HBR.ORG

Harvard Business Review

JULY–AUGUST 2014

96 Strategy
Four Paths to Business Model Innovation
Karan Girotra and Serguei Netessine

104 The HBR Interview
Lenovo CEO Yang Yuanqing on the PC's Future

42 The Big Idea
The Crisis in Retirement Planning
Robert C. Merton

The New Basics of MARKETING


GUCCI


GUCCI
GUCCI.COM

Breguet, the innovator.

Classique chronograph 5287

The double-seconds chronometer introduced in 1820 was the forerunner of the split-second chronograph and made it possible to precisely determine split times, or the respective durations of two simultaneous events. Because of this invention Breguet is considered the father of modern chronographs. Today, the Classique 5287 split-seconds chronograph perpetuates this rich legacy and this unfailing spirit of innovation. History is still being written…


Breguet
Depuis 1775
BREGUET BOUTIQUES – NEW YORK 646 692-6469 – BEVERLY HILLS 310 860-9911
BAL HARBOUR 305 866-1061 – LAS VEGAS 702 733-7435 – TOLL FREE 877-890-0311 – WWW.BREGUET.COM

Susan Cain Quiet Space
BeMe

Shown with clear glass for illustration purposes only. Actual application would have visual privacy.

Susan Cain Quiet Spaces by Steelcase

In her groundbreaking book, *"Quiet: The Power of Introverts in a World That Can't Stop Talking"*, Susan Cain suggests as much as half of a company's workforce are introverts — many of whom struggle in workplaces designed for extroverts. "There's a time and place for people to come together and exchange ideas, but let's restore the respect we once had for solitude."

Susan Cain Quiet Spaces by Steelcase is a collection of unique solutions expressly designed for introverts at work. These intimate spaces help introverts focus, recharge, rejuvenate — and therefore engage, in ways they've never been able to before.

Learn more at **steelcase.com/quietspaces**

Steelcase

We work with the world's leading organizations to create places that amplify the performance of their people, teams and enterprise.

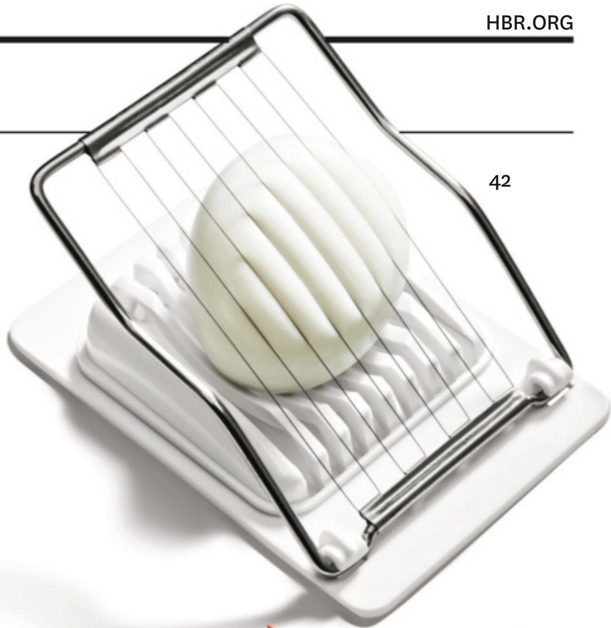
Our approach to digital can grow your business in entirely new ways.
Today, technology can transform every aspect of your company. Now every business is a digital business. Our industry expertise, coupled with our integrated capabilities across interactive, analytics and mobility, can help you take advantage of the opportunity to innovate and compete. We can also manage your digital processes or take them to the cloud. All so your company will see tangible results from the virtual world. That's high performance, delivered.
High performance. Delivered.
Strategy | Digital | Technology | Operations
accenturedigital
© 2014 Accenture. All rights reserved.

Contents

ABOVE
Markus Linnenbrink
DIEDRITTE-DIMENSION
2011
JVA/Prison Düsseldorf Rath, Germany

HBR.ORG
What you need to know about strategy and innovation today.
hbr.org/special-collections/strategy

Features July–August 2014

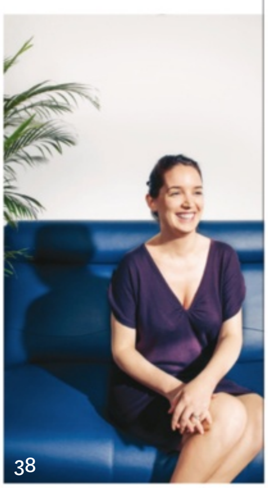

42

96

AUDIO
Analysis from the leading minds in management.
blogs.hbr.org/ideacast


104


86


38

Championing corporate responsibility

CARRERA Calibre 1887 Chronograph with Date

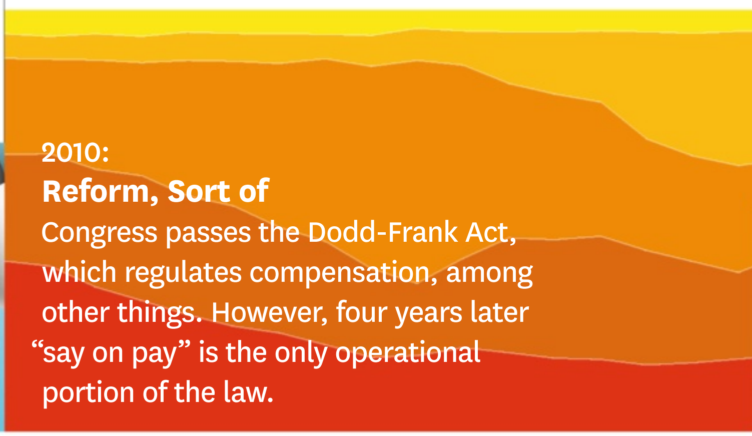
Departments July–August 2014

“The goal is progress, not perfection.
page 23

DISRUPTIVE INNOVATION EXPLAINED
In less than two minutes.
hbr.org/video/disruption

THE HOTLIST
HBR.org’s best of the week, delivered to your in-box.
enewsletters.hbr.org

Changing culture by changing habits page 23



Why are CEOs compensated exceedingly well? page 32

“I never wanted to be a leader.” page 132

hbr.org July–August 2014

Testing Ideas

Your idea seems great on paper. But what about in the real world? Scott Anthony, managing partner of Innosight, outlines several experiments that can give you an early inkling. **hbr.org/video/anthony**

AUDIO

Nikil Saval discusses the secret history of the workplace, from closed-door offices to open plans. **hbr.org/audio/saval**

MANAGEMENT TIPS

Quick, practical advice for you, your manager, and your business. **hbr.org/tip**

BOOK PREVIEW

Download a free chapter from *The Alliance: Managing Talent in the Networked Age*, by Reid Hoffman, Ben Casnocha, and Chris Yeh. **hbr.org/chapters/hoffman**

WHAT'S NEW

The ideas, research, and expert insights that matter most to today's leaders. **blogs.hbr.org**

FOLLOW HBR

@HarvardBiz

facebook.com/HBR

hbr.org/linkedin

HBR in Your In-Box

Get e-mail updates with the latest on management and leadership. Sign up at **enewsletters.hbr.org**.

HBR on Your Phone

Our mobile site is optimized for fast browsing. Visit **hbr.org** anywhere.

HBR on Your iPad

Find the enhanced magazine, the latest blog posts, and selected books. **Available in iTunes**

PHOTOGRAPHY: GETTY IMAGES

From the Editor

Trust and the Global Powerhouse

AT HBR WE OFTEN THEORIZE about what it means to be a truly global company. In practice, few embody the ideal better than Lenovo, the PC manufacturer headquartered in Beijing and in Morrisville, North Carolina (part of the state's Research Triangle).

Directing the company's global positioning is Yang Yuanqing, Lenovo's chairman and CEO. Nearly a decade ago YY, as he is known, moved with his family from Beijing to North Carolina. I met with him recently at the Prestonwood Country Club, where he was presiding over a Lenovo gathering that seemed one part strategy, one part cheerleading. Yang, who is 49, spoke with me about the thrill of becoming the world's top PC producer and the challenges of being dominant in a sector that's likely to decline globally. (See the HBR Interview, page 104.)

As it deals with shifts in the market, Lenovo plans to stick with the global formula it adopted years ago. One distinctive element: a nearly exclusive reliance on local managerial talent, which "builds a culture of trust," Yang told me. In fact, he says, of Lenovo's 54,000 employees worldwide, only about 50 are expats.

Lenovo became a global player in 2005, when it acquired IBM's PC division. It has grown considerably since then through a range of popular products and further acquisitions, including the purchases this year of IBM's low-end server business and Google's Motorola Mobility unit.

Winning in the post-PC world (or the "PC-plus" world, as Lenovo puts it) won't be easy. But Yang seems to relish taking on the likes of Apple and Samsung. And other companies, he says, can learn from Lenovo's example: "We have a diverse team and culture."

Adi Ignatius, Editor in Chief

PHOTOGRAPHY: ELIE HONEIN

EDITORIAL OFFICES
60 Harvard Way, Boston, MA 02163
617-783-7410 | fax 617-783-7493
www.hbr.org

Volume 92, Number 7/8
July–August 2014
Printed in the U.S.A.

SUSTAINABLE FORESTRY INITIATIVE
Certified Chain of Custody

WORLDWIDE ADVERTISING OFFICES

NEW YORK
75 Rockefeller Plaza, 15th floor
New York, NY 10019
212-872-9280 | fax 212-956-0933
Maria A. Beacom, *Account Manager*
Daniel Cohen, *Account Manager*
Molly Watanabe, *Account Manager*

CHICAGO
847-466-1525 | fax 847-466-1101
James A. Mack, *Central U.S. Sales Director*

MIDWEST AND SOUTHEAST
312-867-3862 | cell 312-401-2277
Samuel K. White, *Midwest and Southeast Sales Director*

LOS ANGELES
310-216-7270

SAN FRANCISCO
415-986-7762

FRANCE
33-01-4643-0066

HONG KONG
852-237-52311

INDIA
91-11-4353-0811

JAPAN
81-03-3541-4166

KOREA
82-2-730-8004

UAE
971-4-228-7708

UNITED KINGDOM
44-20-7291-9129

For all other inquiries, please call 212-872-9280.
For advertising contact information, please visit our website at www.hbradsales.com.

A NOTE TO READERS
The views expressed in articles are the authors' and not necessarily those of *Harvard Business Review*, Harvard Business School, or Harvard University. Authors may have consulting or other business relationships with the companies they discuss.

LIBRARY ACCESS
Libraries offer online access to current and back issues of *Harvard Business Review* through EBSCO host databases.

ARTICLE REPRINTS
To purchase reprints of *Harvard Business Review* articles, go to **www.hbr.org**.

SUBMISSIONS
We encourage prospective authors to follow HBR's "Guidelines for Authors" before submitting manuscripts. To obtain a copy, please go to www.hbr.org; write to The Editor, *Harvard Business Review*, 60 Harvard Way, Boston, MA 02163; or e-mail hbr_editorial@hbr.org.

Unsolicited manuscripts will be returned only if accompanied by a self-addressed stamped envelope.

SUBSCRIPTION SERVICES

UNITED STATES AND CANADA
800-274-3214 | fax 813-354-3467
Harvard Business Review, P.O. Box 62180
Tampa, FL 33662-2180

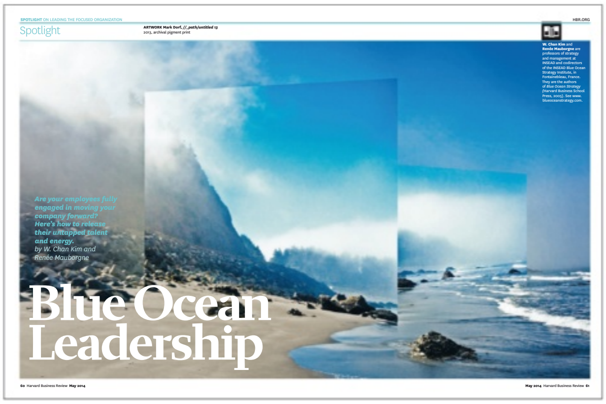
ALL OTHER COUNTRIES
31-20-4874465 | fax 31-20-4874412
Harvard Business Review, P.O. Box 20501
1001 NM Amsterdam, The Netherlands

ONLINE hbr.org/subscriberservices

RATES PER YEAR
United States, $119 | Canada, US$139
International, US$165 | Mexico, US$139

Interaction

How to Lead a More Engaged Workforce



HBR article by **W. Chan Kim** and **Renée Mauborgne,** May

Disengaged employees are an unfortunate reality in the workplace, and poor leadership is often to blame. After 10 years of research and hundreds of interviews, the authors determined why leadership so often falls short. Their "blue ocean leadership" approach focuses on what leaders at all levels must do—not who they must be—to transform their organizations.

What really appeals to me is the idea of employees as customers of the service called leadership. Leaders engage employees, who engage customers, who in turn engage more customers. This all leads to better results.
Jennifer W. Campbell, senior consultant, leadership and change

The concept of employees as customers is similar to the concept of servant leadership. This style is excellent in the long term. For short-term projects or fast-paced work environments, it may not produce the desired results. Steve Jobs said that customers might not know what products they need. Similarly, you sometimes need to educate employees or give them an extra push so that they're motivated to give their all and rise to challenges.
Ajatshatru Kaushal, postgraduate student, Myra School of Business

One thing that stopped me in my tracks was that the piece opened with the problem of employee disengagement. Given that the rest of the piece rightly places responsibility with leadership, it would seem more appropriate to recast the data in terms of organizations' failure to engage employees. Casting it as "Just 30% of employees are engaged" puts the blame on employees.
Sandra Pickering, founding partner, Opento

Most of this article is about a process for understanding expectations of leaders at different levels in an organization, which is often not well thought through. Saying that people are not engaged and that leaders need to engage them is a partial truth. People need to take some ownership of the problem themselves; it is not all up to the leader. Leadership is a relationship and requires action on both parts.
Christopher Smith, director, Bath Consultancy Group

What hasn't been mentioned is the communication structure within the organization. Staff engagement depends directly

Piketty's "Capital," in a Lot Less Than 696 Pages

HBR.org article by **Justin Fox,** April

Fox gave a synopsis of the new economic tome *Capital in the Twenty-First Century,* in which Thomas Piketty argues that capitalism won't rein in inequality on its own and proposes a global wealth tax.

I think your superb summary omitted only Piketty's connection to "annales," the tradition of integrative historical, social, and economic analysis pioneered by Marc Bloch and Fernand Braudel. It's an important reason his work is so telling.
Peter D. Kinder, board member, Trillium Asset Management

Whom does Piketty propose to collect this global wealth tax from, and where would it go? And while market capitalism may increase relative inequality, it also increases standards of living. The average person today has access to medical technologies the richest people 100 years ago did not. A century from now, the average person will have access to medical care that the richest people today do not.
Prentice Alexander Adkinson, student

Interact with Us

The best way to comment on any article is on **HBR.ORG**. You can also reach us via
E-MAIL: hbr_letters@hbr.org
FACEBOOK: facebook.com/HBR
TWITTER: twitter.com/HarvardBiz
Correspondence may be edited for space and style.

on the communications employees receive and the manner in which communications are delivered. This is where many organizations lose employees.
Donna M. De Julius, development and training lead, Maximus

Companies can inspire employees by communicating their strategy through storytelling. When companies take time to engage their employees through stories and visuals, it makes information memorable, accelerates understanding, and helps create a consistent language for all within the organization.
Lucia Mamogobo, production manager, Thinkspiration—To the Point

I would have loved to see how many companies actually applied blue ocean leadership to develop their managers into leaders. BOL is perhaps useful in conducting research and gaining some insights. In terms of application, I fail to see much practical value in it. Personally, I feel that blue ocean strategy was more insightful than blue ocean leadership.
Kavin S. Kanagasabai, lecturer, Regent's University and Webster University, London

The author responds: *Piketty is not entirely clear on who would collect this tax or where it should go, though he implies that it might help reduce other taxes and make them more progressive. He has ambitious ideas about linking the world's banking systems, which would allow for easier tax collection. And I agree that market capitalism has enabled progress, but the big question is whether wealth inequality might have other, negative consequences (on democracy, for example).*

Interaction

Why I Tell My Employees to Bring Their Kids to Work

HBR.org article by **Sabrina Parsons,** April

The CEO of Palo Alto Software makes a case for establishing a work culture that emphasizes the importance of employees' personal lives, which means flexible hours and the option to bring kids and babies to the office as necessary. Respect for people's families and personal time achieves loyalty, hard work, and better results, she argues.

I've read about high-profile companies that employ five-star chefs or provide services like dog walking and laundry. It's pretty obvious that these "perks" are in place to keep people at their desks for as many hours a day as possible. In contrast, the benefits you offer would keep someone employed at your company for longer.
Kelly Schrock, owner, KingStreet

This model just isn't realistic for many industries. It would have been great if the fast-paced PR firm I worked for had this policy, but it would have required a total cultural shift—and a completely different, more family-friendly clientele. This CEO is doing amazing things; I would love it if she could help spread this way of thinking by, perhaps, making sure her outside consultancies are family-friendly places too.
Rachel Konik, MS candidate in speech-language pathology, Kean University

The pressure shouldn't be on families to adapt to rigid work paradigms; work must adapt to families. When our office manager returned from maternity leave, she brought her baby with her. We've had issues along the way, but we retained a fantastic employee and learned how much is possible when you have open, flexible thinking. We strive to adopt creative strategies for our employees' unique life-cycle needs, and we have high loyalty and pretty much zero turnover. All of us (even our clients) have benefited from the delightful presence of a baby in the workplace.
Carey Brown, general partner, Employee Assistance of the Pacific

Companies need to recognize that the definition of a family doesn't apply just to people with children. People will "ooh" and "ahh" over a baby in the office, but I doubt the same reaction would happen if someone brought in a cognitively impaired parent who needs as much supervision as a child. Many companies offer child care; I would like to see them offer options for adult day care as well. It's just as costly as child care, if not more.
Marci Sheeran, account executive, MacCorkle Insurance Service

This is a very good initiative that would enable an employee to channel his or her strength toward the growth of the firm. Kids are part of our success whether we accept it or not.
Folawiyo Kareem Olajoku, senior special assistant to the governor of Osun, Nigeria

Navigating the Cultural Minefield

HBR article by **Erin Meyer,** May

Many managers make embarrassing faux pas when working abroad or with foreign colleagues. To help people understand cultural differences, Meyer has created a tool that maps eight behaviors—such as leading and persuading—where cultural gaps are most common.

It's risky to create expectations based on behaviors anticipated by assessment tools. A vital element of successful cross-cultural engagement is unique, rather than general, cultural traits.
Kenny Leahman, founder and owner, KELeahman Coaching and Consulting

Much of the advice offered here is quite applicable—if we are talking about countries like India and the United States in the 1980s and 1990s. I can attest that things have dramatically changed in both contexts. We should not jump into tackling such a multidimensional subject with tool kits and infographics.
Majdi Haroun, director of enterprise strategy and architecture, Microsoft

Your approach to working across cultures is more accessible than the usual conceptual frameworks. One question is how to motivate team members across cultures. Have you collected data on that?
Elizabeth Abbot, intercultural specialist, Brookfield Global Relocation Services

The author responds: *Though motivating isn't one of the behaviors in the tool, if managers adapt their leading style (egalitarian versus hierarchical), evaluating style (frank versus diplomatic negative feedback), and persuading style (deductive versus inductive arguments) using the Culture Map, the result will be a more motivated global workforce.*

PHOTOGRAPHY: HOWARD KINGSNORTH/GETTY IMAGES


IF YOU CAN
HOLD A PHONE
YOU CAN HOLD A
MEETING
GoToMeeting
by CITRIX
2:00 PM
Join a Meeting
GoToMeeting
Enter meeting ID
Meeting ID 123-456-789
Join
Join a Meeting
Sign In
Settings

Idea Watch

New Thinking, Research in Progress ***hbr.org***

ILLUSTRATION: EIKO OJALA

ORGANIZATIONS

Managing Change, One Day at a Time

Leaders trying to transform company culture can learn from an unexpected source: addiction treatment programs.

by Keith Ferrazzi

At a client's off-site meeting a few years ago, I gave a talk on how companies can bring about dramatic cultural change—the focus of my firm's consulting work. At the end, a man quietly approached and asked, "Are you a friend of Bill's?" Seeing my confused expression, he attempted a clarification: "Are you a friend of Bill W's?" "Who's Bill W?" I said. The man explained that Bill Wilson was the founder of Alcoholics Anonymous and that members use the question "Are you a friend of Bill's?" to discreetly inquire about whether acquaintances are in AA. "I'm not," I replied. "Why do you ask?" He said that the methods I'd described to lead change reminded him of the methods AA uses to help people stop drinking—so much so that he'd wondered if I was a 12-stepper myself. I thought it was an interesting exchange but gave it no further thought at the time.

Soon afterward a senior executive at another client told me that the process we'd used to coach his team had inspired him to confront his alcohol abuse—even though we hadn't, of course, discussed addiction during the coaching. This made me curious. So over the past several years, my team and I studied a variety of addiction treatment programs. We examined the methods and success rates of traditional 12-step programs along with less conventional techniques, from the regimen depicted on the TV show *The Biggest Loser* to therapies for troubled youth and training protocols for orca whales. We approached the endeavor with skepticism—on the surface, change management and addiction treatment seem wholly dissimilar. Over time, however, we saw many parallels between how the two bodies of work leverage human nature to modify behavior. In the process, we discovered a provocative lens and language to help change managers better understand their mission and methods.

At the simplest level, the comparison is this: Organizations can't change their culture unless individual employees change their behavior—and changing behavior is hard. Many change programs focus on providing strategies, technologies, and training. But often that's not enough. When it comes to modifying deeply ingrained behavior, 12-step programs have a superior track record. They use incentives, celebration, peer pressure, coaching to adopt new habits, negative reinforcement, and role models—things organizations can draw on.

Analogies are never perfect, and there are clearly points where the comparison doesn't hold. For instance, AA relies heavily on spirituality, asking participants to put their faith in a higher power and to declare themselves powerless—sentiments that are generally not appropriate for driving corporate change. Still, in our work with clients including eBay, Dow Chemical, Accenture, AOL, and Lincoln Financial, we have found the comparison useful. Even people who have never attended a 12-step program know some of the basics from pop culture portrayals; making the similarities to corporate change explicit, as in the insights below, can help them understand the challenges of changing an organization's culture and how to overcome them.

Nothing happens without a readiness to change. John Kotter, the preeminent change management expert, has written: "People don't change a minute before they're ready." In the AA canon, "hitting rock bottom" is often the catalyst, but for companies, change readiness doesn't require failure. Sometimes a leader's admission of vulnerability helps others recognize and address their failings (think of the sharing done in AA meetings). You can't force people to change—you can only help them want to. AA's process recognizes this truth; few managers do.

It's important to replace old habits with new ones. Many former smokers chew gum or toothpicks. AA serves coffee to give attendees a beverage in place of the ones they've given up. In change management, the goal is to replace negative habits with positive ones. At one restaurant chain, store managers used to begin the day by going over the numbers from the previous shift. Although analyzing numbers isn't inherently bad, it is an isolating behavior, usually done in an office with the door closed—and data alone often don't explain why sales went up or down. So we helped managers start the day with a different routine: talking with crew members to learn whether anything unusual had happened on the previous shift and only then going through the numbers. This increased managers' understanding of business conditions and boosted employee engagement—and sales rose.

Peer support and pressure drive change. One of the best ways to change human behavior is to gather people with similar problems together. This was first recognized in 1905 by the Boston physician Joseph Pratt, who organized groups for tuberculosis patients that emphasized the need for rest, fresh air, and proper nutrition. Over the past century research has shown that support groups benefit people with a wide range of medical and psychological conditions. In our work we find that bringing employees together in peer groups to discuss change initiatives can create accountability, mutual generosity, a judgment-free attitude, and increased pressure on reluctant employees to change.

Sponsorship deepens commitment and sparks results. AA pairs experienced members, or sponsors, with newcomers for one-on-one support; research has shown that these role model relationships increase both parties' ability to stay sober. The corporate version, called peer coaching or mentorship, has been widely embraced: For example, 70% of *Fortune* 500 companies use it with their salespeople. We find that identifying and celebrating early adopters of the behaviors a company wants to instill can create positive contagion. Pairing these role models with slower-to-adopt colleagues can be far more effective than coaching by outside experts.

Community without hierarchy is a catalyst for change. AA is famous for its organizational structure, in which local groups are self-directed. Addiction specialists sometimes raise concerns that groups without therapists or other formal leaders lack professionalism, but research has shown that this structure increases members' security, comfort, and sense of mutuality in the relationships they form. Corporations will always require a hierarchy, but peer role models can successfully lead projects within a change initiative.

You are the company you keep. Studies have shown that people with a close friend or relative who drinks heavily are 50% likelier to be heavy drinkers themselves. That is why AA discourages members from associating with their old drinking pals. Similarly, having an obese friend

To Change the Culture, Change the Habits

HBR recently spoke with **LISA BUCKINGHAM,** the chief human resources officer at Lincoln Financial (a client of Keith Ferrazzi's).

HBR: Why are habits so important?

Buckingham: Organizations can develop dysfunctional habits. For instance, when I arrived at Lincoln Financial, in 2008, I noticed that most meetings started five minutes late and that people would be using their smartphones while other people were presenting. Starting late hurts productivity, and multitasking can hurt relationships, so we eliminated those behaviors. Now meetings start promptly, and if you need to check your phone, you leave the room. Those are small habits, but they make a big difference in our culture. I've never been to AA or Weight Watchers, but Keith's insights about how their methodologies translate to company change initiatives are really profound, because systemic change can't happen without changes in individual behavior.

What other similarities to 12-step groups have you observed in your work to build a cohesive team?

Support groups create a safe environment that allows people to be authentic, and we try to do the same thing. We strive for openness and candor. We begin our meetings with a "personal and professional check-in" during which people talk for a few minutes about what's going on in their lives. It requires us to be vulnerable, it helps build our relationship as a team—and very often it gives us an opportunity to ask how we can help one another.

How do you recognize small wins?

We try to take a moment to celebrate every single success. Many of our managers send handwritten thank-you notes. We might send congratulatory e-mails to individual team members and copy our CEO. Those things make people feel appreciated—and that matters when competitors try to recruit them away. We aim to show gratitude. Sending flowers to a valued employee on a random day is never a bad idea.

increases one's own chances of becoming obese, and a person's income can be estimated by averaging the income of his or her five closest friends. This knowledge can guide change managers, who should evaluate the ROI of helping particular employees to change in light of those employees' potential to get others to follow suit. In our work we strive early on to identify influential employees; this can be as simple as asking workers which of their colleagues are informal leaders. Often it's possible to leverage this influence in subtle ways: For example, by changing where employees sit, you can seed influentials throughout the organization.

Continuous introspection is key. Early on in the AA program, members examine their past behavior and start trying to change. AA talks about continuously taking a moral inventory; we see this in effective corporate change initiatives as well. In the wake of the global financial crisis and General Motors's bankruptcy filing, for example, the company practiced that kind of deep introspection, found its behavior wanting, and drew on its experience in total quality management to improve its relationships with dealers. Before the crisis, GM had managed those relationships by relying heavily on checklists, specifications, and mandated actions. Now it promised and demonstrated a new focus on listening and collaboratively solving problems as a trusted adviser to its dealers (who are, in the industry's model of franchised dealerships, part of its customer base), and it achieved better solutions and increased buy-in. The new approach is proving helpful as the company deals with recent recalls.

Changes in practice may represent breakthroughs. In the AA program, a profound transformation occurs when a participant shifts from an emotional framework of guilt, shame, remorse, and resentment toward a more positive, optimistic mind-set. But "mind-set" is hard to measure, and minds are hard to change; therefore, in our work we focus on identifiable shifts in *practice.* We coach new practices or habits that emphasize growth rather than cost-cutting, for example, or that grow profitability rather than revenue. When you spot such a shift, celebrate it; it's an important marker of progress.

It pays to acknowledge small wins. AA doesn't ask members never to drink again—that goal would probably seem unreachable. It asks them not to drink *that day,* and it recognizes small milestones by awarding "sobriety coins," usually monthly, for periods of abstinence. Change managers should take a lesson from this practice and find ways for employees to demonstrate and celebrate incremental achievements. One of the biggest reasons corporate transformations fall short, according to Kotter, is that managers fail to "systematically plan for, and create, short-term wins."

The goal is progress, not perfection. Ninety percent of recovering alcoholics relapse at some point. That's hardly surprising: The newly sober are bombarded with sensory cues that their brains associate with their addiction—the smell of beer, the sound of glasses clinking in a toast. In organizations, too, change doesn't always follow a straight line. However, this is an area where we diverge from many 12-step programs: Unlike AA, which takes away all a member's sobriety coins as penalty for any relapse, we coach people to overcome setbacks and move forward to the next win. Celebrating the reversal of a relapse can help desired behaviors regain momentum.

CHANGE IS HARD—particularly when the situation involves chemicals the body craves. Neuroscience has shown that people's emotional responses to work create their own chemical reactions, releasing powerful neurotransmitters such as adrenalin, dopamine, and serotonin. Successful change can be addictive in a positive way. No matter how habituated employees are to established business practices, they can adapt to new ways of working.

HBR Reprint F1407A

Keith Ferrazzi is the CEO of Ferrazzi Greenlight, a research-based consulting and coaching company; a coauthor of *Never Eat Alone* (expanded edition from Crown Business, 2014); and the author of *Who's Got Your Back* (Broadway Books, 2009).

ILLUSTRATION: JOEL KIMMEL

Research Watch

Robin Hood Rankings

People in cultures that are relatively accepting of inequality in power or wealth are less likely to give to the needy, according to research by **Karen Page Winterich,** of Pennsylvania State University, and **Yinlong Zhang,** of the University of Texas at San Antonio. Countries with high levels of giving, including Australia, Canada, Ireland, New Zealand, and the U.S., were found to be less accepting of inequality; those with low levels of giving, including Bulgaria, China, India, Russia, and Serbia, were more accepting of inequality. An acceptance of inequality may reduce people's sense of responsibility for others, the researchers say.

STRATEGY *by J.P. Eggers*

Get Ahead by Betting Wrong

Companies that invest heavily in R&D are often torn between emerging technologies, wondering which will win in the market and is therefore the one to develop. (The classic example is VHS versus Betamax video recorders.) Conventional wisdom suggests that they pay dearly for getting it wrong. But my research shows that betting on a losing technology and then switching to the winner can position a company to come out ahead of competitors that were on the right track all along.

Much of my investigation centered on flat-panel computer displays. I examined company and product data for 55 firms from the 1980s through the 2000s. Initially, companies pursued either plasma screens or liquid crystal displays. LCDs turned out to be the right call, but several firms with an early focus on plasma, including IBM, ended up as the top LCD performers. Why? I believe that switching to a new technology often forces companies to rapidly ascend a steep learning curve, and they can then use their knowledge to beat competitors whose learning proceeded more slowly.

My study encompassed detailed data on 694 products, 30 years of financial data, thousands of industry patents and scientific publications, interviews with more than 25 longtime industry veterans, and dozens of internal strategic planning documents from one particular firm. It yields several insights for companies facing competing technologies:

Avoid overcommitting. This can be hard. The need to build specific expertise, the allure of being seen as a leader, and the imperative to be decisive tend to push firms into full-on commitments, which can become entrenched as confirmation bias tilts managers toward data suggesting that they've made the right choice. Consider joint ventures and other alliances to avoid overinvestments you may come to regret.

Don't let shame or despair knock you out of the game. Shame has been shown to be a particularly corrosive response to failure. Remember that no one could have known which technology would win. And try to avoid seeing things as worse than they are. Some of the companies that bet wrong decided, unnecessarily, to get out of flat-panel displays altogether.

If you realize you've made a mistake and should change course, move quickly. Studies have shown that the ideal moment to enter a high-tech industry is just as the dominant design emerges.

Transfer knowledge. Make use of the information you gathered for a losing bet. The heavy glass required by plasma technology forced IBM to become skilled at glass design, which helped it push glass technology in new directions in products such as the original ThinkPad laptop after it switched to LCD.

It can be dangerous to be right at the outset. Managers in some LCD-first companies interpreted the pivot point as an unconditional endorsement of everything they had been doing. As a result, they failed to recognize the need to rethink some details of their technology, such as the importance of color displays, and their complacency helped former plasma companies pull ahead.

HBR Reprint F1407B

27% OF FLAT-SCREEN MAKERS THAT ORIGINALLY BET ON PLASMA SUCCESSFULLY SWITCHED WHEN LCD BECAME DOMINANT.

COMPARED WITH SCREENS FROM LCD-FIRST FIRMS, THE SWITCHERS' PRODUCTS WERE BETTER (ACCORDING TO PRODUCT REVIEW ANALYSIS) BY **14%**

J.P. Eggers is an assistant professor of management and organizations at NYU's Stern School of Business.

ILLUSTRATION: ISTOCKPHOTO


IF WE™ want sustainable transportation, could we look to the sea?
Algae-based bioplastic materials – a dream our software could bring to life.
Innovative thinkers everywhere use INDUSTRY SOLUTION EXPERIENCES from Dassault Systèmes to explore the true impact of their ideas. Insights from the 3D virtual world are unlocking new and innovative ways to create and manufacture automotive parts from unconventional and biodegradable raw materials. How many more secrets does the sea still hold?
3D
V+R
3DEXPERIENCE
It takes a special kind of compass to understand the present and navigate the future.
3DS.COM/TRANSPORTATION
DASSAULT SYSTEMES | The 3DEXPERIENCE Company

Stat Watch

DAILY STAT
To receive HBR's Daily Stat by e-mail, sign up at **hbr.org/dailystat.**

23%

Employees who spent the last 15 minutes of each day of their training period writing and reflecting on what they had learned did 23% better in the final training test than other employees, according to a study by **Giada Di Stefano,** of HEC Paris; **Francesca Gino** and **Gary Pisano,** of Harvard Business School; and **Bradley Staats,** of the University of North Carolina. "Learning by doing" is more effective when coupled with deliberate reflection, or "learning by thinking," the study shows.

MARKETING *by Silvia Bellezza and Anat Keinan*

How "Brand Tourists" Can Grow Sales

Growing an exclusive brand by moving down market can be tricky: Such efforts often dilute the symbolic value for core customers. Consider what happened after Burberry brought its iconic plaid to a host of new products (including dog leashes) in the early 2000s. Sales soared—but soon the brand's ubiquity drew media ridicule (and a slew of counterfeits). To restore its cachet, Burberry reserved the plaid for use in linings and other discreet places. Tiffany, Gucci, and Pierre Cardin have learned similar hard lessons.

New research we conducted, however, counters the notion that downward extensions always tarnish the brand. Under certain conditions, noncore consumers can actually intensify a brand's prestige.

Imagine that brands are like countries. An influx of immigrants might generate a backlash among a nation's citizens (its "core customers"), who are apt to see them as threats. But the presence of tourists—visitors who admire the locale though they're not looking to stay—generally raises a country's status. So, too, with brands. We call this effect "brand tourism."

In six studies of brands ranging from Prada to the elite endurance race known as Tough Mudder, we found that core customers' perceptions were influenced by the way in which noncore users were presented. In one study, for instance, we told owners of Prada purses that anyone who visited a boutique was given a high-quality paper shopping bag bearing the Prada logo (whether or not she bought anything). We told one group of owners that bag recipients saw themselves as part of the Prada community (making them, in effect, brand immigrants), and told a second group that the recipients carried the bags to show their admiration for the brand (making them brand tourists). The first group felt that the free bags diminished the brand, while the second reported feelings of greater pride in being a Prada owner. For each brand we studied, positioning noncore customers as brand tourists created positive feelings among core customers. Similarly, we found that advertising noncore products as a sample of, rather than a substitute for, the core offering generated the brand tourism effect.

