its own diversification, which included acquiring Skype. Its aging e-commerce auction model seemed vulnerable to competitors, and its share price had fallen from $59 in 2004 to a low of $10 in 2009.

Some of the biggest stock upturns occur when a company has to return to its core.

When John Donahoe became the CEO at eBay, he recognized that to get the company moving again, he would have to divest noncore businesses, revamp eBay's e-commerce platform, and, most important, shift its focus to a hotbed of innovation: mobile commerce. To successfully enter the mobile space, however, he would have to turbocharge the company's innovation pipeline and capabilities—and the only way he could manage that, he told us, would be "to fill eBay with young entrepreneurs." In doing so, he was guided by a general truth about transforming stalled-out companies: Often, outside forces need to be brought in.

Not long after he took over, Donahoe began to acquire small, founder-led companies at a rate of about one every three months. He wasn't interested solely in acquisitions and technological innovations. He wanted to retain the founders and their teams, frequently so that he could move them into core-business positions. "Many of these founders like our approach," Donahoe told us, "because they can innovate at scale in eBay, and they get to expose their innovations to 130 million customers globally."

One of them was Jack Abraham, the 25-year-old founder of Milo, a shopping engine that searched stores for the best-priced merchandise. At one of the regular Friday meetings that Donahoe held with company leaders under 30, Abraham raised his hand and proposed a major innovation for the home page. Donahoe told him to go figure out what resources he needed to explore the idea. Immediately after the meeting, Abraham found five of the best developers in the company, went out for drinks with them that night, and persuaded them to leave with him the next morning for two weeks in Australia, where they would be as isolated from California headquarters as possible and could work on developing a prototype.

What they came up with blew Donahoe away. "Had we asked a normal product team," he said, "I would have gotten back hundreds of PowerPoint slides and a two-year time frame and a budget of $40 million. Yet these guys went away, worked 24/7, and built a prototype. These guys build. They do no PowerPoint. They just build."

Obviously, Donahoe's approach is best suited to fast-moving markets where incumbents need to constantly add technologies and build new capabilities. Not all these initiatives have been lasting successes. The fivefold increase in eBay's stock price during Donahoe's tenure was driven by many things, including the success and spin-off of PayPal (whose independent status has enhanced its founder's mentality), yet it is a clear example of the power of pulling in business owners from the outside and harnessing their energy and entrepreneurialism.

STALL-OUTS ARE frightening for companies—if ignored or mishandled, they can lead to lasting reversals of fortune. But like any other daunting challenge, they can also be viewed as an opportunity. When we analyzed value swings on the stock market, we found that some of the biggest upturns occur when a company is forced to return to its core and redefine it in the process. Managers need not panic when stall-out occurs. Companies that reignite their mission, renew their obsession with the front line, and instill an owner's mentality throughout the organization can reach new heights.

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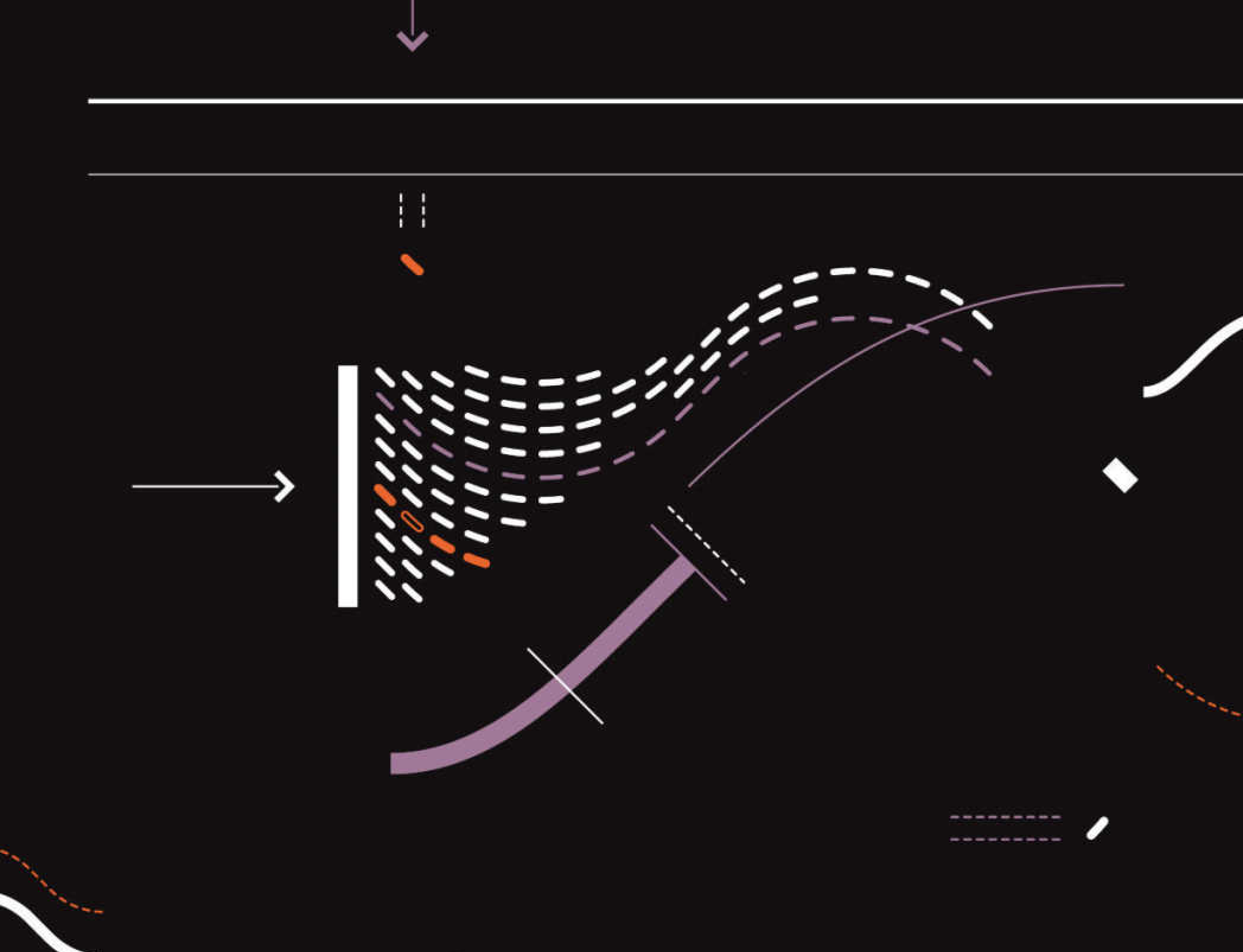
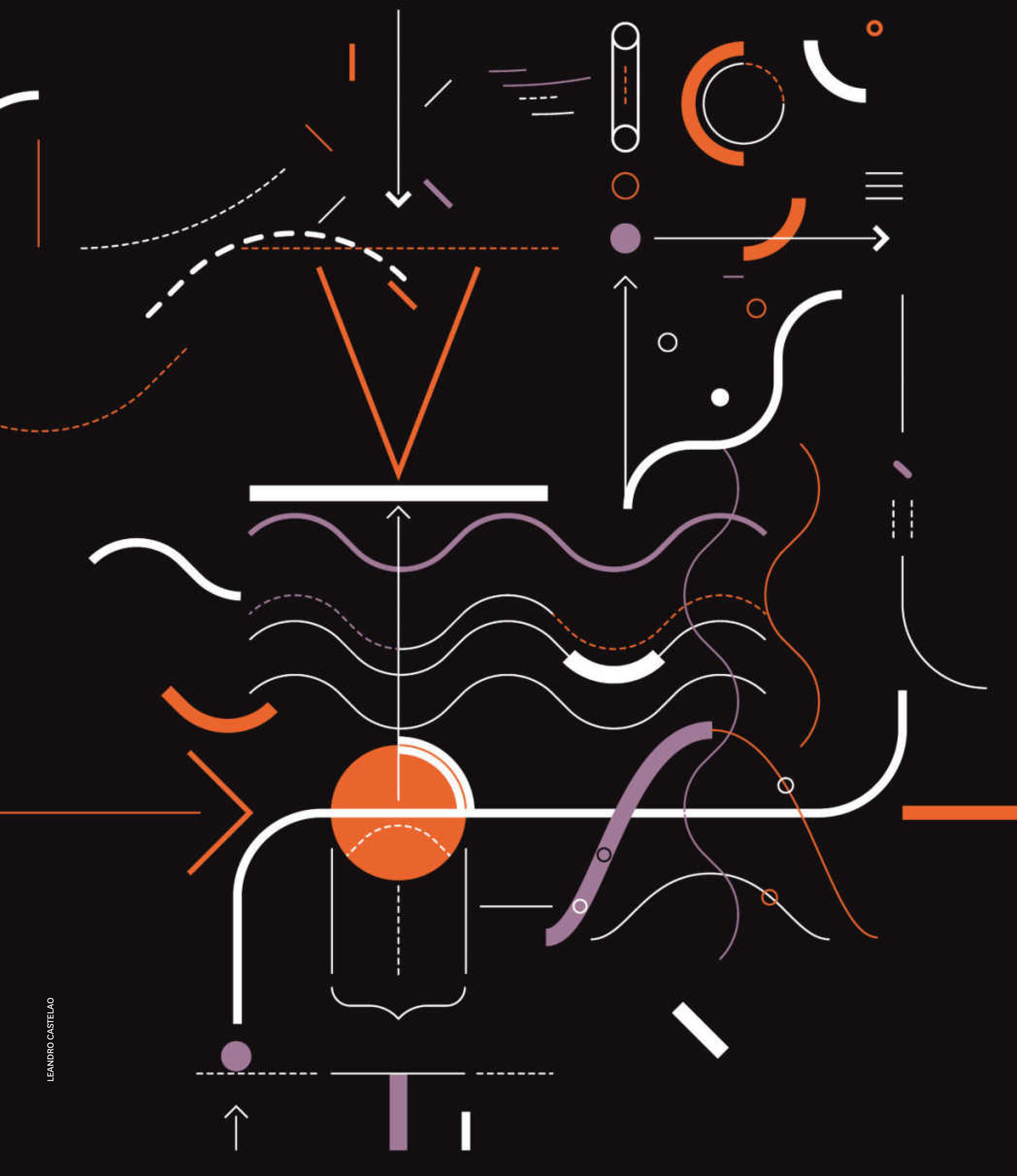


THE OTHER DISRUPTION

When innovations threaten the organizational model

BY JOSHUA GANS



LEANDRO CASTELAO

Since Clayton Christensen published *The Innovator's Dilemma,* in 1997, management scholars have focused on innovations that disrupt customer demand patterns. The story usually plays out like this. A new entrant develops an innovative product that is initially attractive only to a niche segment of customers and may underperform mainstream products on traditional measures. At first, customers reject the innovation, but as it improves rapidly along performance dimensions that they care about, they begin to embrace it, and the new entrant becomes a real threat to incumbents.

Over the past two decades, managers have developed a defensive playbook for confronting this kind of "demand side" disruptive innovation. Most commonly, they'll either acquire new entrants or "disrupt themselves" by setting up autonomous units charged with exploring potentially disruptive innovations. The idea is that once the disruptive innovation begins to dominate the industry, the firm will be ready to roll its new technology into its principal operations, transforming itself in the process.

But pulling that off turns out to be more difficult in practice than it sounds in theory: In many cases, disrupted incumbents find themselves unable to transfer the new technologies into their mainstream operations because doing so requires them to fundamentally change the way they manufacture and distribute their products. In essence, the basic architecture of the product—how it is put together—changes along with customer expectations and preferences, creating "supply side" disruption.

Consider the challenge the iPhone posed to the BlackBerry in 2007. By all accounts, the iPhone initially was a poor performer in terms of call quality, battery life, and network usage compared with the BlackBerry, and it did not include the keyboard that BlackBerry users loved. But the iPhone's fundamentally new product design, as we know with hindsight, represented the future, and customers began to embrace it. BlackBerry and its peers moved quickly to include iPhone-like features—such as a touch screen and a better web browser—but they were unable to compete effectively because the innovation required them to redesign the process for making phones from the ground up. Only newer entrants like Samsung, who were not locked into an existing production model and could more easily orient the organization around the new product architecture, were able to really challenge the iPhone.

Though less commonly understood, supply-side disruption is arguably more dangerous than the kind Christensen describes; indeed, disruption of a product's architecture threatens a company's very survival in a way that changes in customer demands do not. The good news is that demise is not necessarily inevitable when product architectures and, therefore, organizational structures are upended. Incumbent firms can survive, and some even thrive on, repeated architectural disruptions. On the basis of research by Rebecca Henderson, Mary Tripsas, and others and my own study of companies facing disruption, I have identified three prescriptions for long-term survival: an integrated organizational model, ownership of a feature important to the end customer, and a strong sense of corporate identity. Let's look at each of these in turn.

The Virtue of Integration

The first rule of surviving architectural disruption—developing an integrated organizational model—has its roots in the work of management scholar Rebecca Henderson. From 1987 to 1988, she collected data and conducted interviews on the impact of innovation on the photolithographic alignment industry. Photolithography is the standard method of fabricating printed circuit boards (PCB) and microprocessors. Henderson found that while the industry experienced continual incremental innovation in aligner technology, it also underwent four separate waves of disruptive innovation. The four waves didn't affect prices, which remained stable—a pattern that differs from Christensen's examples, in which disruptors enter at the low end of the market and apply downward pressure across the industry. Rather, they changed the way the aligners were put together and manufactured, representing a relatively pure example of architectural, or supply-side, disruption.

Idea in Brief

THE PROBLEM
The defensive playbook for confronting disruptive innovations calls for companies to set up separate units to develop competing technologies. In practice, though, companies struggle to transfer new innovations and capabilities back into their mainstream operations.

WHY IT HAPPENS
Many disruptions necessitate changes to the basic architecture of a product—the way it's put together. Adapting to this requires deep organizational integration across tasks and functions, but most large companies organize R&D and operations around product components.

THE SOLUTION
Incumbent firms that survive changes to product architecture usually owe their success to one or more of three key factors: an integrated organizational model, ownership of a feature important to the end customer, and a strong sense of corporate identity.

With each wave of disruption, market share shifted dramatically in favor of new entrants. On average, they captured more than half the market in their first year. When an incumbent was first with a new architecture, it gained only 7% of the market, on average. Incumbents also fared worse in terms of market share gained per dollar of R&D spent on the architectural innovations.

Yet one incumbent company, Canon, bucked the trend and maintained its market share throughout the waves of disruption. Henderson found that what chiefly distinguished Canon from its competitors was its more integrated organization, which supported investments in different generations of technology at the same time. Canon cultivated tightly knit teams that had a wide range of capabilities and experience across all the technology generations. This organizational structure meant that it was able to imagine and respond to new product architectures. By contrast, Canon's competitors were largely organized around the traditional product architecture. Their teams focused on building specialized knowledge of components and generating rapid but incremental innovation, with consequent improvements in efficiency and performance.