Our findings suggest several strategies for companies that want to extend a brand but are concerned about alienating core customers. First, firms can manage the extent to which noncore users can claim membership in the brand community. A university, for example, might reserve the right to use the school's logo on business cards for its full-time students. Tough Mudder sells an array of merchandise, but its "finisher only" line is available solely to participants who complete the race.

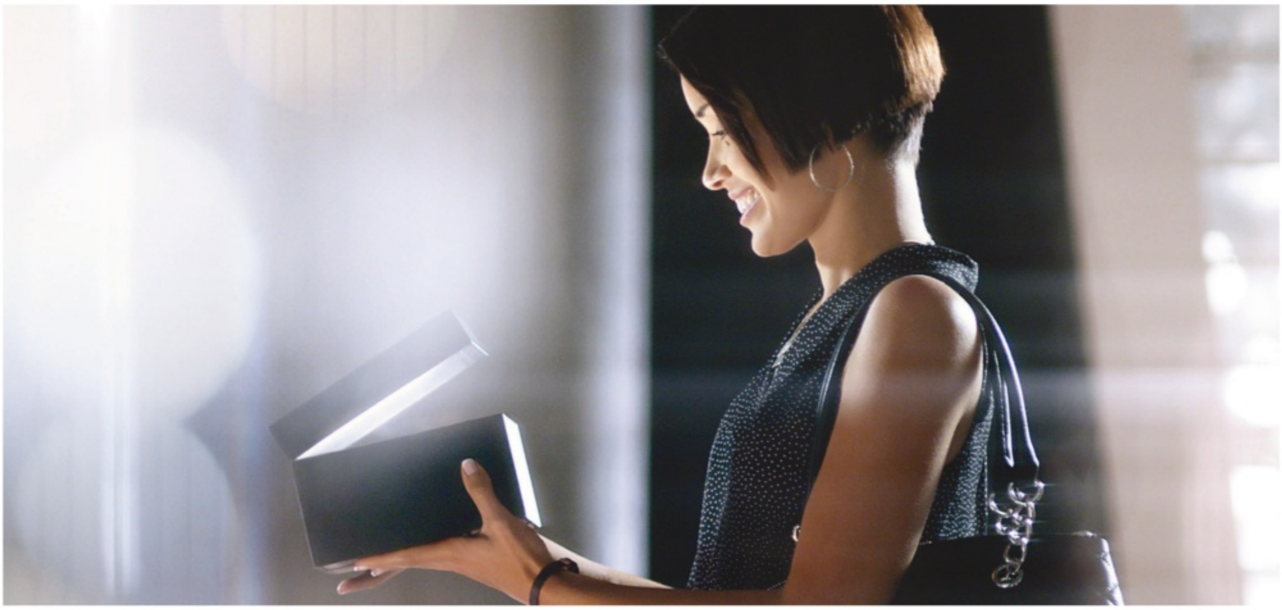
Firms can also differentiate core products and brand extensions by using special packaging or separate distribution channels. They can target a consumer segment whose members wouldn't realistically be mistaken as belonging to the "in group" (babies wearing Lululemon apparel, for instance). Or they can follow the lead of Bulgari, which donated proceeds from a less-expensive jewelry line to charity, casting new buyers in a positive light.

Creating an exclusive brand shouldn't be about erecting barriers to keep consumers out; indeed, growth requires the welcoming of new faces. Even luxury brands now tout the number of Facebook fans and Twitter followers they have. Some go a step further, building museums dedicated to the history of the brand, such as Florence's Gucci Museo. Brand tourism strategies typically won't be quite so literal as that—but they're clearly effective.

HBR Reprint F1407C

Silvia Bellezza is a doctoral candidate at Harvard Business School, and **Anat Keinan** is an associate professor of marketing at HBS.

ADVERTISEMENT



INNOVATION IN THE AGE OF EXPERIENCE

We live in an age where businesses need to look beyond the aesthetics of a product or the practicalities of a service...where consumer engagement and loyalty count far more than features and benefits alone...where consumers expect to interact with or even influence suppliers – not just be sold to.

Products are no longer enough for today's consumers who value experience over all else.

THE AGE OF EXPERIENCE HAS ARRIVED

Executives and academics everywhere accept that in the modern economy, the key to success is delivering consumer experiences that demonstrate true differentiation.

And yet, the task is a daunting one at best. What exactly is meant by experience? And, more importantly, how can a business influence it, given the complex array of emotional, rational and physical responses that inevitably drive consumer connection?

IF WE CHANGE THE WAY WE INNOVATE, CAN WE DEVELOP EXPERIENCES THAT CONSUMERS DEMAND?

The key to making consumer experience the true focus of innovation is to capture insights and expertise from across a business's entire ecosystem.

Shaping the right consumer experience requires not only the involvement of but also the collaboration between all roles within a company – from marketing and management to sales and engineering.

Only by connecting all the dots between people, ideas and data can a business drive consumer loyalty, engagement and value.

IF WE WANT TO THRIVE IN THE AGE OF EXPERIENCE, WHERE CAN WE TURN?

The **3D**EXPERIENCE® platform from Dassault Systèmes is a business experience platform: a new class of collaborative environment specifically designed to help companies create differentiating consumer experiences.

It enables everyone within a company to play an active role in experience development.

With a single, easy-to-use, compass-like interface, the **3D**EXPERIENCE platform powers INDUSTRY SOLUTION EXPERIENCES – based on 3D design, analysis, simulation and intelligence software in a collaborative, interactive environment.

The Age of Experience represents a significant opportunity for businesses prepared to place a new focus on creating unique and truly rewarding consumer experiences.

It's time to ask the right questions, understand the present and navigate the future – now made possible with the **3D**EXPERIENCE platform.

Discover the **3D**EXPERIENCE platform and our INDUSTRY SOLUTION EXPERIENCES at **3DS.COM**.

The **3D**EXPERIENCE Platform Explained

The **3D**EXPERIENCE platform is a business experience platform. It provides software solutions for every organization in your company – from engineering to marketing to sales – that help you, in your value creation process, to create differentiating consumer experiences.

With a single, easy-to-use interface, it powers INDUSTRY SOLUTION EXPERIENCES, based on 3D design, analysis, simulation and intelligence software in a collaborative interactive environment. It is available on premise and in public or private cloud.

It takes a special kind of compass to understand the present and navigate the future.

About Dassault Systèmes Dassault Systèmes, the **3D**EXPERIENCE Company, provides business and people with virtual universes to imagine sustainable innovations. Its world-leading solutions transform the way products are designed, produced and supported. Dassault Systèmes' collaborative solutions foster social innovation, expanding possibilities for the virtual world to improve the real world. The group brings value to over 190,000 customers of all sizes, in all industries, in more than 140 countries.

Defend Your Research

HBR puts some surprising findings to the test

Jennifer Mueller is an associate professor at the University of San Diego.

Managers Reject Ideas Customers Want

The research: Jennifer Mueller of the University of San Diego, Jeff Loewenstein of the University of Illinois at Urbana-Champaign, and Jennifer Deal of the Center for Creative Leadership studied a company that was considering dozens of new product ideas. The researchers asked middle managers, C-suite executives, idea generators, and other stakeholders to rate each idea on its creativity, feasibility, and profitability. Then they asked customers how desirable each idea was. The customers wanted the most-creative ideas, the team found, but not the ideas that people in the firm thought would be most profitable or feasible.

The challenge: Are companies emphasizing the wrong product qualities when they innovate? Are they missing opportunities to launch hits as a result? **Professor Mueller, defend your research.**

Mueller: It makes sense that companies would be attracted to feasible ideas, but we found strong evidence that they are not what customers want. The number one predictor of whether customers wanted a product was how creative it was. And we also found evidence that customers wanted feasible ideas *less* because they were less creative. In other words, creativity isn't being seen by customers as the icing on the cake; it *is* the cake.

HBR: So organizations aren't rejecting creative ideas, they're accepting feasible ones. That seems easy to fix.
The problem goes deeper than that. Our research also suggests that a focus on feasibility can make it harder to even recognize when ideas are creative. In one study we primed people with a "how" mind-set, asking them to describe how to do things, or a "why" mind-set, asking them to describe why they did things. People with the "how" mind-set, which is highly related to feasibility concerns, rated innovative ideas as less creative than those with a "why" mind-set did.

If firms have to consider feasibility, how can they overcome this disconnect?
We believe that the major reason novelty and feasibility are thought to be at odds is that new ideas involve more unknowns. CEOs want to see metrics, such as ROI, to determine the viability of ideas, but for the newest ideas, such metrics are hard to produce, if not impossible. If decision makers are more tolerant of uncertainty—if they focus on the "why" or consider that there are many possible solutions—it may mitigate their tendency to reject creative ideas.

Are you saying that firms should just forget about whether ideas are feasible?
No. But they should recognize that feasibility concerns make creative ideas harder to stomach. Steve Jobs was notorious for his "reality distortion field." He'd say, "Let's do this new thing." His staff would say, "How is that possible?" He'd say, "Just do it." Maybe this aided creativity because it made feasibility concerns less powerful.

Wait—don't people think that creative ideas are also feasible?
Though scholars think that creative products are useful and feasible by definition, our new research shows that only a minority of people agree. A minority disagree, and the rest are unsure. But it could be that organizational decision makers see feasibility as a sign of creativity, which leads them to green-light feasible ideas.

So people have different opinions about what's creative? That's hardly surprising.
It's more profound than that. For a long time, theories of creativity suggested that judgment of creativity was based on expertise. But we're finding that two people with the same expertise will look at an idea and rate its creativity very differently based on their mind-set ("how" versus "why") or feelings of uncertainty, which may be related to where they sit in the organization. The current theory doesn't deal with this.

So there is no accepted definition of what a creative idea is?
The scholars agree, but our new work shows that laypeople might not. We've found around 30 cues that people use to identify creativity. Some people rely on a narrow set of cues, some on a much

ILLUSTRATION: ADRIAN JOHNSON

broader range. For 20% of our sample, any one of the cues could indicate creativity. Though we don't have data to support this idea yet, it could mean that 20% of people view something that is highly useful but not novel as creative.

What are some of the cues?
Seven of them involve novelty. Other cues include rarity and whether the idea has a mass market. Feasibility was a cue too but did not show up consistently. That raises the possibility that people view feasibility as a sign of creativity when they're in an intolerant "how" mind-set and as less of one when they're in a tolerant "why" mind-set.

What are some implications of using different cues when assessing creativity?
CEOs often say, "We want innovation!" To which workers answer, "Great! Here are some creative ideas." But what the CEO thinks is creative and what the idea generators think is creative are different. Also, we have some evidence that people in the same work group (such as C-suite execs, researchers, or middle managers) tend to think alike about what creativity means, but views among groups vary. So idea generators may produce one version of creativity and decision makers may approve another, and the result is something consumers think is boring and that doesn't sell.

Can't CEOs just foist a definition on the firm and say, "This is what makes a creative idea here"?
Possibly. But first the CEOs need to be aware of all the specific cues, in order to emphasize some and de-emphasize others. They can't just say they want innovation, creativity, novelty, or even usefulness. Those terms are pretty vague. We are just now discovering the cues, however. CEOs also need to be aware that some environments may make certain cues more salient.

Defining creativity is starting to sound like the old saw about defining history: It's like trying to nail Jell-O to the wall. Not only is it impossible, but what's the point of trying?
That statement summarizes how most companies feel. This is new research, and any new idea involves a great deal of uncertainty, which makes it seem less appealing. We have a long way to go before we'll have a full-fledged theory, but we're heading that way. We have to get this right.

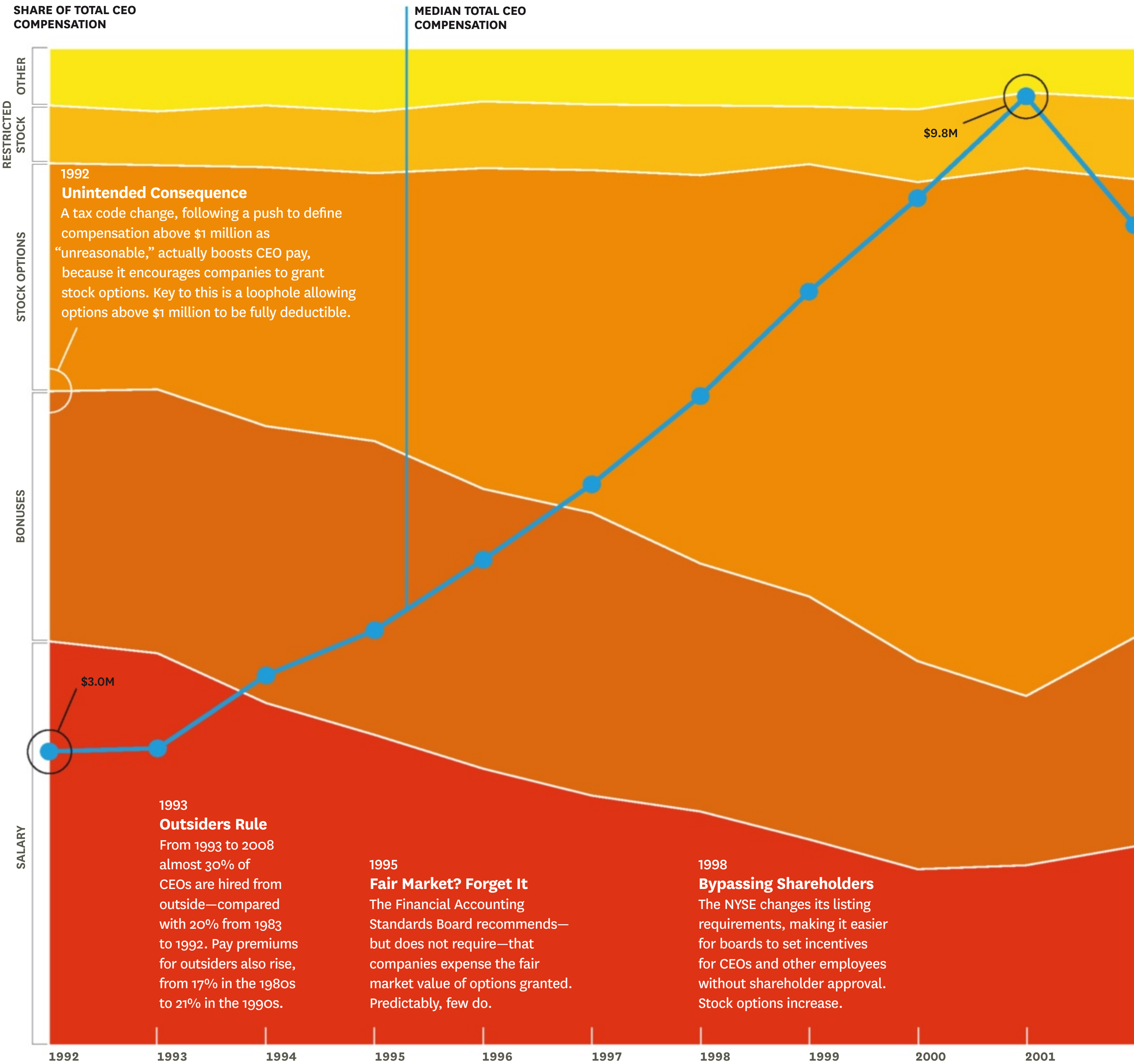
Why?
Companies say all the time that they have to be more creative, that not changing is dying. Then they quickly discover this mush—how difficult creativity is. Firms implement feasible ideas that customers don't want. Decision makers avoid uncertainty by telling themselves that customers don't care about new ideas even though they do. For a long time people thought the problem was how to generate creative ideas. We now know a lot about that, but we're finding an even earlier challenge: How do we make sure the ideas we're choosing among are the most creative in the first place, and that we're not filtering out the best ones?

HBR Reprint F1407D
Interview by **Scott Berinato**

Vision Statement

The Whys and Wherefores of Executive Pay

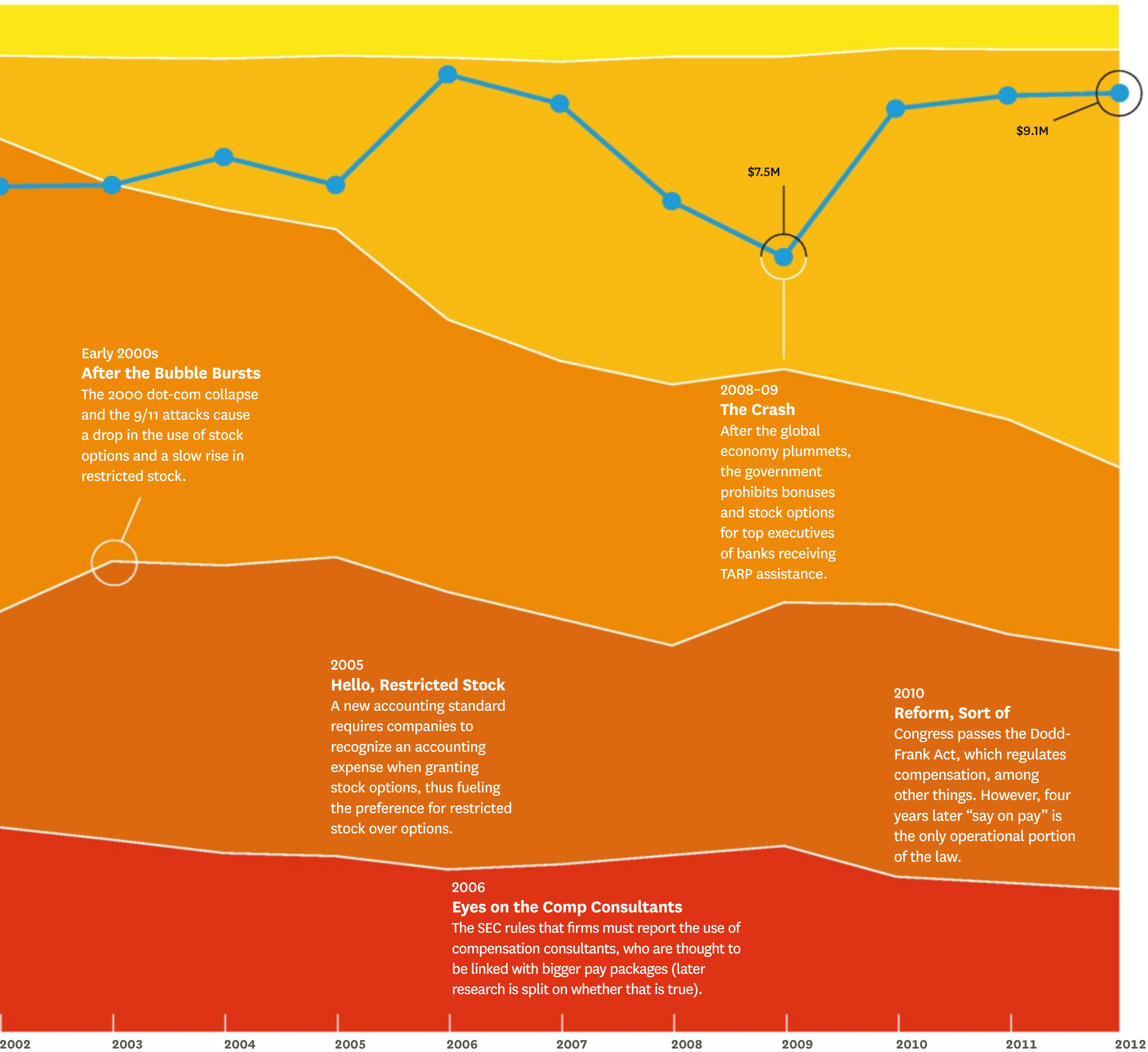
The CEOs of U.S. companies are compensated exceedingly well. A recent analysis by the AFL-CIO found that the heads of S&P 500 companies are paid 331 times as much, on average, as production and nonsupervisory employees. Regardless of whether this is fair—some believe that CEOs aren't paid



nearly enough—it's worth understanding how we got here.

As the blue line below shows, CEO pay took off in the 1990s. This resulted in part from activist shareholders' and academics' pushing for stronger links between compensation and returns. The SEC also changed holding-period rules so that the acquisition of an option rather than its exercise was the basis for reporting a purchase, making stock options much more attractive to executives.

Kevin J. Murphy, a professor at the USC Marshall School of Business and an expert on executive pay, has collected data and examined research on the earnings of the S&P 500 CEOs since 1992. He finds that—as the bands of color illustrate—much of the story of executive comp in recent decades comes down to four words: *stock options* and *restricted stock*. **HBR Reprint** F1407Z



Charan

Ram Charan is a worldwide business adviser and speaker and the author of 15 books. His most recent is *Global Tilt* (Crown Business, 2013).

It's Time to Split HR

It's time to say good-bye to the Department of Human Resources. Well, not the useful tasks it performs. But the department per se must go.

I talk with CEOs across the globe who are disappointed in their HR people. They would like to be able to use their chief human resource officers (CHROs) the way they use their CFOs—as sounding boards and trusted partners—and rely on their skills in linking people and numbers to diagnose weaknesses and strengths in the organization, find the right fit between employees and jobs, and advise on the talent implications of the company's strategy.

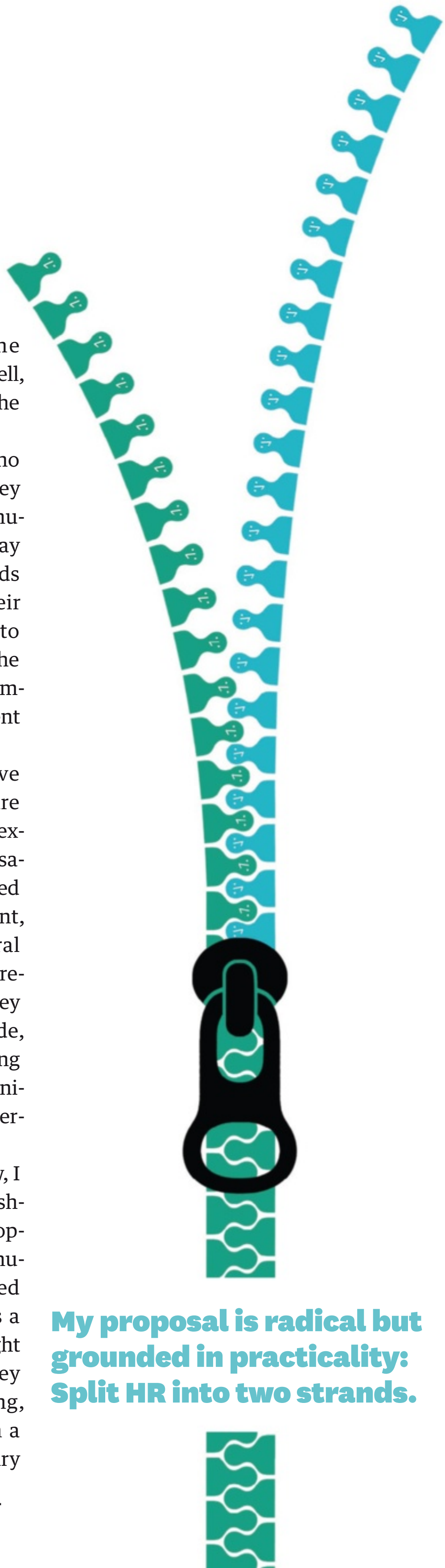
But it's a rare CHRO who can serve in such an active role. Most of them are process-oriented generalists who have expertise in personnel benefits, compensation, and labor relations. They are focused on internal matters such as engagement, empowerment, and managing cultural issues. What they can't do very well is relate HR to real-world business needs. They don't know how key decisions are made, and they have great difficulty analyzing why people—or whole parts of the organization—aren't meeting the business's performance goals.

Among the few CHROs who do know, I almost always find a common distinguishing quality: They have worked in line operations—such as sales, services, or manufacturing—or in finance. The celebrated former CHRO of GE, Bill Conaty, was a plant manager before Jack Welch brought him into HR. Conaty weighed in on key promotions and succession planning, working hand in glove with Welch in a sweeping overhaul of the company. Mary Anne Elliott, the CHRO of Marsh, had had several managerial roles outside HR. She is overhauling the HR pipeline to bring in other people with business experience. Santrupt Misra, who left Hindustan Unilever to join Aditya Birla Group in 1996, became a close partner of the chairman, Kumar Mangalam Birla, working on organization and restructuring and developing P&L managers. He runs a $2 billion business as well as heading HR at the $45 billion conglomerate.

Such people have inspired the solution I have in mind. It is radical, but it is grounded in practicality. My proposal is to eliminate the position of CHRO and split HR into two strands. One—we might call it HR-A (for administration)—would primarily manage compensation and benefits. It would report to the CFO, who would have to see compensation as a talent magnet, not just a major cost. The other, HR-LO (for leadership and organization), would focus on improving the people capabilities of the business and would report to the CEO.

HR-LO would be led by high potentials from operations or finance whose business expertise and people skills give them a strong chance of attaining the top two layers of the organization. Leading HR-LO would build their experience in judging and developing people, assessing the company's inner workings, and linking its social system to its financial performance. They would also draw others from the business side into the HR-LO pipeline. After a few years these high potentials would move to either horizontal or higher-level line management jobs. In either case they would continue to rise, so their time in HR-LO would be seen as a developmental step rather than a ticket-punching exercise.

This proposal is just a bare outline. I expect to see plenty of opposition to it. But the problem with HR is real. One way or another, it will have to gain the business acumen needed to help organizations perform at their best.

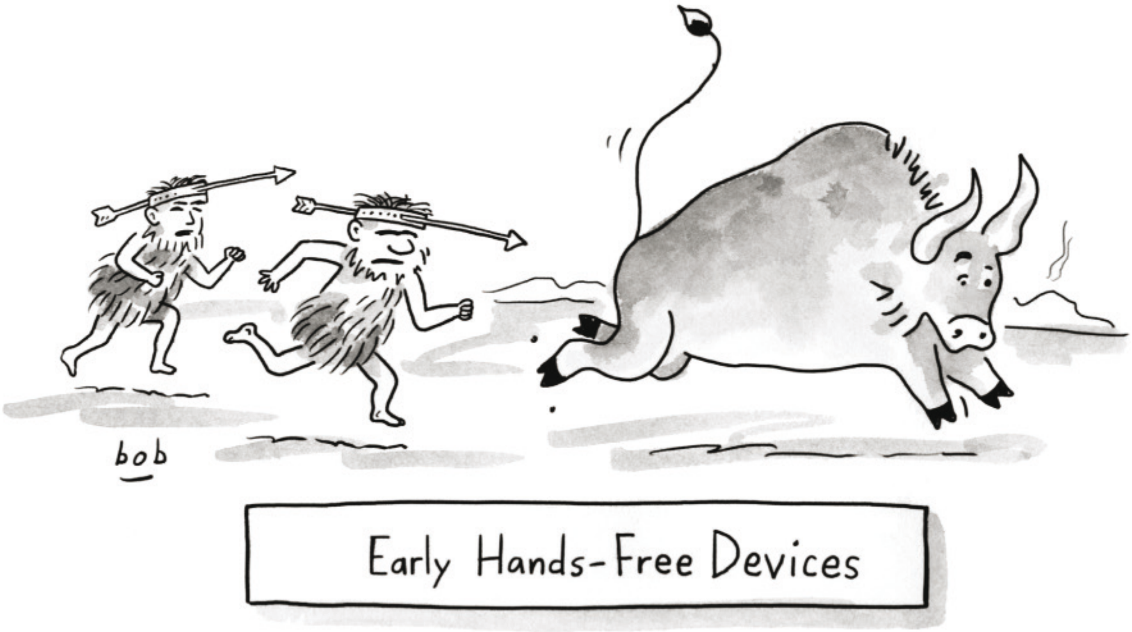


My proposal is radical but grounded in practicality: Split HR into two strands.

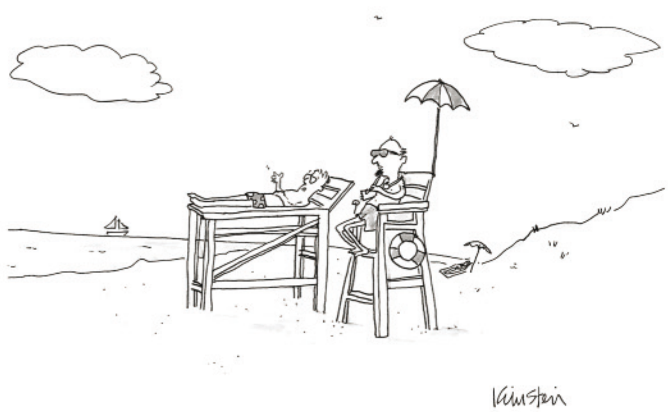
ILLUSTRATION: MIGUEL PORLAN

HBR Reprint F1407E

Strategic Humor



CAPTION CONTEST



"I'm loving this blue ocean strategy."

This month's winning caption was submitted by **Lance Kelly** of Manchester, Connecticut.

CARTOONS: BOB ECKSTEIN, PAULA PRATT, KEN KRIMSTEIN

Girsky

Steve Girsky is a board member at General Motors, where he served as vice chairman from 2010 to 2014.

PHOTOGRAPHY: DAN SAELINGER/TRUNK ARCHIVE

Many Stakeholders, One Story

For the first two decades of my career, I worked as a Wall Street analyst, and one thing above all drove my success: the effort I put into synthesizing all the messages coming out of a company into one strong story line.

Occasionally corporate executives would ask for pointers on enhancing their relationship with the Street. My advice was pretty simple: Don't make it so hard for people to discern your narrative. Communicate a clear and consistent story, and offer data points over time that demonstrate progress toward your vision.

That sounds like common sense, but you'd be surprised how many companies change their messages often or present differing agendas to different audiences. Big organizations have a lot of internal parts whose motivations vary, and they address groups of stakeholders with conflicting priorities. Take the automotive industry,

Don't make it so hard for people to discern your narrative.

which I spent 20 years covering. It touches consumers, dealers, suppliers, employees, labor unions, social activists, and more. It's natural to emphasize what the immediate audience wants to hear, but it's also easy to move too far in that direction.

In 2005 I left the analyst business and started working in the industry. For nine years I've served as lead director at a large supplier, Dana Holding Corporation; been an adviser to the United Auto Workers; and done several stints at General Motors, including one after its bankruptcy. It wasn't long before I realized that the advice I'd been giving applied far beyond dealing with investment analysts.

Throughout my career I gave presentations to the UAW to help its members understand the financial realities of the business. Many auto industry challenges are rooted in antagonism between manufacturers and labor unions, whose relationship has historically suffered from too little transparency. I spoke candidly to the union members and shared real numbers, just as the company would do with analysts. The workers, who weren't used to hearing this, felt respected and better understood why GM needed their help.

The situation was similar at Opel, the German auto operation GM has owned since 1929. When I was named chairman of the Opel supervisory board, in 2012, the company was losing several million dollars a day. I made big changes, beginning with asking top management to give presentations to the employees every four weeks. I suggested that the union's consultants attend important management meetings so that they'd know exactly what was going on. I told German politicians and the union that GM was likely to make unpopular decisions, including closing a plant—bad news that some might have been tempted to gloss over.

Today, companies can no longer assume that inconsistencies in their stories will go unnoticed. Workers are smart; they may not buy stock, but they are heavily invested in the company's success. Customers are smart too—and often interested in far more than product features. Smart managers won't resent the need to come up with a unified story. They will see the power of having one.

Opel's losses were reduced by 60% in 2013, and it looks destined to break even by its mid-decade deadline if not before. Of course the achievement is bigger than a communications strategy. Opel is delivering lower costs, better products, and strong leadership by a new management team. But every improvement has been facilitated by a clear, consistent understanding of what Opel needs to do. And when its dramatic turnaround is complete, everyone will know the story.

HBR Reprint F1407F

chocolate
made with
cloud
Lindt is making its online sales more to the taste of its customers with the help of IBM Cloud. Now Lindt can deliver custom chocolates to consumers anywhere in the US.
ibm.com/madewithcloud
Made with IBM
IBM and its logo, ibm.com and Made with IBM are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. See current list at ibm.com/trademark. ©International Business Machines Corp. 2014.

The CEO of Ozon on Building an e-Commerce Giant in a Cash-Only Economy

by Maelle Gavet

At first I didn't want to have anything to do with Ozon. I was coming up for partnership at the Boston Consulting Group, and it was one of the firm's smallest clients. I couldn't see how it would help my chances for promotion, but a senior partner insisted that I lead the engagement.

A few months later I resigned from BCG to become Ozon's sales and marketing director—and a year and a half later, in 2011, I became its CEO.

Why did I take such a risk? To begin with, I had been an entrepreneur once before, and I missed the excitement. I also quickly realized that Ozon could become the Amazon of Russia. Not many e-commerce alternatives were around four years ago, and I could tell that the market was set to explode. Russians were going online at an extraordinary rate, with internet penetration rates increasing by 15% a year and reaching 55% in 2013.

In traditional retail, you're happy if you grow by 5%, so this rate of expansion was really exciting. I could make big changes

THE IDEA

Russia's economy is cash based, and its delivery networks are shaky. To drive growth in e-commerce, Ozon had to create a proprietary distribution system, a new logistics and customer service model, and a highly engaged team.

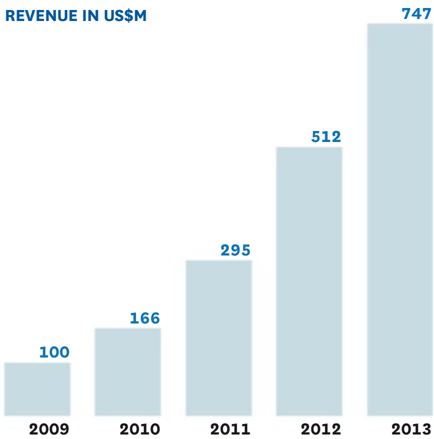
PHOTOGRAPHY: NICK WILSON/REDUX

happen quickly. I loved working at BCG, where my expertise was in retail and logistics, but the opportunity to be part of a hypergrowth story was too good to pass up. Perhaps most important, I would get to lead a large team. Ozon already had hundreds of employees at that point; at BCG I would never be leading a team of more than 10 or 20.

Why did they offer me the job? I was only 32 and French. I didn't really know about e-commerce (unless you count buying stuff from Amazon). But age and nationality don't matter much at tech start-ups, and I spoke good Russian. I also had some technology in my background. Ozon's board understood that figuring out how to deliver goods to consumers in Russia, with its shaky distribution systems, was the key to unlocking the country's e-commerce market. It was the opportunity of a lifetime, and I seized it with both hands.

Ozon Facts & Financials

Founded 1998
Headquarters Moscow
Current number of employees 2,355



SOURCE OZON

The Challenges of a New Market

People often accuse Ozon of being an Amazon clone. That's understandable. We started with books, expanded into movies and music, then moved into electronic items, and finally carried a full range of consumer goods—pretty much everything except groceries. All told, we now offer 3.5 million products, most of which we sell directly, though a growing number are sold on our site by third-party merchants. Like Amazon, we offer website platform services to independent retailers as well. We even have our version of Zappos: Sapato.ru, an online shoe boutique.

Yet our similarity to Amazon isn't why we've succeeded. To understand that, you have to look at the challenges of Russia's retail environment, which is very different from America's or Western Europe's. When I joined Ozon, Russia lacked a reliable, flexible, and speedy national delivery infrastructure, and no amount of web functionality can make up for a parcel's arriving late or not at all. When we started offering third-party products through Ozon.ru, the merchants on our site were failing to make delivery 50% of the time because they had to rely on the Russian postal system; there were no nationwide couriers.

Russia is also a cash market. People don't pay until the parcel is delivered. That means if you don't deliver, you don't get paid—and you handle a lot of cash. In 2010 about 82% of payments were made in cash; 75% still are today. In a cash economy it's also harder to track customers and monitor fraud. People often think that Amazon identifies them through a login name and a password—but that's not entirely true, because you can register as often as you want. The one thing you cannot do is use the same credit card for two accounts, so your credit card number is your unique ID.

Russian consumers also have a strong need for personal contact; online customer service doesn't cut it. Even today, 5% to 10% of orders come in by phone, because some people use the website as a catalog rather than as a store. When I joined Ozon, we had a call center that was open weekdays from 9 AM to 6 PM Moscow time. I thought we should probably close it, because customers could migrate to the website. But after spending a couple of days at the center listening to calls, I came back convinced that rather than closing it, we should invest in making it a 24/7 operation.

To succeed in Russian e-commerce, we needed more than website functionality. Our strategy hinged on logistics and customer support. We had to persuade people that they could get their purchases more quickly and reliably by ordering them online and having them delivered than by hoping to find them in stock at a shop. We needed a way to safely take and process the cash they paid with. Finally, we had to provide personal contact with customers and harvest data about their purchases and preferences. Put simply, we had to build an infrastructure from the ground up.

Creating Our Own FedEx

That sounded like a pretty daunting mission for what was still basically a tech start-up. When I joined as sales and marketing director, our delivery operation had just 100 people in two business units. One unit was focused on Moscow and Saint Petersburg, and the other on the rest of Russia. Each had its own IT platform for tracking orders. We also used the Russian post. The company was thinking about getting out of direct delivery by partnering with DHL and regional Russian delivery companies. We would focus on managing the interface with customers and tracking purchasing behavior.

After much debate the board and I made the decision to invest seriously in developing our own logistics capabilities. This would be a source of competitive advantage that could not easily be replicated; why give up control of such a key link in the value chain? If we went with an independent courier, that might prevent customers from making the personal connection with a retailer that is so important for generating brand loyalty; they'd be trusting DHL rather than Ozon. Besides, we had to solve the national delivery problem quickly, and we would waste time by negotiating with small regional delivery companies. Finally, we believed that we should control the handling of cash directly; it would certainly be cheaper and would most likely be safer.

Our first step was to combine the two logistics business units to create an integrated national hub-and-spoke network, targeting 2,000 pickup points. (See the exhibit "Ozon's Growing Footprint.") For the most part, we arranged franchiselike deals with shopkeepers who had well-located properties. In return for a cut of the sales, they took delivery of packages and exchanged them for customers' cash payments, which we collected at frequent intervals. We contracted with air-freight companies for long-haul transportation to hub airports and managed local transportation ourselves. This involved hiring and training staff and leasing vehicles.

But 2,000 points is a pretty big network to serve. We'd need five times as much volume as we then had if we were to make delivery quick and reliable enough to gain customers' trust. If you're sending a plane every day (or two or three times a day), the customer won't notice if you miss one plane. But if you deliver once a week, a missed plane means a week's delay in the order's arrival. We quickly realized that to get sufficient volume to run the network efficiently, we would have to deliver for third parties. That would also solve our problem with the merchants that sold through Ozon.ru. If we could improve their delivery rates as well, we would attract more retailers, more customers for them, and more volume for us.

But this posed a really big technical challenge. We couldn't just merge and adapt our existing tracking software if we were going to handle other sellers' packages as well as our own. We would have to rebuild the entire system. It's testimony to the members of our IT team that they enabled us to launch O-courier, a third-party delivery service, in September 2013. Their achievement also highlights the fact that the Ozon story has really been a team effort: Credit for the success of the company over these past three years belongs to our employees and our shareholders, because everyone has gone the extra mile to make our strategy work.

Communicating the Strategy

The most tangible consequence of our strategy was that we very quickly built up a large workforce. We now have almost 2,400 people on the payroll (up from about 900 when I joined). That doesn't include the thousands of independent contractors, such as people who manage the pickup

Ozon's Growing Footprint

Ozon developed this network of pickup points in the space of a few years. From January 2010 to April 2014 it opened nearly 2,000—more than half of them in 2013 alone. Naturally, most points are concentrated in heavily populated areas, such as Moscow and Saint Petersburg.

THE DARKER THE DOTS, THE MORE POINTS IN THAT AREA.

2010	5 PICKUP POINTS OPENED
2011	298
2012	392
2013	1,120
2014	91 (AS OF APRIL 9)

points or make deliveries from the hubs to the pickup points. All these people represent the Ozon brand, and how well they do so will determine whether we can stay on top of Russian e-commerce.

Leading people often seems to be an afterthought in the tech world. But even Facebook and Google are at least as much about their people as about their cool technology. You won't win in a competitive marketplace unless you have people who love their jobs and want to give their very best. Sometimes that means getting up at three in the morning or working over the weekend to fix a problem. Although this kind of firefighting is critically important, perhaps more important is that we make every contact with a customer a positive one. If customers have alternatives, companies don't. I spend probably 40% of my time on creating a highly engaged workforce. Making sure people are excited about the company they work for is extremely important—but we seldom talk about that in the internet world, and I don't understand why.

A big challenge we face is managing expectations around advancement and career development. Ozon has grown very rapidly, and we are able to attract great talent because people want to grow with the company. They'll get experience, more responsibility, and, of course, more money. But not everyone can grow as fast as the company, and someone who was perfect for her job a year ago may not be perfect for it anymore. You may have to promote someone behind her to be her supervisor. That's a hard message to deliver.

You're also asking people to be very comfortable with uncertainty, and a big part of management's job is to help people through that. With so much going on in the market, people may feel that you're constantly doing different things. You might be focusing more on the top line one year and on costs the next. In the C-suite we can see how it all fits together, but that understanding has to be communicated, which is one of the most important parts of our job.

We do that in several ways. To begin with, we have monthly onboarding meetings at which I personally get together with new recruits and invite them to ask whatever they choose. But the big event is a quarterly meeting with all our employees. Everyone comes to a hotel in Moscow, and the other executives and I get up on a stage to explain our strategy, what we've been doing to implement it, how it's been changing, and so on. We have a one-hour Q&A session, during which people can and do ask hard questions: Why did we undershoot this or that target? Why couldn't we open more pickup points in such and such a city? The questions are submitted in advance, and they're anonymous. Sometimes we have to admit that we screwed up, which isn't great for the ego but does send a positive message about accountability, a key element of the culture we want to create.

I can't yet say that we are where we ultimately want to be in creating our culture and engaging the team. But I can say that we consider this to be a top priority and are 100% committed to doing what it takes.

Russia still has a long way to grow. Out of 140 million people, only about 20 million use the internet to shop.

Planning for Future Growth

Even as we expand, we'll stay geographically focused. Russia still has a long way to grow. Out of 140 million people, some 60 million to 70 million are online, but only about 20 million use the internet to shop. We're opening up in Latvia and Kazakhstan, but basically we'll stick to the home region.

We'll be looking for e-commerce customer acquisition opportunities that leverage our platforms. Sapato is a good example of how we'll do this. It might seem odd to take on a stand-alone brand. Why not sell shoes directly through Ozon.ru (which in fact we do)? The reason lies primarily in the fact that people in the online world still have expectations about branding. Those who buy the fashionable shoes for sale at Sapato would probably never buy them at Ozon. But Sapato creates many synergies in purchasing and delivery for Ozon.

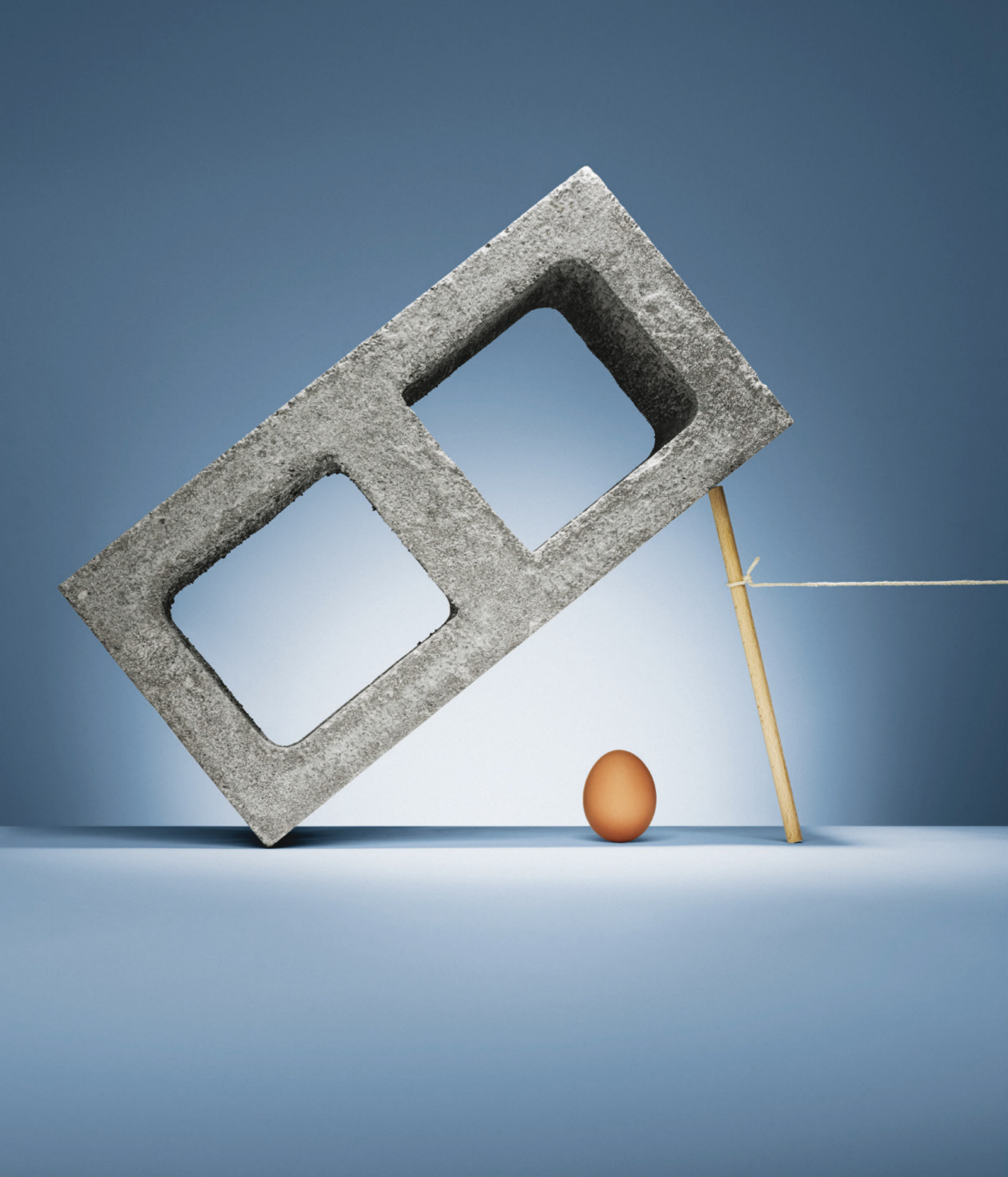
Getting into adjacent industries will be a major avenue for growth. We already have Ozon.travel—our version of Expedia—and bigger opportunities exist. When people are shopping with you and you're already handling their cash, consumer credit is a natural extension. It would give us a lot more information about our customers, and the future of e-commerce is very much about understanding customer data. One of our shareholders, the Japanese e-commerce company Rakuten, actually has a bank and is well placed to help us develop a strategy in this direction. But that's something for the future.

WHEN I first joined Ozon, I saw the challenge as primarily one of retail and logistics. But the longer I've been here, the more I've understood the critical importance of our team and our technology. It's smart technology that creates tracking systems to reliably get the product to the customer on time. It's technology that allows us to capture, store, and retrieve data about our customers. And going through the experience of building the capabilities that connect everything we do made me realize that I really like IT. It reminds me of what I used to do at BCG: Our clients already had the answers; what they wanted was some kind of structure to make those answers work. That's the Ozon story: creating a business model and a team that can adapt and grow with the huge opportunities we have.

HBR Reprint R1407A

Maelle Gavet is the CEO of Ozon.

The Big Idea



Robert C. Merton, a recipient of the 1997 Alfred Nobel Memorial Prize in Economic Sciences, is the School of Management Distinguished Professor of Finance at the MIT Sloan School of Management. He is also the resident scientist at Dimensional Fund Advisors, a Texas-based global asset management firm, and University Professor Emeritus at Harvard University.

The Crisis in Retirement Planning

Our approach to saving is all wrong: We need to think about monthly income, not net worth.
by Robert C. Merton

Corporate America really started to take notice of pensions in the wake of the dot-com crash, in 2000. Interest rates and stock prices both plummeted, which meant that the value of pension liabilities rose while the value of the assets held to meet them fell. A number of major firms in weak industries, notably steel and airlines, went bankrupt in large measure because of their inability to meet their obligations under defined-benefit pension plans.

PHOTOGRAPHY: MARK HOOPER

The result was an acceleration of America's shift away from defined-benefit (DB) pensions toward defined-contribution (DC) retirement plans, which transfer the investment risk from the company to the employee. Once an add-on to traditional retirement planning, DC plans—epitomized by the ubiquitous 401(k)—have now become the main vehicles for private retirement saving.

But although the move to defined-contribution plans arguably reduces the liabilities of business, it has, if anything, increased the likelihood of a major crisis down the line as the baby boomers retire. To begin with, putting relatively complex investment decisions in the hands of individuals with little or no financial expertise is problematic. Research demonstrates that decision making is pervaded with behavioral biases. (To some extent, biases can be compensated for by appropriately framing choices. For example, making enrollment in a 401(k) plan the default option—employees must opt out rather than opt in—has materially increased the rate of enrollment in the plans.)

More dangerous yet is the shift in focus away from retirement income to return on investment that has come with the introduction of saver-managed DC plans: Investment decisions are now focused on the value of the funds, the returns on investment they deliver, and how volatile those returns are. Yet the primary concern of the saver remains what it always has been: Will I have sufficient income in retirement to live comfortably? Clearly, the risk and return variables that now drive investment decisions are not being measured in units that correspond to savers' retirement goals and their likelihood of meeting them. Thus, it cannot be said that savers' funds are being well managed.

In the following pages I will explore the consequences of measuring and regulating pension fund performance like a conventional investment portfolio, explain how retirement plan sponsors (that is, employers) and investment managers can engage with savers to present them with meaningful choices, and discuss the implications for pension investments and regulation.

These recommendations apply most immediately to the United States and the United Kingdom, which have made the most dramatic shift among developed nations toward putting retirement risks and responsibilities in the hands of individuals. But the trend toward defined-contribution plans is ubiquitous in Asia, Europe, and Latin America. Thus the principles of providing for retirement income apply everywhere.

Assets Versus Income

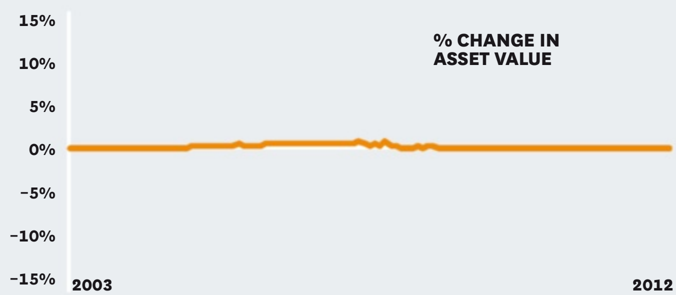
Traditional defined-benefit pension plans were conceived and managed to provide members with a guaranteed income. And because this objective filtered right through the scheme, members thought of their benefits in those terms. Ask someone what her pension is worth and she will reply with an income figure: "two-thirds of my final salary," for example. Similarly, we define Social Security benefits in terms of income.

The Real Meaning of Risk in Retirement

The seeds of the coming pension crisis lie in the fact that investment decisions are being made with a misguided view of risk. Case in point: When wealth maximization is the goal of retirement saving, the T-bill is seen as a risk-free investment. But when volatility is measured in terms that matter to retirees (how much a saver would receive annually if the investment were converted into an income stream), we clearly see that the T-bill is actually quite risky.

Investing in T-bills will keep your principal safe…

Consider an individual who invests retirement savings of $1 million in T-bills. As the chart below shows, the change in asset value over time is close to zero, so the saver has minimal risk of losing any of the invested principal.



Idea in Brief

THE RISK PROBLEM
The move to saver-managed defined-contribution pension plans—most notably 401(k)s—has increased the likelihood of a pension crisis down the line as the baby boomers retire.

WHY IT'S HAPPENING
Pension savings are invested so as to maximize capital value at the time of retirement, an objective imposed by regulation. But the goal of most savers is to achieve a reasonable level of retirement income. This mismatch almost guarantees that savings are badly managed, because an investment that is risk-free from an asset value standpoint may be very risky in income terms. At the same time, the defined-contribution process requires savers who often have little or no financial expertise to make complicated decisions about risk.

THE SOLUTION
Investment practice and regulation need to be changed to prioritize income security over capital gain, and communication needs to focus on variables the saver understands and give a clearer idea of the likelihood of reaching a given income target rather than emphasize investment returns.

The language of defined-contribution investment is very different. Most DC schemes are designed and operated as investment accounts, and communication with savers is framed entirely in terms of assets and returns. Asset value is the metric, growth is the priority, and risk is measured by the volatility of asset values. DC plans' annual statements highlight investment returns and account value. Ask someone what his 401(k) is worth and you'll hear a cash amount and perhaps a lament about the value lost in the financial crisis.

The trouble is that investment value and asset volatility are simply the wrong measures if your goal is to obtain a particular future income. Communicating with savers in those terms, therefore, is unhelpful—even misleading. To see why, imagine that you are a 45-year-old individual looking to ensure a specific level of retirement income to kick in at age 65. Let's assume for simplicity's sake that we know for certain you will live to age 85. The safe, risk-free asset today that guarantees your objective is an inflation-protected annuity that makes no payouts for 20 years and then pays the same amount (adjusted for inflation) each year for 20 years. If you had enough money in your retirement account and wanted to lock in that income, the obvious decision is to buy the annuity.

But under conventional investment metrics, your annuity would almost certainly look too risky. As interest rates move up and down, the market value of annuities, and other long-maturity fixed-income securities such as U.S. Treasury bonds, fluctuates enormously. In 2012, for instance, there was a 30% range between the highest and lowest market value of the annuity for the 45-year-old over the 12 months. However, the income that the annuity will provide in retirement does not change at all. Clearly, there is a big disconnect about what is and is not risky when it comes to the way we express the value of pension savings.

...but the income you can buy with the principal is highly volatile.

But consider the same individual who wants to convert the T-bills into an income stream to live off in retirement. The return (change in how much annual income the saver receives) depends enormously on exactly when he makes the conversion.

The graph shows the percent change in the amount of inflation-protected income that could be purchased with the T-bill portfolio at a given time (for example, by converting it into a deferred inflation-proof annuity).

This simulation is done by totaling the current market value of a portfolio of traded U.S. Treasury inflation-protected securities bought so as to provide adequate funds to purchase the income stream in 20 years. In the absence of an active market in deferred inflation-proof annuities, this provides an estimated value of the deferred income.

Laws intended to protect consumers would have the unintended consequence of prohibiting savers from holding the risk-free income asset.

Unfortunately that disconnect is now being codified in DC plan regulation. Required disclosures emphasize net asset value and its changes. In the interest of consumer protection, regulators in the European Union have even considered requiring minimum rates of return on portfolios. But if the goal is income for life after age 65, the relevant risk is retirement income uncertainty, not portfolio value. To truly protect consumers, such regulatory "floors" would need to be specified in terms of the safety of the future income stream, not the market value of that stream.

Yet under regulations that set a minimum floor on portfolio value, retirement plan managers would not be allowed to invest savers' funds in deferred annuities or long-maturity U.S. Treasury bonds—the very assets that are the safest from a retirement income perspective. That's because, if interest rates were to rise, their price (that is, their market value) could easily fall below the minimum required asset value. Ironically, therefore, laws intended to protect consumers would have the unintended consequence of prohibiting savers from holding the risk-free income asset.

At the same time, the law would encourage investments in assets that are actually highly risky from an income perspective. U.S. Treasury bills (T-bills) are commonly treated as the definitive risk-free asset. Over eight years, the dollar returns to T-bills have been stable, and principal has been fully protected. But as the exhibit "The Real Meaning of Risk in Retirement" illustrates, if we look at the unit of measure that matters to our consumer—how much the saver would receive if the investment were converted into an income stream—then T-bills are shown to be very risky, nearly as volatile as the stock market.

To understand what that means in commonsense terms, consider a person who plans to live off the income from $1 million invested in T-bills. Suppose he retires in a given year and converts his investments into an inflation-protected annuity with a return of 4% to 5%. He will receive an annual income of $40,000 to $50,000. But now suppose he retires a few years later, when the return on the annuity has dropped to 0.5%. His annual income will now be only $5,000. Yes, the $1 million principal amount was fully insured and protected, but you can see that he cannot possibly live on the amount he will now receive. T-bills preserve principal at all times, but the income received on them can vary enormously as return on the annuity goes up or down. Had the retiree bought instead a long-maturity U.S. Treasury bond with his $1 million, his spendable income would be secure for the life of the bond, even though the price of that bond would fluctuate substantially from day to day. The same holds true for annuities: Although their market value varies from day to day, the income from an annuity is secure throughout the retiree's life.

The seeds of an investment crisis have been sown. The only way to avoid a catastrophe is for plan participants, professionals, and regulators to shift the mind-set and metrics from asset value to income.

An Income-Focused Investment Strategy

So what should retirement planners be investing in? The particulars are, of course, somewhat technical, but in general, they should continue to follow portfolio theory: The investment manager invests in a mixture of risky assets (mainly equity) and risk-free assets, with the balance of risky and risk-free shifting over time so as to optimize the likelihood of achieving the investment goal. The difference is that risk should be defined from an income perspective, and the risk-free assets should be deferred inflation-indexed annuities.

It's important to note that the fund manager need not actually commit the employee to purchasing a deferred annuity but should manage the risk-free part of the portfolio in such a way that, on retirement, the employee would be able to purchase an annuity that would support the target standard of living regardless of what happens to interest rates and inflation in the meantime.

This kind of liability-driven investment strategy is called “immunization.” It’s equivalent to how an insurer hedges an annuity contract that it has entered into and how pension funds hedge their liabilities for future retirement payments to plan members. What investment managers often fail to realize is that the same strategy can be employed at the individual investor level. (For a more detailed discussion see the sidebar “Portfolio Management: When Income Is the Goal.”)

My point is that the financial technology already exists to invest individual pension contributions in this way. Employees still get a pot of money upon retirement and thus retain the same freedom of choice over their retirement savings that they have under current defined-contribution arrangements. The difference is that the value of the pot would be obtained through an investment strategy meant to maximize the likelihood of achieving the desired income stream at retirement. Of course, that value might be much more or much less than the value of the pot obtained through a wealth-maximizing investment strategy.

Moving to an income-focused pension strategy will require changes not only to the way retirement plan providers actually invest the money but also to how they engage and communicate with savers. Let’s look at what’s wrong with current practice in this regard.

Little Meaningful Dialogue

In the conventional DC model, the provider asks the employee at the beginning of the engagement how much risk he is willing to take on in investing the accumulated savings, which basically puts constraints on the proportions invested in bonds and equities. Very often the employee does not feel capable of specifying a level of risk or a retirement goal, so the plan provider makes representative assumptions and offers a default investment in a mutual fund that has a risk level deemed appropriate for the employee’s age group.

From that moment on, the dialogue between the provider and the saver consists of regular reports on the value of the pooled fund, the amounts contributed, the annual returns achieved, and the size of the employee’s share of

PORTFOLIO MANAGEMENT

When Income Is the Goal

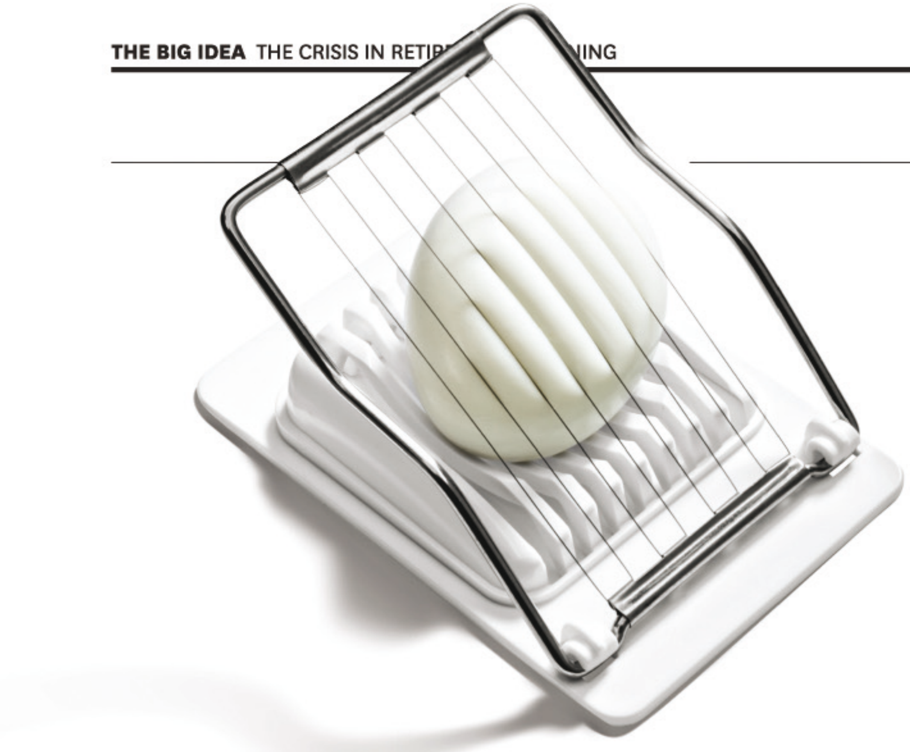
What does it mean, in practical terms, to shift the focus of retirement planning from amassing the biggest pot of money possible to guaranteeing a retirement income for life?

In my view, plan providers, employers, and savers must adopt a liability-driven strategy. As in a conventional plan, the accumulated savings are allocated between a well-diversified risky portfolio (made up of various low-cost mutual funds) and risk-free securities. The main difference lies in the definition of a “risk free” investment and the approach to taking on risk.

The risk-free portfolio. Under the proposed scheme, the risk-free retirement asset is a bond-like security that makes no coupon payments until the date of retirement and then makes level payments, adjusted for inflation, each month for the rest of the retiree’s life. Because it is not feasible to purchase this security, called a deferred real annuity, until the employee is close to retirement, the fund manager creates a facsimile of the asset through a dynamic trading strategy that mixes U.S. Treasury Inflation-Protected Securities (TIPS) of various maturities to reflect the maturity structure of the employee’s target retirement income. This way of using financial technology to match the returns and cash flows of a reference security is called a *replicating portfolio* strategy and has been widely used for several decades, although only recently in this specific application. The idea is to ensure that the amount of money in the portfolio at retirement is sufficient to purchase the replicated deferred annuity, no matter what the interest rate may be at the time. The retiree is not committed to purchasing the annuity, however, and can use the funds any way he chooses.

Balancing the portfolios. Unlike mechanical rule asset allocations, the approach advocated here takes on risk only when it improves the chance of achieving the desired income goal. And it takes as much risk out of the portfolio as possible once the goal is achieved, avoiding a scenario in which the saver achieves his goal only to fall below it if the markets subsequently go down.

It is important to note that the capital value of a pension pot managed in this way will most likely be very volatile, because risk is being hedged to eliminate income volatility, not price volatility. For this reason, good communication with savers is essential.



Rather than trying to make employees smarter about investments, we need to create a smarter dialogue about how plan providers can help them achieve their income goals.

the fund. The employee feels happy if the value and returns look positive, but he typically has little or no idea what the implications of this performance might be on the chances of maintaining his standard of living in retirement as measured by income—an outcome which, as I demonstrated earlier, may not at all be related to returns on investment.

When employees try to become engaged and make decisions about their retirement, they are often confronted with very technical decisions, such as "How much debt versus equity do you want?" or "How much exposure to large-cap European stocks do you want?" It's a bit like having salespeople ask car buyers what engine compression ratio they want. Some buyers might know that a high ratio is good, but very few understand exactly what that means: how many more miles to the gallon they'll get, how much faster they'll go from zero to 60 miles per hour, or how much more reliable the car will be than one with a lower ratio. But fuel efficiency, speed, and reliability are the factors that car buyers care about.

Consumer education is often proposed as a remedy, but to my mind it's a real stretch to ask people to acquire sufficient financial expertise to manage all the investment steps needed to get to their pension goals. That's a challenge even for professionals. You'd no more require employees to make those kinds of decisions than an automaker would dump a pile of car parts and a technical manual in the buyer's driveway with a note that says, "Here's what you need to put the car together. If it doesn't work, that's your problem."

Experience also suggests that customer engagement in investment management is not necessarily a good thing. People who are induced to open a brokerage account in their IRAs often become very active in investing for their pension, trading stocks around the world on their computers after work. This is far from a good idea; such short-term trading will not improve the savers' chances of successfully achieving retirement goals—in fact, it will diminish them.

Choosing *not* to educate customers is not a radical idea. Many technologically sophisticated products are actually designed to minimize learning requirements on the part of the user. If you were to drive a car made in 1955, the accelerator would feel the same to your foot as one does in a new car today. Of course, in 1955, the accelerator was connected to pieces of metal that made the carburetor open. Today all the connections are electronic, and you could activate them with your finger. Car manufacturers keep the pedal to help us feel comfortable—we've always pushed the accelerator with our foot. How would you like it if you bought your next car and found a joystick instead of a steering wheel?

The bottom line is that we have to be realistic about what we can expect people to understand (or what they should have to understand). Rather than trying to make employees smarter about investments, we need to create a smarter dialogue about how the plan provider or its investment management agents can help them achieve their goals. Let's look now at what that dialogue might be like.

Redefining Customer Engagement

To create meaningful engagement in pension planning, a plan provider should begin by asking employees not about risk but about their expectations for income needs in retirement.

Clearly, employees in their twenties, thirties, or forties will not be able to be very specific about this, but they're likely to agree that a reasonable goal would be to have a standard of living more or less the same as they'd be experiencing in the last five or so years before retirement. This would be, in effect, a plausible default option.

Once the working expectations have been agreed on, the provider can calculate the probabilities of achieving each employee's target standard of living for given levels of contribution, expressed as a percentage of salary, and for a given working life. The provider will of course need more information, such as the employee's current salary and the salary levels of retiring employees, estimates of interest and inflation rates, and Social Security and defined-benefit pension expectations. But all these data can be obtained from the employer or other sources, or assumed based on publicly available financial market indicators.

The customer need worry about three things only: her retirement income goals, how much she is prepared to contribute from her current income, and how long she plans to work. The only feedback she needs from her plan provider is her probability of achieving her income goals. She should not receive quarterly updates about the returns on her investment (historical, current, or projected) or about the current allocation of her assets. These are important factors in achieving success, but they are not *meaningful* input for the choices about income that the customer has to make.

Suppose the saver learns that she has a 54% chance of achieving her desired income in retirement. Like a high cholesterol number, that relatively low probability serves as a warning. What can she do to improve her outlook? There are only three things: Save more, work longer, or take more risk. These are, therefore, the only decisions a saver needs to think about in the context of retirement. And those choices have immediate impact because if you increase savings, your take-home paycheck is going to be smaller. If you decide to retire at a later age, you will have to explain that decision to your family and loved ones.

The income-focused dialogue between investment provider and saver should continue right up to and after retirement. Typically, employees start thinking more seriously about their detailed preferences closer to the actual date of retirement. By this time, they have a much better sense of their health status, their ability and willingness to continue working beyond retirement, what dependent responsibilities they have, whether they have other sources of income from, say, a working spouse, where and how they want to live, and the other things they'd like to do with their savings. They may no longer want to stick to the default of investing all their retirement pot into an annuity because they may wish to be able to realize a lump sum at some stage.

Close to retirement, the provider and the future pensioner need to refine the goals. A good framework in which to do this is to divide income needs into three categories:

Category 1: Minimum guaranteed income. Income in this category must be inflation-protected and guaranteed for life, thus shielding the retiree from longevity risk, interest rate fluctuations, and inflation. Government benefits, such as Social Security, and any defined-benefit pensions would be included in this category. (DB plan payments with no inflation adjustment should be treated as if they were falling at the expected rate of inflation.) To increase the amount of guaranteed income above and beyond those benefits, the pensioner would have to buy an inflation-protected life annuity from a highly rated insurance company, the "safe" asset described above. A graded annuity whose income payments grow at the expected rate of inflation can also be used when inflation-protection is not available. The annuity could provide a joint survivorship feature for a spouse but would provide no other death benefits or payouts.

Opting for guaranteed income comes with downsides. Annuities are inflexible and allow for no liquidity to alter the income stream if circumstances change, if there is an unanticipated need for a lump sum of money, or if the retiree wishes to make bequests. With reason, therefore, some people are uncomfortable using all their assets to purchase a risk-free annuity, especially if they have no additional nonpension savings that can provide them with some flexibility. For this reason, they ought to consider trading off some—but not all—guaranteed future income for alternatives that offer more flexibility.

Category 2: Conservatively flexible income. The more flexible but still relatively safe alternative to annuities is a portfolio of U.S. Treasury Inflation-Protected Securities ("TIPS") that offer a periodic payout of inflation-protected income for a fixed time horizon, typically the life expectancy of the participant at retirement. Both the portfolio interest income and principal at each bond's maturity are used for income payments, so there is no capital residual after the term.

There are two advantages to this type of conservative additional income relative to guaranteed income. Because the savings can be held in liquid UST assets, they are available in whole or in part to the participant at any time, for medical emergencies or other lump sum expenditures. And any assets remaining in the fund at the pensioner's death would be available for bequests. The main disadvantage, of course, is that there is no income beyond the term. That is, the retiree takes the risk of outliving the pool of assets. (Savers can purchase deferred annuity contracts that do not pay anything until one reaches a later age—for instance, 85—to provide longevity "tail" insurance.)

Category 3: Desired additional income. Many DC plan participants will find that their targeted mix of guaranteed and conservative incomes, along with nonpension plan personal assets (for instance, their house, bank accounts, and savings deposits), is sufficient to meet all their retirement goals. In this case, they may allocate 100% of their DC accumulation to investing in the relevant financial instruments (annuities and bond funds) for guaranteed and conservative additional incomes. But some participants may find that their anticipated total income and assets will not be enough to finance the level of retirement income they desire. In that case they may wish to accept lower income now (that is, increase savings) or invest a portion of their DC accumulations in risky assets that hold out the possibility of earning sufficient returns to permit achieving the desired higher retirement income.

Few employees will have the wherewithal to afford a full-time financial adviser. Thus, an effective retirement system must guide savers to good retirement outcomes through clear and meaningful communication and simplicity of choices, during both the accumulation phase and the postretirement payout phase.

Again, this approach can be implemented today using existing financial technology on a cost-effective basis and to scale. For example, I have developed, with Dimensional Fund Advisors, such a system for interacting with customers, and I successfully installed this kind of solution in a large Dutch company in 2006.

Implications for Investors and Regulators

An approach that uses smarter products rather than tries to make consumers smarter about finance calls for different kinds of investments and, in turn, changes to the way regulatory oversight is provided.