Although Canon was routinely a few years behind competitors with next-generation products, ceding first-mover advantage, its organizational structure enabled it to seize other kinds of advantage. In particular, Canon's engineers had the benefit of learning from their competitors' innovations and used those insights to reinvent not just its components but also its product architecture. Indeed, two of the waves of disruption—the proximity printer and scanning projection—were based on technology and processes that Canon had developed internally.

Although other incumbents also recognized the value of emerging technologies, their organizational models appeared to resist the innovations. Here's a typical example. In 1965, Kasper Instruments, a component supplier in the photolithography industry, introduced a contact aligner; just five years later, it had captured half the market. But when it realized, in 1973, that "proximity" capability could further improve its product and launched the new technology, microprocessor manufacturers rejected the innovation. The new technology took off only after Canon introduced an improved proximity aligner in the late 1970s. Kasper's inability to profit from its early insight stemmed from its failure to understand that introducing the capability required changing the relationship between the aligner's components.

The Importance of Unique Assets

The big risk in taking an approach like Canon's is forfeiting first mover advantage. This risk, however, is eliminated if the company owns a core element of the product whose architecture is being disrupted—something that the customer values. Nowhere is this more clearly illustrated than in the print typesetting industry.

Typesetting dates back to the 1400s and Gutenberg's invention of movable type. Not until 1886 was the modern approach of using a keyboard as the primary input device invented by Ottmar Mergenthaler. His Linotype machine, which used liquid metal to create the type, reigned for about 60 years as the only method of typesetting. Mergenthaler Linotype, along with two other firms—Intertype and Monotype—dominated the industry.

In 1949 the technology changed, and hot metal pouring gave way to a photographic process using a xenon flash. A decade later, the process went digital and the xenon flash was replaced by a cathode ray tube. Finally, in 1976, today's laser typesetting technology became the standard. You might expect, on the basis of Henderson's research, that with each wave of innovation a new entrant would have become the market leader. Yet Mergenthaler long remained a dominant player in the industry.

When the xenon-flash phototypesetting technology emerged, the three incumbents had time to work out their strategies, and it was the choices they made at this point that decided their futures. All three developed machines that incorporated the new technology. Intertype was the first to market. Allying itself with external partners such as Kodak, it sought to graft the technologies onto its existing machines, leaving its component interfaces and production processes unchanged in any fundamental way.

Mergenthaler took a very different approach, as research by Mary Tripsas, of Boston College's Carroll School of Management, shows. After an initial failed attempt to build a new machine, it went back to the drawing board, recruited people with expertise in the new technology, and integrated them closely with an existing team in order to design not just a new machine but a completely new model for producing it. As was the case with Canon, this process slowed Mergenthaler down: It took 10 years to come out with its first phototypesetting machine. How, then, did Mergenthaler survive the delay to reap the benefits from its superior architecture?

The answer is simple. It owned fonts. The primary customers of typesetters were newspapers and publishers. Each had a look and feel to its products that depended crucially on the font it used. And as it turned out, those fonts were proprietary and owned by the incumbent hot metal typesetters. So if a customer wanted Helvetica (perhaps the most popular font of all time), it would have to purchase the font from Mergenthaler. The company did not own any specific intellectual property other than the trademark on the name, but that proved enough to give the company an advantage. Although the dominant technology of the machines may have changed over the years, customer demand for the fonts never waned.

Of course, all three companies owned fonts. So why did Mergenthaler benefit more than the others? Because it exploited the breathing space provided by its ownership of fonts to explore the architectural disruption that the new technology entailed and eventually offered a demonstrably better typesetter. It could have opted to unbundle its fonts and abandon typesetting altogether, but until digital typesetting appeared, it was not easy to separate the price of a font from the cost of typesetting with it, so supplying the machine remained an integral part of the business. It is only since the advent of full digital typesetting that Mergenthaler has exited the physical part of the business to focus on marketing and licensing its fonts.

The Power of Identity

Both Mergenthaler and Canon demonstrate that firms can ride out architectural disruptions in cases in which the final products (newspapers and printers) remain functionally the same even though the underlying technology of producing them has changed radically. But some architectural disruptions trigger fundamental changes in the value proposition as well, necessitating a reinvention of corporate strategy along with a reconfiguration of the way companies develop and manufacture their products. A good example of disruption on this scale is the photography industry.

We all know the story of how the leading incumbents, Polaroid and Kodak, failed to make the transition from film to digital photography. Although both had anticipated the shift, organizational priorities and internal conflicts made it difficult to

How It's Made Matters

Early in the evolution of a complex, technology-based product, engineers experiment with different ways of putting the components together. Eventually, a dominant product architecture emerges—one that sets standards for components and how they relate to one another. At this stage, engineers working on the products are consciously aware of the rationale behind the dominant design. They have the architectural knowledge to understand how a change in one component affects the performance of others and to manage trade-offs as components evolve.

From that point on, most firms begin to organize themselves around the product components. Specialized teams on a smartphone, for example, work on the battery, the casing, the input screen, and so on. It makes sense to have these component teams working furiously on improving their parts of the product: It is wonderfully efficient and leads to a smoothly operating firm. The downside is that engineers and designers become less aware of the overall product architecture and the trade-offs and relationships embedded within it; architectural knowledge becomes tacit and part of the wallpaper.

When technological advances lead to a new product architecture, companies with modular organizations often falter. Because of their specialization, component teams lose sight of technological advances outside their area of focus as well as the larger picture of how components are put together. (At this point, it's very possible that nobody in the firm is focused on overall architectural design.) When a new architecture emerges, managers tend to undervalue it, because it usually doesn't initially deliver as good a performance as the continually improving established architecture does.

By contrast, firms whose operations remain more closely integrated across task and function boundaries adapt better to architectural change (at least in principle). Their architectural knowledge is conscious and widely distributed; they are more alert to the potential of a new architecture to deliver very rapid performance improvement in production and to give rise to products that displace those of incumbents.

embrace a radically new business model that did not include high margins from film as a revenue source. One company, however, was able to make the shift: Fujifilm. Mary Tripsas offers an explanation—one that takes a leaf out of Ted Levitt's seminal HBR article "Marketing Myopia": When a firm establishes an externally oriented identity built around the needs and desires of customers and the emerging technologies and markets that support them, it can manage the inevitable conflicts over capital and resources without having to sacrifice the strengths.

Fujifilm, like its competitors, realized the potential for digital photography early on. It began researching new technologies in 1975 and produced prototype products in the early 1980s. At the time, the bulk of its sales came from film, photographic paper, and photographic chemicals, but the company also had businesses in x-ray film and processors, microfilm, graphic arts films, magnetic tape, and carbonless copying paper. This breadth of capabilities and scope allowed Fujifilm to define itself as something more than a film manufacturer or photography company like Kodak and other competitors. In 1978 it began describing itself instead as an "audio-visual information recording company." This was the first step in a longer strategic process that moved the company's identity away from the rather specific domain of photography to the broader domains of "image and information."

This orientation had clear strategic implications for Fujifilm. For instance, it could consider launching a high-priced hardware product for electronic radiography without worrying about violating the traditional "razor and blades" business model whereby photography companies sold their hardware cheap in order to get customers hooked on film. The more inclusive identity of Fujifilm made it easier for managers to envision and implement new business models suited to the digital world. Fujifilm also took a path very different from competitors' in how it approached research and development. For example, its digital imaging units were integrated with the main R&D division, whereas Polaroid's were distinct. This gave Fujifilm's digital units legitimacy and minimized internal conflicts during the transition away from film. The company was also able to find new imaging applications for the existing chemistry capabilities it had built up through the film business, notably applying chemicals in display screens for digitally generated images.

By becoming an "information and imaging" company, therefore, Fujifilm was able to thrive in the digital realm in ways its competitors failed to do.

The Real Dilemma

Facing down the threat of architectural disruption does come at a cost. Organizational integration requires managers to move fluidly across teams or develop cross-functional teams responsible for multiple technologies—old and new—simultaneously so that embedded architectural knowledge is brought to the top. This model is diametrically opposed to traditional prescriptions for high performance, which call for modular structures and stand-alone "next generation" product development teams.

Further Reading

For more on the theoretical underpinnings of ideas in this article, see the following:

"Architectural Innovation: The Reconfiguration of Existing Product Technologies and the Failure of Established Firms"
by Rebecca M. Henderson and Kim B. Clark (Administrative Science Quarterly, 1990)

"Product Development Capability as a Strategic Weapon: Canon's Experience in the Photolithographic Alignment Equipment Industry"
by Rebecca M. Henderson (Managing Product Development, 1996)

"Surviving Radical Technological Change Through Dynamic Capability: Evidence from the Typesetter Industry"
by Mary Tripsas (Industrial and Corporate Change, 1997)

"Managing in an Age of Modularity"
by Carliss Y. Baldwin and Kim B. Clark (HBR, September–October 1997)

"Disruptive Technologies: Catching the Wave"
by Joseph L. Bower and Clayton M. Christensen (HBR, January–February 1995)

Therefore, companies face a dilemma: Organizing around a modular structure is extremely efficient in developing component innovation; however, the separate divisions create organizational barriers, closing off paths by which new architectural knowledge can be integrated into the primary business.

So what's the most coherent strategy for survival? Demand-side disruptions can often be managed reactively through acquisition or even cooperation with the emerging disruptors. In many industries, my research shows, disruptors and incumbents do in fact cooperate very successfully, suggesting that the conventional disruption narrative—whereby the plucky disruptor displaces the incumbent—is not the standard plot. Much more often incumbents acquire the disruptor or license from it. This is not to say that managers facing demand-side disruption should sit idle. Even reactive management requires the development of internal capabilities, and, as empirical evidence emphatically shows, few companies are good at acquiring or integrating other companies or at managing relationships with entrepreneurial firms.

That said, companies should put most of their focus on managing proactively for architectural disruptions, because they are more likely to be firm-ending events. Managers should organize the firm toward deeper integration and build a more inclusive identity so that architectural innovations can be absorbed and exploited, while ensuring that they retain control or ownership of key aspects of the end customer experience that will remain relatively constant through disruption. This will represent a substantial shift in managerial focus and best-practice assumptions—which is hardly surprising considering the general lack of attention paid to architectural disruption.

WHEN IT comes to disruption, companies that survive best generally don't perform best. They may be solid competitors, but they are unlikely to be the leading player. By the same token, companies that perform best may ultimately be doomed—sooner or later they'll encounter a disruption that will render them obsolete. To some extent, this is also nature's model. Large, specialized animals like pandas and polar bears struggle to survive the depredations of humanity. By contrast, adaptable, usually smaller mammals—think foxes and monkeys—seem to be carving out a successful niche for themselves in towns and cities. The difference is that animals can't choose whether to be adaptable or not. Companies and their managers can.

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Joshua Gans is a professor at the University of Toronto's Rotman School of Management, where he holds the Jeffrey S. Skoll Chair of Technical Innovation and Entrepreneurship. He is also the chief economist of the University of Toronto's Creative Destruction Lab and the author of *The Disruption Dilemma* (MIT Press, 2016).

A New Narrative

Most managers are very familiar with the disruptive innovation narrative described by Clay Christensen: Disruptors enter a market and compete fiercely with incumbents, gobbling up market share as their innovations gain traction. So it may come as a surprise to learn that more often competition between disruptive innovators and incumbents morphs into cooperation.

In a recent study of more than 50 years of start-up strategies in the automatic speech recognition industry, Matt Marx, David Hsu, and I examined innovations in the industry that fit Christensen's definition of disruptive: technologies that entered at the low end of the market and improved steadily over time on traditional metrics. New entrants introduced most such innovations, but they typically ended up being acquired by or cooperating with incumbents.

A case in point is Vlingo, which in 2010 developed a mobile speech recognition app. Unlike existing software, the new technology did not confine users to a predefined set of recognizable phrases but rather allowed them to speak naturally. Not surprisingly, it was initially less accurate than previous technologies.

Vlingo's long-term goal was to embed its technology in mobile devices and other companies' apps under license, but because of its poor performance early on, it needed to prove to mobile providers that consumers would take to the technology. So it went to market with its own app, competing directly with companies it hoped to eventually secure licensing deals with. This strategy worked: Customers began to embrace the technology, and Vlingo was able to switch from competing against incumbent firms to cooperating with them.

Vlingo was not alone: We found (controlling for other factors) that among new entrants who started out competing with incumbents, those with disruptive technologies were four times as likely to switch to cooperation as those with nondisruptive innovations. This suggests that for incumbents, waiting until a disruptive technology has been proven and then cooperating with the most promising entrant is a successful strategy for dealing with demand-side disruption.

Adam Grant is a professor of management and psychology at the University of Pennsylvania's Wharton School and the author of *Originals: How Non-Conformists Move the World* (Viking, 2016).

How to Build a Culture of Originality

ANYONE CAN INNOVATE IF GIVEN THE OPPORTUNITY AND THE SUPPORT. **BY ADAM GRANT**

NICK VEDROS/GETTY IMAGES; PHOTO ILLUSTRATION: STEPHEN WEBSTER

If there's one place on earth where originality goes to die, I'd managed to find it. I was charged with unleashing innovation and change in the ultimate bastion of bureaucracy. It was a place where people accepted defaults without question, followed rules without explanation, and clung to traditions and technologies long after they'd become obsolete: the U.S. Navy.

But in a matter of months, the navy was exploding with originality—and not because of anything I'd done. It launched a major innovation task force and helped to form a Department of Defense outpost in Silicon Valley to get up to speed on cutting-edge technology. Surprisingly, these changes didn't come from the top of the navy's command-and-control structure. They were initiated at the bottom, by a group of junior officers in their twenties and thirties.

When I started digging for more details, multiple insiders pointed to a young aviator named Ben Kohlmann. Officers called him a troublemaker, rabble-rouser, disrupter, heretic, and radical. And in direct violation of the military ethos, these were terms of endearment.

Kohlmann lit the match by creating the navy's first rapid-innovation cell—a network of original thinkers who would collaborate to question long-held assumptions and generate new ideas. To start assembling the group, he searched for black sheep: people with a history of nonconformity. One recruit had been fired from a nuclear submarine for disobeying a commander's order. Another had flat-out refused to go to basic training. Others had yelled at senior flag officers and flouted chains of command by writing public blog posts to express their iconoclastic views. "They were lone wolves," Kohlmann says. "Most of them had a track record of insubordination."

Kohlmann realized, however, that to fuel and sustain innovation throughout the navy, he needed more than a few lone wolves. So while working as an instructor and director of flight operations, he set about building a culture of nonconformity. He talked to senior leaders about expanding his network and got their buy-in. He recruited sailors who had never shown a desire to challenge the status quo and exposed them to new ways of thinking. They visited centers of innovation excellence outside the military, from Google to the Rocky Mountain Institute. They devoured a monthly syllabus of readings on innovation and debated ideas during regular happy hours and robust online discussions. Soon they pioneered the use of 3-D printers on ships and a robotic fish for stealth underwater missions—and other rapid-innovation cells began springing up around the military. "Culture is king," Kohlmann says. "When people discovered their voice, they became unstoppable."

Empowering the rank and file to innovate is where most leaders fall short. Instead, they try to recruit brash entrepreneurial types to bring fresh ideas and energy into their organizations—and then leave it at that. It's a wrongheaded approach, because it assumes that the best innovators are rare creatures with special gifts. Research shows that entrepreneurs who succeed over the long haul are actually more risk-averse than their peers. The hotshots burn bright for a while but tend to fizzle out. So relying on a few exceptional folks who fit a romanticized creative profile is a short-term move that underestimates everyone else. Most people are in fact quite capable of novel thinking and problem solving, if only their organizations would stop pounding them into conformity.

When everyone thinks in similar ways and sticks to dominant norms, businesses are doomed to stagnate. To fight that inertia and drive innovation and change effectively, leaders need sustained original thinking in their organizations. They get it by building a culture of nonconformity, as Kohlmann did in the navy. I've been studying this for the better

Idea in Brief

WHAT'S POSSIBLE
We tend to believe that true innovators are a rare breed. But most people are quite capable of original thinking, and leaders can set them up for success by building a culture of nonconformity.

WHAT GETS IN THE WAY
Unfortunately, leaders often fail to do this because they have trouble moving past their flawed assumptions—for instance, believing that doing fewer things leads to better work, and that strong cultures squash originality.

WHAT TO DO
Give employees ways and reasons to generate lots of new ideas (being prolific actually increases quality). Have fellow innovators evaluate the ideas (they do the best job of predicting success). And strike the right balance between cohesion and dissent in your organization (you need both).

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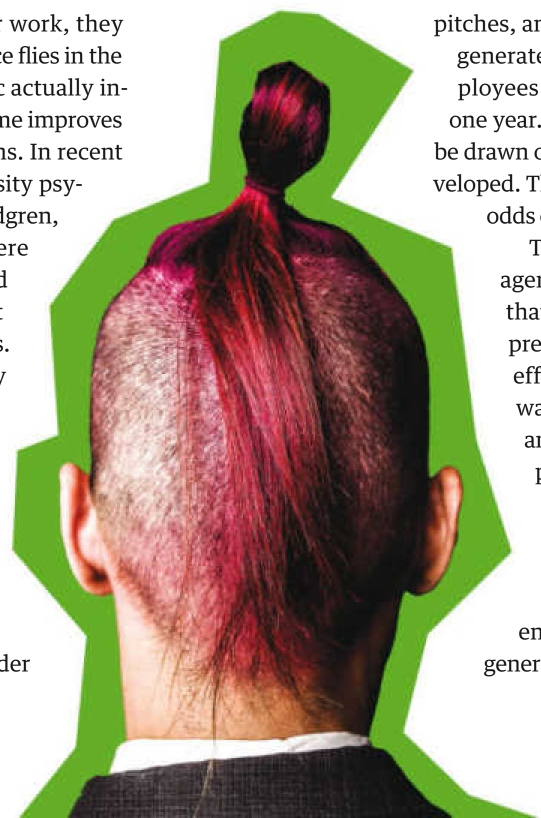
part of a decade, and it turns out to be less difficult than I expected.

For starters, leaders must give employees opportunities and incentives to generate—and keep generating—new ideas, so that people across functions and roles get better at pushing past the obvious. However, it's also critical to have the right people vetting those ideas. That part of the process should be much less democratic and more meritocratic, because some votes are simply more meaningful than others. And finally, to continue generating and selecting smart ideas over time, organizations need to strike a balance between cultural cohesion and creative dissent.

Letting a Thousand Flowers Bloom

People often believe that to do better work, they should do fewer things. Yet the evidence flies in the face of that assumption: Being prolific actually increases originality, because sheer volume improves your chances of finding novel solutions. In recent experiments by Northwestern University psychologists Brian Lucas and Loran Nordgren, the initial ideas people generated were the most conventional. Once they had thought of those, they were free to start dreaming up more-unusual possibilities. Their first 20 ideas were significantly less original than their next 15.

Across fields, volume begets quality. This is true for all kinds of creators and thinkers—from composers and painters to scientists and inventors. Even the most eminent innovators do their most original work when they're also cranking out scores of less brilliant ideas. Consider Thomas Edison. In a five-year period, he came up with the lightbulb, the phonograph, and the carbon transmitter used in telephones—while also filing more than 100 patents for inventions that didn't catch the world on fire, including a talking doll that ended up scaring children (and adults).



MATT CARR/GETTY IMAGES; PHOTO ILLUSTRATION: STEPHEN WEBSTER

Of course, in organizations, the challenge lies in knowing when you've drummed up enough possibilities. How many ideas should you generate before deciding which ones to pursue? When I pose this question to executives, most say you're really humming with around 20 ideas. But that answer is off the mark by an order of magnitude. There's evidence that quality often doesn't max out until more than 200 ideas are on the table.

Stanford professor Robert Sutton notes that the Pixar movie *Cars* was chosen from about 500 pitches, and at Skyline, the toy design studio that generates ideas for Fisher-Price and Mattel, employees submitted 4,000 new toy concepts in one year. That set was winnowed down to 230 to be drawn or prototyped, and just 12 were finally developed. The more darts you throw, the better your odds of hitting a bull's-eye.

Though it makes perfect sense, many managers fail to embrace this principle, fearing that time spent conjuring lots of ideas will prevent employees from being focused and efficient. The good news is that there are ways to help employees generate quantity and variety without sacrificing day-to-day productivity or causing burnout.

Think like the enemy. Research suggests that organizations often get stuck in a rut because they're playing defense, trying to stave off the competition. To encourage people to think differently and generate more ideas, put them on offense.

That's what Lisa Bodell of futurethink did when Merck CEO Ken Frazier hired her to help shake up the status quo. Bodell divided Merck's executives into groups and asked them to come up with ways to put the company out of business. Instead of being cautious and sticking close to established competencies, the executives started considering bold new directions in strategy and product development that competitors could conceivably take. Energy in the room soared as they explored the possibilities. The offensive mindset, Carnegie Mellon professor Anita Woolley observes, focuses attention on "pursuing opportunities…whereas defenders are more focused on maintaining their market share." That mental shift allowed the Merck executives to imagine competitive threats that didn't yet exist. The result was a fresh set of opportunities for innovation.

Solicit ideas from individuals, not groups. According to decades of research, you get more and better ideas if people are working alone in separate rooms than if they're brainstorming in a group. When people generate ideas together, many of the best ones never get shared. Some members dominate the conversation, others hold back to avoid looking foolish, and the whole group tends to conform to the majority's taste.

Evidence shows that these problems can be managed through "brainwriting." All that's required is asking individuals to think up ideas on their own before the group evaluates them, to get all the possibilities on the table. For instance, at the eyewear retailer Warby Parker, named the world's most innovative company by *Fast Company* in 2015, employees spend a few minutes a week writing down innovation ideas for colleagues to read and comment on. The company also maintains a Google doc where employees can submit requests for new technology to be built, which yields about 400 new ideas in a typical quarter. One major innovation was a revamped retail point of sale, which grew out of an app that allowed customers to bookmark their favorite frames in the store and receive an e-mail about them later.

Since employees often withhold their most unusual suggestions in group settings, another strategy for seeking ideas is to schedule rapid one-on-one idea meetings. When Anita Krohn Traaseth became managing director of Hewlett-Packard Norway, she launched a "speed-date the boss" initiative. She invited every employee to meet with her for five minutes and answer these questions: Who are you and what do you do at HP? Where do you think we should change, and what should we keep focusing on? And what do you want to contribute beyond fulfilling your job responsibilities? She made it clear that she expected people to bring big ideas, and they didn't want to waste their five minutes with a senior leader—it was their chance to show that they could innovate. More than 170 speed dates later, so many good ideas had been generated that other HP leaders implemented the process in Austria and Switzerland.

Bring back the suggestion box. It's a practice that dates back to the early 1700s, when a Japanese shogun put a box at the entrance to his castle. He rewarded good ideas—but punished criticisms with decapitation. Today suggestion boxes are often ridiculed. "I smell a creative idea being formed somewhere in the building," the boss thinks in one *Dilbert* cartoon. "I must find it and crush it." He sets up a suggestion box, and Dilbert is intrigued until a colleague warns him: "It's a trap!!"

But the evidence points to a different conclusion: Suggestion boxes can be quite useful, precisely because they provide a large number of ideas. In one study, psychologist Michael Frese and his colleagues visited a Dutch steel company (now part of Tata Steel) that had been using a suggestion program for 70 years. The company had 11,000 employees and collected between 7,000 and 12,000 suggestions a year. A typical employee would make six or seven suggestions annually and see three or four adopted. One prolific innovator submitted 75 ideas and had 30 adopted. In many companies, those ideas would have been missed altogether. For the Dutch steelmaker, however, the suggestion box regularly led to improvements—saving more than $750,000 in one year alone.

The major benefit of suggestion boxes is that they multiply and diversify the ideas on the horizon, opening up new avenues for innovation. The biggest hurdle is that they create a larger haystack of ideas, making it more difficult to find the needle. You need a system for culling contributions—and rewarding and pursuing the best ones—so that people don't feel their suggestions are falling on deaf ears.

Developing a Nose for Good Ideas

Generating lots of alternatives is important, but so is listening to the right opinions and solutions. How can leaders avoid pursuing bad ideas and rejecting good ones?

Lean on proven evaluators. Although many leaders use a democratic process to select ideas, not every vote is equally valuable. Bowing to the majority's will is not the best policy; a select minority might have a better sense of which ideas have the greatest potential. To figure out whose votes should be amplified, pay attention to employees' track records in evaluation.

At the hedge fund Bridgewater, employees' opinions are weighted by a believability score, which reflects the quality of their past decisions in that domain. In the U.S. intelligence community, analysts demonstrate their credibility by forecasting major political and economic events. In studies by psychologist Philip Tetlock, forecasters are rated on accuracy (did they make the right bets?) and calibration (did they get the probabilities right?). Once the best of these prognosticators are identified, their judgments can be given greater influence than those of their peers.

So, in a company, who's likely to have the strongest track record? Not managers—it's too easy for them to stick to existing prototypes. And not the innovators themselves. Intoxicated by their own "eureka" moments, they tend to be overconfident about their odds of success. They may try to compensate for that by researching customer preferences, but they'll still be susceptible to confirmation bias (looking for information that supports their view and rejecting the rest). Even creative geniuses have trouble predicting with any accuracy when they've come up with a winner.

Research suggests that fellow innovators are the best evaluators of original ideas. They're impartial, because they're not judging their own ideas, and they're more willing than managers to give radical possibilities a chance. For example, Stanford professor Justin Berg found that circus performers who evaluated videos of their peers' new acts were about twice as accurate as managers in predicting popularity with audiences.

Make it a contest. Idea competitions can help leaders separate the wheat from the chaff, whether they're sifting through suggestion-box entries or hosting a live innovation event. At Dow Chemical, for example, employees participate in an annual innovation tournament focused on reducing waste and saving energy. The tournament calls for ideas

A Syllabus for Innovators

When aviator Ben Kohlmann set out to build a culture of nonconformity in the U.S. Navy, he found inspiration in many sources. Here's a sampling of the items he recommends to people who want to think more creatively, along with his comments on how they've influenced his own development.

SPEECHES

"Lead Like the Great Conductors"
TED TALK BY ITAY TALGAM

Much can be learned from professions we have no understanding of. People are people—and recognizing the commonalities is useful.

"How Great Leaders Inspire Action"
TED TALK BY SIMON SINEK

Sinek cracks the code of influence: Deep-seated desire is what inspires followers and builds movements.

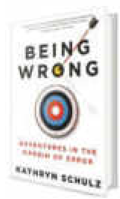
FICTION

Ender's Game
BY ORSON SCOTT CARD

This novel illustrates how tactical and strategic teams can be adaptable—and how genius can emerge at a young age. It's especially apropos reading in the military, where we promote on seniority and not merit.

Dune
BY FRANK HERBERT

A compelling story about insurgency and taking on established powers, *Dune* explores the ambiguous nature of messianic saviors.



NONFICTION

Being Wrong: Adventures in the Margin of Error
BY KATHRYN SCHULZ

We're wrong a lot, and yet we almost never admit it. Schulz helped me critically evaluate my own biases and better understand how people view and portray themselves.

The Hard Thing About Hard Things
BY BEN HOROWITZ

Horowitz doesn't merely talk about how to lead; he's actually lived it. And who doesn't love a guy who starts his chapters with rap lyrics?

The (Mis)behavior of Markets
BY BENOIT MANDELBROT

Mandelbrot is the father of fractal theory, and his insight into how that plays into the stock market transformed my understanding of luck's role in managerial successes and failures.

Boyd: The Fighter Pilot Who Changed the Art of War
BY ROBERT CORAM

When I read this in college, I realized that those who don't toe the party line often have the most impact.

Mindset: The New Psychology of Success
BY CAROL DWECK

Dweck argues that intelligence is not fixed. My world opened up once I discovered that we can grow into what we want to be.

Letters to a Young Contrarian
BY CHRISTOPHER HITCHENS

I'm a person of faith, but I appreciate the way Hitchens incisively questions everything, even faith. I've used his methods many a time to develop contrarian positions and win debates.

TV SHOWS

Sherlock (BBC SERIES)
Each episode is pure fun—but yields lots of learning at the same time.

RALPH ORLOWSKI/GETTY IMAGES; BEN PRUCHNIE/GETTY IMAGES that require an initial investment of no more than \$200,000, and those costs must be recoverable within a year. Peers review the submissions, with monetary rewards going to the winners. Innovation researchers Christian Terwiesch and Karl Ulrich report that over more than a decade, the resulting 575 projects have produced an average return of 204% and saved the company \$110 million a year.

When an innovation tournament is well designed, you get a large pool of initial ideas, but they're clustered around key themes instead of spanning a range of topics. People spend a lot of time preparing their entries, which can boost quality, but the work happens in a discrete window of time, so the contest is not a recurring distraction.

Thorough evaluation helps to filter out the bad ideas. The feedback process typically involves having a group of subject matter experts and fellow innovators review the submissions, rate their novelty and usefulness, and provide suggestions for improvement.