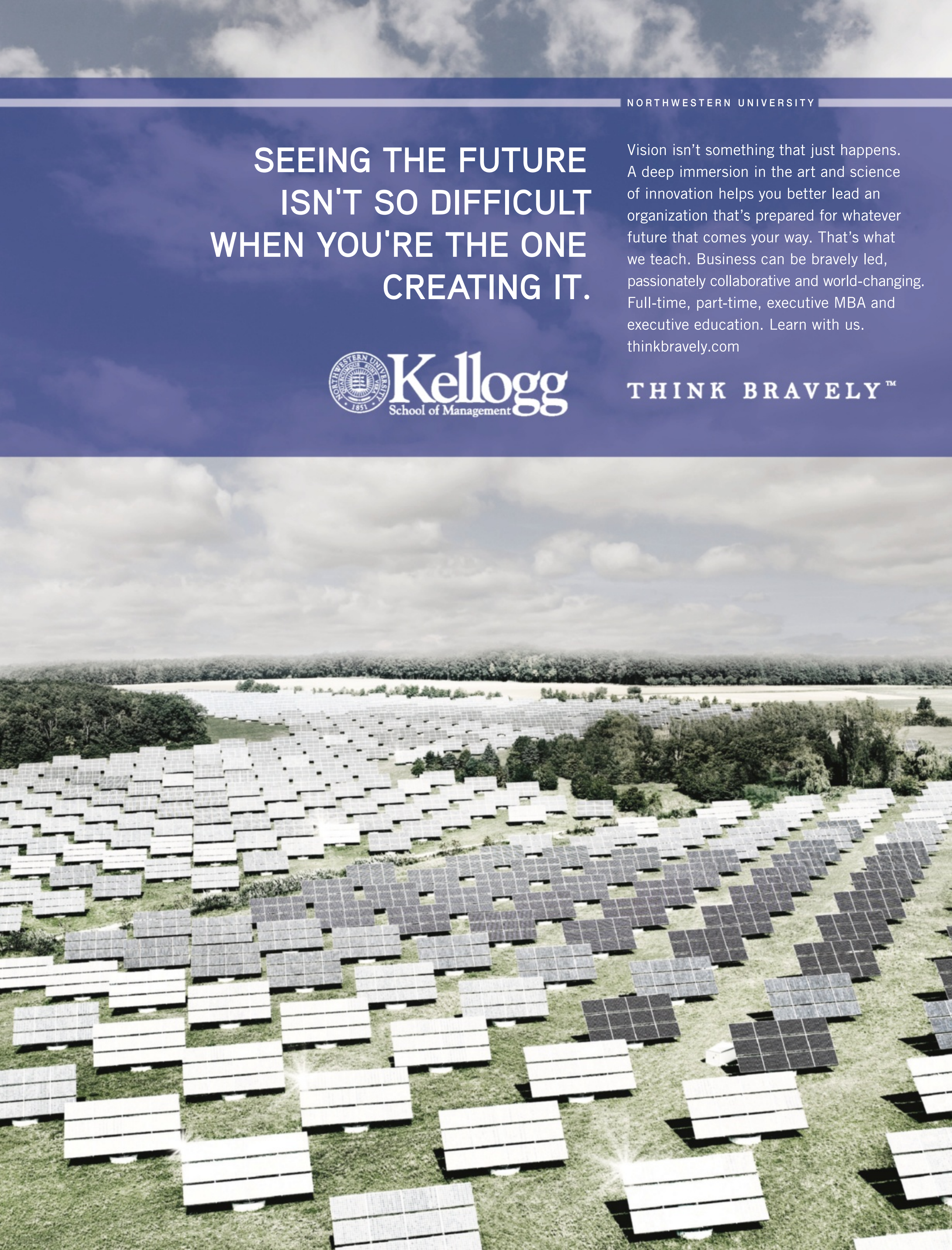
Under current regulation, accumulated DC investments are restricted largely to stocks, bonds, and money market instruments, or mutual funds made up of them. The problem, as we have seen, is that these kinds of investments cannot deliver security in terms of income. Switching to the kind of income-driven investment strategy proposed here will require an altogether more sophisticated investment technology, for which the existing education-and-disclosure approach to regulation is clearly unworkable.

The logical alternative is to place the burden of oversight on the company sponsoring the plan: the participant's employer, who generally has the financial expertise (or access to it) to assess the competences and processes of the plan providers. In fact, this is already starting to happen: The Pension Protection Act of 2006, with its opt-out provision and the associated setting of a default investment strategy for those who do not make a selection, encouraged employers to take a much more assertive role in managing DC plans. More, however, will be needed.

Savers, on the whole, should welcome such changes to the status quo. Although I don't do academic research on this particular issue, evidence suggests that people trust their employers—certainly more than they trust banks, insurance companies, or brokerage firms. Shifting the regulatory burden as gatekeeper of provider quality and of well-designed products (but not as guarantor of investment performance) onto plan sponsors, therefore, seems to me to be a reasonable policy, certainly more reasonable than expecting even well-educated people with very high IQs to read prospectuses, evaluate past performance, and generally make sense of complex financial strategies.

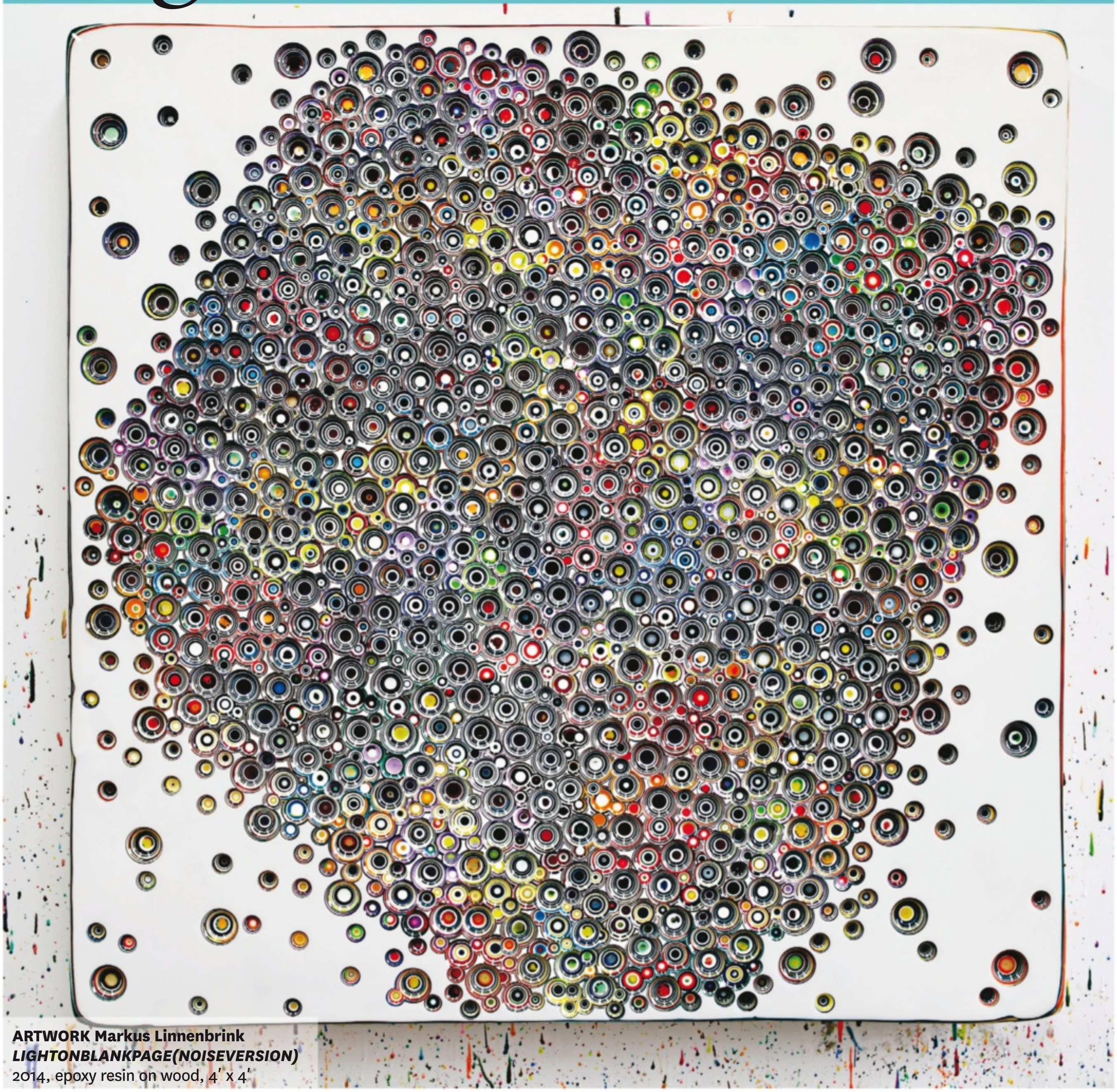
IT IS fair enough to expect people to provide for their retirement. But expecting them to acquire the expertise necessary to invest that provision wisely is not. We wouldn't want them to. We don't want a busy surgeon to spend time learning about dynamic immunization trading instead of figuring out how to save lives, any more than we would want skilled finance professionals to spend time learning how to do their own surgery. But unless we rethink the way we engage savers and invest their money, this is precisely where we're headed. I realize that what I'm advocating may seem perverse at a time when trust in financial institutions, and indeed in financial innovation, has fallen to pretty low levels. Yet it seems just as perverse to deny savers the benefits of financial technology.

HBR Reprint R1407B


NORTHWESTERN UNIVERSITY
SEEING THE FUTURE ISN'T SO DIFFICULT WHEN YOU'RE THE ONE CREATING IT.
Vision isn't something that just happens. A deep immersion in the art and science of innovation helps you better lead an organization that's prepared for whatever future that comes your way. That's what we teach. Business can be bravely led, passionately collaborative and world-changing. Full-time, part-time, executive MBA and executive education. Learn with us. thinkbravely.com
Kellogg School of Management
THINK BRAVELY™

Spotlight

The New Marketing Organization



ARTWORK Markus Linnenbrink
LIGHTONBLANKPAGE(NOISEVERSION)
2014, epoxy resin on wood, 4′ x 4′

Spotlight

ARTWORK Markus Linnenbrink
DIEDRITTEDIMENSION, 2011
JVA/Prison, Düsseldorf Rath, Germany

The Ultimate Marketing Machine

Most marketing organizations are stuck in the last century. Here's how the best meet the challenges of the digital age.

by Marc de Swaan Arons, Frank van den Driest, and Keith Weed

In the past decade, what marketers do to engage customers has changed almost beyond recognition. With the possible exception of information technology, we can't think of another discipline that has evolved so quickly. Tools and strategies that were cutting-edge just a few years ago are fast becoming obsolete, and new approaches are appearing every day.

Yet in most companies the organizational structure of the marketing function hasn't changed since the practice of brand management emerged, more than 40 years ago. Hidebound hierarchies from another era are still commonplace.

Marketers understand that their organizations need an overhaul, and many chief marketing officers are tearing up their org charts. But in our research and our work with hundreds of global marketing organizations, we've found that those CMOs are struggling with how to draw the new chart. What does the ideal structure look like? Our answer is that this is the wrong question. A simple blueprint does not exist.

Marketing leaders instead must ask, "What values and goals guide our brand strategy, what capabilities drive marketing excellence, and what structures and ways of working will support them?" Structure must follow strategy—not the other way around.

Former McDonald's CMO Larry Light understood that principle when he became the chief brand officer of the InterContinental Hotels Group, where the marketing team was intent on reorganizing its operation. Light quickly focused the team on defining marketing's purpose, its goals, and a process for achieving them. Once those had been clarified, a rational reorganization could occur.

To understand what separates the strategies and structures of superior marketing organizations from the rest, EffectiveBrands—in partnership with the Association of National Advertisers, the World Federation of Advertisers, Spencer Stuart, *Forbes,* MetrixLab, and Adobe—initiated Marketing2020, which to our knowledge is the most comprehensive marketing leadership study ever undertaken. Coauthor Keith Weed, the CMO of Unilever, is the chairman of the initiative's advisory board. To date the study has included in-depth qualitative interviews with more than 350 CEOs, CMOs, and agency heads, and over a dozen CMO roundtables in cities worldwide. We also conducted online quantitative

Idea in Brief

THE CHALLENGE
How marketers engage with customers has profoundly changed. Yet in most companies the organization of the marketing function is stuck in the past. What strategies, structures, and capabilities should marketers adopt to excel?

THE RESEARCH
The Marketing2020 study surveyed more than 10,000 marketing executives globally about their organizations' data analytics capabilities, brand strategy, cross-functional and global interactions, employee engagement, and other factors and compared the responses of high-performing and low-performing organizations.

THE CONCLUSION
High performers excelled in their ability to leverage customer insight, communicate a societal purpose, and deliver a rich customer experience. They also demonstrated superior cross-functional collaboration, strategic focus, organizational agility, and training. New, fluid organizational structures facilitate these capabilities.

surveys of 10,000-plus marketers from 92 countries. The surveys encompassed more than 80 questions focusing on marketers' data analytics capabilities, brand strategy, cross-functional and global interactions, and employee training.

We divided the survey respondents into two groups, overperformers and underperformers, on the basis of their companies' three-year revenue growth relative to their competitors'. We then compared those two groups' strategies, structures, and capabilities. Some of what we found should come as no surprise: Companies that are sophisticated in their use of data grow faster, for instance. Nevertheless, the research shed new light on the constellation of brand attributes required for superior marketing performance and on the nature of the organizations that achieve it. It's clear that "marketing" is no longer a discrete entity (and woe to the company whose marketing is still siloed) but now extends throughout the firm, tapping virtually every function. And while the titles, roles, and responsibilities of marketing leaders vary widely among companies and industries, the challenges they face—and what they must do to succeed—are deeply similar.

Winning Characteristics

The framework that follows describes the broad traits of high-performing organizations, as well as specific drivers of organizational effectiveness. Let's look first at the shared principles of high performers' marketing approaches.

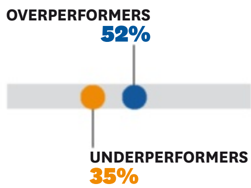
Big data, deep insights. Marketers today are awash in customer data, and most are finding narrow ways to use that information—to, say, improve the targeting of messages. Knowing what an individual consumer is doing where and when is now table stakes. High performers in our study are distinguished by their ability to integrate data on what consumers are doing with knowledge of *why* they're doing it, which yields new insights into consumers' needs and how to best meet them. These marketers understand consumers' basic drives—such as the desire to achieve, to find a partner, and to nurture a child—motivations we call "universal human truths."

The Nike+ suite of personal fitness products and services, for instance, combines a deep understanding of what makes athletes tick with troves of data. Nike+ incorporates sensor technologies embedded in running shoes and wearable devices that connect with the web, apps for tablets and smartphones, training programs, and social networks. In addition to tracking running routes and times, Nike+ provides motivational feedback and links users to communities of friends, like-minded athletes, and even coaches. Users receive personalized coaching programs that monitor their progress. An aspiring first-time half-marathon runner, say, and a seasoned runner rebounding from an injury will receive very different coaching. People are rewarded for good performance, can post their accomplishments on social media, and can compare their performance with—and learn from—others in the Nike+ community.

Purposeful positioning. Top brands excel at delivering all three manifestations of brand purpose—functional benefits, or the job the customer buys the brand to do (think of the pick-me-up Starbucks coffee provides); emotional benefits, or how it satisfies a customer's emotional needs (drinking coffee is a social occasion); and societal benefits, such as sustainability (when coffee is sourced through fair trade). Consider the Unilever Sustainable Living Plan, which defines a set of guiding principles for sustainable growth that emphasize improving health, reducing environmental impact, and enhancing livelihoods. The plan lies at the heart of all Unilever's brand strategies, as well as its employee and operational strategies.

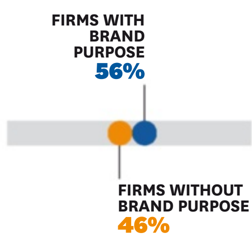
USE OF DATA DISTINGUISHES THE LEADING BRANDS

% of respondents who said that their organization leveraged all data and analytics to improve marketing effectiveness



PURPOSE-BASED POSITIONING BOOSTS SALES

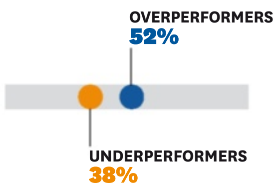
% of respondents who said that their organization's revenue growth was higher than competitors'



In addition to engaging customers and inspiring employees, a powerful and clear brand purpose improves alignment throughout the organization and ensures consistent messaging across touchpoints. AkzoNobel's Dulux, one of the world's leading paint brands, offers a case in point. In 2006, AkzoNobel was operating a heavily decentralized business structured around local markets, with each local business setting its own brand and business goals and developing its own marketing mix. Not surprisingly, the outcome was inconsistent brand positioning and results; Dulux soared in some markets and floundered in others. In 2008, Dulux's new global brand team pursued a sweeping program to understand how people perceived the brand across markets, paint's purpose in their lives, and the human truths that inspired people to color their environments. From China, to India, to the UK, to Brazil, a consistent theme emerged: The colors around us powerfully influence how we feel. Dulux wasn't selling cans of paint; it was selling "tins of optimism." This new definition of Dulux's brand purpose led to a marketing campaign, "Let's Color." It enlists volunteers, which now include more than 80% of AkzoNobel employees, and donates paint (more than half a million liters so far) to revitalize run-down urban neighborhoods, from the favelas of Rio to the streets of Jodhpur. In addition to aligning the once-decentralized marketing organization, Dulux's purpose-driven approach has expanded its share in many markets.

CONNECTING TO CORPORATE STRATEGY

% of respondents who said that in their organization marketing is regarded as a strategic partner for business growth



Total experience. Companies are increasingly enhancing the value of their products by creating customer experiences. Some deepen the customer relationship by leveraging what they know about a given customer to personalize offerings. Others focus on the breadth of the relationship by adding touchpoints. Our research shows that high-performing brands do both—providing what we call "total experience." In fact, we believe that the most important marketing metric will soon change from "share of wallet" or "share of voice" to "share of experience."

McCormick, the spices and flavorings firm, emphasizes both depth and breadth in delivering on its promise to "push the art, science, and passion of flavor." It creates a consistent experience for consumers across numerous physical and digital touchpoints, such as product packaging, branded content like cookbooks, retail stores, and even an interactive service, FlavorPrint, that learns each customer's taste preferences and makes tailored recipe recommendations. FlavorPrint does for recipes what Netflix has done for movies; its algorithm distills each recipe into a unique flavor profile, which can be matched to a consumer's taste-preference profile. FlavorPrint can then generate customized e-mails, shopping lists, and recipes optimized for tablets and mobile devices.

Organizing for Growth

Marketing has become too important to be left just to the marketers in a company. We say this not to disparage marketers but to underscore how holistic marketing now is. To deliver a seamless experience, one informed by data and imbued with brand purpose, all employees in the company, from store clerks and phone center reps to IT specialists and the marketing team itself, must share a common vision.

Our research has identified five drivers of organizational effectiveness. The leaders of high-performing companies connect marketing to the business strategy and to the rest of the organization; inspire their organizations by engaging all levels with the brand purpose; focus their people on a few key priorities; organize agile, cross-functional teams; and build the internal capabilities needed for success.

Connecting. In our work with marketing organizations, we have seen case after case of dysfunctional teamwork, suboptimal collaboration, and lack of shared purpose and trust.

Despite cultural and geographic obstacles, our high-performing marketers avoid such breakdowns for the most part. Their leaders excel at linking their departments to general management and other functions. They create a tight relationship with the CEO, making certain that marketing goals support company goals; bridge organizational silos by integrating marketing and other disciplines; and ensure that global, regional, and local marketing teams work interdependently.

Marketing historically has marched to its own drummer, at best unevenly supporting strategy handed down from headquarters and, more commonly, pursuing brand or marketing goals (such as growing brand equity) that were not directly related to the overall business strategy. Today high-performing marketing leaders don't just align their department's activities with company strategy; they actively engage in creating it. From 2006 to 2013, our surveys show, marketing's influence on strategy development increased by 20 percentage points. And when marketing demonstrates that it is fighting for the same business objectives as its peers, trust and communication strengthen across all functions and, as we shall see, enable the collaboration required for high performance.

Another way companies foster connections is by putting marketing and other functions under a single leader. Motorola's Eduardo Conrado is the senior VP of both marketing and IT. A year after Antonio Lucio was appointed CMO of Visa, he was invited to also lead HR and tighten the alignment between the company's strategy and how employees were recruited, developed, retained, and rewarded. Coauthor Keith Weed leads communications and sustainability, as well as marketing, at Unilever. And Herschend Family Entertainment, owner of the Harlem Globetrotters and various theme parks, has recently expanded CMO Eric Lent's role to chief marketing and consumer technology officer.

Inspiring. Inspiration is one of the most underused drivers of effective marketing—and one of the most powerful. Our research shows that high-performing marketers are more likely to engage customers and employees with their brand purpose—and that employees in those organizations are more likely to express pride in the brand.

Inspiration strengthens commitment, of course, but when it's rooted in a respected brand purpose, all employees will be motivated by the same mission. This enhances collaboration and, as more and more employees come into contact with customers, also helps ensure consistent customer experiences. The payoff is that everyone in the company becomes a de facto member of the marketing team.

The key to inspiring the organization is to do internally what marketing does best externally: create irresistible messages and programs that get everyone on board. At Dulux, that involved handing paint and brushes to thousands of employees and setting them loose on neighborhoods around the world. Unilever's leadership conducts a quarterly live broadcast with most of the company's 6,500 marketers to celebrate best brand practices and introduce new tools. In addition, Unilever holds a series of globally coordinated and locally delivered internal and external communications events, called Big Moments, to engage employees and opinion leaders companywide directly with the broader purpose of making sustainable living commonplace. Research shows this has led to a significant increase in employee commitment. Nike has a marketing staffer whose sole job is to tell the original Nike story to all new employees.

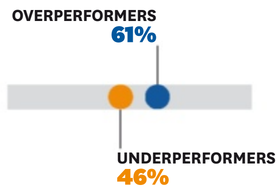
Inspiration is so important that many companies, Unilever among them, have begun measuring employees' brand engagement as a key performance indicator. Google does this by assessing employees' "Googliness" in performance appraisals to determine how fully people embrace the company's culture and purpose. And Zappos famously offers new hires $3,000 to leave after four weeks, effectively cutting loose anyone who is not inspired by the company's obsessive customer focus.

Focusing. When we asked eight global marketing executives in one organization to list their top five marketing objectives, only two goals made it onto everyone's list. The remainder was a motley assortment of personal or local objectives. Such misalignment, our data show, increases the farther teams are from an organization's center of power. With marketing activities ever more dispersed across global companies, that risk must be carefully managed.

By a wide margin, respondents in overperforming companies agreed with the statements "Local marketing understands the global strategy" and "Global marketing understands the local marketing reality." Winning companies were more likely to measure brands' success against key performance indicators such as revenue growth and profit and to tie incentives at the local level directly to those KPIs.

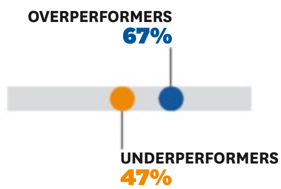
INSPIRING WORKERS TO GET RESULTS

% of respondents who said their company ensures that all employees are fully engaged with the brand purpose



FOCUSING ON THE RIGHT METRICS

% of respondents who said that their brand's key performance indicators are clearly linked to overall business performance



Marketing has become too important to be left just to the marketers. All employees, from store clerks to IT specialists, must be engaged in it.

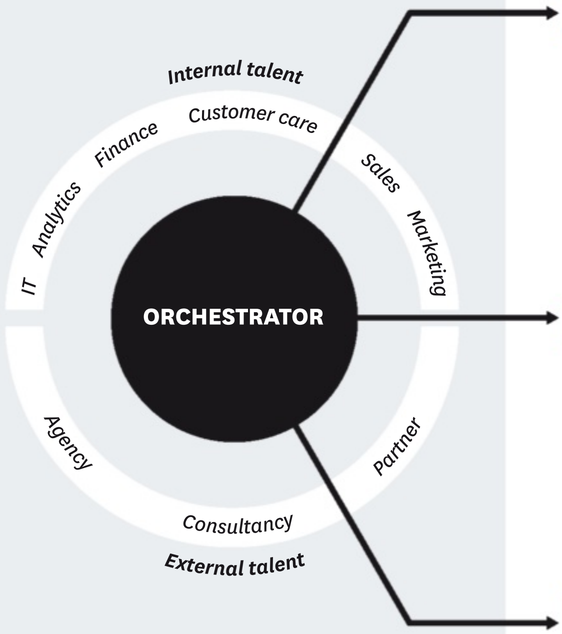
The Orchestrator Model

Drawing from a broad pool

CMOs and other marketing leaders such as chief experience officers and global brand leaders increasingly operate as orchestrators, tapping talent from both inside and outside the company to staff short-term task forces for specific initiatives.

Creating teams with three key types of capabilities

The rise of social and digital media has changed the makeup of marketing teams, which were traditionally staffed by generalists. Today effective teams bring together people with three kinds of focus: "think," "feel," and "do."



"THINK" • Focused on data and analytics

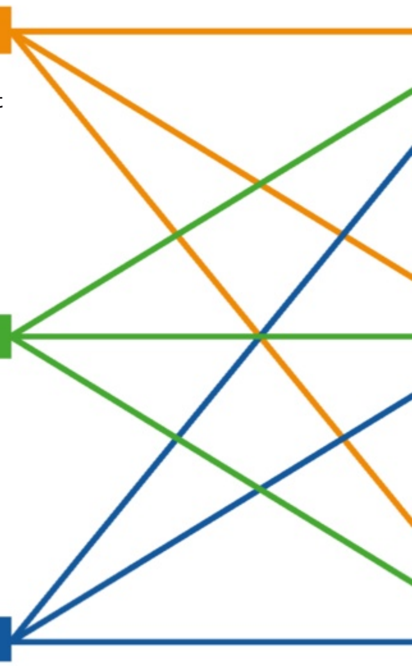
- Architecture and modeling director
- Digital privacy analyst
- Market data analyst
- Senior data architect
- Senior data modeler
- Web analyst

"FEEL" • Focused on consumer engagement

- Customer service representative
- Member engagement coordinator
- Online community manager
- PR executive
- Social media community manager
- Usability specialist

"DO" • Focused on content and production

- Concept creator
- Designer
- Digital studio producer
- Marketing content manager
- Senior digital content strategist
- Web design production specialist



Visualization by **Matt Perry**

Ironically, almost all companies were meticulous in planning and executing consumer communication campaigns but failed to devote the same care to internal communications about strategy. That's a dangerous oversight.

Marc Schroeder, the global marketing head for PepsiCo's Quaker brand, understood the need for internal cohesiveness when he led a cross-regional "marketing council" to develop and communicate the brand's first global growth strategy. The council defined a purposeful positioning, nailed down the brand's global objectives, set a prioritized growth agenda, created clear lines of accountability and incentives, and adopted a performance dashboard that tracked industry measures such as market share and revenue growth. The council communicated the strategy through regional and local team meetings, including those with agencies and retail customers worldwide, and hosted a first-ever global brand stewardship event to educate colleagues. As a result of those efforts, all Quaker marketing plans are now explicitly linked to one overall strategy.

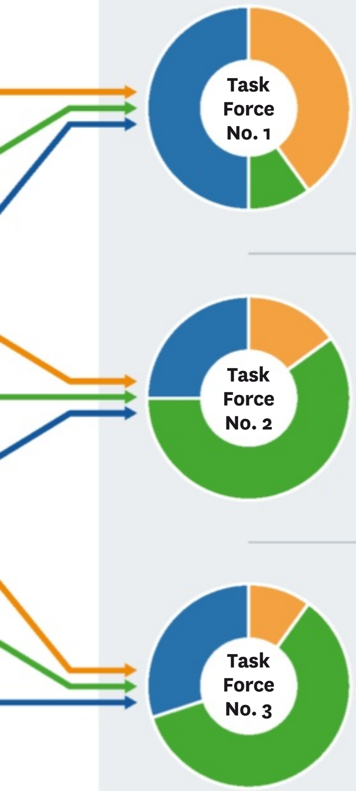
Organizing for agility. Our research consistently shows that organizational structure, roles, and processes are among the toughest leadership challenges—and that the need for clarity about them is consistently underestimated or even ignored.

We have helped design dozens of marketing organizations. Typically we enter the scene after a traditional business consultancy has done preliminary strategy, cost, and head-count analyses, and our role is to work with the CMO to create and implement a new structure, operating model, and capability-building program. Though we believe there is no ideal organizational blueprint, our experience does suggest a set of operational and design principles that any organization can apply.

Today marketing organizations must leverage global scale but also be nimble, able to plan and execute in a matter of weeks or a few months—and,

Tailoring the team

The proportion of each type of capability on the team varies with its job.



How Liberty Global applies the model

To improve customers' experience, the cable service provider Liberty Global set up task forces focused on individual touchpoints. Here's what some of the teams looked like and the results they got.

TOUCHPOINT	KEY PLAYERS	TEAM MIX	DURATION	RESULTS
Gets set-top box	**Leader:** Customer care executive **Functions involved:** IT, network, logistics, customer care, marketing	Thinkers **40%** Feelers **10%** Doers **50%**	One year	**Problem:** Complex set-top box required too many on-site visits to set up. **Solution:** Developing remote installation guides and allowing remote installations by customer care agents.
Receives first bill	**Leader:** Marketing executive **Functions involved:** Marketing, IT, customer care, billing	Thinkers **15%** Feelers **60%** Doers **25%**	6 months	**Problem:** Customers found bills frustrating and confusing. **Solution:** Developing personalized video messages to explain the first bill.
Sees new customer offer	**Leader:** Marketing executive **Functions involved:** R&D, IT, network, billing, marketing, customer care	Thinkers **10%** Feelers **60%** Doers **30%**	3 months	**Problem:** Customer defections peaked when attractive offers were made to new customers. **Solution:** Extending the same offers to existing customers too, thus simplifying offerings.

increasingly, instantaneously. Oreo famously took to Twitter during the blackout at the 2013 Super Bowl, reminding consumers, "You can still dunk in the dark," making the brand a trending topic during one of the world's biggest sporting events. That the tweet was designed and approved in minutes was no accident; Oreo deliberately organized and empowered its marketing team for the occasion, bringing agency and brand teams together in a "mission control" room and authorizing them to engage with their audience in real time.

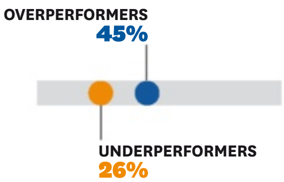
Complex matrixed organizational structures—like those captured in traditional, rigid "Christmas tree" org charts—are giving way to networked organizations characterized by flexible roles, fluid responsibilities, and more-relaxed sign-off processes designed for speed. The new structures allow leaders to tap talent as needed from across the organization and assemble teams for specific, often short-term, marketing initiatives. The teams may form, execute, and disband in a matter of weeks or months, depending on the task.

New marketing roles. As companies expand internationally, they inevitably reorganize to better balance the benefits of global scale with the need for local relevance. Our research shows that, as a result, the vast majority of brands are led much more centrally today than they were a few years ago. Companies are removing middle, often regional, layers and creating specialized "centers of excellence" that guide strategy and share best practices while drawing on needed resources wherever, and at whatever level, they exist in the organization. As companies pursue this approach, roles and processes need to be adapted.

Marketing organizations traditionally have been populated by generalists, but particularly with the rise of social and digital marketing, a profusion of new specialist roles—such as digital privacy analysts and native-content editors—are emerging. We have found

BUILDING NEEDED CAPABILITIES

% of respondents who said that their organization's training program was tailored to the specific needs of their business



it useful to categorize marketing roles not by title (as the variety seems infinite) but as belonging to one of three broad types: "think" marketers, who apply analytic capabilities to tasks like data mining, media-mix modeling, and ROI optimization; "do" marketers, who develop content and design and lead production; and "feel" marketers, who focus on consumer interaction and engagement in roles from customer service to social media and online communities.

The networked organization. A broad array of skills and organizational tiers and functions are represented within each category. CMOs and other marketing executives such as chief experience officers and global brand managers increasingly operate as the orchestrators, assembling cross-functional teams from these three classes of talent to tackle initiatives. Orchestrators brief the teams, ensure that they have the capabilities and resources they need, and oversee performance tracking. To populate a team, the orchestrator and team leader draw from marketing and other functions as well as from outside agencies and consulting firms, balancing the mix of think, do, and feel capabilities in accordance with the team's mission. (See the exhibit "The Orchestrator Model.")

Companies are using this model to create task forces for a range of marketing programs, from integrating online and physical retail experiences to introducing new products. When Unilever launched Project Sunlight—a consumer-engagement program connected with its sustainable-living initiative—the team drew talent from seven expertise areas. The international cable company Liberty Global uses task forces to optimize the customer experience at key engagement points—such as when customers receive a bill. These teams are led by managers from a variety of marketing and nonmarketing functions, have different durations, and draw from each of the three talent pools in different measure.

Coca-Cola, Unilever, and Shiseido have set up dedicated marketing academies to create a single marketing language and approach.

The task-force model is both agile and disciplined. It requires a culture in which central leadership is confident that local teams understand the strategy and will collaborate to execute it. This works well only when everyone in the organization is inspired by the brand purpose and is clear about the goals. Google, Nike, Red Bull, and Amazon all embrace this philosophy. Amazon's Jeff Bezos captured the ethos when he said at a shareholders' meeting, "We are stubborn on vision. We are flexible on details."

Building capabilities. As we have shown, the most effective marketers lead by connecting, inspiring, focusing, and organizing for agility. But none of those activities can be fully accomplished, or sustained, without the continual building of capabilities. Our research shows pronounced differences in training between high- and low-performing companies, in terms of both quantity and quality.

At a minimum the marketing staff needs expertise in traditional marketing and communications functions—market research, competitive intelligence, media planning, and so forth. But we've seen that sometimes even those basic capabilities are lacking. Courses to onboard new staff and teach targeted skills are just the price of entry. The best marketing organizations, including those at Coca-Cola, Unilever, and the Japanese beauty company Shiseido, have invested in dedicated internal marketing academies to create a single marketing language and way of doing marketing.

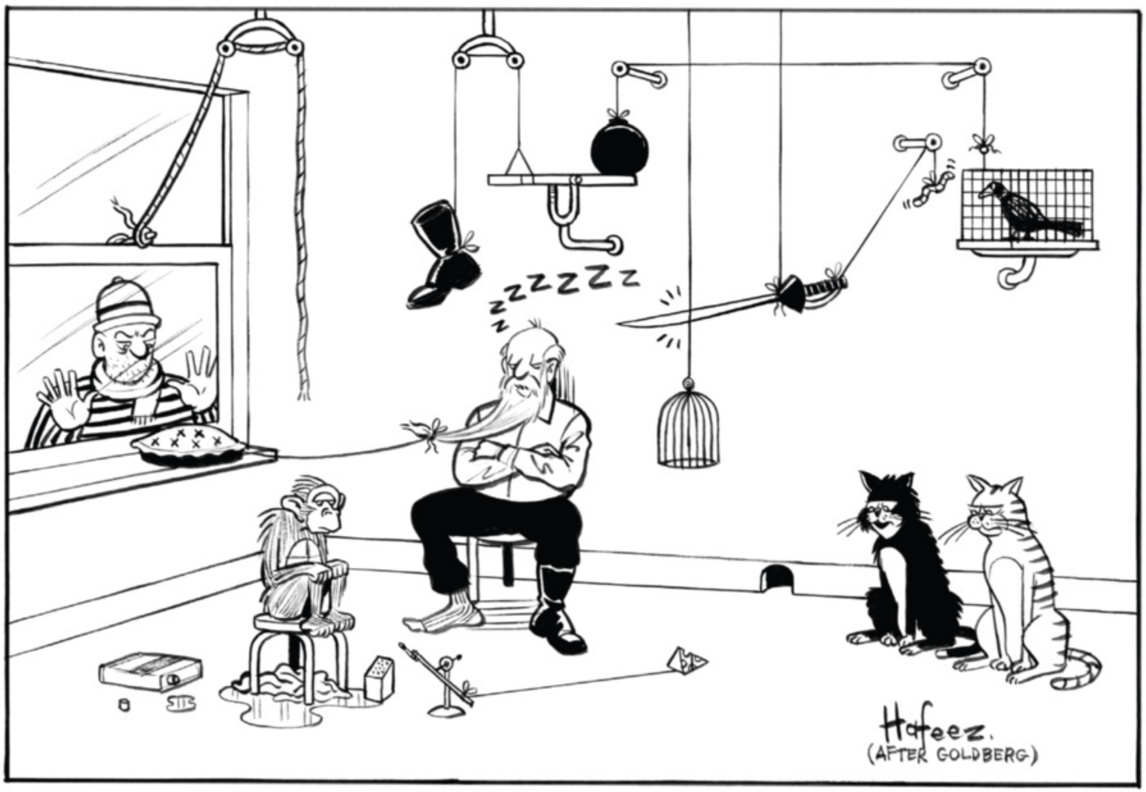
Senior managers across the company can benefit from programs for sharing expertise on consumer habits, competitor strategy, and retail dynamics. Virgin, Starbucks, and other corporations have created intensive "immersion" programs for this purpose. Executives at the director level can profit from advanced courses that focus on strategic considerations such as portfolio management and partnering. We find that senior leaders often gain a lot from digital and social media training, as they're frequently less well versed in those areas than their junior colleagues are. Appreciating this, companies including Unilever and Diageo have taken their senior leaders to Facebook for training. We've collaborated with partners at Google, MSN, and AOL to develop similar programs, including "reverse mentoring," which pairs very senior managers with younger staffers. Even the CMO can benefit from continued, targeted training. Visa's Antonio Lucio, for instance, hired a digital native to teach him about social media and monitor his progress.