With the right judges in place, an innovation contest not only leverages the wisdom of the crowd but also makes the crowd wiser. Contributors and evaluators get to learn from other people's successes and failures. Over time, the culture can evolve into one where employees feel confident in their ability to contribute ideas—and develop better taste about what constitutes quality. Because successful innovators earn recognition and rewards, everyone has an incentive to participate.

So start by calling for ideas to solve a problem or seize an opportunity, and then introduce a rigorous process for assessment and feedback. The most promising submissions will make it to the next round, and the eventual winners should get the staff and resources necessary to implement their ideas.

Cultivating Both Cohesion and Dissent

Building a culture of nonconformity begins with learning how to generate and vet ideas, but it doesn't end there. To maintain originality over time, leaders need to keep fighting the pressures against it.

We used to blame conformity on strong cultures, believing they were so cultish and chummy that members couldn't consider diverse views and make wise decisions. But that's not true. Studies of decision making in top management teams show that cohesive groups *aren't* more likely than others to seek consensus, dismiss divergent opinions, and fall victim to groupthink. In fact, members of strong cultures often make better decisions, because they communicate well with one another and are secure enough in their roles to feel comfortable challenging one another.

Here's the evidence on how successful high-tech founders in Silicon Valley built their start-ups: They hired primarily for commitment to the mission, looking for people who would help carry out their vision and live by their values. Founders who looked mainly for technical skill or star potential didn't fare nearly as well. In mature industries, too, research shows that when companies place a strong emphasis on culture, their performance remains more stable.

Yet there's a dark side to strong, cohesive cultures: They can become homogeneous if left unchecked. As leaders continue to attract, select, and retain similar people, they sacrifice diversity in thoughts and values. Employees face intense pressure to fit in or get out. This sameness can be advantageous in predictable environments, but it's a problem in volatile industries and dynamic markets. In those settings, strong cultures can be too insular to respond appropriately to shifting conditions. Leaders have a hard time recognizing the need for change, considering different views, and learning and adapting.

Consider BlackBerry: After disrupting the smartphone market, senior leaders clung to the belief that users were primarily interested in efficient, secure e-mail. They dismissed the iPhone as a music player and a consumer toy, hired like-minded insiders who had engineering backgrounds but lacked marketing expertise, and ultimately failed to create a high-quality web browser and an app-friendly operating system. The result? A major downsizing, a billion-dollar write-off, and a colossal collapse of market share.

So to balance out a strong culture, you also need a steady supply of critical opinions. Even when they're wrong, they're useful—they disrupt knee-jerk consensus, stimulate original thought, and help organizations find novel solutions to problems. In the navy's rapid-innovation cell, the norm is "loyal opposition," says Joshua Marcuse, one of Ben Kohlmann's collaborators in the Pentagon. "Agitating against the status quo is how we contribute to the mission."

In short, make dissent one of your organization's core values. Create an environment where people can openly share critical opinions and are respected for doing so. In the early days of Apple, employees were passionately committed to making the Mac a user-friendly household product. But each year, the Mac team also gave an award to somebody who had challenged Steve Jobs. Every one of those award winners was promoted.

Cohesion and dissent sound contradictory, but a combination of the two is what brings novel ideas to the table—and keeps a strong culture from becoming a cult. Here are some ways to hold these principles in productive tension:

Prioritize organizational values. Give people a framework for choosing between conflicting opinions and allowing the best ideas to win out. When companies fail to prioritize values, performance suffers. My colleague Andrew Carton led a study showing that across hospitals, heart attack readmission rates were lower and returns on assets were higher when leaders articulated a compelling vision—but only if they spelled out no more than four organizational values. The more values they emphasized beyond that, the greater the odds that people interpreted them differently or didn't focus on the same ones.

Values need to be rank-ordered so that when employees face choices between competing courses of action, they know what comes first. At the software company Salesforce.com, trust is explicitly defined as the number one value, above growth and innovation. That communicates a clear message to employees: When working on new software, never compromise data privacy. At the online shoe and clothing retailer Zappos.com, CEO Tony Hsieh prioritizes employee happiness over customer happiness. The airline WestJet identifies safety as its most important value. And at GiveForward, a company that helps people raise money for causes, compassion tops the list. Although media coverage is critical to the company's success, cofounder Ethan Austin notes, "We will not push a story in the media unless we are certain that the customer whose story we are sharing will benefit more than we do."

ISTOCKPHOTO; PHOTO ILLUSTRATION: STEPHEN WEBSTER

Once you've prioritized the values, keep scrutinizing them. Encourage new hires to challenge "the company way" when they disagree with it. They're the ones with the freshest perspective; they haven't yet gone native. If they familiarize themselves with the culture before speaking up, they'll have already started marching to the same drummer. At Bridgewater, when new employees are trained, they're asked about the company's principles: Do you disagree?

Solicit problems, not just solutions. When working with executives, organizational psychologist David Hofmann likes to ask them to fill in the blanks in this sentence: "Don't bring me ___; bring me ___." Without fail, they shout out, "Don't bring me *problems*; bring me *solutions!*"

Although leaders love it when employees come up with solutions, there's an unintended consequence: Inquiry gets dampened. If you're always expected to have an answer ready, you'll arrive at meetings with your diagnosis complete, missing out on the chance to learn from a range of perspectives. This may be especially common in the United States: In a recent study comparing American and German decision groups, the Germans made twice as many statements about problems and 30% fewer statements about solutions. "Americans are driven to find solutions quickly," the researchers observe, "often without a complete and thorough analysis of the problem."

When individual members of a group have different information, as is usually the case in organizations, it's smarter to get all the problems out there before pursuing solutions. At the digital music company Spotify, instead of working on projects, people organize around long-term business problems. "If they were easy to solve," chief technology officer Oskar Stål notes, "we would have solved them already. When we create a new team, people typically stay together on a business problem for at least a year. If it becomes successful, the team and mission will exist for a long time." Angie's List cofounder Angie Hicks holds weekly office hours to hear concerns from employees. And when Anita Krohn Traaseth became the CEO of the Norwegian government's innovation efforts, she again used "speed dates" to give employees a voice. To make sure she had full visibility into problems, she asked people to name their three biggest bottlenecks and what they would like to safeguard or change. Only after gathering problems across a tour of 14 offices did she begin implementing solutions.

Don't appoint devil's advocates—go find them. Research by UC Berkeley psychologist Charlan Nemeth shows that assigning someone to play devil's advocate doesn't overcome confirmation bias. Though people may pay lip service to considering the counterargument, they'll stick to their own views in the end.

To make a difference, the devil's advocate has to actually hold a dissenting view, not just voice it for argument's sake, and the group has to believe that the dissent is authentic. Under those circumstances, groups look at more information *against* the majority view than for it, and they're less confident in their original preferences. It's rare that role-played disagreement is forcefully argued or taken seriously; actual disagreement is what stimulates thought.

Groups with authentic dissenters generate more—and better—solutions to problems. Abraham Lincoln famously asked his political rivals to join his cabinet, knowing they would genuinely hold contrarian views. At a recent Berkshire Hathaway annual meeting, Warren Buffett invited a trader who was shorting the stock to share his criticisms. Of course, this strategy works only if the dissenter's input is clearly valued and respected.

Model receptivity to critical feedback. Many managers end up promoting conformity because their egos are fragile. Research reveals that insecurity prevents managers from seeking ideas and leads them to respond defensively to suggestions. Employees quickly pick up on this and withhold ideas to avoid trouble. One way to overcome this barrier is to encourage people to challenge you out in the open.

Years ago at the software company Index Group, CEO Tom Gerrity gathered his full staff of about 100 people and had a consultant give him negative feedback in front of everyone. When employees saw their CEO listen to critical opinions, they were less worried about speaking up. And managers became more receptive to tough comments themselves.

You can also get people to challenge you by broadcasting your weaknesses. "When you're the leader, it is really hard to get good and honest feedback, no matter how many times you ask for it," Facebook COO Sheryl Sandberg says. "One trick I've discovered is that I try to speak really openly about the things I'm bad at, because that gives people permission to agree with me, which is a lot easier than pointing it out in the first place." For example, Sandberg tells her colleagues that she has a habit of talking too much in meetings. "If I never mentioned it, would anyone walk up to me and say, 'Hey, Sheryl, I think you talked too much today'? I doubt it."

FOR A CULTURE of originality to flourish, employees must feel free to contribute their wildest ideas. But they are often afraid to speak up, even if they've never seen anything bad happen to those who do.

To fight that fear in the navy, Ben Kohlmann rejected the military's traditional emphasis on hierarchy. Everyone communicated on a first-name basis, ignoring rank. "If you have an idea, pitch it to the crowd and run with it," he told members of his rapid-innovation cell. And he introduced them to people who had successfully championed creativity and change in the navy, to show them it was possible.

Other ways to nip fear in the bud include applauding employees for speaking up, even when their suggestions don't get adopted, and sharing your own harebrained ideas. Without some degree of tolerance in the organization for bad ideas, conformity will begin to rear its ugly head. Ultimately, listening to a wider range of insights than you normally hear is the key to promoting great original thinking.

If at first you don't succeed, you'll know you're aiming high enough.

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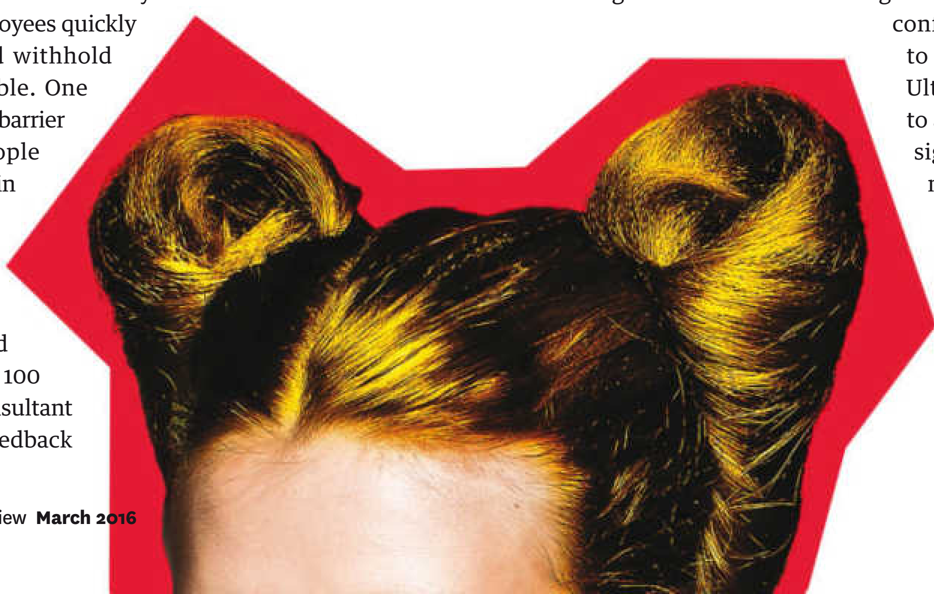

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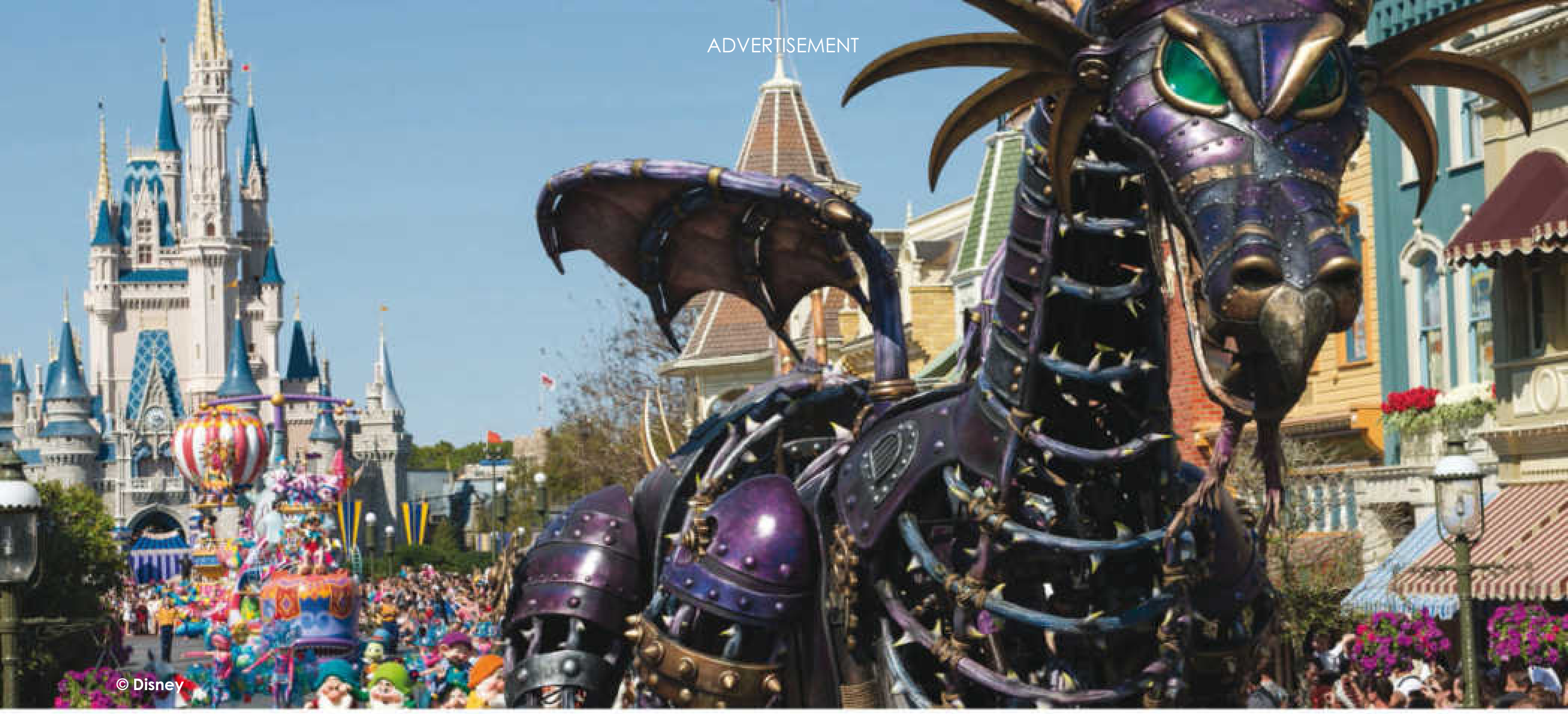


"WHAT TIME IS THE 3 O'CLOCK PARADE?"

ALMOST EVERY DAY in the Magic Kingdom at Walt Disney World Resort, a guest stops one of our Cast Members to ask "What time is the 3 o' clock parade?"

The question appears to have an obvious answer. But at Disney, we know that frequently the *true question* lies beyond the obvious—and that question can provide us a unique opportunity to deliver the kind of customer experience that builds a lifelong relationship.

Instead of simply giving the answer—the actual 3 o'clock start time—to our excited and sometimes distracted guests, Cast Members stop to ask questions and then personalize the guest's experience. Drawing from their theme park knowledge and training, Cast Members offer suggestions like telling guests what time the parade will pass by certain locations in the park. They also suggest possible vantage points to view the parade, and they even recommend places to take a break or when to leave one area of the park to see the parade on time.

This understanding of our guests and the ability to anticipate and respond to this question in a way that exceeds expectation are not new. Since Walt Disney World opened in 1971, both frontline employees and leaders have worked to fully understand and operationalize our service approach.

At Disney Institute, we know an organization cannot expect to deliver exceptional customer service without a profound understanding of its customers on an individual level. To provide an exceptional service experience, the organization must understand each customer's needs *and* wants, and be able to respond accordingly in the moment.

Today, this kind of knowledge is more important than ever, especially as organizations work to differentiate themselves from their competitors. Customer experience must be approached holistically, with those responsible for each area of a company's offerings giving intentional thought to and focus on how their decisions will shape and impact the best overall customer experience.

How do organizations do this? It's about fostering employee engagement. It's about really understanding your customers, creating a plan for delivering exceptional customer service, and then empowering employees to deliver it. It's about training leaders to reinforce the right behaviors that support exceptional customer experiences at every level.

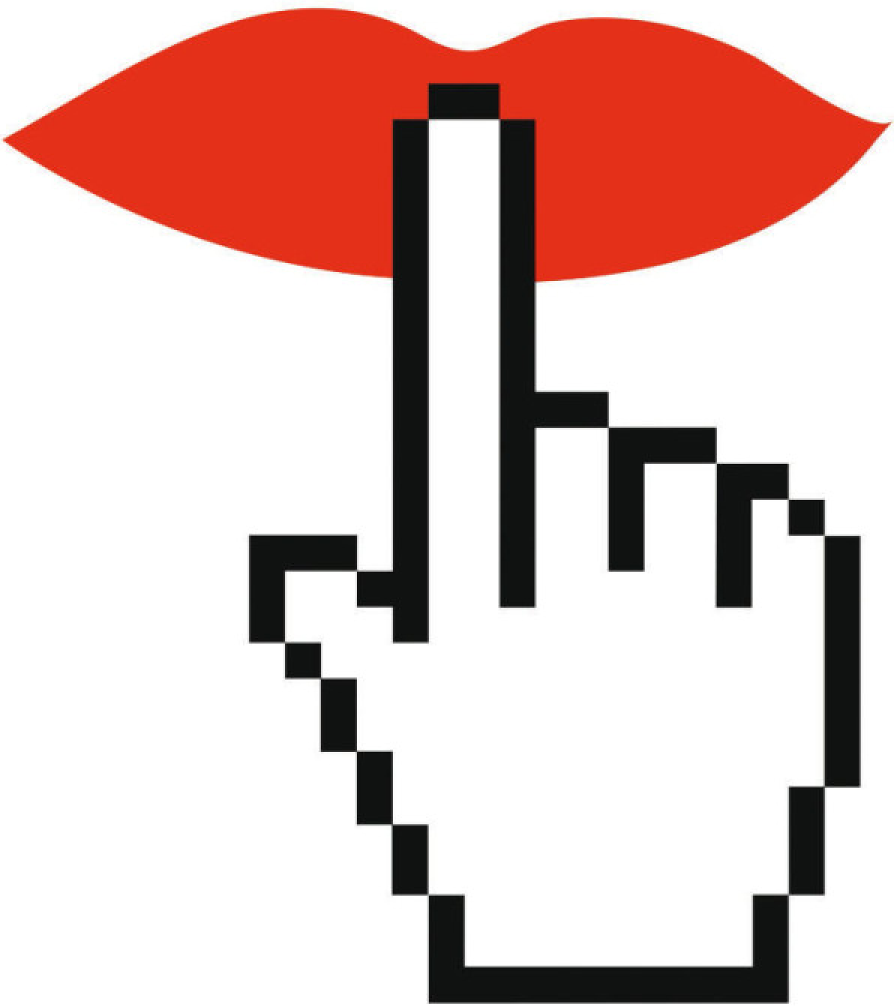
And it's about discovering and acting on your organization's areas of opportunity, such as that question "What time is the 3 o'clock parade?"

Ask yourself, what is your organization's "3 o'clock parade" question?

How can you help train your employees to forgo the seemingly obvious "need" in favor of understanding what each customer truly "wants?" How will your organization seize this opportunity to exceed customer expectations and create a powerful mechanism for value enhancement?

About Disney Institute As the trusted, authoritative voice on the Disney approach to customer experience, Disney Institute uses business insights and time-tested examples from Disney parks and resorts worldwide to help organizations develop the customer experience culture they are capable of delivering. For nearly three decades, Disney Institute has helped professionals discover ways to positively impact their organizations and the customers they serve through immersion in leadership, service, and employee engagement. Unique to Disney Institute is the opportunity to go behind the scenes in a "living laboratory" to observe firsthand how Disney methodologies are operationalized and how they can be adapted and applied to any work environment. For more information, visit **DisneyInstitute.com**.

Experience



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When an employee crosses the line on social media PAGE 103

Managing Yourself Learning to Learn

Mental tools to help you master new skills
by Erika Andersen

Organizations today are in constant flux. Industries are consolidating, new business models are emerging, new technologies are being developed, and consumer behaviors are evolving. For executives, the ever-increasing pace of change can be especially demanding. It forces them to understand and quickly respond to big shifts in the way companies operate and how work must get done. In the words of Arie de Geus, a business theorist, "The ability to learn faster than your competitors may be the only sustainable competitive advantage."

TAMARA SHOPSIN

I'm not talking about relaxed armchair or even structured classroom learning. I'm talking about resisting the bias against doing new things, scanning the horizon for growth opportunities, and pushing yourself to acquire radically different capabilities—while still performing your job. That requires a willingness to experiment and become a novice again and again: an extremely discomforting notion for most of us.

Over decades of coaching and consulting to thousands of executives in a variety of industries, however, my colleagues and I have come across people who succeed at this kind of learning. We've identified four attributes they have in spades: aspiration, self-awareness, curiosity, and vulnerability. They truly want to understand and master new skills; they see themselves very clearly; they constantly think of and ask good questions; and they tolerate their own mistakes as they move up the learning curve.

Of course, these things come more naturally to some people than to others. But, drawing on research in psychology and management as well as our work with clients, we have identified some fairly simple mental tools anyone can develop to boost all four attributes—even those that are often considered fixed (aspiration, curiosity, and vulnerability).

Aspiration

It's easy to see aspiration as either there or not: You want to learn a new skill or you don't; you have ambition and motivation or you lack them. But great learners can raise their aspiration level—and that's key, because everyone is guilty of sometimes resisting development that is critical to success.

Think about the last time your company adopted a new approach—overhauled a reporting system, replaced a CRM platform, revamped the supply chain. Were you eager to go along? I doubt it. Your initial response was probably to justify not learning. (*It will take too long. The old way works just fine for me. I bet it's just a flash in the pan.*) When confronted with new learning, this is often our first roadblock: We focus on the negative and unconsciously reinforce our lack of aspiration.

When we *do* want to learn something, we focus on the positive—what we'll gain from learning it—and envision a happy future in which we're reaping those rewards. That propels us into action. Researchers have found that shifting your focus from challenges to benefits is a good way to increase your aspiration to do initially unappealing things. For example, when Nicole Detling, a psychologist at the University of Utah, encouraged aerialists and speed skaters to picture themselves benefiting from a particular skill, they were much more motivated to practice it.

Researchers have found that shifting your focus from challenges to benefits is a good way to increase your aspiration to do initially unappealing things.

A few years ago I coached a CMO who was hesitant to learn about big data. Even though most of his peers were becoming converts, he'd convinced himself that he didn't have the time to get into it and that it wouldn't be that important to his industry. I finally realized that this was an aspiration problem and encouraged him to think of ways that getting up to speed on data-driven marketing could help him personally. He acknowledged that it would be useful to know more about how various segments of his customer base were responding to his team's online advertising and in-store marketing campaigns. I then invited him to imagine the situation he'd be in a year later if he was getting that data. He started to show some excitement, saying, "We would be testing different approaches simultaneously, both in-store and online; we'd have good, solid information about which ones were working and for whom; and we could save a lot of time and money by jettisoning the less effective approaches faster." I could almost feel his aspiration rising. Within a few months he'd hired a data analytics expert, made a point of learning from her on a daily basis, and begun to rethink key campaigns in light of his new perspective and skills.

Self-Awareness

Over the past decade or so, most leaders have grown familiar with the concept of self-awareness. They understand that they need to solicit feedback and recognize how others see them. But when it comes to the need for learning, our assessments of ourselves—what we know and don't know, skills we have and don't have—can still be woefully inaccurate. In one study conducted by David Dunning, a Cornell University psychologist, 94% of college professors reported that they were doing "above average work." Clearly, almost half were wrong—many extremely so—and their self-deception surely diminished any appetite for development. Only 6% of respondents saw themselves as having a lot to learn about being an effective teacher.

In my work I've found that the people who evaluate themselves most accurately start the process inside their own heads: They accept that their perspective is often biased or flawed and then strive for greater objectivity, which leaves them much more open to hearing and acting on others' opinions. The trick is to pay attention to how you talk to yourself about yourself and then question the validity of that "self-talk."

Let's say your boss has told you that your team isn't strong enough and that you need to get better at assessing and developing talent. Your initial reaction might be something like *What? She's wrong. My team is strong.* Most of us respond defensively to that sort of criticism. But as soon as you recognize what you're thinking, ask yourself, *Is that accurate? What facts do I have to support it?* In the process of reflection you may discover that you're wrong and your boss is right, or that the truth lies somewhere in between—you cover for some of your reports by doing things yourself, and one of them is inconsistent in meeting deadlines; however, two others are stars. Your inner voice is most useful when it reports the facts of a situation in this balanced way. It should serve as a "fair witness" so that you're open to seeing the areas in which you could improve and how to do so.

One CEO I know was convinced that he was a great manager and leader. He did have tremendous industry knowledge and great instincts about growing his business, and his board acknowledged those strengths. But he listened only to people who affirmed his view of himself and dismissed input about shortcomings; his team didn't feel engaged or inspired. When he finally started to question his assumptions (*Is everyone on my team focused and productive? If not, is there something I could be doing differently?*), he became much more aware of his developmental needs and open to feedback. He realized that it wasn't enough to have strategic insights; he had to share them with his reports and invite discussion, and then set clear priorities—backed by quarterly team and individual goals, regular progress checks, and troubleshooting sessions.

Changing Your Inner Narrative

UNSUPPORTIVE SELF-TALK	SUPPORTIVE SELF-TALK
I don't need to learn this.	What would my future look like if I did?
I'm already fine at this.	Am I really? How do I compare with my peers?
This is boring.	I wonder why others find it interesting.
I'm terrible at this.	I'm making beginner mistakes but I'll get better.

Curiosity

Kids are relentless in their urge to learn and master. As John Medina writes in *Brain Rules,* "This need for explanation is so powerfully stitched into their experience that some scientists describe it as a drive, just as hunger and thirst and sex are drives." Curiosity is what makes us try something until we can do it, or think about something until we understand it. Great learners retain this childhood drive, or regain it through another application of self-talk. Instead of focusing on and reinforcing initial disinterest in a new subject, they learn to ask themselves "curious questions" about it and follow those questions up with actions. Carol Sansone, a psychology researcher, has found, for example, that people can increase their willingness to tackle necessary tasks by thinking about how they could do the work differently to make it more interesting. In other words, they change their self-talk from *This is boring* to *I wonder if I could...?*

You can employ the same strategy in your working life by noticing the language you use in thinking about things that already interest you—*How...? Why...? I wonder...?*—and drawing on it when you need to become curious. Then take just one step to answer a question you've asked yourself: Read an article, query an expert, find a teacher, join a group—whatever feels easiest.

I recently worked with a corporate lawyer whose firm had offered her a bigger job that required knowledge of employment law—an area she regarded as "the single most boring aspect of the legal profession." Rather than trying to persuade her otherwise, I asked her what she was curious about and why. "Swing dancing," she said. "I'm fascinated by the history of it. I wonder how it developed, and whether it was a response to the Depression—it's such a happy art form. I watch great dancers and think about why they do certain things."

I explained that her "curious language" could be applied to employment law. "I wonder how anyone could find it interesting?" she said jokingly. I told her that was actually an OK place to start. She began thinking out loud about possible answers ("Maybe some lawyers see it as a way to protect both their employees and their companies...") and then proposed a few other curious questions ("How might knowing more about this make me a better lawyer?").

People employed by their families' firms earn 4.5% less, on average, than employees of nonfamily businesses, but they are 4.1% more satisfied than workers making similar wages, according to a study of companies in 14 countries.

"JOB SATISFACTION AND WAGES OF FAMILY EMPLOYEES," BY JORN H. BLOCK, JOSÉ MARÍA MILLÁN, CONCEPCION ROMAN, AND HAIBO ZHOU

Soon she was intrigued enough to connect with a colleague who was experienced in employment law. She asked him what he found interesting about it and how he had acquired his knowledge, and his answers prompted other questions. Over the following months she learned what she needed to know for that aspect of her new role.

The next time you're asked to learn something at the office, or sense that you should because colleagues are doing so, encourage yourself to ask and answer a few curious questions about it—*Why are others so excited about this? How might this make my job easier?*—and then seek out the answers. You'll need to find just one thing about a "boring" topic that sparks your curiosity.

Vulnerability

Once we become good or even excellent at some things, we rarely want to go back to being *not* good at other things. Yes, we're now taught to embrace experimentation and "fast failure" at work. But we're also taught to play to our strengths. So the idea of being bad at something for weeks or months; feeling awkward and slow; having to ask "dumb," "I-don't-know-what-you're-talking-about" questions; and needing step-by-step guidance again and again is extremely scary. Great learners allow themselves to be vulnerable enough to accept that beginner state. In fact, they become reasonably comfortable in it—by managing their self-talk.

Generally, when we're trying something new and doing badly at it, we think terrible thoughts: *I hate this. I'm such an idiot. I'll never get this right. This is so frustrating!* That static in our brains leaves little bandwidth for learning. The ideal mindset for a beginner is both vulnerable and balanced: *I'm going to be bad at this to start with, because I've never done it before. AND I know I can learn to do it over time.* In fact, the researchers Robert Wood and Albert Bandura found in the late 1980s that when people are encouraged to expect mistakes and learn from them early in the process of acquiring new skills, the result is "heightened interest, persistence, and better performance."