Underperforming marketers, on the other hand, underinvest in training. Their employees receive just over half a day of training a year, on average, while overperformers give people nearly two full days of tailored, practical training by external experts.

AT FIRST BLUSH, the Marketing2020 study reveals what you might expect: Marketers must leverage customer insight, imbue their brands with a brand purpose, and deliver a rich customer experience. They must connect, inspire, focus, organize, and build, as detailed here. The finding that's striking—and should serve as both a warning and a call to arms—is that most organizations haven't been able to put all those pieces together. Our data show that only half of even high-performing organizations excel on some of these capabilities. But that shouldn't be discouraging; rather, it illuminates where there's work to do. Regardless of how marketing delivers its messages in the future, the fundamental human motivations that marketers must satisfy won't change. The challenge now is to create organizations that can truly speak to those needs.

HBR Reprint R1407C

Marc de Swaan Arons and **Frank van den Driest** are the founders of the global marketing strategy consultancy EffectiveBrands and the authors of *The Global Brand CEO* (Airstream New York, 2010). **Keith Weed** is the chief marketing and communication officer of Unilever and the chairman of the Marketing2020 advisory board.

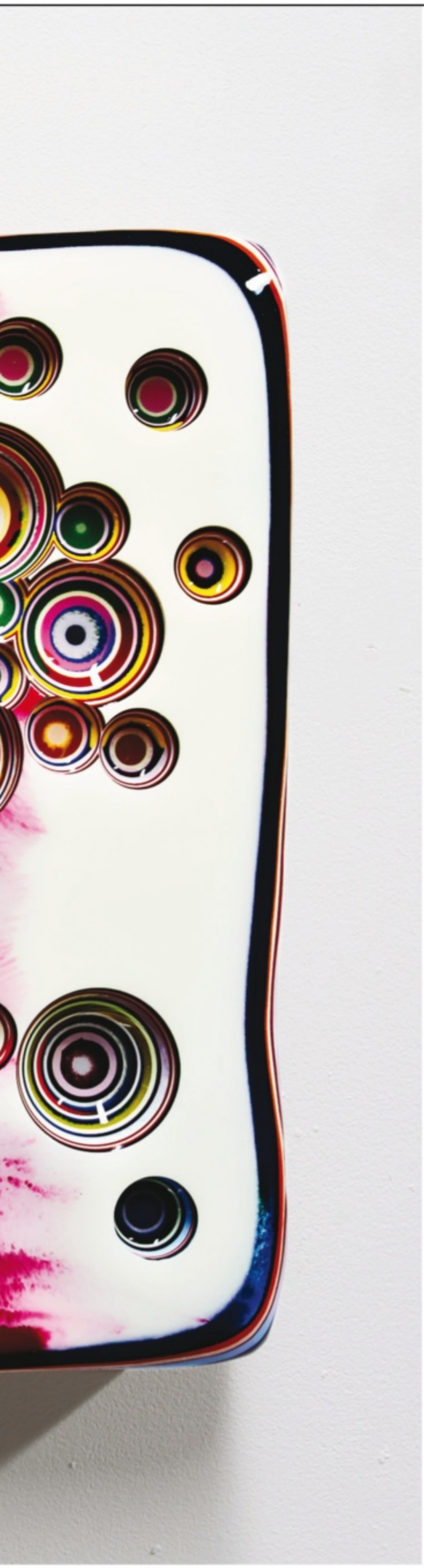


"It works, but is it scalable?"

CARTOON: KAAMRAN HAFEEZ

Spotlight

ARTWORK Markus Linnenbrink
HOWTOSURVIVE, 2012, epoxy resin
on wood, 13" x 17"



Aditya Joshi is a partner at Bain & Company, a leader in the Customer Strategy and Marketing practice, and the head of the firm's Marketing Excellence area.

Eduardo Giménez is a partner at Bain and a member of the firm's Consumer Goods practice in Europe, with a focus on marketing organizations.

Decision-Driven Marketing

Good decision processes break down silos and improve performance. *by Aditya Joshi and Eduardo Giménez*

Marketers have always had to build brands, create demand, promote sales, and help their companies earn customers' loyalty. But today's turbulent environment means they must play critical new roles: They must be strategists, allocating scarce resources to support company priorities and increasing return on investment. They must be technologists, tracking and capitalizing on the most useful of the sophisticated technologies that are flooding their field. And they must be scientists, because the future of their business may not look much like the past: Experiments that were once sideshows to preplanned campaigns are increasingly central to a marketer's job.

Over the years we've seen many individual marketers try valiantly to take on these challenges. But most of them are stymied by structural constraints and capability limitations. Strategic priorities somehow fail to cross organizational boundaries, to the point where sales and marketing may find themselves at odds. The skills that marketers need often reside elsewhere, such as in IT or central analytics groups.

The gap between marketers' aspirations and what their organizations can accomplish creates intense pressure to reshape how marketing is done. So where to begin? In recent years some leading companies have developed an innovative approach that focuses on the seams between marketing and the other functions it interacts with—the C-suite, IT, sales, finance, and so on. It is at these seams that communication most often breaks down and processes stall. To complicate matters, the boundaries themselves are blurring, and some tasks are moving from one function to another. The cutting-edge companies create a different kind of marketing organization—one that is less siloed, more interactive, and more collaborative, and that increases marketing's value and effectiveness.

The Decision Perspective

Leadership teams confronting organizational barriers often try to redraw the boxes and lines of their org charts. But that leads to incomplete solutions at best, because it risks simply creating new silos. As the marketing pioneers have discovered, a more fruitful approach is to identify the critical decisions involved in successfully marketing a company's products or services and focus on improving the effectiveness of those decisions. In essence, the leaders of these companies inject more discipline into decision-making processes—clarifying roles for marketing and other relevant functions and establishing decision criteria. Their approach isn't complicated, but it requires a new mind-set for all the parties concerned and a shared commitment to rethinking how decisions are made and work is done. To be sure, some companies will find that they need to consider organizational changes as well. But the decision perspective helps them establish a firmer foundation for any restructuring and drives progress in the interim.

Typically, three categories of marketing-related decisions cross organizational seams:

Strategy and planning decisions involve aligning marketing goals with business and customer strategies and aligning the priorities of marketing and sales. These decisions typically address questions such as:

- On which customer segments and product lines should we focus marketing support?
- What is the optimal level of spending, and what is the right allocation among vehicles and channels?
- What is the testing and learning plan?

Execution decisions, the marketer's traditional purview, are more challenging than they used to be. A proliferation of marketing vehicles and digital technologies has vastly increased the complexity of creating and delivering messages and offers in an environment where ever-faster execution and relentless budget pressure are the norm. These decisions include issues such as:

- Which product features should we highlight in our marketing efforts?
- What incentives should we give customers to get them to try or buy our offerings?
- What is the right mix of traditional and digital marketing vehicles?

Operations and infrastructure decisions cover all the new capabilities that are increasingly important to marketing's success. They address questions such as:

- How will new marketing technologies and tools be evaluated, bought, and managed?
- What is the right degree of integration between digital and traditional marketing?
- What does that imply for the nature and location of digital marketing capabilities?

About the Spotlight Artist

Each month we illustrate our Spotlight package with a series of works from an accomplished artist. The lively and cerebral creations of these photographers, painters, and installation artists are meant to infuse our pages with additional energy and intelligence to amplify what are often complex and abstract concepts.

This month we feature the work of **Markus Linnenbrink,** a German painter and sculptor. Linnenbrink's stripes and drips—often created as room-size environments—emphasize color and process. More of his work can be seen at **markuslinnenbrink.com**.

It is at the seams between marketing and the other functions that communication most often breaks down and processes stall.

Idea in Brief

THE CHALLENGE
Marketing organizations must collaborate with other functions more than ever before. But structural constraints and communication glitches often isolate them from the information and resources they need.

THE SOLUTION
To break down barriers, marketing pioneers are revamping the decision processes at the boundaries between functions, focusing on three areas: planning and strategy, execution, and operations and infrastructure.

THE PAYOFF
Companies including Target and Nordstrom have improved collaboration between marketing and other functions with simple tools that streamline decision making by establishing clear roles, explicit decision criteria, and well-defined processes.

More generally, marketers must determine which activities to keep in-house, which to automate, and which to outsource.

None of these decisions can be made by marketing alone, because they lie at the seams between functions. Some require collaboration with the CEO or a general manager. Others require close interaction with sales, product management, pricing, analytics groups, IT, or other functions on marketing's boundaries. (See the exhibit "Decisions at the Seams.") That's when what we call "mining the seams" comes into play: When marketing works closely with other functions to execute key decisions, it can avoid organizational bottlenecks and get things done far more quickly and effectively than in the past.

Judging from the experience of most marketing organizations, mining the seams is easier said than done. Impediments include divergent assumptions and a lack of alignment and shared commitment between functions. For instance, when we ask people in marketing and other relevant areas what roles they play in a decision, their answers are likely to be all over the map and even contradictory.

In a classic example, both marketers and product developers in one automaker's European division believed that they had the final say on which features to include in a new model. Not surprisingly, the result was constant haggling and delays that compromised product launches. (See "Who Has the D?" by Paul Rogers and Marcia Blenko, HBR January 2006.)

Mining the Seams: A Practical Guide

How should marketing revamp decision processes at the boundaries between functions? Consider a global financial services company that was grappling with how to allocate marketing dollars among its various product lines. Given the zero-sum nature of such an exercise and the naturally conflicting objectives of

DECISIONS AT THE SEAMS

As marketing works jointly with other functions at its boundaries to make and execute shared decisions, it must answer questions like the ones below.

1 Where should we double down on marketing spend? Where should we pull back?

2 How should we align performance metrics to ensure that marketing and sales focus on the same opportunities?

3 Should we build, buy, or outsource the marketing technologies we need?

4 What criteria should we use to allocate scarce analytical resources to marketing rather than other functions?

5 How should we determine the optimal price incentive to prompt desired customer behavior?

6 How should we set financial expectations for tried-and-true marketing investments versus unproven but promising ones?

the many stakeholders, this was a particularly contentious issue.

The company redesigned the decision process using a three-step approach: It conducted a decision X-ray, performed a decision reset, and implemented the new process.

A *decision X-ray* diagnoses how the decision is currently made. In this case, a team began by gathering input from the key participants in the budget-allocation decision, using interviews and surveys.

Both marketers and product developers at one automaker believed that they had the final say on which features to include in a new model.

The team mapped the decision process in detail and then conducted a workshop with the participants to discuss the collected input. A number of issues stood out: People lacked clarity on decision roles—they had varying opinions not only about who the decision maker was but also about who was responsible for recommending allocations. The decision process lacked basic disciplines, including a consistent methodology, criteria to guide the allocation, and clear guidance on what data were needed. Meetings often ended without explicit conclusions or agreement on next steps. Not surprisingly, both the quality and the speed of this decision were perceived as poor.

A *decision reset* entails redesigning a decision process to improve its effectiveness. Here the team kicked off the redesign by creating a working group of senior executives involved in the allocation decision, including representatives from marketing, finance, and the relevant business units. The marketing representative, who reported directly to the CMO, chaired the group.

In a series of three workshops this group examined every aspect of the decision. The task was to specify the what, the who, the how, and the when for the new process.

- Defining the what—what exactly are we deciding?—involved securing agreement on the scope of the allocation process and the guiding principles that would inform marketing allocations.
- Specifying the who meant identifying and agreeing to specific decision roles for each participant—who would draft the recommendation, who would provide input, who would actually make the decision, and so on. (For one method of assigning roles, see the exhibit "Deciding How to Decide.")
- Determining the how and the when meant agreeing on the allocation methodology and criteria, on what data participants would need, and on the timing of the decision.

This redesign required a significant investment of time and considerable tact, because the changes being discussed were contentious. Roles in particular required several discussions before the participants could agree. But the investment was worthwhile, because the new process was both more disciplined and more effective—and, crucially, it had buy-in from the various functions participating in the decision.

In the final step the company piloted the process during the next quarterly budget reforecast, evaluating the process steps and decision roles and assessing the allocation outcomes. Not everything worked as planned, but team members were able to modify both the procedures and the roles. Then they rolled out the redesigned process as part of the next annual budgeting cycle. Today this company's marketing allocations are much more explicitly aligned with its business strategy. Moreover, defining roles in advance has sped up decision making considerably.

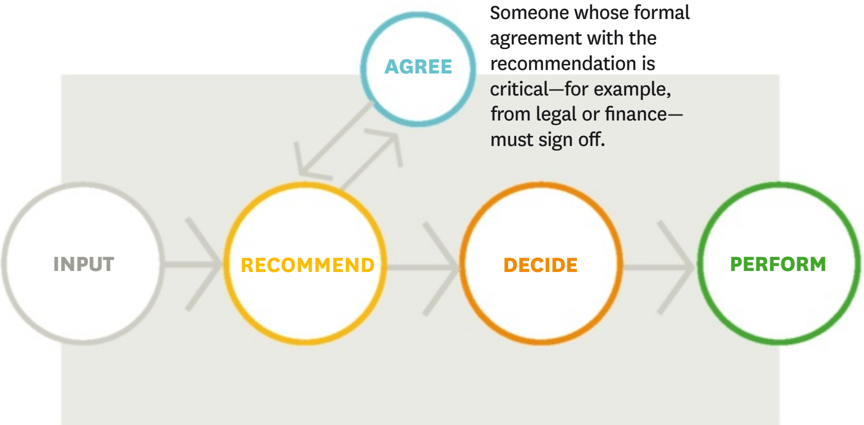
This three-step approach can be applied to a broad array of marketing decisions that lie at the seams. As evidence, let's look at three critical collaborations: marketing and strategy; marketing and sales; and marketing, IT, and analytics.

Marketing and strategy. At many companies, marketing focuses largely on tactical planning and execution. It develops television or print-media campaigns, for example, but final approval rests with the C-suite, business unit heads, or product managers. Such a narrow role for marketing is inefficient and ineffective in an always-on, do-it-now, multichannel world—and risks putting the function at cross-purposes with the company's key priorities.

When Jeff Jones arrived at Target as the CMO, in 2012, the company's marketing organization had a rich history of making "magic"—its processes were highly creative but also highly subjective. Jones

DECIDING HOW TO DECIDE

Assigning roles for key decisions is often complex, but an agreed-upon tool can facilitate the process. When teams use this one, developed by Bain and known by the loose acronym RAPID, they usually settle on a single decision maker.



Focus on getting only the input that is critical to making and implementing a good decision.

The recommender gathers input from preassigned groups before proposing an action.

The person with “the D” is ultimately held accountable for it.

A company assigning rights related to marketing communications decisions might diagram the roles of various functions this way.

DECISIONS	PRODUCT MANAGEMENT	CENTRAL MARKETING	REGULATORY	MARKETING/ CREATIVE	SALES/ CUSTOMER SERVICE
WHAT IS THE OVERALL MESSAGING STRATEGY?	R / D			I / P	
WHAT CLAIMS DO WE WANT TO MAKE? WHAT FEATURES AND BENEFITS DO WE WANT TO EMPHASIZE?	D	R	A	I / P	I
WHAT IS THE LOOK AND FEEL OF THE MATERIALS?	I	D	I	R / P	

FUNCTIONS INVOLVED

A split role in a box indicates distinct decision roles for different people (usually at different levels) within the same function.

wanted to maintain that creativity but felt it was also essential to devise a more systematic approach, incorporating the technological tools, data, and structure that could consistently deliver powerful marketing for Target’s products. That required a new strategic mind-set, which Jones distilled into three principles for his team: Drive traffic. Deepen engagement. Strengthen shoppers’ love for the brand. Every key marketing initiative had to reflect at least one of those principles.

Jones and his team revamped the operating model to develop a more structured decision process. They designed a tool called a *strategy brief*—a standard template used to plan every major marketing initiative or campaign. The brief placed a particular emphasis on the business problem being addressed. It also included a clear definition of the target customers; insights about their behavior; concise descriptions of relevant market, competitor, and customer trends; a crisp articulation of the marketing challenge; and an explicit statement of the desired customer and business outcomes—all in two pages or less. This was a far cry from the typical marketing packet, with its reams of data and limited insights. The power of the brief lies in the clarity it provides on the insights and criteria that will govern the decisions required for any initiative.

To achieve the desired impact, Target also had to define decision roles and processes for creating and using each brief. First the leadership team took part in a workshop to agree on high-level decision rights for category marketing, merchants, media strategy, customer insights, creative, and other areas. Then a working team designed and documented the strategy brief process, testing the assigned decision rights by using an actual marketing initiative as a live pilot. The team held additional workshops to assess what was or wasn’t working in the pilot and made adjustments before rolling out the approach more broadly.

At Target, category marketers are now responsible for creating each brief, with well-defined points for input from merchants, media strategy, and customer insights. They specify what decisions are to be made in each marketing meeting, who should attend those meetings, what the decision rights are for each decision, and what inputs each participant should contribute. The alignment, clarity, and transparency that a strategy brief facilitates enable Target’s category marketing team to effectively partner with merchandising in articulating the company’s business objectives and broad marketing strategy. The team can also incorporate marketing expertise, such as in creative strategy or media mix, thus ensuring smoother and more successful planning and execution of its major initiatives. And it can get the job done much faster, with less back-and-forth among the various participants.

Marketing and sales. It's almost a business cliché that these two functions frequently go their separate ways, with little communication—let alone collaboration—between them. That was the situation at one global technology company a few years ago. Like most business-to-business companies, this one relies heavily on its skilled salespeople to close deals and grow revenue with its largest customers. Marketing is responsible for conducting campaigns and creating collateral materials to support the sales reps. In the past, unfortunately, those materials often didn't meet the reps' needs, so many reps would revise what they were given or create their own materials. In fact, an internal survey revealed that they were spending an average of nearly one day a week digging around in the company's systems to find or develop what they felt they needed, instead of spending time with customers. Not only was this wasteful, but it resulted in materials that varied widely in appearance, tone, and consistency of message, chipping away at the company's investment in creating a distinct brand.

Again, the decision perspective proved useful. First, leaders redefined the job of the sales enablement (or sales support) organization, which reported to the head of sales, and gave it a charter to work closely with marketing. Then they spelled out decision rights and processes. Sales enablement would set standards for collateral materials according to its understanding of the needs of different types of sellers, such as account executives, specialists, and pre-sales executives. Marketing would develop templates for each collateral piece, specifying the kind of content to be included, with the final decision made by sales enablement. Marketing would also oversee the look and feel of each piece to ensure consistency with visual brand guidelines. Individual product teams took responsibility for providing information on product features and the value proposition. With clarity of objectives and access to the necessary data, marketing professionals could create materials that were satisfactory from both a sales and a brand perspective.

To accelerate the development of powerful customer insights, Nordstrom shifted responsibility and decision rights for many analytic activities to marketing in partnership with IT.

Now the collateral materials meet the needs of the sales reps, who can be confident that they are up-to-date and reflect the sales department's input. And the reps are freed up to devote more time to actual selling, with obvious financial benefits.

Another example comes from the consumer packaged goods industry. Historically, CPG marketers have tried to grow their categories through a continual stream of product introductions. But that creates a recurring problem: The proliferation of products not only saturates shelves and confuses shoppers but also strains sales reps, who are constantly trying to get attention for yet another offering. Moreover, new-product launches often receive lukewarm support—or none at all—from retailers, whose own capacities are stretched.

Today a few European CPG companies are pioneering a different approach to decisions about introducing new products, redefining the how and the who of the process. Product-marketing teams consider the shelf constraints of channel partners right from the beginning, gathering data on how much space they can realistically expect in a store and how much time shoppers spend in front of their products. The role of sales reps is now more important:

The frontline input they provide about constraints implied by the promotional calendar, the availability of endcaps, and so on, becomes a critical consideration—and sometimes a gating factor—for the product launch and the marketing strategy. By resetting the decision process to factor in such input early on, marketers can better time new-product introductions, raising the odds of success.

Marketing, IT, and analytics. Cutting-edge marketing organizations increasingly rely on technology: CRM systems, big data analytics, marketing optimization tools, and a host of other specialized software. Historically, the IT function has housed and managed most of this technology, and central analytics groups have mined and processed the data. But that's changing rapidly.

Look, for example, at how the marketing function at Nordstrom is evolving. The company's overarching strategic goal is still to improve the customer experience every year. But in the past its central marketing organization played the role of order taker, executing the plans of merchants in each category. Moreover, individual teams focused on the department or the product line for which they were responsible, while no one was building a holistic view of the customer.

Today the company faces new challenges, such as tracking and engaging customers across all four of its sales channels (Nordstrom, Nordstrom Rack, Nordstrom.com, and HauteLook). It has begun to address these challenges with far more sophisticated analytic and testing capabilities than were previously available. It has learned, for example, that customers who buy from multiple channels typically have a higher lifetime value than single-channel shoppers. It has learned that customers who spend $100 in some key categories often have a higher lifetime value than those who spend the same amount in other categories. That kind of analysis allows Nordstrom's marketers to put customers, rather than categories or brands, at the center of their efforts. Brian Dennehy, the company's new CMO, has embraced an aggressive test-and-learn philosophy and is gauging success along such metrics as customer acquisition, customer migration across channels, and customer lifetime value.

To accelerate the development of powerful insights, Nordstrom shifted responsibility and decision rights for many analytic activities to marketing in partnership with IT. Marketing now partners with IT to evaluate and select the technologies that allow it to acquire the needed analytic capabilities. Of course, the IT department retains a crucial role in such decisions and must approve the technologies from the perspective of interconnectivity, security, and network stability. But reassigning decision rights and clarifying roles for the marketing, analytics, and IT functions has ensured that Nordstrom can rapidly enhance vital tools and technology capabilities.

EVERY MARKETING ORGANIZATION will probably find that some seams matter more than others. We have discussed only three of the interfaces between marketing and other functions. Their importance will vary widely from one company to another, and some organizations will find that completely different interfaces—with product development, for example, or even finance—create opportunities. No company can address all the seams at once. But organizations that identify the most important decisions and learn how to make them more effectively will be on their way to better and more powerful marketing.

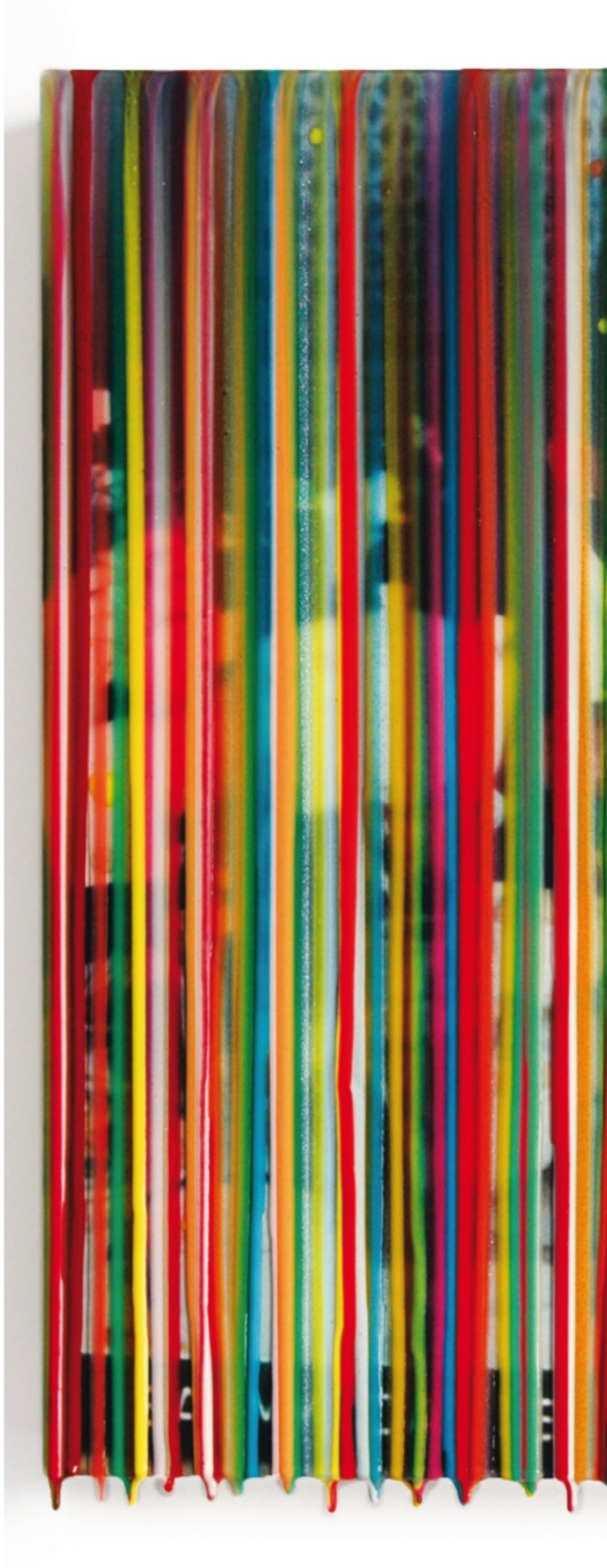
HBR Reprint R1407D

"Admittedly, it's a niche market."

CARTOON: CROWDEN SATZ

Spotlight

ARTWORK Markus Linnenbrink
SAMMYDAVISJRKEEJOO ANDPETERLAWFORD
2010, c-print, epoxy resin on wood, 24" x 31"



Unlock the Mysteries of Your Customer Relationships

Are you connecting with consumers the way they want you to?

by Jill Avery, Susan Fournier, and John Wittenbraker

Consumers have always had relationships with brands, but sophisticated tools for analyzing customer data are finally allowing marketing organizations to personalize and manage those relationships. With this new power comes a new challenge: People now expect companies to understand what type of relationships they want and to respond appropriately—they want firms to hold up their end of the bargain. Unfortunately, many brands don't meet those expectations.

Despite the "R" in CRM and the $11 billion spent on CRM software annually, many companies don't understand customer relationships at all. They lack

relational intelligence—that is, they aren't aware of the variety of relationships customers can have with a firm and don't know how to reinforce or change those connections. They may be very good at capturing simple demographic data—gender, age, income, and education—and matching them with purchasing information to segment customers into profitability tiers. But this is an industrial view of customer relationships, a sign that many firms still think of customers as resources to be harvested for the next up-sell or cross-sell opportunity rather than as individuals looking for certain kinds of interactions.

As a consequence, consumer companies often manage relationships haphazardly and unprofitably, committing blunders that undermine their connections with customers. A person wanting to be treated like a friend is more likely to be treated as a mere party to an exchange—or, even worse, as an adversary. It goes the other way, too: A customer looking for a mere exchange may get an off-putting attempt at building a friendship. In study after study, we find that consumers are frequently frustrated by companies' inability to meet their relationship expectations.

Through our two decades of research on brand relationships in a wide variety of industries across the globe, we've learned how companies can glean information about the kinds of connections their customers are looking for. We've also identified a number of relationship types, complete with the rules each type implies. Some of the types are what you'd expect; others veer into surprising territory. Do your customers want to have a *fling* with the brand? Do they assume a *master-slave* relationship, with the customer playing master to a servile company? We'll explain these and show why they matter for profitability.

Drawing on our analysis of firms that have made progress in managing relationships, we'll show how companies can unlock the mysteries contained in their portfolios of relationships and deliver on customers' expectations.

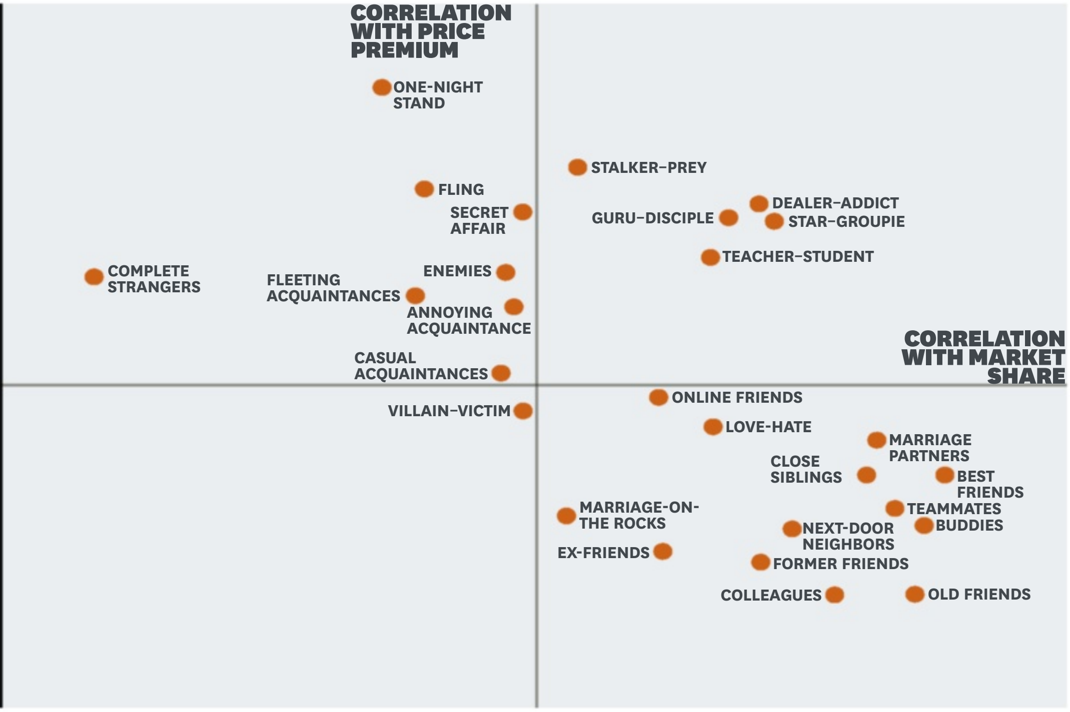
A New Approach to Relating

Why are relationships important? Consider these examples from our research.

A customer of a grocery delivery start-up is very happy to have found a service that can save him from one of his least favorite chores: going to the supermarket. He wants this business to survive, so he sends in suggestions for fixing operational glitches. But he gets no response—just a stream of

VALUING "FRIENDS" AND "ACQUAINTANCES"

Determining which customer-relationship types offer the most value involves weighing several factors. Here we show the degree to which various kinds of relationships can help a company build market share or charge a price premium. For instance, customers looking for a *one-night stand* with the brand are generally willing to pay a higher premium than those who see themselves as *colleagues* of the brand.



Idea in Brief

THE PROBLEM
Many consumer companies lack *relational intelligence*—they don't understand how many different kinds of relationships customers can have with brands, nor do they know how to reinforce or change those connections. A person wanting to be treated like a friend, for instance, might find herself being treated as a mere party to an exchange.

THE SOLUTION
Companies need to get better at capturing data that tell which relationship types—whether *flings* or partnerships or something else—their customers are looking for. They then must shift customers toward relationships that advance the firm's strategic goals. That requires understanding the unspoken rules of each type of connection. It also means reorganizing marketing around relationships.

CASE IN POINT
Pinterest has found ways to shift users into more-valuable relationship types, encouraging *strangers* to engage in flings with the site by positioning it as a place where people can continually discover new things. *Fleeting acquaintances* are encouraged to connect with other users who have similar interests. As users continue to expand their connections on the site, their relationships with Pinterest shift to *casual acquaintances* and, eventually, to *teammates*.

promotional e-mails encouraging him to place orders more frequently. Dismayed, the customer cuts back his use of the service, believing that the company isn't interested in developing a relationship on his terms.

A clothing brand popular with plus-size baby boomer women tries to reposition itself as relevant to younger, thinner customers and in so doing alienates established customers, who feel betrayed and disrespected—as though they've been dumped for someone more attractive.

A high-powered professional who's recognized by an online retailer as a loyal customer repeatedly tries to explain why she's frustrated with the company's policy of requiring signatures for deliveries, which inevitably come in the middle of the day, when she's not at home. Her presumption that the company wants to maintain a strong bond with her is dashed by unhelpful interactions with managers who refuse to be flexible about the policy. One finally makes a mindless attempt to "solve" her problem by offering her a $200 gift card. She ends up canceling a $7,000 order.

All three firms employed CRM to manage customer data, yet their extensive knowledge of purchasing patterns and demographics did nothing to prevent those misfires.

The grocery delivery service's CRM system was set up to push out promotions according to a set schedule or customers' purchasing patterns—not to listen for and capture customers' signals. Consequently, the company missed that this customer wanted much more than a simple exchange relationship. The clothing company didn't understand that by giving stores a makeover, replacing flowing silhouettes with clothes that were cinched at the waist, and showing garments accessorized with high heels rather than flats, it was undermining its intimate relationships with the customers who had the deepest connection to the brand. The case of the online retailer represents an organizational failure to broaden the reach of marketing to such functions as legal and customer service. This customer expected the retailer to treat her like a star in all interactions; she may even have wanted to play the master to the company's slave, insisting that the company satisfy all her demands.

These acute CRM failures point to an opportunity for marketing organizations to improve their relational intelligence. The first step toward that goal is recognizing that people have different kinds of relationships with brands. Through a structured quantitative survey approach, we analyzed the relationships between consumers in China, Germany, Spain, and the United States and more than 200 brands in 11 industries, including hair care, airlines, cars, and media. We saw that people's connections with brands varied along multiple dimensions, and we identified 29 distinct types of relationships. This approach is unfamiliar to most consumer companies, but it's more eye-opening and valuable than the demographic, behavioral, or values-based customer segmentation they have been practicing for decades.

The types include both positive and negative relationships (some customers view themselves as *buddies* or *close siblings* of the brand; others as *ex-friends* or even *enemies*), as well as some that are mixed (customers may have a *love-hate* relationship with a brand). They include relationships that are distant and those that are intimate (some customers feel that they and the brand are *complete strangers* or that they're participating in *one-night stands*; others see themselves as *best friends* or *marriage partners*) as well as ties that are intense and others that are weak. In some cases one party holds the power, and in others it is shared.

Some of the types are surprising to managers. Take the master–slave and fling concepts: Of course people can be very demanding, but managers don't fully grasp that for some customers, the whole point of the relationship is to fulfill their need to be listened to and treated with utmost respect, just as they fail to see that quite a few customers—particularly in fashion, consumer technology, social media, and gaming—seek a passionate, but fleeting, engagement. Some managers are also uncomfortable, at first, with our terminology, which may seem overly intimate. But our research has confirmed that these relationship metaphors accurately represent consumers' experiences with firms and brands. The labels also drive home a point. The master–slave idea, for example, usefully encapsulates a set of expectations and behaviors that companies need to acknowledge.