I know a senior sales manager from the United States who was recently tapped to run the Asia-Pacific region for his company. He was having a hard time acclimating to living overseas and working with colleagues from other cultures, and he responded by leaning on his sales expertise rather than acknowledging his beginner status in the new environment. I helped him recognize his resistance to being a cultural novice, and he was able to shift his self-talk from *This is so uncomfortable—I'll just focus on what I already know* to *I have a lot to learn about Asian cultures. I'm a quick study, so I'll be able to pick it up.* He told me it was an immediate relief: Simply acknowledging his novice status made him feel less foolish and more relaxed. He started asking the necessary questions, and soon he was seen as open, interested, and beginning to understand his new environment.

THE ABILITY to acquire new skills and knowledge quickly and continually is crucial to success in a world of rapid change. If you don't currently have the aspiration, self-awareness, curiosity, and vulnerability to be an effective learner, these simple tools can help you get there.

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Erika Andersen is the founding partner of Proteus International and the author of *Growing Great Employees, Being Strategic, Leading So People Will Follow,* and the forthcoming *Be Bad First.*

Case Study Should We Fire Him for That Post?

A small-business owner reacts to a prized employee's inappropriate Facebook commentary.

by Mary Anne Watson and Gabrielle R. Lopiano

By the time Susannah Winslow remembered that her ringer was off, she had seven text messages from her father, Dell, who was also her boss. Dell was the president of Downcity Motors, which owned BMW, Range Rover, and Mercedes-Benz dealerships in Charlotte, North Carolina, and had been in the Winslow family for three generations. Susannah, the general manager, was poised to take over in five years, when her dad retired.

It's Monday morning, Dad, she thought, sighing. Dell was an early riser who got to his office at 6:30 AM. Still, he rarely sent e-mails or texts at that hour. Something was clearly up.

"Dad, it's me," she said when he picked up the phone.

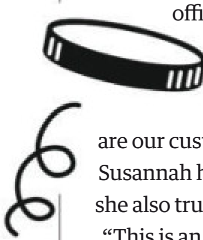
"Susie. Finally. We've got a problem. Kenton's been bad-mouthing us on Facebook again."

Everyone at the company called James Kenton by his last name, a sign of affection and respect for one of Downcity's most successful salespeople. He had joined the Mercedes dealership straight out of college and quickly became its biggest producer, far outselling his peers across the company's locations.

Tell us what you'd do in this situation. Go to **HBR.org**.

Dell continued, "Greg Coucher called over the weekend. I just heard the voicemail this morning." Coucher was Downcity's contact at BMW headquarters. "He said that Kenton wrote something nasty about Friday's Mercedes launch, and he was glad it wasn't about a BMW promotion. He implied that we need to keep a tighter rein on our staff."

Susannah had heard Kenton's griping about the rollout. Tyson Beck, the Mercedes dealership sales manager, had been in charge of planning it, but Kenton had been breathing down his neck for weeks, asking for details. He wanted them to serve fancy canapés, not "low class" barbecue. When he found out that Tyson was planning to use plastic tablecloths, Kenton had even come by Susannah's office to say, "This isn't a Walmart employee picnic. We're selling *luxury* here. What are our customers going to think?" Susannah had seen his point, but she also trusted Tyson.



"This is an embarrassment, Susie," Dell said now. "The kid clearly hasn't learned his lesson. He's got to go."

"Let's not be rash, Dad," she replied. "I'll deal with it as soon as I'm in."

What's Our Policy on This?

Tyson and Susannah were hunched over her computer, looking at Kenton's Facebook page. Dell sat on the small office couch with his arms crossed.

Susannah read: "So thrilled that Downcity went 'all out' for the most important Mercedes launch in years. Nothing says luxury like plastic tablecloths and soda pop." Kenton had posted a photo of a soda can with the Downcity Motors sign looming in the background.

"OK," Tyson said. "It's pretty bad. I'll have him delete it."

"But hasn't the whole world already seen it?" Dell asked. He didn't have a Facebook account and wasn't interested in social media. His daughter handled Downcity's online presence.

"Not really," Susannah replied. "He can restrict who sees it, depending on his privacy settings. And it looks like…" She clicked through to the post. "Shoot—he shared it pretty broadly."

"So that's how Greg Coucher saw it?" Dell asked. "And how do we know that no one at Mercedes headquarters has seen it?"

TAMARA SHOPSIN

Susannah grimaced. She and Greg were Facebook friends; she assumed that he had friended staff members at the other Downcity dealerships and also car company executives he'd met.

"Only Kenton's 'friends' would see his posts, Dad," Susannah said, thinking of all the loyal customers whom Kenton had probably friended.

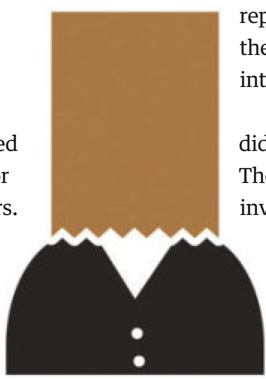
"Right," said Tyson. "Unless his friends repost the photo."

Susannah shot him a "you're not helping matters" look.

"I'll remind him that this is inappropriate," Tyson promised. "I'm sure he'll take it down, just like last time."

About a month earlier, another salesperson had pointed out to Susannah that Kenton had posted two photos: One was of seven cars lined up for service in the lot with the caption "Why am I here before the mechanics?" The other was of a BMW that had been driven into a pond by the 16-year-old son of a customer who had let the boy take the wheel during a test drive. When Tyson and Susannah had talked to Kenton about the pictures, he'd said that he was just sharing his work experiences with friends and family members. He then pointed out that the company should think about taking a harder line with tardy employees and teenage test drivers.

"We were clear that this shouldn't happen again," Dell said, and he was right. Susannah had asked Kenton not to post anything else that reflected negatively on Downcity or its customers and partners. "At some point we have to question Kenton's judgment and whether he can represent the company."



Tyson looked shocked. "Are you suggesting we fire him? He posted this late Friday night, clearly not on company time or from a company computer. He thinks he's being funny. He's not trying to hurt the company."

"But he *is* hurting it—at least according to Greg Coucher." Then Dell smiled. "Are you worried about hitting your numbers without him?"

"Of course I am," Tyson said. "That's what you pay me to do, and he's our biggest producer. Not only would we be kissing sales good-bye, but I'd have to train a new person."

Toby Diller, Downcity's head of HR, walked in. "I'm sorry I'm late," he said. "I got your e-mail, Susannah. Has anyone talked to Kenton yet?"

"I was about to," Tyson said.

"Let's hear from Toby first," Dell said. "We let Kenton get away with a slap on the wrist last time, but don't we have a policy on this sort of thing?"

Toby explained that technically they didn't. They hadn't yet updated their employee manual to cover social media. He and Susannah exchanged glances. They'd been talking about this for months, but it kept dropping down on the to-do list.

"All we have is a line that reads, 'No one should be disrespectful or use profanity or any other language that injures the image or reputation of the company,'" Toby said.

"Well, this seems to be a clear violation of that," Susannah replied. "And what about the section on unauthorized interviews?"

Tyson jumped in. "He didn't give an interview. There's no journalist involved here."

"That's just what Facebook seems like to me—people interviewing themselves all day long," Dell said. "I don't get this generation. Not one bit."

"Don't be such a curmudgeon," Susannah countered. "We were all young once, and if we'd had access to the technology Millennials have, we probably would have gotten into the same trouble."

"He's getting *us* in trouble—that's the difference," Dell said. "Susie, figure this out. I think I've made my views clear. I'd be happy to see him gone by the end of the day, even if he is our top salesman."

Make an Example of Him?

Susannah and Toby climbed into a Range Rover Sport. The dealership had few places for a private conversation, so they often used the roomy interior of one of their cars.

"It's impossible to think with Tyson and Dad hovering," Susannah said. "I just need to understand my options."

Case Study Teaching Notes

Mary Anne Watson and Gabrielle R. Lopiano developed the case on which this one is based for use in HR classes.

WHAT DREW YOU TO THIS STORY?

Employee use of social media has become increasingly important over the past decade, and no one can deny its power to make or break a company's reputation.

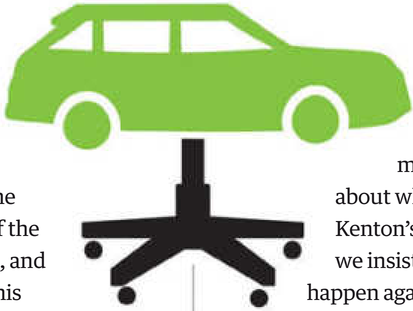
WHAT ISSUES DO YOU HOPE IT RAISES IN THE CLASSROOM?

We want students to become more aware of the consequences of their posts and the limitations on "freedom of speech" at work. The case might also frame a discussion about fairness in firing and other disciplinary actions and the impact of the employment-at-will doctrine.

WHAT REACTION DO YOU EXPECT FROM STUDENTS?

We think it's a topic they can easily relate to and debate. Some will think the salesperson is disloyal and deserves to be let go. Others will defend him because he posted those comments on a private site on his own time.

HBR's fictionalized case studies present problems faced by leaders in real companies and offer solutions from experts. This one is based on "Facebook Folly at Northeast BMW" (case no. NA0353-PDF-ENG), by Gabrielle R. Lopiano and Mary A. Watson (North American Case Research Association, 2015), which is available at **HBR.org**.



"I think you've got three," Toby said. "First, since the photos he posted of the event were his own, and he was expressing his opinion—which he's entitled to—on his personal Facebook page, we could ignore it."

"That seems awfully lenient to me," Susannah said. "I don't want him—or anyone else—thinking this kind of behavior is OK."

"The second option is to make an example of him. Because he damaged the company's reputation in a public forum, we could take some sort of disciplinary action." Toby laid out a few alternatives: make a note in Kenton's personnel file, request that he rescind his remarks, or suspend him from work, with or without pay.

"And you think we could legally do any of those things?"

"I do. I think we could even fire him. That's the third option. He violated the employee handbook when he was disrespectful of the company image, and it was a second offense. That would set a clear precedent regarding employee social media use, which, given the age of many of our new hires, is becoming increasingly important."

Susannah asked if Kenton might sue. "He might," Toby said, "but I don't think he'd have a case. It's not like this qualifies as free speech."

She wasn't so sure. Were they essentially censoring Kenton? What if he had posted something about poor working conditions? Wouldn't that be protected?

Of course, her father and grandfather had always insisted on treating employees well. Other car dealers might behave as if salespeople were a dime a dozen, but Downcity was different, as proven by its incredibly low turnover.

"I guess I'm more worried about what he might say. Kenton's a good guy; if we insist that this can't happen again, I think he'll try his best. But if we fire him, he's essentially free to say whatever he wants about us."

"I hear you," said Toby. "But I'm more in Dell's camp. We gave Kenton a second chance to demonstrate good judgment, and he failed again. Besides, I don't think we can decide not to fire him just because of what he might post on Facebook. Then it's as if we're hogtied because he's such a hothead."

Kenton did have them in a bind, Susannah thought.

Get Ready for a New Generation

The next day Susannah went to Green's Lunch with Rachel Evans, a rising star on the sales team, for one of their regular get-togethers. Knowing how challenging it could sometimes be to work with almost all men, Susannah had taken Rachel under her wing.

"I get that you probably can't talk about the Kenton thing," Rachel said after they'd ordered. "But remember when you asked me to help you understand our generation? I wonder if I can shed any light."

"You're right that I can't discuss it," Susannah said. "But I'll listen."

"I can see how this might not be a big deal to Kenton," Rachel said. Susannah raised her eyebrows at the implication that he wasn't remorseful.

"Don't get me wrong. I think he's a little embarrassed. But we've grown up with social media, sharing our opinions with friends, family, and even our employers, so we all have a story about posting something we regretted. And to be fair, he didn't say anything that wasn't true. He just added some sarcasm. We all thought the refreshments were a little off-brand."

"On the other hand," Rachel continued, "what he did was unnecessary and stupid. He got in trouble once but still did it again. He should have tighter privacy settings and maybe think twice before friending his professional contacts. And he should approach Tyson or you directly if he wants things done differently at the dealership—not gripe with all of us or do it online."

Susannah winced. Kenton *had* come to her and Tyson; they'd just ignored his feedback.

Rachel was on a roll: "If you look through his feed, you'll see that he says a lot of positive things about Downcity too. He loves his job and our cars, which is why he's so good at selling them. But I worry that he just can't help himself and it's only a matter of time before he does it again."

Susannah smiled. "Thanks, Rachel. That was very helpful. Now let's talk about you. How was the conference last week?" But even as her protégé answered, she kept thinking about Kenton. Should she just let it go? Should he simply be reprimanded again? Or should the consequences be greater this time?

Mary Anne Watson is a professor of management and the associate director of the TECO Energy Center for Leadership at the University of Tampa. **Gabrielle R. Lopiano** is a PhD candidate in organization and management at Emory University's Goizueta Business School.

What should Susannah do about Kenton's Facebook remarks?

See commentaries on the next page.

The Experts Respond

Megan Erickson Moritz is an attorney at BrownWinick Law Firm, where she practices employment law.

SUSANNAH SHOULD not fire Kenton—at least not yet. Given the information she has, terminating or even disciplining him would put Downcity at risk for legal action.

Here's why: Section 7 of the National Labor Relations Act protects employees' right to engage in "concerted activities" for "mutual aid or protection." Kenton's concerns about the marketing event may very well stem from its possible negative impact on vehicle sales and his commissions. Rachel suggests that other salespeople had similar feelings, so the Facebook post could be construed as Kenton's expressing their views on a subject related to their employment. If that behavior were punished, he would have a legitimate basis for filing an unfair labor practice charge with the National Labor Relations Board.

Terminating or even disciplining Kenton would put Downcity at risk for legal action.

Tyson may be right that Kenton's gripes were his own, and Downcity could certainly argue that point to the NLRB, especially if no other employees "liked" or commented on them, or if some colleagues expressed concern that his behavior—more than the mismanaged event—was in fact likely to damage customer or vendor relationships. But asking employees for a statement along those lines could be viewed as coercive, and Kenton would need only one supporter to prove that he was voicing a shared opinion.

So before she decides what to do, Susannah should look into what, if anything, Kenton discussed with others, whether anyone else shared his views, and whether any of their worries might reasonably be tied to wages, commissions, or other terms of employment.

One thing she and Toby should do now, however, is whip the company's policies and practices into shape (with the help of experienced legal counsel) and then train employees in them, clarifying expectations. The NLRB would most likely find their current policy overbroad, which would also be a violation. Downcity could incorporate a clearer open-door policy, ensuring that staff members feel comfortable airing concerns with managers and that managers know they must listen and respond. This might help lessen the likelihood that employees would air workplace complaints online.