To categorize your customers by relationship type, you'll need to gather information that reveals their feelings and expectations about the brand. In other words, you'll need to develop relational radar to pick up their signals.

Listening for Signals

To begin, firms must understand the types of relationships currently in their portfolios. The most straightforward approach is to use surveys and interviews. Frito-Lay, for example, conducted extensive ethnographic interviews with a sample of customers to understand what kinds of relationships they had or desired with each of the company's brands. Most Cheetos customers, the company discovered, were adults who were using the product to feel playful and a tad naughty. These people, whom managers dubbed "rejuveniles," relished the snack's bright orange color, funny shapes, cheesy messiness, and even the telltale residue on their hands (licking their fingers made them feel they were breaking the rules). We refer to this kind of relationship as a *secret affair*.

Companies can further increase their understanding by boosting the relational intelligence of their CRM systems. Many companies receive vast amounts of data—via e-mails, online chat sessions between customers and reps, and phone calls—that contain relational signals, but they're poor at collecting and analyzing all this information. These signals convey what kinds of relationships customers want (and are assuming they have) with the brand as well as how those relationships may be evolving. The key is to start listening for and capturing them.

Web-crawling and data-mining technologies can enable companies to pick up broad relational signals from social media. GfK and other social-media listening firms such as Oxyme scrape and analyze chatter on Twitter, Facebook, blogs, and discussion forums and use trained coders and specialized software to identify users' emotions. Although people who post on social media may not always represent a company's typical customer, patterns of emotions can suggest important groupings of relationships and trends within them. For example, if you're seeing intense, positive emotion, particularly joy, and if words such as "love" and "loyal" are cropping up in discussions about a brand, you're most likely looking at customers who are signaling that they are in a marriage partner relationship with the brand. Consumers who speak of being "addicted" or "obsessed" or express longing may be in a *dealer–addict* relationship.

Listening to and capturing data also allow companies to convert customers' signals into knowledge about such factors as whether people are seeking to ratchet up or dial down their engagement with the company, whether relationships are in distress, and how customers are reacting to the company's various actions (new prices or privacy terms, for example).

The data you've gathered and coded will let you see your brand's current relationship profile. You can put this knowledge to use by determining which relationships offer the most value.

Stronger, committed bonds tend to be more durable; thus they contribute to building market share, and their predictability makes them easier to manage. Our research shows, however, that they are often less profitable than other types. Relationships such as marriage partners and best friends are resource-intensive—building and maintaining them requires significant investments. And once customers are entrenched in close relationships, any price increase or change in terms can be seen as a betrayal. Amazon's decision to raise the price of its Prime membership by 25% made some customers pause to consider the power Amazon had amassed. They felt exposed and vulnerable in the face of it. Suddenly customers could see that in forging what they thought was a comfortable partnership, they had become dependent on Amazon.

Our research shows that flings tend to allow high price premiums, but their fleeting nature produces revenue peaks and troughs, and trying to meet expectations for excitement can be expensive. Yet flings are highly profitable and remarkably resilient. In an experiment, we created two online photo-service brands, using color, language, and images to

RULES AND REGULATIONS

Each type of customer relationship is governed by its own rules, which are based on the customer's expectations. Here are a few examples:

Basic Exchange

The customer enters the relationship to obtain a good product or service at a fair price. The customer is looking for dependability and doesn't want to have to think or do too much.

EXAMPLE
A loyal customer sticks with a toothpaste brand.

Business Partners

The customer wants to work with the company as a valued and reliable partner to solve problems over the long term.

EXAMPLE
A customer of a grocery delivery service provides a stream of sensible suggestions for improving service, and the company follows up on the ideas.

Fling

The customer wants to experiment with a new identity. He or she expects the company to provide excitement, fuel his or her passion during every interaction, and not encourage reflection or rational thinking about purchases.

EXAMPLE
A customer of a watch company delights in—and purchases—a steady stream of new models with dazzling designs.

Best Friends

The customer is looking for intimacy and emotional support. He or she wants a two-way flow of honest communication and expects that the company won't disclose personal information or take advantage of his or her vulnerability.

EXAMPLE
A retail customer expects to be notified in advance of changes in operations or prices, or of other relevant business decisions, and the customer offers loyalty and understanding in return.

Buddies

The customer is looking for sustained interaction but doesn't want a close or emotional relationship. He or she expects that the company will not make demands or limit his or her freedom to associate with others.

EXAMPLE
A beer lover wants to choose from a large selection of brews to suit different occasions and resists individual brands' efforts to win his loyalty.

Master-Slave

The customer enters this type of relationship to intensify feelings of self-worth. He or she demands that the company listen, anticipate his or her every need, satisfy every demand, and not ask questions.

EXAMPLE
An online retail customer cuts off her relationship after a series of small service infractions that signal disrespect.

encourage friendships with one and flings with the other. The friendship brand engendered stronger ties, but when each site "accidentally" lost pictures, the friendship brand suffered while the fling brand grew stronger. The breach seemed to inject new energy into the relationships, perhaps by adding an element of risk and excitement. (See the exhibit "Valuing 'Friends' and 'Acquaintances.'")

Understanding the Rules

Once you've profiled your customer relationships, you can begin to manage them in ways that create a portfolio that advances strategic goals. You'll need to understand the unspoken rules that, if broken, jeopardize the relationship. The rules cover such issues as what the consumer and brand will give to and get from the relationship and how and when the consumer and firm will engage. (See the sidebar "Rules and Regulations.")

The rules are based on customers' expectations. In flings, consumers expect novelty, excitement, frivolity, and a form of identity play. If a brand meets those expectations, customers will respond by becoming passionate about it; the brand will become, for a time, a focal point in their lives. Any failure to meet the expectations will be interpreted as a violation of the rules, and the relationship will be undermined.

Armed with awareness of the rules, you can act to deliver on your customers' expectations while engineering your portfolio to include an ideal mix of relationships. Sometimes that means bolstering desired connections; sometimes it means shifting customers toward more-desirable types; sometimes it means changing gears to nurture the kinds of relationships a targeted customer group would prefer. We'll look briefly at each strategic course of action.

Bolstering desired relationships. When customers demonstrate a desire for a type of relationship that's useful to the company—because it advances the mission, drives profitability or market share, or contributes to earnings stability—the firm needs to reciprocate. For example, if customers show a willingness to go above and beyond for the firm, as the grocery delivery customer did, the company can respond by recognizing him or her as an honored partner who can influence new product and service designs.

Consider Swatch, which reinforces customers' flings with the brand by putting inexpensive, boldly designed watches on the market for just one season. That strategy gives people an opportunity to play with new identities and engage with the brand briefly, at a low commitment level—a far cry from the traditional approach to watch marketing, which focuses on selling one or two high-priced products to each customer over a lifetime.

General Mills found out it was destroying, not bolstering, its coveted marriage partner relationships in posting a new rule on its website stating that customers who downloaded coupons, entered sweepstakes, or joined the company online in communities like Facebook would be barred from suing if a dispute arose. Loyal customers lashed out. Within days, the company was forced to rescind the policy.

Brand relationships in car sharing offer another example. Zipcar missed the mark with early marketing campaigns focused on fostering social connections among users and building a community around the brand. Research has shown, however, that car sharing customers are interested primarily in functional value. They want clean, well-maintained, up-to-date vehicles, a variety of cars to choose from, excellent customer service, and convenient options. Avis's recent acquisition of Zipcar is well-aligned with that insight. Avis has the scale and competency to bolster the exchange relationship consumers desire.

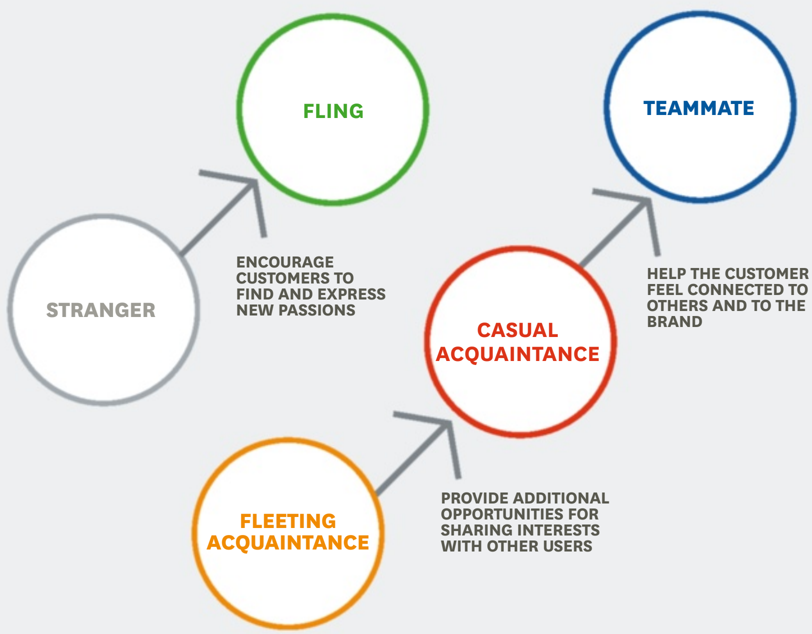
Shifting customers toward desired relationships. Many people enter into commercial interactions with certain types of companies—banks, cable TV providers, airlines, and corporate giants such as Walmart—expecting adversarial relationships. An understanding of that expectation is an opportunity for a reset. By incorporating singing and dancing into the onboard recitation of safety rules, Virgin Airlines tries to shift customers into a more positive bond with the company, such as a buddy relationship.

A company that wants to increase the proportion of close relationships in its portfolio in order to build long-term value has numerous options for doing so. It all comes back to paying attention to the rules and being aware of how relationships work. Rules can be bent, but not too far or too fast. Customers who have established casual ties with the brand can be coaxed in the direction of best-friend relationships, for example, through interactions that continue to meet their expectations while surprising them with the added pleasure of greater closeness.

While many relationships between consumers and social media brands never move beyond stranger or fleeting acquaintance, Pinterest—a site that lets users curate collections of products, images, recipes, and so on—moves users down various paths that lead them away from these less valuable relationships. One path encourages users in a

RENEGOTIATING RELATIONSHIPS

Noting that many of its primary connections with customers were remote or short-term, social media company Pinterest, which lets users curate collections of images and products, can take action to move customers into more-valuable relationships. Although most *strangers* will never become *teammates,* the company can develop *flings* with those users.



The fashion company Eileen Fisher discovered that the younger forty-something women the brand was starting to attract did not want to be *old friends* with the company. They wanted a relationship that was more transactional.

stranger relationship to engage in flings with the site by positioning it as a place where people can continually discover new things. On another path, users in a fleeting acquaintance relationship are encouraged to share their curated collections with people who have similar interests. As users build out their social circles, their relationship with Pinterest shifts to that of a casual acquaintance. And as they "pin" more items and continue to deepen their connections to others, users recognize that Pinterest is working in concert with them to expand their horizons socially, allowing a transition into a *teammate* relationship with the brand. (See the exhibit "Renegotiating Relationships.")

Changing gears. Consider the fashion company Eileen Fisher, which found that the high-touch sales approach that had worked well with fifty-something customers in the company's retail stores wasn't working for the forty-something (and younger) shoppers the company was starting to attract. With the help of research from IDEO, the company came to understand that for reasons including their hectic schedules, the younger women weren't as comfortable sharing intimate details about their lives with sales assistants. They didn't want to be *old friends* with the company; they wanted a relationship that was more distanced and transactional. Sales assistants had to adjust their approach.

A New Orientation

What does all this mean for the structure and function of the marketing organization? The actions we've recommended can't take hold or be effective if the marketing organization retains its traditional ways of doing things.

It's critical to regard relationships as long-term assets. Too many firms put their CRM databases in the hands of the IT department or outside software consultants, base their customer service responses on simple algorithms, relegate crisis management to the PR function, and fill their marketing units with people who have inadequate emotional intelligence and a poor understanding of the psychology of relationships. We've found that the optimal approach involves reorienting the marketing function around relationships, creating relationship-oriented roles for employees, and expanding marketing's purview.

Reorganize marketing around relationships. Marketing organizations need to identify both the positive, lucrative bonds and the negative, less profitable connections in their companies' relationship portfolios. After choosing a strategy—bolster, shift, or change gears—marketers need to educate staff, change their hiring practices, establish appropriate incentives, and shape processes around relationships.

Frito-Lay's entire marketing organization for salty snacks went through a three-day training program designed to educate people on the psychology of relationships and the reality of relationship rules and signals. As a result, the company rewrote its communications materials using relationship language and goals.

Similarly, Icelandic telecommunications firm Síminn implemented an 18-month program to help every employee, from receptionist to ditch digger to software engineer, become immersed in the company's relationship-oriented strategy and learn how to translate it to their jobs. Exercises helped employees internalize when decisions and behaviors supported or undermined the strategy. Moreover, marketing partnered with human resources to rewrite job descriptions with the aim of hiring people who are sensitive to relationships and can adjust, on the fly, to the relationship signals they receive.

Eileen Fisher has started adding relationship data to the customer "personas" it creates. These personas now reflect the type of relationship at play and the rules and profitability associated with it. Employees at all levels, from top management to sales clerks, understand the importance of customer relationships and emphasize them in decision making.

Reorganizing processes around relationships can be a far-reaching undertaking. At Swatch, for example, the rules of flings govern functions as diverse as marketing communications, product design, and supply chain: The company created the Swatch Design Lab, populating it with artists, architects, and industrial designers who could crank out two collections per year, each consisting of 70 styles, that would surprise consumers.

Create new roles for employees. In most marketing organizations, it's no one's job to think about relationship segments or take steps to bolster or otherwise manage the various types of bonds that customers form with the brand and company. In industries where adversarial relationships are common, companies should consider the use of "adversary managers": employees with specialized conflict management and negotiation skills. Brands with master–slave relationships may benefit from the addition of highly trained concierges who can meet customers' every desire.

Companies with best-friend relationships could take a lesson from Harley-Davidson. As part of the strategy that brought the firm 20-plus years of double-digit growth, Harley established a team of employees dedicated to communing with customers through the Harley Owners Group (HOG), the official riders' club. These employees, all motorcycle enthusiasts, spent on average 280 days per year on the road with customers to develop the kind of intimacy that could cement Harley's status as a best friend.

Expand the marketing umbrella. To be truly effective, a relationship orientation needs to go well beyond marketing-related functions. Relational intelligence must pervade every aspect of the company that touches customers or affects interactions with them, particularly in two areas that are often outsourced: IT and customer service. The company's computer systems must be able to gather and analyze the specific and highly nuanced relationship data in consumers' social media interactions and communications with the company. IT departments could benefit from employees trained in the social sciences, such as social psychology, clinical psychology, and family counseling. These individuals are better equipped to derive meaning from the data than the IT analysts traditionally entrusted to manage and mine CRM data.

Customer service is particularly important when it comes to relationships. The practices of outsourcing customer service and paying people low wages to deliver it have led companies to standardize and heavily script the responses employees use when interacting with customers.

The customer who was offered a $200 gift card after she complained about the retailer's delivery policy had been a loyal customer for 15 years and was in the practice of placing many orders on the website, spending tens of thousands of dollars per year. Like many high-end consumer firms, the company was pretty good at relationships in general—it had

A team of Harley-Davidson employees, all motorcycle enthusiasts, spent time on the road with customers to develop the kind of intimacy that could cement Harley's status as a *best friend*.

recognized her spending pattern and awarded her senior-level membership in its CRM program. Yet when she asked for help, a rep in an online chat used perfunctory language that seemed heavily scripted. The customer offered several potential solutions while imploring the rep to view her file and contact her personal shopper. The rep just restated the shipping policy, leaving the customer feeling disrespected and dehumanized. It was after she elevated her complaint to senior management that the vice president of customer service offered her the gift card as reparation for the service failure—a move that infuriated her, because her goal had become not only to receive her purchases but also to fix the retailer's internal processes.

To maintain a seamless approach, companies must educate customer service reps about the value of relationships and inform them about individuals' existing and desired ties with the company. That's why marketing must have a say in the management of customer service. For a taste of this alternative universe, try calling, chatting with, or e-mailing the customer service people at relationship-savvy Zappos. Chances are you'll engage with someone who has a personality and the freedom to be flexible with you.

Marketing needs to be empowered to share its knowledge of customers with all other customer-touching aspects of the business, from public relations to sales to website design, so that this knowledge can be incorporated into everything the company does. Even the finance and legal departments should be involved in the management of relationships. That won't be easy: Finance, focused on return-on-investment and profit maximization, may be unwilling to offer the inducements that facilitate certain types of relationships and may balk when asked to fund relationship building programs that take years to pay off. The legal department, centered on control of the brand asset and avoidance of lawsuits, may prohibit customer-facing employees from admitting guilt and offering heartfelt apologies when transgressions threaten to undermine relationships.

Even operational aspects of a company can be tailored to meet relationship goals. TD Bank, in its effort to deepen its relationships with customers, redesigned the service experience to recognize customers as friends—with pens that weren't bolted to tables, doors that didn't slam shut at 5:00, and lobbies that didn't shuttle customers like cattle through ropes and stanchions.

COMPANIES' INABILITY to understand or deliver on relationships was perhaps excusable when there was no easy access to what was in consumers' heads and hearts. But now that CRM technology has enabled firms to develop true one-to-one relationships with customers, they need to reorient the technology away from collecting economic data and toward capturing relationship data. Companies' continuing obtuseness about relationships represents a glaring failure of will. What is needed is data-driven empathy—that is, a deep understanding of the customer's condition—so that companies can interact as credible relationship partners. Combining big data with relational intelligence allows companies a window into the kinds of relationships customers have or desire. Reorienting the marketing function around relational intelligence and disseminating it throughout the organization will help address this failure and—at long last—fulfill the promise of customer relationship management.

HBR Reprint R1407E

Jill Avery is a senior lecturer at Harvard Business School and a former brand manager at Gillette, Samuel Adams, and AT&T. **Susan Fournier** is the Questrom Professor in Management at Boston University. **John Wittenbraker** is the global director of innovation, brand, and customer experience at the market research firm GfK.

"We've updated the company manual."

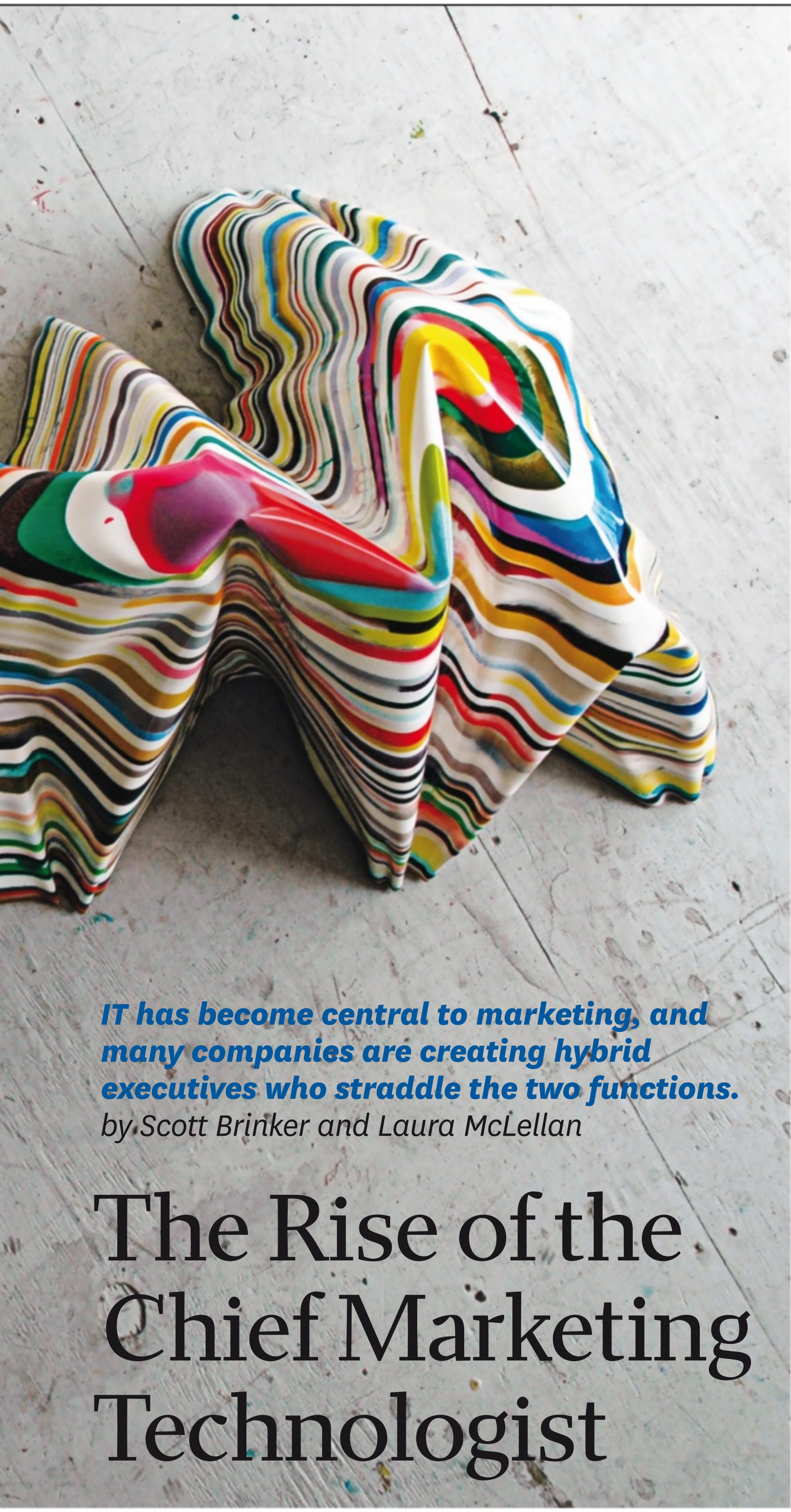
CARTOON: BOB VOJTKO

Spotlight

ARTWORK Markus Linnenbrink
EVERYWHEREALLTHETIMEEVERYTHING
2009, epoxy resin, pigments, 20″ x 39″ x 82″

Scott Brinker is the chief technology officer at ion interactive. Follow his blog at chiefmartec.com.

Laura McLellan is a research vice president at Gartner, where she focuses on marketing strategies.



IT has become central to marketing, and many companies are creating hybrid executives who straddle the two functions.

by Scott Brinker and Laura McLellan

The Rise of the Chief Marketing Technologist

Marketing is rapidly becoming one of the most technology-dependent functions in business. In 2012 the research and consulting firm Gartner predicted that by 2017, a company's chief marketing officer would be spending more on technology than its chief information officer was. That oft-quoted claim seems more credible every day.

A new type of executive is emerging at the center of the transformation: the chief marketing technologist. CMTs are part strategist, part creative director, part technology leader, and part teacher. Although they have an array of titles—Kimberly-Clark has a "global head of marketing technology," while SAP has a "business information officer for global marketing," for example—they have a common job: aligning marketing technology with business goals, serving as a liaison to IT, and evaluating and choosing technology providers. About half are charged with helping craft new digital business models as well.

Regardless of what they're called, the best CMTs set a technology vision for marketing. They champion greater experimentation and more-agile management of that function's capabilities. And they are change agents, working within the function and across the company to create competitive advantage.

Before we describe the role in detail, let's consider the forces that gave rise to it.

In a digital world, software is the chief means of engaging prospects and customers. A marketing team's choice of software and how to configure and operate it, along with how creatively the team applies it, materially affects how the firm perceives and influences its audience and how the audience sees the firm.

As digital marketing and e-commerce increasingly augment or replace traditional touchpoints, the importance of mastering those capabilities grows. Digital marketing budgets are expanding annually at double-digit rates, and CEOs say that digital marketing is now the most important technology-powered investment their firms can make.

This rise in digital budgets is not merely a migration of spending from traditional to digital media. A growing portion of marketing's budget is now allocated to technology itself. A recent Gartner study found that 67% of marketing departments plan to increase their spending on technology-related activities over the next two years. In addition, 61% are increasing capital expenditures on technology, and 65% are increasing budgets for service providers that have technology-related offerings.

The challenge of effectively managing all this technology is daunting. There are now well over 1,000 marketing software providers worldwide, with offerings ranging from major platforms for CRM, content management, and marketing automation to specialized solutions for social media management, content marketing, and customer-facing apps. Relationships with agencies and service providers now include technical interfaces for the exchange and integration of code and data. And bespoke software projects to develop unique customer experiences and new sources of advantage are proliferating under marketing's umbrella.

Bridging Marketing and IT

In this new environment, the CMO and the CIO must collaborate closely. But executive-level cooperation isn't enough; a supporting organizational structure is also needed. A company can't simply split marketing technology down the middle, King Solomon style, and declare that the CMO gets the marketing half and the CIO gets the technology half. Such a neat division might look good on paper, but it leaves yawning knowledge gaps in practice. Marketing might not understand how to fully leverage what IT can offer, and IT might not understand how to accurately translate marketing requirements into technical capabilities.

Instead, marketing technology must be managed holistically. In a virtuous cycle, what's possible with technology should inspire what's desirable for marketing, and vice versa. The right structure will help marketing become proficient with the array of

CMTS' EXPANDING REACH

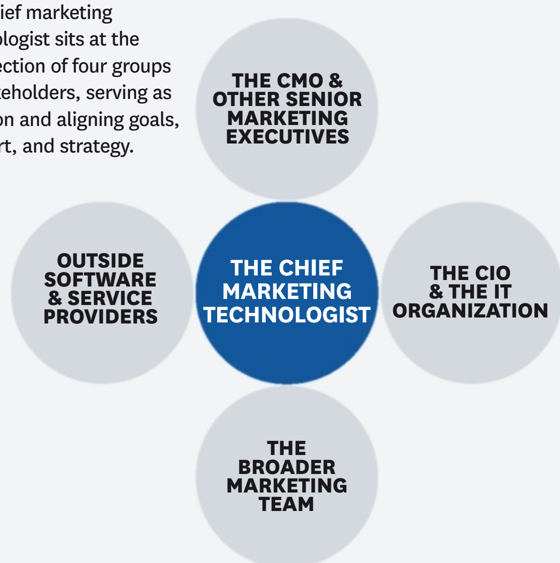
AGENTS OF INNOVATION

Organizations with a chief marketing technologist are generally ahead of their peers in digital marketing maturity and experimentation to create competitive advantage. They spend, on average, one third more of their total marketing budget on digital (**30%** versus **21%**) and twice as much of it on innovation (**10%** versus **5%**).

SOURCE GARTNER

AT THE NEXUS

The chief marketing technologist sits at the intersection of four groups of stakeholders, serving as a liaison and aligning goals, support, and strategy.



software it must use to attract, acquire, and retain customers. It will help marketing leadership recognize how new technologies can open up new opportunities. And it will allow marketing to deftly handle the technical facets of agency and service provider relationships in both contract negotiations and day-to-day operations.

The CMT's job, broadly, is to enable this holistic approach. He or she is the equivalent of a business unit–level CIO or CTO. People in this role need technical depth—many have backgrounds in IT management or software development—but they must also be passionate about marketing. A common profile is an executive with an undergraduate degree in computer science and a graduate degree in business. Many CMTs have experience in digital agencies or with building customer-facing web products.

Most CMTs report primarily to marketing, either to the CMO or to another senior marketing executive, such as the VP of marketing operations or the VP of digital marketing. Many also have dotted-line reporting relationships with IT.

Acting as the connective tissue between different constituencies, these executives engage with four key stakeholders: the CMO and other senior marketing executives, the CIO and the IT organization, the broader marketing team, and outside software and service providers (see the exhibit "At the Nexus"). We will describe their interactions with these stakeholders in turn.

The CMO and other senior marketing executives. The chief marketing technologist supports these executives' strategy by ensuring technical capabilities and advocating for approaches enabled by new technologies. For example, Joseph Kurian, Aetna's head of marketing technology and innovation for enterprise marketing, championed the use of "voice of the customer" software to collect user feedback across the company's mobile and web interfaces. The software has improved customers' digital interactions with Aetna—a key strategic priority.

The CIO and the IT organization. CMTs facilitate and prioritize technology requests from marketing, translating between technical and marketing requirements and making sure that marketing's systems adhere to IT policies. Andreas Starke, the business information officer for global marketing at SAP, is the principal point of contact between the two functions and streamlines the planning and execution of marketing technology projects. For example, he led the rollout of a shared automation platform to replace the disjointed systems used by previously siloed marketing groups.

The broader marketing team. The CMT ensures that the marketing staff has the right software and training. Brian Makas, the director of marketing technology and business intelligence at ThomasNet, saw that field sales reps and support staff were inefficiently coordinating their activities through weekly Excel spreadsheets. He jettisoned that time-consuming process in favor of real-time views obtained through the company's CRM system—and implemented the new protocol in just a week.

Outside software and service providers. Here, the CMT assesses how well providers' technical capabilities meet marketing's needs, helps integrate the systems, and monitors their performance. Shawn Goodin, the director of marketing technology at the Clorox Company, led the evaluation of six vendors for a platform that would optimize customers' experiences across channels and devices and integrate consumer data across marketing, sales, and R&D.

The work of these CMTs shows just how open-ended this new role is—and why an executive fully at home in both marketing and IT is essential for the job.

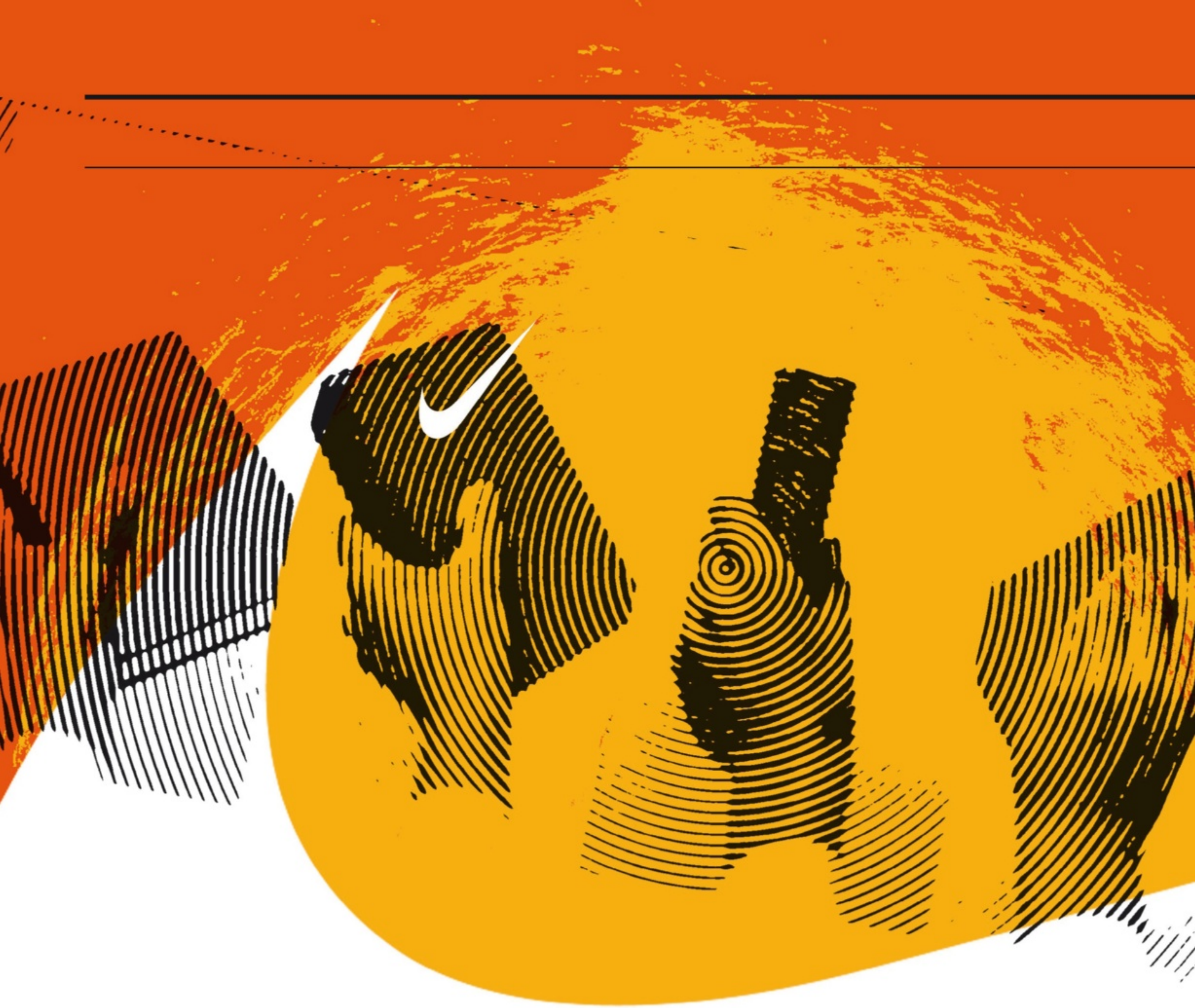
HBR Reprint R1407F

Profile of a CMT

Mayur Gupta, Kimberly-Clark's global head of marketing technology and operations, epitomizes the evolving role of the CMT. Before coming to Kimberly-Clark, he was an enterprise architect and marketing technology strategist at SapientNitro, a marketing services provider that combines the creative culture of an agency with the technical capabilities of a systems integrator. In his current role, he is primarily responsible for managing the company's marketing technology strategy and road map—advising on which big bets the company should make in expanding its technology-enabled marketing capabilities and how to prioritize and manage their adoption.

Gupta and his team work closely with brand leaders throughout the company, identifying new ways to leverage software and information. For instance, he led the deployment of a new platform that integrates customer data from within and outside the firm to drive Kimberly-Clark's "omnichannel" strategy, which aims at delivering more-consistent and personalized experiences across touchpoints. More broadly, he collaborates with IT leadership throughout the life cycle of such projects, from defining goals to acquiring and implementing technology.

Gupta also leads the technology practice in the company's Digital Innovation Lab, which is affiliated with a network of technology start-ups, accelerators, and incubators. Its projects range from experiments with connected devices and the Internet of Things to uses of augmented reality to optimize the shopping experience.



Sustainability in the Boardroom

Lynn S. Paine is a John G. McLean Professor of Business Administration and the senior associate dean for faculty development at Harvard Business School. She is a coauthor of *Capitalism at Risk: Rethinking the Role of Business* (Harvard Business Review Press, 2011).

ILLUSTRATION: ANDY MARTIN

Lessons from Nike's playbook

by Lynn S. Paine

A board member was exchanging a few words with the CEO of a fast-growing athletic apparel maker before the annual shareholders' meeting when the two caught sight of a group of labor activists at the back of the hall. The group was known for protesting labor conditions in the Asian contract factories where the company's products were made. The CEO turned to the director and, without prior warning, said that he planned to ask her to take charge of the meeting if any disruption occurred. When the activists marched to the front of the auditorium partway through the meeting, that's exactly what he did.

Although corporate directors are often faced with difficult questions about the conduct of the companies they serve, rarely are they confronted in such a public fashion. But that's what happened to Jill Ker Conway at Nike's 1996 annual meeting. A former president of Smith College and a self-proclaimed jock, Conway had been recruited to Nike's board by the chairman and then-CEO, Phil Knight, in 1987 for her expertise on women's issues and her understanding of the student perspective.

Fortunately, Conway was not taken wholly unawares when Knight called on her to chair the proceedings. A few months earlier she had told him that she expected labor issues in the contract factories to come up at the meeting and felt that at least one director should be able to speak about them firsthand. During that conversation she had offered to visit some of Nike's contract factories in Southeast Asia as part of a trip she was about to take to her native Australia. With Knight's blessing, she had made the first in what would become an extensive series of visits over the next few years. So she was well equipped to preside when a heated exchange broke out between the labor group's leader and the assembled shareholders and, later, to advise on a formal research effort that would shape many of Nike's early corporate responsibility initiatives.

Surveys suggest that no more than 10% of U.S. public company boards have a standalone corporate responsibility or sustainability committee.

Much has been written about Nike's extensive corporate responsibility efforts and how they have transformed the company from an organization whose name was synonymous (as Phil Knight said in 1998) with "slave wages, forced overtime, and arbitrary abuse" to a pioneer in using social and environmental issues as catalysts for innovation. Far less attention has been paid to the board's role in these efforts or to Nike's creation of a board-level corporate responsibility committee to institutionalize the company's commitment to responsible performance.

That's not surprising. Those engaged in the mainstream corporate governance discussion have been largely silent on the subject of the board's role in overseeing corporate responsibility and sustainability. Why that's so is not entirely clear, especially with the increasing pressures on (and opportunities for) companies to help address serious economic, social, and environmental problems around the globe. It may result in part from the intense focus over the past decade on financial reporting, executive compensation, and board leadership in the wake of the Sarbanes-Oxley Act, the 2008 financial crisis, and the Dodd-Frank Act. Although that focus has been mainly to the good, one unfortunate side effect has been the relative neglect of other aspects of governance.

In view of growing concern about business and sustainability, and given the importance of corporate responsibility for ongoing value creation, directors should be asking whether their board's oversight in those areas is sufficient. Recent surveys suggest that no more than 10% of U.S. public company boards have a committee dedicated solely to corporate responsibility or sustainability. Nike's experience indicates that such a committee could be a useful addition to many if not most boards in at least five ways: as a source of knowledge and expertise, as a sounding board and constructive critic, as a driver of accountability, as a stimulus for innovation, and as a resource for the full board. A look at how Nike's corporate responsibility committee has served each of these functions will show why.

A Source of Knowledge and Expertise

Chief executives often seek directors who have expertise and relationships that could help the company, but rarely with corporate responsibility or sustainability issues in mind. Yet domain-specific knowledge and relationships are as relevant for those areas as for any others.

When protests over labor practices abroad broke out on U.S. college campuses in the mid-1990s, Nike was fortunate to have in Conway a director with extensive knowledge of the student population and expertise in the societal effects of industrialization. That was not entirely by chance. Conway had been

Idea in Brief

THE PROBLEM
Although more and more companies recognize the importance of corporate responsibility and sustainability to their long-term success, these issues get short shrift in most boardrooms.

THE SOLUTION
To address the risks and opportunities arising from problems such as climate change, water pollution, corruption, and uneven access to wealth, health, and education, Nike's board created a dedicated corporate responsibility committee in 2001.

THE RESULTS
Nike's experience suggests that such a committee could be useful to many companies' boards in at least five ways: as a source of knowledge and expertise, as a sounding board and constructive critic, as a driver of accountability, as a stimulus for innovation, and as a resource for the full board.

---

recruited as part of Knight's efforts to bring fresh thinking and experience to the boardroom at a time when the company was struggling to regain the momentum of its first decade. With the notable exception of one director who was an expert on innovation and creativity, the board had consisted mainly of friends and family of Nike's founding group.

As it happened, in adding Conway the board got geographic, gender, experience, network, and knowledge diversity all at once. So when the activists took to the floor at the 1996 shareholders' meeting, Conway recognized the complexity of the situation. She knew that the protests would only escalate and that improving factory conditions would take time.

Conway is an authority on women's entry into the paid workforce in 19th-century Britain and the United States. Her knowledge of the impact of industrialization on the lives of women and girls made her an especially well-informed observer during her visits to factories in countries that were undergoing industrialization. After Nike hired Maria Eitel as its first vice president of corporate responsibility, in 1998, Conway and Eitel brokered a partnership with the International Youth Foundation to create a nonprofit that would study the largely young female workforce in the factories. Staffers of the nonprofit thus created—the Global Alliance for Workers and Communities—interviewed 67,000 workers in their native languages at off-site locations where the workers could speak fully and freely. Without Conway's ability to tap a global network of women's organizations and university faculty members, Nike would have found it difficult to gain access to those communities in view of the company's reputation at the time.

In 2001 Conway proposed the creation of a board-level corporate responsibility committee. She wanted to engage the board not just in the labor issues that were threatening Nike's reputation among its core consumers but also in a range of other topics that were not being raised to the board. Chief among them were health and environmental issues, which were beginning to command attention both inside and outside the company. Knight endorsed the idea and asked Conway to serve as chair. She accepted on the condition that Knight attend every meeting—her way of making sure that the committee would not be marginalized. "Everybody wanted to come before that committee," Conway recalls; people knew that doing so would put them squarely in front of Knight.

The close alignment between Conway's diverse talents and the corporate responsibility issues Nike faced in the 1990s may have been fortuitous, but boards need not leave the matter of fit to chance. Mapping out the company's principal responsibilities and identifying key issues the firm is likely to confront can reveal the areas of knowledge and experience that would be particularly valuable to have represented on the committee. Members should have an understanding of stakeholders' expectations and the company's governing standards, but imagination, openness to new ideas, and an interest in innovation are also crucial.

The expertise currently gathered in Nike's corporate responsibility committee, for instance, reflects both the company's perennial labor issues and its recent focus on sustainability and innovation. The group includes a university chancellor with a background in biological science and environmental education, a former university basketball coach, a chief executive in an industry whose lifeblood is innovation, a retired media company executive and university trustee, and a former trial lawyer with four decades of service on the Nike board.

A Sounding Board and Constructive Critic

A labor incident in the supply chain. A controversial disclosure. A shift in sustainability strategy. A change

Setting Up a Board-Level Corporate Responsibility Committee

Jill Ker Conway chaired the Nike board's committee from 2001 until her retirement from the board, in 2011. She recently spoke with Lynn Paine about how the committee was created and what makes it effective.

PAINE: In 2001 you proposed the creation of a board-level committee as a way to institutionalize Nike's commitment to corporate responsibility. Why did you think that was important?
CONWAY: I had worked on corporate responsibility issues when I was a director of IBM World Trade. They had many problems about introducing their technology into the developing world and making a lot of money out of it but not really responding to the needs of the society. So I had some experience of what those committees could do.
I also felt that because people come and go, if you have a legitimate structure for managing these issues, they are much better dealt with—knowledge and understanding accumulate, better records are kept, and so on.

Why aren't such committees more common? Do you think a company's ownership structure has any bearing on this question? I ask because Nike has a controlling shareholder who was also a founder, and I wonder what effect, if any, that has had on the company's handling of these issues. I'm absolutely certain it has had an effect. When we set up the Global Alliance to do our survey of workers, I trekked around the world trying to recruit other consumer products companies with the same kinds of supply chains to join us. The only ones that had any interest were those with significant family ownership. I don't think executives of a typical public corporation have that same feeling of moral responsibility that the principal founder or owner has.

Speaking more practically, do you have any suggestions for a director who believes the board needs to be more engaged with corporate responsibility issues but isn't sure how to make it happen? Well, number one, the person has to be committed to the enterprise totally and not be a complainer. Second, I think they have to have some kind of intellectual framework into which they can fit what they are urging people to do. You can't just say, "It would be nice if we did things better for low-income countries and poor families." You have to really have some picture of what might be achieved by undertaking some

in organizational structure. A proposal to invest in a new environmental technology. The range of corporate responsibility issues that Nike (or any company) might face is complex and varied. By asking insightful questions, making suggestions, offering perspectives, raising counterpoints, and proposing alternatives, the committee enriches and challenges management's thinking.

Take what happened in 2009, when the committee was considering a thorny situation involving two subcontractors in Honduras who had closed their doors and dismissed 1,800 employees without notice and without paying the roughly $2 million in severance that the employees were owed under local law. Nike had no legal responsibility for the severance payments and had stated publicly that it would not cover them. But pressure mounted from universities and student groups across the United States for Nike to make good on the subcontractors' obligations.

The discussion, led by Conway, was intense. The committee brainstormed ways to help the workers without setting a precedent for Nike's paying out whenever a subcontractor defaulted on obligations to its employees. After the meeting the management team decided to rethink Nike's position. The result was an innovative arrangement whereby the Honduran government made the severance payments while Nike created a $1.5 million workers' relief fund and provided support for vocational training and health coverage for the laid-off workers.

Even when committee discussions ultimately reinforce a direction that has been proposed, the process can highlight strengths and weaknesses in management's thinking and point to critical communication and execution challenges. That was the case in 2011 and 2012, when Nike was developing its next-generation sustainability targets. For nearly a decade the company had from time to time announced targets and reported progress in areas such as labor conditions in the contract factories, the use of environmentally preferred materials, and reducing greenhouse gas emissions, waste, and toxic substances in the supply chain—issues that by 2006

For more of Conway's thoughts on the role of a board-level corporate responsibility committee and her experiences at Nike, go to **hbr.org/conway-interview**.

major changes. And third, you can't be afraid to be criticized. You need a sense of humor and the ability to get people laughing so that they are relaxed when they're trying to talk about this subject rather than holding on to the edge of the table and worrying.

Are there particular skills or perspectives that should be represented on a corporate responsibility committee? One thing that's very important is to have members who are deeply interested in innovation. You need people who are imaginative, open to new ideas, and capable of envisioning a different organization of things. Of course, you also have to have some core values. I'm a committed feminist, and I was bound to do the best I could to see that this major economic transformation didn't leave young women stranded just the way they'd always been.

What are some of the factors that make for an effective corporate responsibility committee? It's very important to work with the finance committee and the financial analysts, because there's always a lot of loose talk about how much this or that is going to cost or whether it's going to have any yield. Another thing that is always persuasive and gets people nodding in agreement is the committee's sense that a lot of really bad mistakes are being avoided and a lot of fruitful opportunities are being created. It's also important to put people at ease when talking about difficult subjects. Sometimes you need to talk to people one-on-one and just take the time to find out what's on their mind or why they're troubled. When we were beginning, I went around and asked everybody what they thought this committee should do. We talked about the business model and what new ways of evolving it might come out of such a committee, and so on.

How does boardroom culture affect the corporate responsibility discussion? One of the things I've been struck by is all my colleagues on the Nike board, whatever their political orientation, saying, "I have learned more on this board than from anything else I've done." I believe nobody thinks about board structures as a place where you really gain new knowledge and new insight, but I think my colleagues would all say that.

Where does that sense of learning come from? It's how the board is run. You know, the board has dinner together every board meeting. And some unfortunate person is picked on by Phil to start the discussion of some important long-range subject. These are long discussion dinners, where people talk about what the original goal was for the company, how it has grown, what we are doing that's true to that dream, and so on. And in the board meeting, nobody is afraid of asking a question or looking silly—it's very open. Phil usually sits in the middle of the boardroom and is very quiet and just lets people start talking. The freedom with which people are encouraged to talk about things that they may not feel they know all that much about leads to a different kind of discourse. It sends people home saying, "That was really interesting at the board session. I've got to go look that up."

It sounds like a really fun board. It is. It is. People just love it.

were being discussed under the mantle of "sustainability." By 2011 the previous targets had largely been achieved. The management team wanted to link the company's new sustainability targets more tightly with its growth strategy and day-to-day operations by providing specific sustainability goals for business and functional units across the organization.

That was a massive undertaking. For more than six months a dedicated team worked with managers and experts throughout the company to identify potential target areas and define measurable objectives for each. At various points the team advised the committee of its progress and shared its methodology, eventually floating preliminary proposals for targets. The committee had several responses. It questioned whether the targets were ambitious enough—and realistic enough. Some directors asked whether there were too many metrics and whether broader goals would be preferable to specific targets in certain areas. Others wanted to know more about what factors had been taken into account and how the pros and cons had been weighed. In the end, the committee's stress test did not change the team's approach. But the scrutiny lent assurance that the thinking was robust, and it provided a useful preview of likely reactions to the proposed targets from managers and others who had not yet been involved. And, of course, the prospect of review by a dedicated board-level committee gave the team an added incentive to proceed with rigor throughout the process.

The committee's value as a sounding board depends as much on its distinctive outlook as on the specific knowledge and experience that its members bring to the discussion. Four of the five members of Nike's committee are independent directors, which means that they combine a third-party perspective with the loyalty, care, and confidentiality required of fiduciaries. At once outsiders and insiders, they are uniquely positioned to be the constructive skeptics every good management team needs, especially when dealing with issues that affect the public interest.

PHOTO ILLUSTRATION: ANDY MARTIN; PHOTOGRAPHY: TAMARA VONINSKI/FAIRFAX

A Driver of Accountability

One of the newly established committee's initial tasks was to oversee the publication of Nike's first stand-alone corporate responsibility report. The committee continues to oversee public reporting on corporate responsibility and sustainability, but it also fosters accountability through a range of other activities. It spends the first half of each regular two-hour meeting (held five times a year, in conjunction with the full board's regular meetings) reviewing the company's progress toward its sustainability targets along with the contract factories' performance against Nike's health, safety, environmental, and other standards. The factory discussions focus on trends in performance rather than on compliance audits (those are conducted by a group within the corporate audit function that reports to the CFO and to the audit committee of the board).

Even when committee discussions reinforce a proposed action, the process can point to key communication and execution challenges.

To assess and track performance, the committee relies on data generated by the management team using Nike's factory-rating system, which includes various measures of labor and environmental performance in addition to the traditional measures of product quality, cost, and delivery. At each meeting the committee examines current ratings, considers trends over time and across regions, addresses pressing issues, and tries to identify opportunities for improvement.

In conducting these oversight activities, the committee engages directly with key executives. True to Knight's 2001 pledge to Conway, either Knight or the current CEO, Mark Parker, attends each meeting. The executive in charge of corporate responsibility (initially Eitel, now Hannah Jones) has also worked closely with the committee since its inception. In 2009, as part of an effort to embed sustainability principles more deeply in the business, a second senior executive was added as a liaison to the committee: Eric Sprunk, at the time the vice president of merchandising and products and now the COO. This change at the board level coincided with changes at the corporate level, including the introduction of dual-reporting lines between the corporate responsibility group and key business functions such as finance, innovation, and supply chain, and an expansion of the corporate responsibility group's work from achieving day-to-day operational compliance to building a fundamentally more sustainable business model. The shift in orientation was reflected in the group's adoption of a new name—"sustainable business and innovation"—and the creation of the SB&I lab, an in-house group that includes members with private equity and venture capital expertise and is charged with seeking external technologies and partnerships to advance the sustainability agenda.

Perhaps the most potent way in which the committee fosters accountability is through regular meetings with executives and managers from different business and functional areas. The second hour of committee meetings is typically devoted to a particular strategy or activity of the SB&I group and a particular strategy or activity of a business unit or function. Under the format put in place in 2009, heads of the business units or functions typically appear before the committee at least once every 18 months to explain how their strategies align with SB&I strategies and how that alignment is reflected in their group's accountability metrics. CFO Don Blair says that the experience of presenting to the committee and having committee members sitting across the table asking questions "puts a little backbone into what the business leader is undertaking to do."

A Stimulus for Innovation

One surprising role of Nike's corporate responsibility committee is to provide support and encouragement for innovation, especially innovation aimed not just at improving operations incrementally but also at building a fundamentally more sustainable business model. For Nike that means a business model that can continue to deliver growth in the face of looming macro-environmental challenges such as resource scarcity, climate change, and demographic shifts, to name just a few.

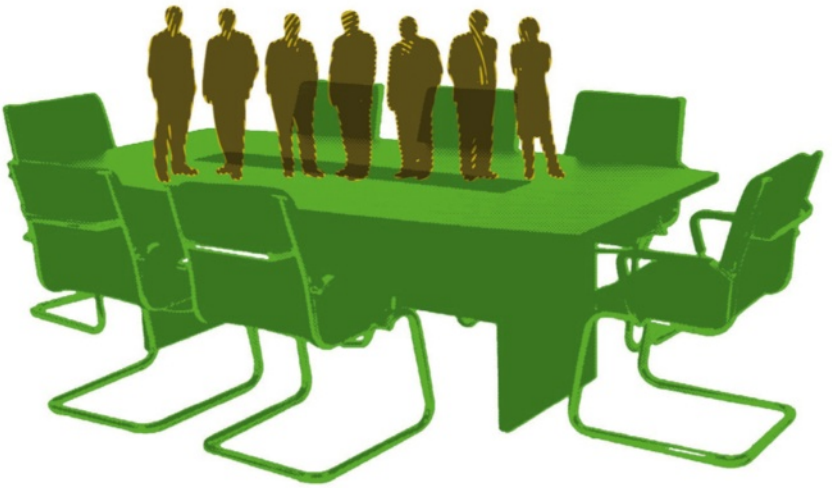
When Conway and Eitel initiated the contract factory studies, they took a strategic approach to improving working conditions, recognizing that actors in addition to Nike would be crucial to continued success. Community groups, government authorities, and outside experts would have to be mobilized to tackle problems stemming as much from weaknesses in local institutions and infrastructure as from Nike's practices. And because many of the factories made products for other companies as well, it would be necessary to engage other industry players.

Accordingly, when asked by the top leadership team in 2001 whether Nike should disclose the results of the worker interview project, the committee said yes, hoping that would foster the broader engagement needed for widespread improvements in labor conditions. Similarly, in 2005, when Jones proposed disclosing the names and locations of Nike's contract factories—information that was typically treated as highly proprietary—the committee lent its support. Some feared that the move would put Nike at a disadvantage, enabling competitors to more easily poach its suppliers. But Jones reasoned that the benefits of disclosure would outweigh the risks. Transparency would let Nike's critics see factory conditions for themselves. It would also allow Nike to work with other companies that used the same suppliers in order to coordinate inspections, share costs, and adopt common standards, thus improving labor conditions across the industry.

In its early years, the committee spent much of its time providing advice and, in Conway's words, "putting out fires"—reacting to individual incidents, such as serious breaches of labor standards in the supply chain or major problems affecting health, safety, or the environment. As management began developing more-sophisticated systems to monitor factory compliance with Nike's code of conduct, the committee became more focused on overseeing those systems. Once it was clear that some of the individual incidents the systems identified were part of a larger pattern, the committee's work evolved again.

An 18-month-long task force formed by management in 2005 to study the recurring problem of excessive overtime found that the root cause lay not only in factory deficiencies but also in sudden changes Nike made to materials or volume requirements in response to fluctuations in demand. This insight had profound ramifications: Management and the committee realized that they had reached the limits of what monitoring could accomplish. Better policing would not resolve the labor issue; what was needed were innovative ways to make manufacturing processes inherently safer and more sustainable. As Jones put it, "You can either solve a workers' rights issue by monitoring every single factory 24 hours a day for whether they're wearing protective equipment, or you can innovate a new glue that removes all the toxics so that you don't have to have the personal protective equipment."

So today, although the committee remains engaged in monitoring, oversight, problem solving, and even firefighting on occasion, it spends considerable time advising on Nike's innovation efforts.



For example, in 2012 it weighed in on a proposed strategic investment in DyeCoo Textile Systems, a small Netherlands-based start-up that had developed a waterless process for dyeing polyester using recycled CO2 (hence the name DyeCoo). In addition to saving the 12 to 18 gallons of water per pound of fabric used in traditional dyeing methods, the new technology eliminates chemical discharges into the water supply. Moreover, not having to heat water for dyeing saves energy and cuts dyeing times in half—and a higher-quality product results. But the process was not yet cost-competitive with traditional methods. Management sought the committee's views on a proposal to take a minority stake in DyeCoo with the aim of helping the Dutch company develop and commercialize the technology for use in textile mills and dye houses in the global apparel supply chain.

The committee supported the proposal, and Nike made the investment. In late 2013 a Nike contract manufacturer in Taiwan opened a facility that uses DyeCoo's technology.

The extent of the corporate responsibility committee's focus on innovation came as a surprise to the current chair, Phyllis Wise, when she joined the committee in 2009, shortly after being elected to the board. At the time, Wise was the interim president of the University of Washington, where she had overseen the creation of its College of the Environment. She expected that the committee would focus mainly on monitoring labor conditions in the contract factories—still a hot topic on university campuses. But she found that it also spent a great deal of time on innovation processes, product development, new materials, and other forward-looking initiatives. As the top leadership team pursues its quest for game-changing innovations that can drive sustainable growth and profitability, the committee is likely to become even more engaged in the innovation discussion.

One role of Nike's committee is to support innovation, especially innovation aimed at building a more sustainable business model.

A Resource for the Full Board

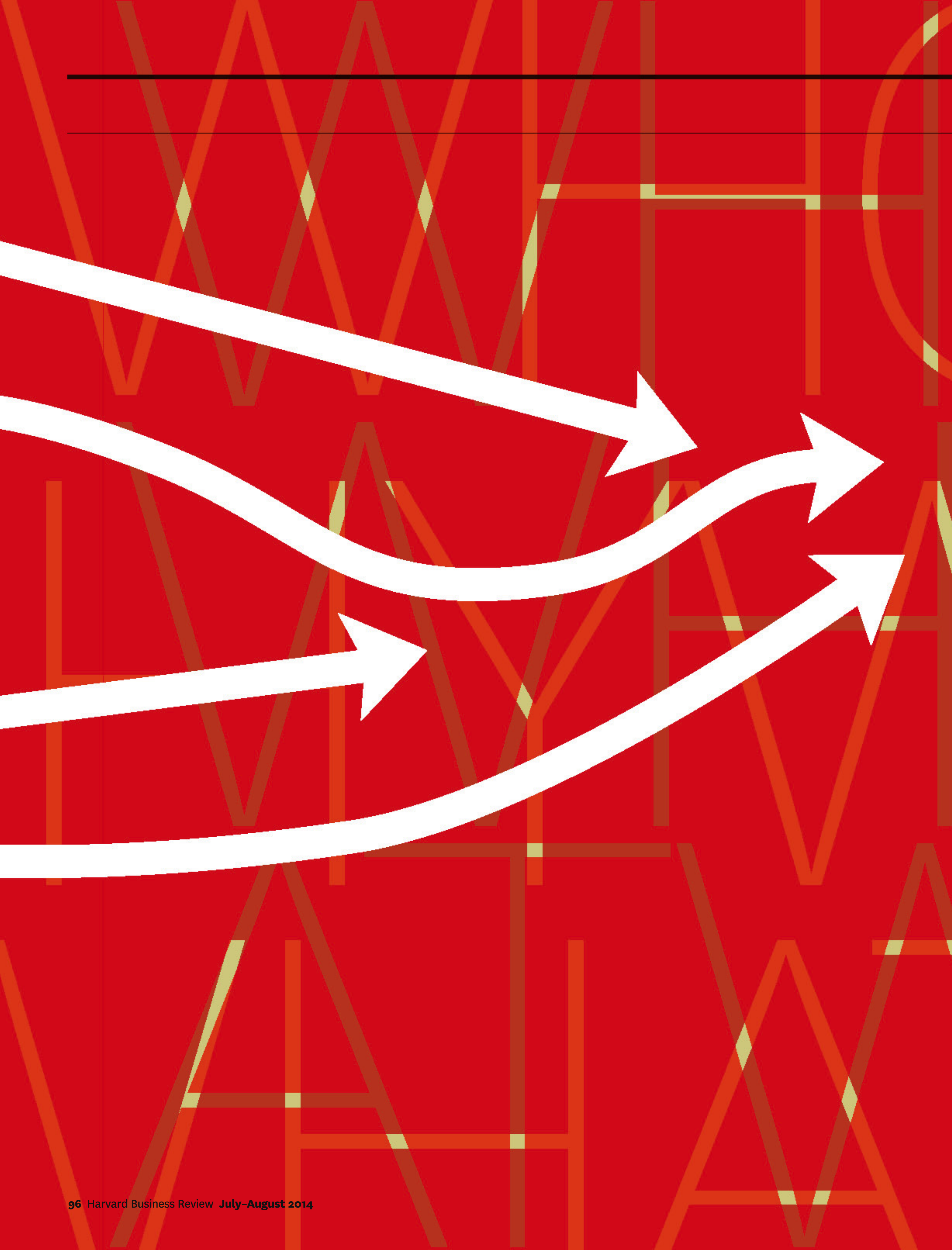
Perhaps the most important function of Nike's corporate responsibility committee is to serve as a custodian of the long view—a counterweight to the myopia that can result from the pressure of short-term objectives and the relentless flow of matters demanding immediate attention. Of the wide spectrum of topics that come before the committee, a significant number involve future conditions or parties who do not currently have a direct market relationship with the company but whose actions could have a powerful effect on its future health and functioning. This group includes factory workers in the supply chain and the millions of ordinary citizens affected by Nike's activities. It also extends to future generations of Nike managers, who may face shortages of critical resources; future generations of consumers and athletes who use Nike products; and beneficiaries of the company's community investment activities, who may one day become influential members or leaders of their communities and countries.

Many companies say that such issues are the responsibility of the full board, and that is certainly true. Yet how many boards actually take up these issues on a regular basis? The evidence suggests that the answer is very few. A review of the annual director surveys conducted by the National Association of Corporate Directors over the past decade indicates that corporate responsibility issues are consistently ranked at the bottom of some two dozen possible board priorities. Nike executives say that board-level discussions of labor issues in the supply chain gained traction only after the corporate responsibility committee was formed.

Creating a corporate responsibility committee does not absolve the full board of its obligation to oversee this aspect of the company's performance. But such a committee can help the board fulfill this obligation through its focus, expertise, and sustained attention. From focus and sustained attention come deeper understanding, better processes, and more-refined instincts. A regular report from the committee to the full board, comparable to reports from other standing committees, can help raise the board's level of understanding and ensure that critical issues receive the scrutiny they require.

GIVEN THE litany of economic, social, and environmental problems plaguing societies around the globe, issues of corporate responsibility and sustainability are likely to become ever more salient. Many companies will face difficult questions of resource allocation, and some may find their business models under attack. Strategically, companies will have to decide whether (and how) to go on the offense and invest in innovation or to bulk up on defense and strengthen their compliance and risk management functions—or both. Individual directors will increasingly be expected to speak to those issues. The time has come for business leaders, boards, and governance experts to start talking about the role of boards and board committees in addressing these questions and to consider whether a corporate responsibility committee should be part of the answer.

HBR Reprint R1407G



Karan Girotra is a professor of technology and operations management at INSEAD in Fontainebleau, France. **Serguei Netessine** is the Timken Chaired Professor of Global Technology and Innovation at INSEAD in Singapore. They are the authors of *The Risk-Driven Business Model: Four Questions That Will Define Your Company* (Harvard Business Review Press, 2014).

four paths to business model innovation

The secret to success lies in who makes what decisions when and why. *by Karan Girotra and Serguei Netessine*

Business model innovation is a wonderful thing. At its simplest, it demands neither new technologies nor the creation of brand-new markets: It's about delivering *existing* products that are produced by *existing* technologies to *existing* markets. And because it often involves changes invisible to the outside world, it can bring advantages that are hard to copy.

The challenge is defining what business model innovation actually entails. Without a framework for identifying opportunities, it is hard to be systematic about the process, which explains why it is generally done on an ad hoc basis. As a result, many companies miss out on inexpensive ways to improve their profitability and productivity.

In the following pages we present a framework to help managers take business model innovation to the level of a reliable and improvable discipline. Drawing on the idea that any business model is essentially a set of key decisions that collectively determine how a business earns its revenue, incurs its costs, and manages its risks, we view innovations to the model as changes to those decisions: *what* your offerings will be, *when* decisions are made, *who* makes them, and *why*. Successful changes along these dimensions improve the company's combination of revenue, costs, and risks.

WHAT Mix of Products or Services Should You Offer?

Uncertain demand is a challenge all businesses face and is in most cases their major source of risk. One way to reduce that risk is to make changes to your company's mix of products or services. In finance, if you have two portfolios offering a 20% return, you choose the less risky one, because it will create more value over time. The same is true with product portfolios.

Companies looking to recalibrate their product or service mix have essentially three options:

Focus narrowly. In October 2010 *Bloomberg Businessweek* ran a cover story with the sensationalist title "What Amazon Fears Most." The article profiled Quidsi, a relatively small New Jersey–based internet start-up cofounded by Marc Lore (a former student of ours) and best known for its main venture, the online retailer Diapers.com.

Diapers would appear to be a terrible product to sell on the internet. They are bulky and expensive to ship, and they have low margins because *everyone*—from convenience stores to Costco—sells them. But diapers have one thing going for them: Demand is highly predictable—birthrates are stable, and infants pee and poop constantly over an extended period of time. Also, product variety is limited, because there are only three or four major diaper manufacturers, and diapers come in just a few sizes. Given that every newly acquired customer will use the product repeatedly for two years or more, the company can count on a steady revenue stream with little or no risk for a long time to come.

Focused business models are most effective when they appeal to distinct market segments with clearly differentiated needs. So if your business currently serves multiple segments, it may be best to subdivide into focused units rather than try to apply one model. Amazon, which bought both Quidsi and the online shoe and apparel retailer Zappos, allows its focused acquisitions considerable autonomy in serving their segments.

The main drawback for a focused business is that it must rely on a single product, service, or customer segment—and it may omit key customer needs. People buy both bread *and* butter.

Search for commonalities across products. The success of Volkswagen owes much to a strategy whereby its cars share components. Although the strategy does not protect VW from general demand swings, it reduces demand variability for individual components, because shared components make it easy for VW to switch production at its plants from one model to another whenever the demand for car models shifts.

Commonalities aren't just shared components among different products. They may also be the capabilities needed to serve various product, customer, and market segments. Consequently, companies can add to their mix products or services that reflect new applications of their capabilities. For instance, in the late 1990s Amazon expanded from books into music, video, and games—all of which required the same logistics capabilities that books did. This allowed the company to cover the risk of failing to acquire enough share in any one of these categories with a potentially superior share in another.

Commonality can, however, carry significant costs if components must be engineered for a wide range of makes and models. What's more, the strategy requires that the component-sharing products not all experience their demand highs and lows simultaneously.

Create a hedged portfolio. Just as financial institutions try to create portfolios of investments that will hedge one another's risks, companies can select an assortment of products or markets to reduce the overall riskiness of the business model. Chile's LAN

Idea in Brief

THE PROBLEM
Business model innovation is typically an ad hoc process, lacking any framework for exploring opportunities. As a result, many companies miss out on inexpensive ways to radically improve their profitability and productivity.

THE SOLUTION
Drawing on the idea that a business model reflects a set of decisions, the authors frame innovation in terms of deciding what products or services to offer, when to make decisions, who should make them, and why the decision makers choose as they do.

AN EXAMPLE
Traditional call centers hire a staff to supply services as needed from a place of work, incurring significant up-front costs and risks. LiveOps created a new model by revising the order of decisions: It employs agents as calls come in by routing the calls to home-based freelancers who have signaled their availability.

Airlines takes such an approach: Unlike most major U.S. carriers, which derive less than 5% of their revenue from cargo, LAN uses the same wide-body planes, flying international routes, to transport both passengers and cargo.

Because almost all travel from the Americas to Europe is on overnight flights, passenger-only airlines keep their planes on the ground for long periods. LAN uses the downtime to carry cargo: A plane to Santiago that has picked up cargo in Europe can deliver it to other Chilean cities before returning to Santiago for its next overnight flight.

This approach reduces the risks associated with LAN's capacity decisions. Airlines make such decisions infrequently—by ordering new airplanes—and they are hard to reverse, leaving the companies vulnerable to periods of over- or underutilized capacity, with harsh effects on revenue. Hedging passengers with cargo mitigates this risk because their respective demand curves rarely rise or fall in concert. Moreover, carrying cargo allows the airline to fly profitably with fewer passengers, so it can afford to serve destinations that other airlines avoid.

Clearly, the approach works mainly for product and market combinations in which demand fluctuations are negatively correlated. For example, a manufacturer of ski apparel could hedge sales in North America with sales in South America—where the seasons are opposite. Overall demand stays fairly constant.

We have identified three strategies that, depending on the circumstances, can improve a business model by changing the timing of decisions.

Postpone the decision. In many industries companies make firm decisions about prices well before they actually sell anything. This, of course, often exposes them to risk. It's risky to price airplane seats early, for instance, because demand on any given route is highly contingent on economic and other conditions and can vary by the time of day, the day of the week, or the week of the month.

American Airlines solved this problem in the 1980s by using the booking system known as SABRE (for semi-automated business research environment), which makes it relatively easy to alter prices quickly by factoring in new information. The ability to price dynamically changed the airline industry forever. On any given flight, the price that passengers have actually paid to fly—even within the same seating class—can vary tremendously. Recently Uber, a company that matches customers who need rides with vehicles for hire, borrowed the same toolbox: In high-demand periods, the company implements "surge pricing," whereby prices for rides go up, reducing demand while increasing supply.

Price quotes can be delayed at the individual level. The casino and hospitality company Caesars Entertainment uses a sophisticated database compiled

Amazon's Path

Founded in 1994 with the U.S. book market in mind, Amazon has adopted many of the strategies in our framework over the years.

1996
PASS THE DECISION RISK TO THE PARTY THAT CAN BEST MANAGE THE CONSEQUENCES
Cash-strapped, the company gets distributors and publishers to carry slow-moving inventory, rather than stocking the books itself.

1997
INTEGRATE THE INCENTIVES
Partners can't keep up with Amazon's growth and quick shipping promise, so the company reverses course and builds its own warehouses.

1998
SEARCH FOR COMMONALITIES ACROSS PRODUCTS
Success with books leads to expansion into music, video, and games—where the company's logistics competencies can be applied.

WHEN Should You Make Your Key Decisions?

Decisions must often be made before you have enough information to make them with confidence.

by its Total Rewards loyalty program. When a repeat customer calls to make a reservation, the agent asks for his Total Rewards number, which links to detailed information about the customer's gambling habits (including average bet size) and hence the profit he is likely to bring the casino. Depending on what the agent sees, the customer may hear anything from "Sorry, all our rooms are booked" to "You're in luck! We can offer you a complimentary stay in our Presidential Suite!"

Change the order of your decisions. Some companies don't have the option of changing the time frame within which they operate, but they *can* shuffle the order in which decisions are made in order to delay investment commitments until pertinent information is known.

Most product development, for example, begins with proposing a solution or a technology for a customer need. If, after initial investments, the solution proves to be a dud, then it's back to the drawing board. But an increasing number of companies, including the open-innovation pioneers InnoCentive and Hypios, have figured out that if they switch that sequence to *performance first, investment after,* they can shift much of the risk of R&D onto others.

These companies offer clients ("seekers") a secure website on which to present R&D problems to a global freelance community of qualified engineers, product designers, and scientists ("solvers"). The companies help seekers define their problems—which might range from the chemical synthesis of a specific molecule to designing the look and feel of a new product—with enough specificity to interest an appropriately skilled subset of solvers. Seekers offer monetary rewards for the right solutions (sometimes more than one is selected), and solvers compete to develop the best solutions and win the rewards.

A similar change in sequence explains the success of one company in the call center industry: LiveOps. Traditional centers make up-front investments in facilities and hard infrastructure (primarily communications) before they sign a single client or take their first call. They must also decide how many agents to hire, at what levels of skill and expertise, and provide training. Next they must sign up clients whose needs match the capabilities they have assembled. Finally, they must develop daily and weekly staffing plans to ensure that enough agents with the right skills will be available to handle calls.

LiveOps, in contrast, employs agents as the calls come in. Its agents work independently from home and signal LiveOps when they are ready to take calls. They are paid according to the duration of a call and—because calls are automatically recorded and scored—their skill at meeting callers' needs. Intelligent software routes callers to the most qualified agents available according to the nature of the call, so capacity and staffing are constantly adjusted *in real time* to meet actual demand.

This approach has its limits. Training on-demand employees in advance is difficult, and because they assume the risk of being idle and making no money, the business model depends on having an ample supply of people for whom downtime has a relatively low cost.