In the real case on which this account is based, the dealership fired the salesperson for two Facebook-related events, and he disputed the termination with the NLRB. The judge concluded that criticism of the refreshments at a sales event probably amounted to protected activity but that the other post, complaining about a Land Rover accident at a different dealership, did not, because the employee hadn't discussed it with colleagues and it was unconnected to the conditions of his employment. Because the dealership had based his termination on the latter, it stood—but the company spent a lot of time and money fighting the case, which I'm sure Dell and Susannah want to avoid.

The frequent, multiple, and sometimes conflicting sources of information about recent NLRB activity make this area a compliance nightmare for employers. However, one thing is clear: The NLRB has been aggressively expanding its reach regarding social media issues in the workplace. Susannah is better off giving Kenton another warning and clarifying company policies so that Downcity is well prepared to take action if and when this happens again.

Comments from the HBR.org community

Employees Should Be Heard
His delivery may be off, but Kenton may also have a valid point about maintaining the brand. Employees should feel that they're valued and being heard.
Erica Ogle, *student, Regis University*

Not a Team Player?
Kenton should be suspended and told that if such behavior continues, termination is a possibility. Toby and Susannah need to reiterate the importance of being a team player.
Aaron Wynn, *HR business partner, Ford Motor Company*

Use His Insights

Management should focus on correcting and learning from bad business decisions, not chasing employees who whine on social media. Instead of punishing Kenton, his bosses should ask him to plan the next launch.

Khaled Barahmeh, *group audit and risk manager, Zamil Group Holding Company*

A Valuable Sales Tool

Once Kenton and the rest of Downcity's salespeople become aware that social media can be a sales tool, they'll realize that their online presence affects not only the company but also their own sales.

Saige Fraiha, *director of product and marketing, MedicFP*

Alexandra Samuel

is a cofounder of Social Signal, one of the world's first social media agencies, and the author of *Work Smarter with Social Media.*

SUSANNAH NEEDS to let Kenton go. I know from running my own company that nothing is harder than firing someone, particularly in a tight-knit family business. But once you've warned an employee about a specific issue and made your expectations clear, you can't keep providing second chances.

If Downcity keeps Kenton, it leaves itself open to ongoing risk: He didn't see why it was inappropriate to publicly mock a company event, so what might he post in the future? Ignoring that risk signals that employees can say what they want online and get away with it. Worse, it tells both employees and partners that the company doesn't care if they publicly disrespect one another or the organization.

To be clear, Downcity doesn't have carte blanche to fire any employee who posts something off-brand on a social network. There's a world of difference between a personal post that diverges from the company line and comments that explicitly disparage the business. It might be uncomfortable if Kenton had criticized a competitor's event, or ranted about how badly BMW owners park, but neither would be an offense for which he should be terminated.

Likewise, any organization must tolerate social media commentary that's posted in the spirit of whistle-blowing. For example, if a female salesperson at Downcity wrote about her perceptions of gender discrimination at work, firing her would be a huge mistake. The company would be setting itself up for a lawsuit (and a PR disaster) and missing a valuable opportunity to address the problem in a transparent way. But Kenton wasn't calling out the company for mistreatment. He was complaining about its strategic choices.

Susannah is smart to try to understand the generational differences around social media. In terms of time spent on social platforms and the kind of personal information shared, younger employees may well vastly differ from their older colleagues. But age is no excuse for poor judgment, and particularly after his prior warning, Kenton should have known better.

As soon as Toby and Susannah have dealt with him, they should focus on writing and sharing that

Once you've warned an employee about a specific issue, you can't keep providing second chances.

social media policy. It should detail what's unacceptable, including posts that cast the company, its partners, or its customers in a negative light. But it should also prepare employees for social media success by describing activities that Downcity encourages and noting resources that can help strengthen their online presence.

All this should be in accessible language, not legalese. I've written social media and community policies for many sites and organizations; when the tone is conversational and helpful (rather than a list of "don'ts"), it inspires good behavior as much as it discourages bad.

Although Downcity didn't have an official social media policy when Kenton aired his criticisms on Facebook, he knew what his bosses expected because they had told him. The media context may be changing, but employers still have a right to insist that employees speak respectfully online about them and the products or services they sell.

HBR Reprint R1603K
Reprint Case only R1603X
Reprint Commentary only R1603Z

TAMARA SHOPSIN

Synthesis
The Case for Activist Investors

by Walter Frick

In 1926 Benjamin Graham wrote a letter to Northern Pipeline with a simple request. He had a small stake in the company, and he'd noticed that it owned millions in railroad bonds and other securities. The man who would one day be known as the dean of Wall Street and the father of value investing wanted it to sell those securities and distribute the profits to shareholders in the form of a dividend.

The company's executives weren't pleased. "Running a pipeline is a complex and specialized business," they responded, "about which you can know very little, but which we have done for a lifetime."

Graham was undeterred. Over the course of a year, he met with anyone who owned more than 100 Northern Pipeline shares and tried to persuade passive investors including the Rockefeller Foundation to join his campaign. "Initiative in this direction should properly come from the shareholders rather than the management," he wrote in a letter to the foundation. "The determination of whether capital not needed in the business is to remain there or to be withdrawn, should be made in the first instance by the owners of the capital rather than by those administering [it]."

The battle was over competing ideas of capitalism. To Graham, managers were hired by shareholders to run their company. The folks in charge at Northern Pipeline believed it was their company and that investors had no understanding of the business—their only contribution to its success was cash. In the end Graham got his way, and the era of the activist investor was born.

Ninety years later, shareholder capitalism is rightly under fire for creating an economy that is overly focused on the short term and prioritizes investors above workers and communities. But the case against activists is not so clear-cut, as two recent books demonstrate.

SHERRY TURKLE: WHAT I'M READING

The Road from Coorain, by Jill Ker Conway (Knopf, 1989)
"From rural Australia, Conway became a pioneering college president, helped invent women's studies, and showed that academics could be astute businesspeople, inventive philanthropists, and stunning writers."

Sherry Turkle is a professor at MIT and the author of *Reclaiming Conversation: The Power of Talk in a Digital Age* (Penguin Press, 2015).

ROB KIM/GETTY IMAGES

In *Dear Chairman,* from which the Northern Pipeline example is borrowed, Jeff Gramm, a hedge funder and Columbia University lecturer, has compiled a history of activism organized around written communications between public companies' shareholders and boards—something he sees as required reading for his students. "A good letter...teaches us how investors interact with directors and managers, how they think about their target companies, and how they plan to profit from them," he explains. These communications are sources of strategic wisdom.

Searching for insights in the ransom letters of corporate raiders (the preferred term in the 1980s) might sound strange, but Gramm has collected more than demands for dividends. Consider Ross Perot's 1985 letter to GM Chairman Roger Smith: "I do not believe that GM can become world class and cost competitive by throwing technology and money at its problems. The Japanese are not beating us with technology or money. They use old equipment, and build better, less expensive cars by better management, both in Japan and with UAW workers in the U.S." Agree or don't, but Perot was offering a strategy.

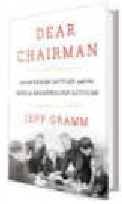
My favorite, though, is a 2005 letter from Daniel Loeb to Irik Sevin, the chairman of Star Gas Partners. In it Loeb made a simple point about corporate governance: You shouldn't appoint your 78-year-old mother to your board. "Should you be found derelict in the performance of your executive duties, as we believe is the case," Loeb wrote, "we do not believe your mom is the right person to fire you from your job."

If *Dear Chairman* resembles the case method, plumbing individual instances of activism for business lessons, *Deep Value,* by Tobias E. Carlisle, reads more like an academic literature review. Heavily footnoted but nonetheless enjoyable, it makes the case for value investing—the search for undervalued stocks—and explains why practitioners such as Warren Buffett, whose 1964 letter to American Express is in Gramm's book, and more strident activists such as Carl Icahn, whose 1985 letter to Phillips Petroleum is also featured in *Dear Chairman,* have been able to beat the market.

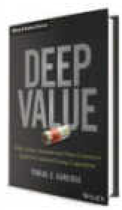
For starters, they're all following in Graham's footsteps. They recognize that public companies are sometimes valued at less than the sum of their parts—the amount they could generate if they were liquidated. They are, as Graham wrote, in the "best judgment of Wall Street...*worth more dead than alive.*" If you're a shareholder in such a company, the worry is that it will fritter away its remaining cash, run down its machines, and end up worth even less than when you invested. But by persuading management to break up and sell, or at least issue a generous dividend, you'll make some return on your investment.

Over the years, of course, activists have expanded their repertoire. In the 1980s they might threaten management with a takeover and demand that the company buy their stock back at a premium—so-called "greenmail," which is now illegal in several U.S. states and heavily taxed by the federal government. Today activists are more likely to push a company to accept an acquisition offer, sell off certain parts of its business, or improve operations.

That means they're helping to drive strategy, as Gramm suggests. But are their ideas any good? Perhaps surprisingly, the answer seems to be yes, at least by some



Dear Chairman: Boardroom Battles and the Rise of Shareholder Activism
Jeff Gramm
HarperBusiness, 2016



Deep Value: Why Activist Investors and Other Contrarians Battle for Control of Losing Corporations
Tobias E. Carlisle
Wiley, 2014

measures. Research shows that activists apparently make companies more profitable and productive, on average—not just in the next quarter but three years after the fact. And although their intervention may be followed by a decrease in R&D spending, the companies appear to become more innovative in the years following. One study found that activists often target firms that are lagging in IT and then help them catch up to their competitors.

The social impact of activists is less well understood. In the above-mentioned study, researchers found that worker pay did not increase alongside profits and productivity at targeted companies. For a society grappling with inequality and wage stagnation, that's deeply troubling. (Then again, activists also have a record of limiting CEO pay.) But it's telling that when the Roosevelt Institute, a think tank, released two excellent papers about short-termism in November 2015, activists weren't mentioned once.

The Icahns and Loebs of the world are easy political targets, because they publicly rattle sabers and make billions by pushing the envelope of activism. And Icahn's recent campaign against Apple is a reminder that some of their attacks are still just about demanding payouts. But we can't blame activists as a group for all the problems created by shareholder capitalism. Shorter CEO tenure and passive investors' focus on quarterly earnings are also to blame. Executive compensation is another major culprit, as William Lazonick explained in HBR in 2014. CEOs who are paid in stock have an incentive to boost their short-term share price through buybacks, whether or not activists are in charge.

Walter Frick is a senior associate editor at *Harvard Business Review*.

PUTTING DIGITAL TO WORK: THE LEAN DIGITAL WAY

Many companies are struggling to harness digital technology and its full potential, creating delays in adopting digital business and operating models—and resulting in missed opportunities and the emergence of competitive threats. A recent study[1] shows that without the right digital transformation strategies, nearly $400 billion per year could end up in initiatives that return inadequate ROI.

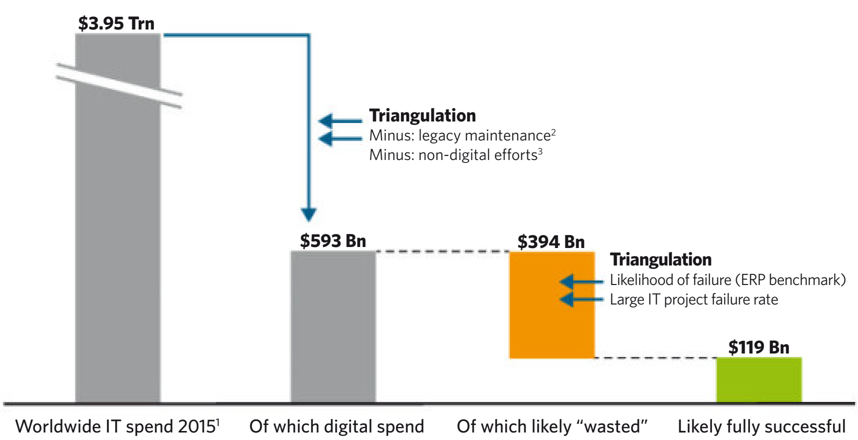
The evidence across many large enterprises indicates that today's challenge is not digital technology; it is the enterprise's ability to reimagine how businesses run—at scale—through digital. The issue is twofold.

First, many efforts lack business-driven focus. As many as 67% of companies starting a digital initiative fail to align interventions to their "true north"—what their customers value, and how the firm can deliver that value by connecting strategy, goals, and actions in a measurable way.

As a result, many ignore the end-to-end value chain and related middle- and back-office processes that industrialize the delivery beyond the front office. The result: a sophisticated "veneer" with a rather limited ability to meaningfully address customers' real needs within a reasonable time frame.

Secondly, many simply layer advanced digital tools atop their complex, pre-existing "legacy" technology and processes, which results in the digitization of broken processes.

For instance, encouraging customers to use cost-effective interaction channels without compromising customer satisfaction and advocacy is a difficult yet necessary balancing act. As a result, some channels such as chat and mobile[2] are used by only 43% and 57% of American adults, while about half of Americans and Australians are considering defecting from their main financial institution for at least one core banking product, or have already switched.[3]

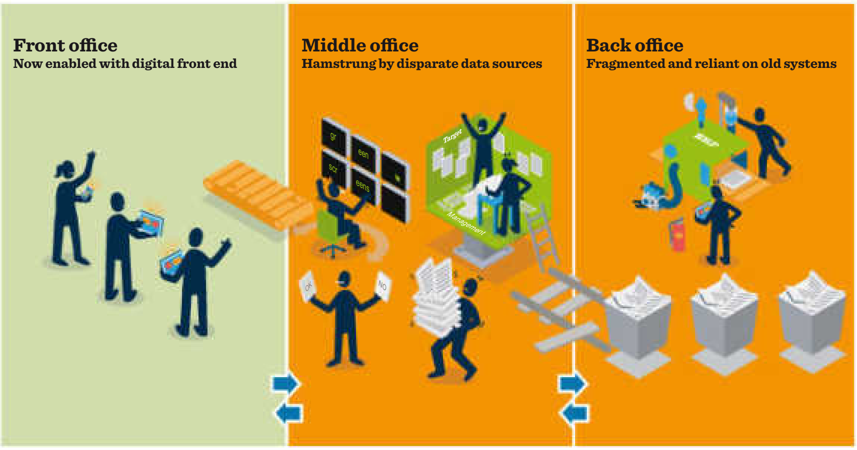


The experience collected in the last years of enterprise adoption of digital technologies (including analytics) indicates that a combination of classic and cutting-edge methods—specifically, Lean principles and a client-discovery process that involves design thinking—can harness digital's revolutionary power.

This approach, called Lean Digital, helps large enterprises cut through the complexity of legacy operations and direct digital efforts in a practical, timely, and cost-effective manner.

Its practical deployment is aptly illustrated across industries by the transformation of a financial services organization—an example of a large, complex organization caught in the perfect storm of technological change, drastically altered competitive dynamics, and evolving customer behavior. The resulting economics can differ strikingly from the most efficient institution, with efficiency ratios[4] ranging from 20% and 35%, compared to 55-60% of the top banks.

1 Genpact Research Institute September 2015 "The Lean Digital Way"
2 Interactive voice response
3 YouGov poll sponsored by Genpact surveyed 7,152 adults in the U.S., Australia, Germany, Netherlands, and the U.K. in late 2015
4 Operating expenditures as percent of outstanding loan balances



GENPACT
GENERATING IMPACT℠

ENTERPRISE-WIDE IMPACT: A CASE STUDY

Using this method, the picture of the value chain, the effective alignment, and the actions needed for transformation efforts emerge:

Front Office: Customers using brokers want more convenience and speed when obtaining a loan. *Design thinking* identifies key emotional drivers of their behavior and helps iterate early process and technology prototypes to improve their experience.

Middle Office: Underwriters struggle with prioritizing brokers' requests, while risk teams require more transparency. Here, *analytics* help triage inbound brokers' requests, inform digital workflow tools that allocate cases by complexity, and prioritize by conversion potential, speeding up the process. They also help optimize pricing based on risk and elasticity—and enable controlled experiments to constantly improve.

Back Office: The staff requires standardization in order to meet compliance requirements, legacy data structures and applications are difficult to modify, and staff can't meet front office requests quickly. Creation of a *common operating environment* may make remediation of key data more efficient so that cumbersome information requests to clients can be avoided, and compliance documentation processing is made more efficient.

While the wheel of innovation does not spin at the same rate across these three layers, these layers must come together to deliver superior customer outcomes. *Lean principles* look end-to-end across the organization to detect idiosyncrasies and interdependencies relevant to the customer journey.

The combination of Lean principles and design thinking guides the allocation of cross-enterprise resources (from business to IT), enables faster experiments, and allows scalable delivery—while enabling agile implementations that adapt over time. It informs the design of new organizational structures (such as shared services and centers of excellence). In addition, it helps direct the deployment of *Systems of Engagement*, a "digital native" agile technology foundation that harnesses data and work flows and industrializes them while minimizing displacement of pre-existing and less flexible systems-of-record.

The approach delivers results not only in superior operational efficiency, but also in effectiveness and customer experience that drive prospect-to-sale conversion rates and advocacy—and premium price. It also improves risk management and compliance at a lower cost.

Digital can change enterprises deeply. But it is imperative that large and complex organizations, in the excitement of new impressive technologies, and somewhat hamstrung by their organizational silos and pre-existing operations and systems, don't make the mistakes typical of new technology waves. Utilizing of a combination of methods, from lean principles to design thinking, can help the digital revolution fulfill its expectations.

Genpact (NYSE: G) stands for "**generating business impact**." We are a global leader in digitally-powered business process management and services. We architect the **Lean Digital**℠ enterprise through our patented Smart Enterprise Processes (SEP℠) framework that reimagines our clients' operating model end-to-end, including the middle and back offices. This creates Intelligent Operations℠ that we help design, transform, and run. The impact on our clients is a high return on transformation investments through growth, efficiency, and business agility. For two decades, first as a General Electric division and later as an independent company, we have been passionately serving a few hundred strategic clients, including one-fourth of the Fortune Global 500, and have grown to over 70,000 people in 25 countries, with key offices in New York City. The resulting business process and industry domain expertise, and experience running complex operations, are a unique heritage and focus that help us drive the best choices across technology, analytics, and organizational design. For additional information, visit www.genpact.com.

EXECUTIVE SUMMARIES MARCH 2016

SPOTLIGHT ON ENTREPRENEURSHIP FOR THE LONG TERM

A tiny percentage of start-ups survive long enough to scale up and achieve long-term viability. This package offers wisdom that should increase the odds of success.

ENTREPRENEURSHIP

Start-Ups That Last

Ranjay Gulati and Alicia DeSantola | page 54

Why do so many promising start-ups go off the rails? Often they have trouble scaling. Founders may resist imposing discipline for fear of losing agility and control—but the price may be chaotic operations and unpredictable performance.

Drawing on extensive case studies and 75 years of research, the authors outline four activities that can help companies handle greater complexity as they seek new avenues for growth. Firms should:

- Hire specialists in functions such as sales, HR, marketing, R&D, and manufacturing. This lets them tackle work more efficiently and catalyzes future growth by creating slack in the rest of the organization.
- Add management structure. A few people at the top can't effectively supervise everyone's increasingly specialized daily work—and it's hard for employees to stay focused and engaged without guidance and processes.
- Establish a framework of plans and goals. Otherwise, improvisation may amount to aimless riffing.
- Sustain the culture. Articulate the founding values in mission statements and job descriptions, and hire and reward for cultural fit.

Between the extremes of ad hoc and prescriptive organizing lies a useful middle ground—and leaders who can find it gain an important edge on their rivals.

HBR Reprint R1603C

STRATEGY

Lean Strategy

David Collis | page 62

Strategy and entrepreneurship are often seen as polar opposites. Strategy means rigorously defining and pursuing one clear path, while entrepreneurship involves continually changing direction to take advantage of new opportunities. Yet the two desperately need each other: Strategy without entrepreneurship is central planning; entrepreneurship without strategy leads to chaos.

There is a way to reconcile the two, through the *lean strategy process*. It ensures that start-ups innovate in a disciplined fashion so that they make the most of their limited resources. Lean strategy helps company builders choose viable opportunities, stay focused, and align the entire organization.

The process begins with setting the venture's vision, or ultimate purpose—perhaps the only aspect of strategy that should be permanent. To deliver on it, senior executives agree on a deliberate strategy, defining the firm's objective (the near-term goal that describes success), scope (what the firm will and will not do), and competitive advantage (how it will win). The deliberate strategy sets the bounds within which experiments will take place and guides daily decisions. But the results of those experiments and decisions lead to learning that reshapes the strategy. Though priorities evolve, at each point in time it's clear to everyone in the firm which ones take precedence.

HBR Reprint R1603E

LEADERSHIP

Reigniting Growth

Chris Zook and James Allen
page 70

Most successful companies eventually face a predictable crisis that the authors call *stall-out*—a sudden large drop in revenue and profit growth or a collapse of once high shareholder returns to well below the cost of capital. Stall-out occurs when the growth engine that powered companies to success stops working. This rarely happens because the business model has suddenly become obsolete—a common misconception. Rather, research by Zook and Allen shows that the business has almost always become too complex, most often owing to bureaucracy that slows the company's metabolism, or internal dysfunction that distorts information and hampers managers' ability to make rapid decisions and take swift action on them.

But stall-out can be overcome. The authors find that most companies that achieve sustainable growth share attitudes and behaviors: (1) They view themselves as business insurgents, fighting in behalf of underserved customers; (2) they have an obsession with the front line, where the business meets the customer; and (3) they foster a mindset that includes a deep sense of responsibility for how resources are used and for long-term results. Those qualities can help any company restart its growth engine by removing gunk and complexity that have built up over the years, inhibiting the clean execution of strategy.

HBR Reprint R1603F

The Big Idea

Features

MARKETING

Branding in the Age of Social Media

Douglas Holt | page 40


Branding in the Age of Social Media

Social media was supposed to usher in a golden age of branding. But things didn't turn out that way.

Marketers originally thought that Facebook, YouTube, and Twitter would let them bypass mainstream media and connect directly with customers. Hoping to attract huge audiences to their brands, they spent billions producing their own creative content. But consumers never showed up. In fact, social media seems to have made brands *less* significant.

What happened? The issue is, social media has transformed how culture works, in a way that weakens certain branding techniques. It has united once-isolated communities into influential *crowdcultures*. Crowdcultures are very prolific cultural innovators. Their members produce their own content—so well that companies simply can't compete. Consider that people making videos in their living rooms top the charts on YouTube, which few companies have managed to crack.

While they diminish the impact of branded content, crowdcultures grease the wheels for an alternative approach, *cultural branding*. In it, a brand sets itself apart by promoting a new ideology that springs from the crowd. Chipotle did this successfully when it made two short films critiquing industrial food, tapping into a movement that began in the organic-farming subculture and blew up into a mainstream concern on social media. Other good examples come from personal care. Axe revived its brand by becoming an over-the-top cheerleader for the "lad" crowd that arose as a response to politically correct gender politics. Dove championed the other side of the divide, with campaigns that spoke to crowdculture concerns about unhealthy beauty standards for women.

Brands succeed when they break through in culture, and crowdcultures are a great vehicle for doing that. But firms can't identify the critical opportunities by relying on traditional segmentation and trend reports.

HBR Reprint R1603B

INNOVATION

The Other Disruption

Joshua Gans | page 78

Companies should focus on managing architectural disruptions, because they are more likely to be firm-ending events.

Most managers are well versed in the defensive playbook for confronting disruptive innovation. Most commonly, they either acquire the new entrants or "disrupt themselves" by setting up autonomous units charged with developing their own new technology that can be rolled into their principal operations once the disruptive innovation begins to dominate the industry.

But quite often, adopting a new technology requires companies to fundamentally change their mainstream operations—the way they manufacture and distribute their products. In these cases where the organizational model changes along with customer expectations and preferences, the playbook often falls short.

In this article Joshua Gans of the University of Toronto's Rotman School of Management identifies three prescriptions for surviving "supply side" disruption: Companies must have an integrated organizational model, ownership of a product feature important to the end customer, and a broad and flexible sense of corporate identity.

Though less commonly understood, supply-side disruption is arguably more dangerous than the kind described by Clayton Christensen in *The Innovator's Dilemma*; indeed, disruption of a product's architecture threatens a company's very survival in a way that changes in customer demands do not.

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MANAGING ORGANIZATIONS

How to Build a Culture of Originality

Adam Grant | page 86


How to Build a Culture of Originality

Fresh, innovative thinking is essential for business growth, and most people—not just a few gifted "visionaries"—are capable of it. So says the Wharton School's Adam Grant, whose research shows that you can develop this skill in your organization by creating a culture of nonconformity.

Start by giving employees license to let their imaginations run wild: A large quantity of diverse ideas will ultimately yield the highest-quality ones. To help people dream up a multitude of new products, strategies, or solutions, encourage them to adopt the mindset of a competitor, for example, and have them generate ideas privately (group brainstorming tends to conform to the majority's taste).

Once lots of ideas are in, get feedback on which one to pursue from the right people: other innovators with a track record of spotting winners. You might even stage a contest to find the best ideas, and have peer judges and other subject-matter experts vet the submissions and suggest improvements.

Sustaining a culture of originality is as important as building it. So focus, too, on balancing cultural cohesion (which can improve decision making) with creative dissent (which prevents a strong culture from becoming a cult). Long-term, it's the combination of the two that brings great ideas to the table.

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How I Did It

LEADERSHIP

The CEO of Rio Tinto on Managing in a Hypercyclical Industry

Sam Walsh | page 33

During the 2000s, in one of the largest commodity booms in history, Rio Tinto allowed itself to be swept up along with other mining companies in the mad rush for growth. Although the smart allocation of capital had traditionally been a strength at the 140-year-old company, Rio Tinto suffered multibillion-dollar write-downs of two of its boom-time acquisitions, and in 2012 it reported a net loss for the first time in 25 years. Early in 2013 the board of directors called on Walsh to take over as CEO.

He knew that to succeed in such a turbulent environment, he would need to reconnect Rio Tinto with its core balance-sheet discipline and put it back on a path of measured, sustainable growth. He and the CFO decided to focus on three initiatives: tighten up investment decisions, allowing only the best projects to proceed; run the entire organization for cash; and drive efficiency throughout the company by cutting costs, exiting businesses, and rationalizing the workforce. But they also chose to pull best practices from other industries and fully harness the efficiency gains from new technology.

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Managing Yourself

Learning to Learn

Erika Andersen | page 98

The ever-increasing pace of change in today's organizations requires that executives understand and then quickly respond to constant shifts in how their businesses operate and how work must get done. That means you must resist your innate biases against doing new things in new ways, scan the horizon for growth opportunities, and push yourself to acquire drastically different capabilities—while still doing your existing job. To succeed, you must be willing to experiment and become a novice over and over again, which for most of us is an extremely discomforting proposition.

Over decades of work with managers, the author has found that people who do succeed at this kind of learning have four well-developed attributes: aspiration, self-awareness, curiosity, and vulnerability. They have a deep desire to understand and master new skills; they see themselves very clearly; they're constantly thinking of and asking good questions; and they tolerate their own mistakes as they move up the curve. Andersen has identified some fairly simple mental strategies that anyone can use to boost these attributes.

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Life's Work

Kevin Spacey acted on Broadway in the 1980s, hit it big in Hollywood in the 1990s, and then surprised everyone by moving to London to become the director of the Old Vic theater. In 2013 he returned to the screen, producing and starring in Netflix's first streaming series, *House of Cards*. When asked what unexpected career move he'll make next, he jokes, "Vegas, baby, Vegas." *Interviewed by Alison Beard*

Read the complete interview online at **HBR.org**.

HBR: Did you accomplish what you set out to at the Old Vic?
Spacey: The most important thing was succession. In Jim Collins's book *Good to Great,* he looks at successful CEOs and what happens after they leave. There are many examples of brilliant, PR-seeking people who were concerned with how their companies did only while they were there. But then you have others who were quieter and surrounded themselves with smart lieutenants and built companies that thrived with the next CEOs and the ones after. I wanted to make sure we built a theater company solidly so that when I left, it would continue.

Why did you take the job? I had focused on my career for 10 years, and I didn't want to spend another 10 pursuing the same dream. I wanted to be challenged on a new level, and the idea of running a theater company was so exciting that I never saw it as walking away from something; I saw it as walking toward something, even though people thought I was out of my mind. I know in my heart that if I hadn't gone to London, hadn't done a play every year, hadn't worked with Trevor Nunn, Matthew Warchus, Howard Davies, I would never have been ready for a role like Frank Underwood in *House of Cards.* The decade at the Old Vic made me a better actor.

And a better leader? When you act or direct you have a responsibility to bring the right energy to create something with the group. I was fortunate to have mentors who were great examples, not because they sat me down and gave me lessons but because of how they behaved. There's a different kind of leadership in running a theater, and I learned as I went along. I read. I asked questions of leaders I admire. I studied other theatrical beginnings, so I knew what to expect.

When you work with young actors, what do you teach them? It's incredible to help them find self-esteem, voice, and collaborative skills. But it's funny: When you tell them something that was passed down to you a long time ago, often in the act of saying it, you think, "My God. I needed to hear that. It's important, and I haven't been doing it myself."

***House of Cards* is made in a highly collaborative way. How does that work?** There's a creative team, and we make the decisions. That doesn't mean we don't have arguments. We challenge one another all the time. But no ego enters the room. It's all about making the best show we can. It's not "What's good for me?" It's "What's good for us?"

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