Split up the key decisions. The lean start-up movement is taking the corporate innovation and start-up worlds by storm (see "Why the Lean Start-Up Changes Everything," HBR May 2013). At the heart of the movement is a new approach for entrepreneurs who are making decisions about their businesses. In the past, starting a risky new venture involved putting together a detailed business plan that would cover all essential pieces of the business model and then executing on the plan. All the key decisions were made at once and up front.

The lean start-up approach divides up the key decisions. A venture starts with relatively imprecise and limited hypotheses about where an opportunity may lie. Multiple stages of information gathering and "pivoting" follow, as the business model is revised to arrive at the final, validated version. Typically, the founders radically change their hypotheses as the venture unfolds.

In the start-up world, this approach is today the rule rather than the exception. BBureau, a mobile beauty and wellness service that was born in our classroom (one of us is an investor and board member), is a case in point. Rather than commit up front to one target market and a fixed portfolio of services, BBureau ran a number of small experiments on many different markets to identify the combinations of customers and services that would be most lucrative for its pop-up delivery model, effectively splitting the venture-design decision into a number of smaller ones.

After numerous rounds of experimentation and refinement, the team converged on a business model that included offering wellness services (such as massages) at boutique hotels and frequently repeated beauty services (such as nail treatments) at office locations. Those combinations kept the company's delivery costs low while ensuring a high customer willingness to pay.

This approach depends on finding decisions that can be divided up. In some cases the decision process is indivisible. (You can't price a little bit now and a little bit later.) In other cases it can be divided up only at some additional cost, and risk-return calculations should be performed.

WHO Are the Best Decision Makers?

Many companies find that they can radically improve decision making in the value chain simply by changing the people who make the calls. Companies can:

Appoint a better-informed decision maker. The whole employee empowerment movement is based on giving decision rights to the most informed person or organization. Google's engineers, for example, have extraordinary freedom to decide what development projects the company should pursue, because Google believes they are better informed about technologies and tastes than the company's executives are.

The best-informed people aren't always in the company. More than 25 years ago, Walmart transferred some decision rights about stocking its store shelves to Procter & Gamble, because it saw that a supplier had the right combination of information and incentives to keep Walmart well stocked with products by optimizing delivery and production schedules. This has become a standard arrangement with the company's large suppliers.

More recently, we've seen decisions being made by algorithms. In the restaurant business, for example, servers are often scheduled for shifts they would rather not work and not scheduled for those they want. Worse, the least-productive servers are frequently put on the most-profitable shifts.

To get around this problem, the Boston-based restaurant chain Not Your Average Joe's uses an analytic tool called Muse, which was developed by Objective Logistics, a start-up in Cambridge, Massachusetts (in which one of us is both an adviser and an investor). Muse tracks servers' performance over time according to sales per customer (as measured by check size) and customer satisfaction (as measured by tips or directly). This has enabled the chain to develop a productivity-based ranking system whereby servers can schedule themselves, choosing both their shifts and the tables they serve.

Although the advantages of making decisions using better information are obvious, empowering employees, suppliers, or customers and collecting extensive data often entail costs and difficulties. Walmart made a considerable up-front investment in the largest private satellite network in the world in order to enable seamless data flow, and the company had to negotiate and coordinate complicated new relationships with trading partners.

Pass the decision risk to the party that can best manage the consequences. The key to Amazon's early prosperity was its drop-shipping model, which allowed it to offer more than a million books while stocking only 2,000 or so of the most popular titles. For the rest, Amazon forwarded orders to book wholesalers or publishers, who then often shipped the products directly to customers using Amazon packaging.

In this innovative model, Amazon's network of wholesalers and publishers independently managed their inventories. They, not Amazon, bore the risk of carrying books without knowing the likely demand for them. But because the risk was widely distributed, all were able to manage their own bits of it with relative ease.

Shifting the decision risk to the party best able to bear it is often an attractive strategy when no decision maker clearly has superior information. In its early years, Amazon was too small and too cash constrained to stock every single book in its catalog, whereas bigger wholesalers were well positioned to match supply with demand from Amazon and thousands of other small retailers. But for this strategy to work, the replacement decision maker's incentives must be aligned with yours. Amazon's model would

Amazon's Path,
CONTINUED

2001

PASS THE DECISION RISK TO THE PARTY THAT CAN BEST MANAGE THE CONSEQUENCES

Amazon hosts the websites of Toys"R"Us, Borders, and Target and performs most site development, order fulfillment, and customer service.

2005

CHANGE THE REVENUE STREAM

Per-item shipping costs deter many customers, so Amazon offers Amazon Prime: Customers buy a shipping subscription rather than paying for individual shipments. This also encourages impulse purchases.

POSTPONE THE DECISION

The acquisition of BookSurge (on-demand book publishing) and CreateSpace (self-publishing of books, CDs, DVDs, and video) allows Amazon to delay publication decisions until customer tastes are known.

have failed if the publishers had been motivated to poach its customers.

Select the decision maker with the most to gain. In many business models, key decisions are made by those with less to gain than others in the chain. A company's customers, for example, often feel that they gain less when they buy a company's products than the company does. That was a problem facing Netafim, the Israeli market leader in drip-irrigation technology.

Drip irrigation is the watering method of choice for small farmers in hot countries. Netafim developed a technology that fine-tunes water application according to the soil's water content, salinity, and fertilization and to meteorological data. The company demonstrated to farmers that its system could increase crop yields by 300% to 500%, making it a potentially lucrative investment.

Initially, though, the technology was a hard sell. Small farmers were reluctant to engage with and pay for anything so sophisticated. They did not trust the company and felt that they were shouldering a lot of risk in adopting its approach. Netafim solved the problem by offering them a free integrated package that included system design and installation, all required hardware, and periodic maintenance. Payback came from a share of each farmer's increased crop yields. Thus Netafim took on all the risks of the decision, and farmers simply said yes or no to a strong chance of earning more money with no downside.

Netafim could do this because it realized that it had the most to gain from the adoption of its technology. Given its expertise and access to sophisticated forecasting systems, the risks were a lot smaller for the company than for the individual farmers. Moreover, it could spread the risk: If the system failed at one farm, Netafim could make up for it elsewhere. As farmers achieved greater success, word would spread; Netafim would increase its sales and realize economies of scale.

Something similar is at work with energy-efficiency companies, many of which essentially take on energy management for their customers, implementing whatever efficiencies they think necessary and bearing all the up-front costs. They then share the savings that result from these improvements with the customers. Like Netafim, they bear additional risk quite easily, because they understand the technology and can predict its performance. And as resistance to adoption declines, their revenues scale up.

There are catches. A company can safely take on more risk only if the relevant technology is very reliable. And behavioral issues may arise: The savings from energy-efficient equipment will shrink if customers decide that they can economically leave their lights on longer.

WHY Do Key Decision Makers Choose as They Do?

When decision makers collaborate to create value, they must also be able to pursue their private objectives without damaging the value chain. Many business model innovations, therefore, come from adjusting decision makers' motivations. There are three ways of doing this:

Change the revenue stream. Traditionally, when the U.S. Department of Defense bought aircraft, it would agree to a time-and-materials contract, under which suppliers charged for labor and materials consumed (on a cost-plus basis) in the course of each maintenance event—just as a mechanic does for car repairs. Unfortunately, this model doesn't provide suppliers with customer-friendly incentives; from their point of view, the more problems the client has, the better. It has been estimated that for every dollar the government spent to buy a new airplane, it spent seven more over the plane's life.

Until, that is, the DoD gave suppliers a reason to care about engine reliability. In 2003, facing pressure to cut costs and improve performance, the department adopted what's called performance-based contracting, which changed the revenue model for contractors. They would be paid for the amount of time the aircraft was actually in service, with the DoD specifying, for example, 95% availability as its threshold. As a result, the longer a jet performed without needing to be taken out of service for maintenance or repair, the more the contractor earned.

When decision makers collaborate to create value, they must also be able to pursue their private objectives.

Changing the revenue stream to align the interests of a decision's stakeholders works best when performance can be fully and unambiguously defined. It would be difficult to set reasonable performance standards and develop appropriate metrics for, say, a new airplane that relied on advanced technologies and materials, because the unknowns involved would simply be too numerous.

Synchronize the time horizons. Traditionally, sourcing relied on competitive-bidding rituals that ensured low prices and moderate but acceptable quality. The chosen provider won the business for a relatively short period of time, after which the bidding process was repeated.

But as overseas sourcing increased, this model developed flaws. Faraway suppliers cut corners on quality control and materials reliability. Worse, revelations of abusive labor practices, product diversion, and the counterfeiting of goods emerged. And because most sourcing transactions were one-off deals, shoddy providers faced few consequences—until, of course, multinationals felt the corrosive impact of repeated performance problems on their brands.

Enter Li & Fung, a Hong Kong–based company that has changed the world of outsourcing by creating a new business model based on combining the flexibility of competitive sourcing with the confidence of long-term relationships. It selects, verifies, and approves suppliers and allocates their business among its manufacturing clients, and it manages each client's relationship with each supplier—including performance, compliance, and crafting incentives for suppliers to invest in people, facilities, and materials. Given the potential for an enduring relationship with Li & Fung, suppliers are motivated to create long-term value for manufacturing partners.

But companies like Li & Fung are few and far between. If your organization sources in sectors or regions where you lack recourse to a trusted intermediary, you will need to manage such relationships directly, which can be difficult.

Integrate the incentives. Companies without a trusted intermediary can develop contractual arrangements and management systems (such as the famous balanced scorecard) to focus independent agents on maximizing an agreed-upon outcome. This is essentially what one of the most promising reforms to U.S. health care is about: Under the bundled payments system, all parties involved in a patient's treatment agree to measure performance according to the outcome for the patient (see "How to Design a Bundled Payment Around Value," on hbr.org).

Sometimes such contractual arrangements can be so complex that it's easier to simply integrate operations. Quad/Graphics, a printing company with approximately 25,000 employees and annual revenue of more than $4 billion, has created its own health care system, complete with doctors and hospitals, lowering health care costs for its employees by some 30% in the process. Patient outcomes have improved as well: For example, the rate of cesarean-section births among women in the Quad health care system is only 12%, compared with 26% nationally.

Achieving full integration is not trivial; many organizations rightly hesitate to take on directly performing activities that are outside their core competencies. Thus we tend to regard it as a last resort, to be applied only when other approaches won't suffice.

USING A framework like ours, any experienced manager can find ways to create a better business model. Companies can also use the framework to make their innovation processes more systematic and open, with business model reinvention becoming a continual, inclusive process rather than a series of isolated, internally focused events. When they do, they find that the resulting capabilities offer a sustainable competitive advantage.

HBR Reprint R1407H

Amazon's Path, CONTINUED

2006

APPOINT A BETTER-INFORMED DECISION MAKER

Amazon takes over retailers' A-to-Z fulfillment function—a logical extension of its third-party services.

CREATE A HEDGED PORTFOLIO

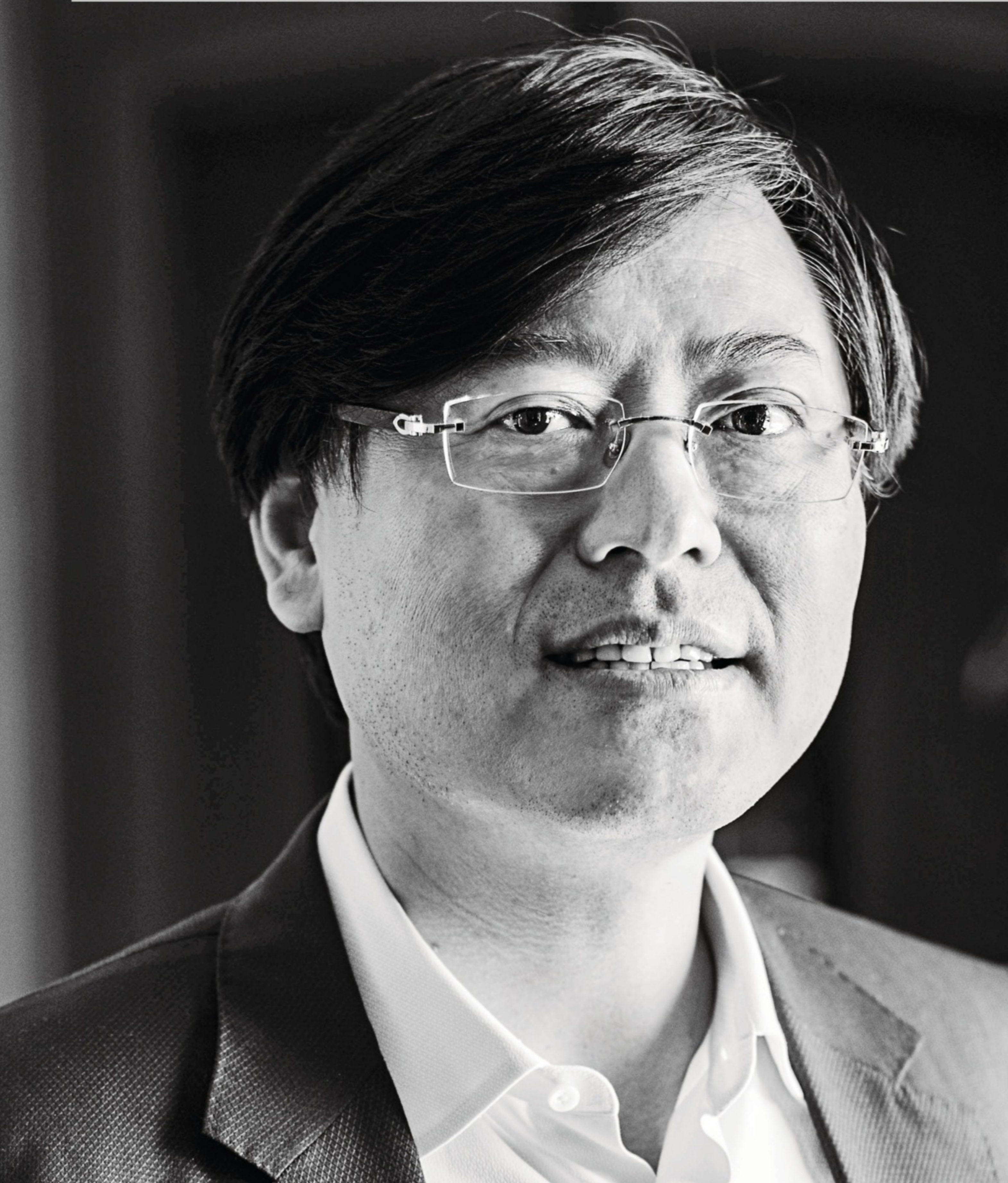
Amazon expands into computing services including storage, simple queue service (SQS), cloud computing, and electronic data systems.

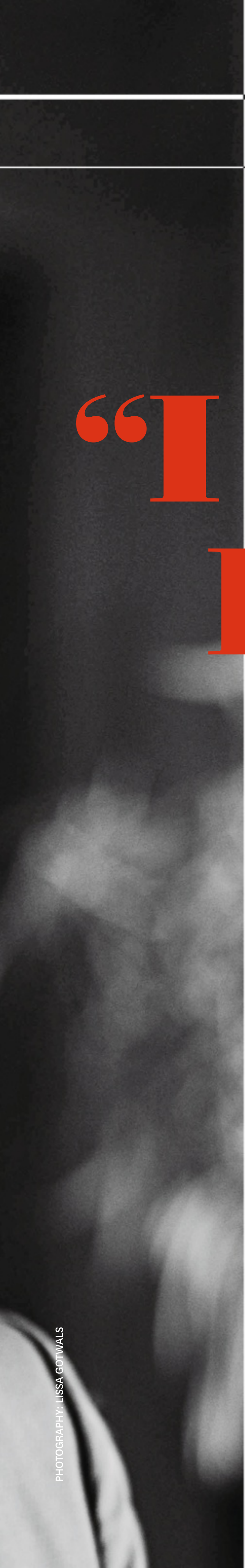
2008–2010

FOCUS NARROWLY

Amazon realizes efficiencies by acquiring focused verticals: Diapers.com (baby consumables) and Zappos (shoes). Acquired retailers operate independently to maintain these efficiencies.

Lenovo CEO Yang Yuanqing





PHOTOGRAPHY: LISSA GOTWALS

"I Came Back Because the Company Needed Me"

SOME CEOS COME ACROSS AS PHILOSOPHERS, AND SOME JUST SEEM TO love selling stuff. Yang Yuanqing, the 49-year-old head of the Chinese computer giant Lenovo, is among the latter. And he's one of the best in the game.

Yang, who studied computer science in his native China, assumed the reins in 2001, when the company's founder, Liu Chuanzhi, moved on to become chairman. Yang served as CEO for three years before succeeding Liu as chairman, and he and Liu engineered the stunning 2005 acquisition of IBM's personal computer business. The deal suddenly made Lenovo (formerly known as Legend) the world's third-largest computer maker. In 2009, after Lenovo had begun to falter during the global recession, the board asked Yang to return as CEO, a post he's held ever since.

Yang has turned things around, pursuing a strategy the company calls "protect and attack"—defending its core market in PCs while moving into new growth areas such as mobile and the cloud. Earlier this year the company made two more eye-popping acquisitions, spending $2.3 billion for IBM's low-end server business and $2.9 billion for Google's Motorola Mobility unit.

As a leader, Yang is probably best known for his efforts to break down Lenovo's hierarchies and empower employees at every level—and for his well-publicized generosity. In 2012 he opted to share well more than half of his $5.2 million bonus—and in 2013 more than three-quarters of his $4.23 million bonus—with Lenovo employees. Yang spoke with HBR's editor in chief, Adi Ignatius, in Morrisville, North Carolina, where Lenovo maintains one of its two headquarters (the other is in Beijing).

HBR: Lenovo recently became number one in worldwide PC sales. That's obviously a great accomplishment, but is it also a reason for concern, given that the global PC market is shrinking?
Yang: When we bought IBM's PC business, almost 10 years ago, we never thought such a thing was possible. It's a dream come true. But we know the world is changing. This is no longer the PC era; it's the "PC-plus" era. So we want to win in other areas: mobile, tablets, back-end servers.

Who do you think are your biggest competitors in the PC-plus world? Apple and Samsung, of course. For now, we're a solid number three. But we won't stop there. Over time we'll challenge them.

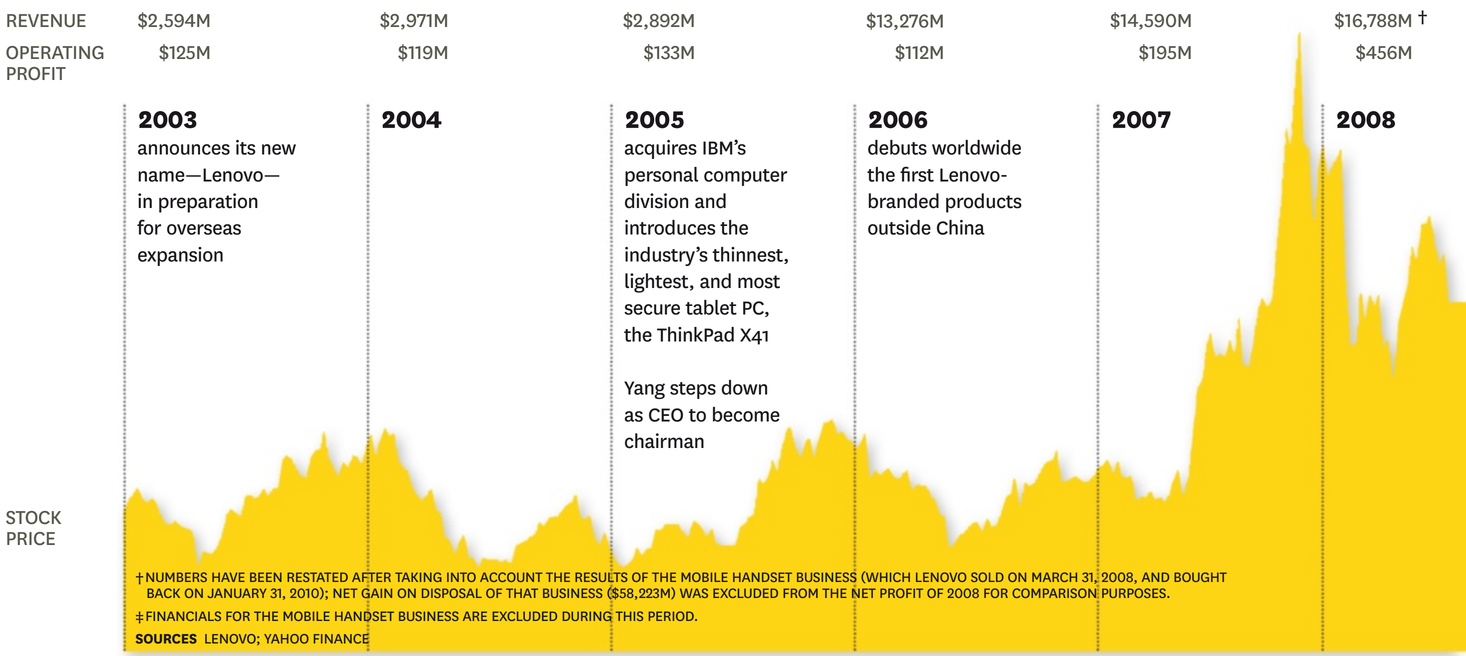
How do you take on giant, innovative companies like Apple and Samsung? We are an innovative company as well, and we have a successful formula. We pursue a clear strategy and execution; we have an efficient business model; we innovate on our products and technology; and we have a diverse team and culture. Innovation is in our genes. We've developed products such as the ThinkPad, which has become iconic in the commercial-customer segment. And we've expanded innovation to the consumer space, with our Yoga PC and tablet.

OK, but people tend to talk about Apple as the ideal example of an innovative company. What does Lenovo do better than Apple? We know how to balance innovation and efficiency. For some companies, innovation means an expensive product. That's not Lenovo's philosophy. We want innovation to be affordable for most of our customers. We have premium products, sure, but we aim most of our products at mainstream or entry-level customers.

Apple has very few products and a relatively limited product range. Lenovo has lots of products for different sectors of the market. Do you plan to change your approach? No, we don't. We want to cover more customers with rich product offerings along the full price range.

Lenovo Goes Global

BIG ACQUISITIONS HAVE HELPED DRIVE BUSINESS SINCE THE COMPANY'S FOUNDING (AS LEGEND) IN BEIJING IN 1984.



† NUMBERS HAVE BEEN RESTATED AFTER TAKING INTO ACCOUNT THE RESULTS OF THE MOBILE HANDSET BUSINESS (WHICH LENOVO SOLD ON MARCH 31, 2008, AND BOUGHT BACK ON JANUARY 31, 2010); NET GAIN ON DISPOSAL OF THAT BUSINESS ($58,223M) WAS EXCLUDED FROM THE NET PROFIT OF 2008 FOR COMPARISON PURPOSES.

‡ FINANCIALS FOR THE MOBILE HANDSET BUSINESS ARE EXCLUDED DURING THIS PERIOD.

SOURCES LENOVO; YAHOO FINANCE

What do you think your best-selling product will be in five years? Today PCs account for 84% of our total business. I think they will continue to be our core, with the tablet now part of this market. But I believe that two other markets—smartphones and the enterprise business—will grow faster than PCs. So in five years, I hope to see a more balanced business.

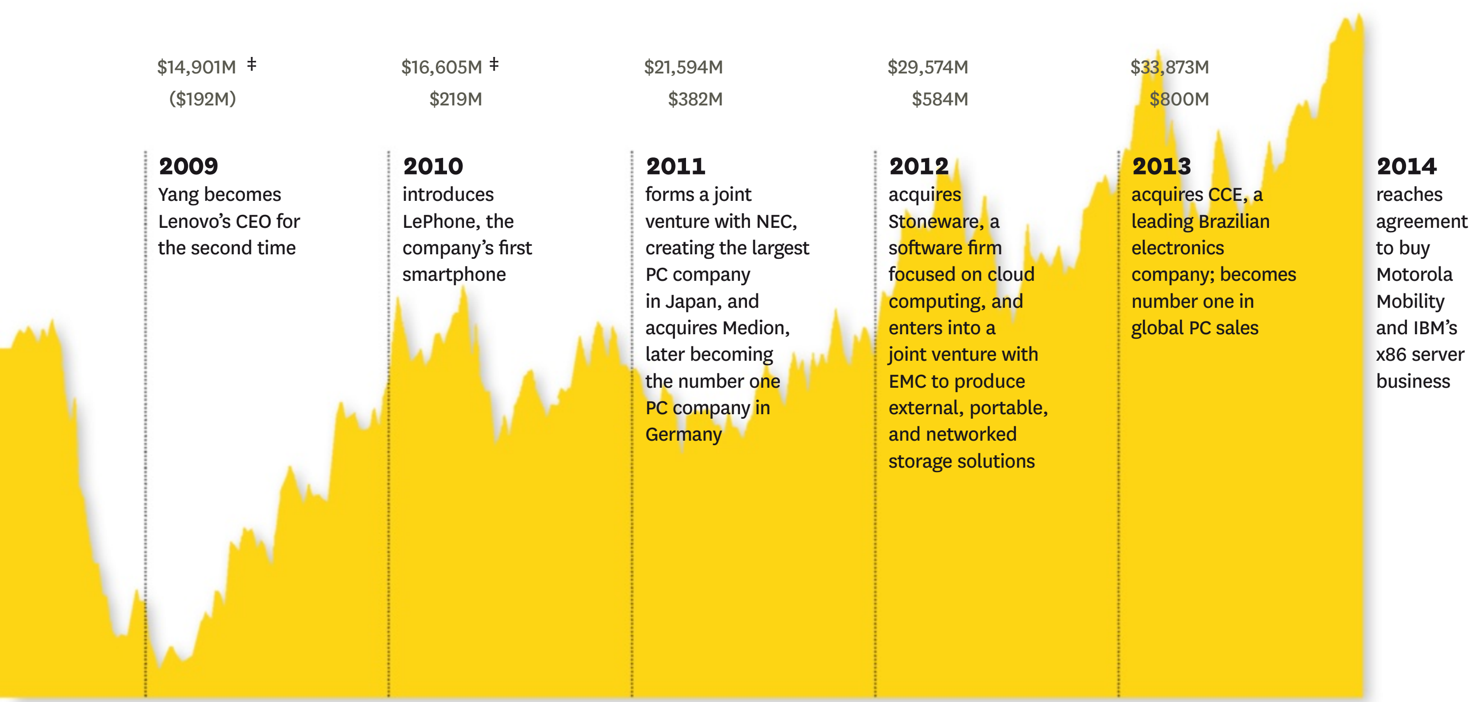
Let's talk about your decision to buy Motorola from Google. Why do you think Google couldn't make it successful? Hardware is not its strength. Google is an ecosystem business—with advertisements, apps, and so on. It bought Motorola mainly for the IP, so it wasn't focusing on the hardware.

How did the deal come about? Right after Google bought Motorola, in 2012, I had dinner at my house with [Google's executive chairman] Eric Schmidt. I said to him, "Do you really think you can handle the hardware business? And if someday you can't, just call me and I'll buy Motorola from you." A year and a half later, he called me, and we quickly reached an agreement.

What is Motorola's value to Lenovo? The IP? The branding? Both. The brand is very important in North America and Latin America. In China, too, even though Motorola is hardly present now. We plan to bring the brand back to China. And we need this kind of IP to be a global player, particularly in mature markets. Plus, Motorola has strong relationships with carriers and retail networks.

You also recently bought IBM's server business. What's your strategy in choosing acquisition targets? We use what we call a triangle process. When deciding on developing a business, we consider whether the market is big enough or attractive enough; whether the business fits with our core; and whether we have the resources to make up for any strengths we might lack to make it work.

Lenovo is often cited for sustaining a healthy corporate culture. What's the secret to that? We focus on three elements. The first is an ownership culture: We try to empower people to think for themselves, to make decisions for themselves. Everyone is an engine. The second is a commitment culture: If you commit to something, you must deliver. And the third is a pioneer culture: We encourage our people to be more innovative.



How do you actually promote innovative behavior? Is it a matter of creating the right incentives? There are a lot of ways to do it. For example, I hold monthly brainstorming sessions with our R&D team. At each session we focus on one topic—it might be a product, a service, or a technology. Another approach is through the budget. For our R&D people, we allow 20% of the budget to be flexible, so they can decide which areas they want to focus on and what they want to develop.

Are you a student of management ideas, or more of an instinctive leader? I tend to learn as I go, from our company's own experience.

During my first stint as CEO, we went in a lot of directions. We tried to do too many things simultaneously and lost sight of our core competence.

Have you been through an instructive failure at Lenovo? Yes. During my first stint as CEO, I decided to diversify away from the PC business. We went in a lot of directions: internet service, IT service, contract manufacturing, phones. We tried to do too many things simultaneously and lost sight of our core competence. It was my mistake, and it failed. But we learned how to think about finding the right strategy.

Why did you come back as CEO in 2009? I came back because the company needed me. During the 2008–2009 financial crisis, Lenovo's performance dropped significantly. We lost $200 million in one quarter! It was very dangerous. So we had no choice. The board asked me to do the job.

What can U.S. companies learn from how Chinese companies do business, and vice versa? I think both can learn from us, because we're not a U.S. or a Chinese company but a global company. Our top 10 executives come from six different countries.

I understand that Lenovo doesn't employ many expats. It's true. We don't assign people to other countries; we rely on local talent. That helps build a culture of trust and helps us understand different markets and industries. Throughout the company we employ only about 50 expatriates among our 54,000 employees.

How important is your share price? Do you think it's a good measure of Lenovo's performance? We don't usually comment on our share price. It's how the market sees us. But our shares dropped to some extent after the two recent acquisitions. Investors worry about whether we can turn around Motorola's business and whether we can make the IBM server business more profitable. We need to prove that we can make those deals work.

Some analysts look at your "protect and attack" strategy and say you're doing well with "protect" but not as well with "attack." That's not right. When we bought IBM's PC business, Lenovo was a $3 billion company. This year our revenue will be close to $40 billion. If we were just trying to "protect," we couldn't reach such a level. Originally we bought only IBM's commercial PC business. But after I returned as CEO, we decided to attack the consumer business, too. In just five years we became number one worldwide. And a few years ago I bought back the phone business that my predecessor had sold. Today we're the number two smartphone player in China and number four worldwide. These are clear examples of "attack."

People often say that no Chinese company has become a truly global brand. Do you think you're there yet—a global brand like Apple or Coca-Cola? I can't say we've made it. But we're a pioneer—among the first brands that originated in China and are now global.

You moved your family to North Carolina several years ago. What has surprised you most about the United States? I'm impressed with the education system. In China kids study mainly for the test, to get high scores. In the United States schools give kids the flexibility to learn what they like. I've also discovered the value of work/life balance. In China we don't go for balance. We just work all the time.

HBR Reprint R1407J

The Globe

How the *Other* Fukushima Plant Survived

by Ranjay Gulati, Charles Casto, and Charlotte Krontiris

When we hear the words "Fukushima disaster," most of us think of Fukushima Daiichi, the nuclear power plant wracked by three core meltdowns and three reactor building explosions following the March 2011 earthquake and tsunami in Japan. Without electricity to run the plant's cooling systems, managers and workers couldn't avert catastrophe: People around the world watched grainy footage of the explosions, gray plumes of smoke and steam blotting the skyline. Since the tsunami, Daiichi has been consumed by the challenge of containing and reducing the radioactive water and debris left behind.

Less well known is the crisis at Fukushima Daini, a sister plant about 10 kilometers to the south, which also suffered severe damage but escaped Daiichi's fate. To shed light on how leadership shaped the outcome, we've reconstructed that story here—from several firsthand interviews; detailed reports by the Tokyo Electric Power Company (TEPCO), the utility that owns both plants; the Nuclear Energy Institute; and a number of public sources. In so volatile an environment, none of the usual rules for decision making and organizational behavior applied. But the site superintendent, Naohiro Masuda, and the rest of Daini's 400 employees charted their way through the chaos, and the plant survived without a meltdown or an explosion.

At a magnitude of 9.0, the earthquake was the largest in Japan's recorded history,

ABOVE Coastline of Japan's Fukushima prefecture

PHOTOGRAPHY: GOOGLE EARTH/ZENRIN

March 11, 2011

1 — **2:46 PM**
Earthquake hits. Workers evacuate the administration building and cram into the Emergency Response Center.

2 — **3:22 PM**
Tsunami waters surge, soon knocking out power at the ERC. Only two power sources remain: the radioactive-waste building and a generator at Unit 3.

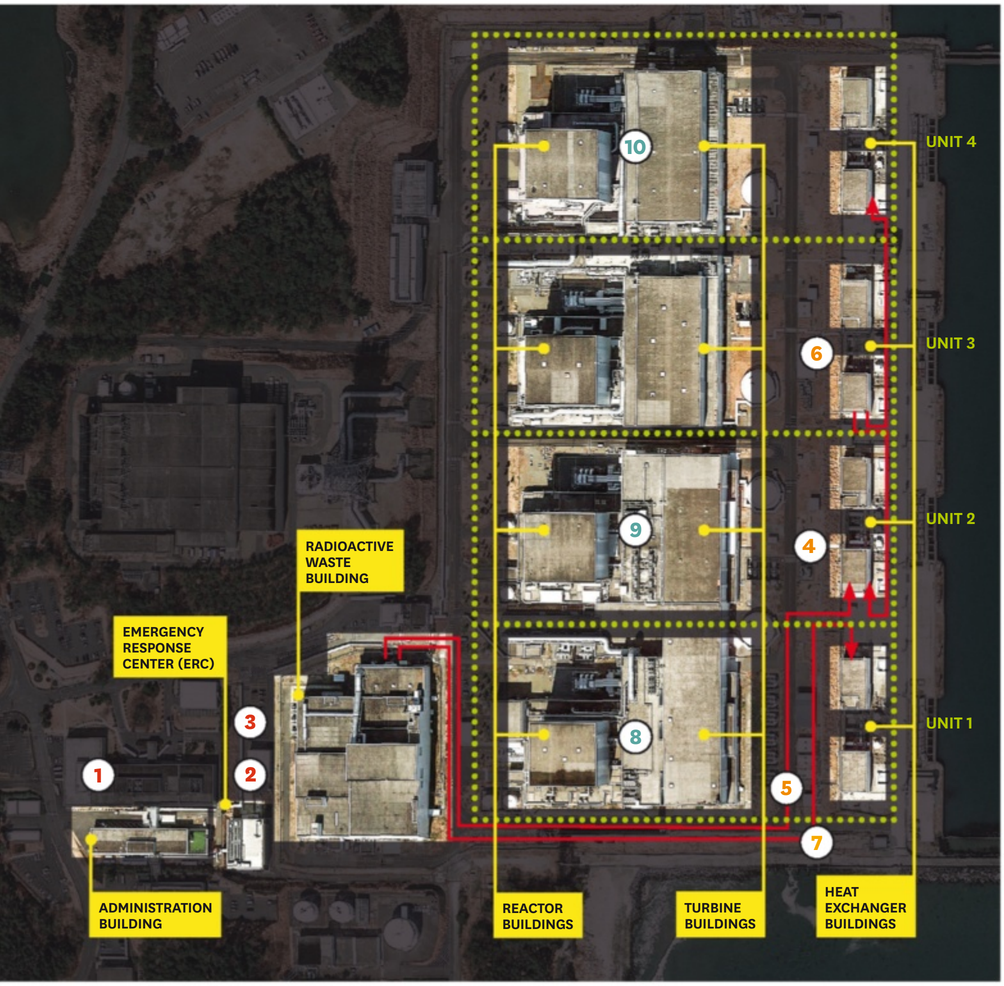
6:33 PM
Three of the four reactors have lost their cooling functions.

3 — **10:00 PM**
Small teams of workers go outside to assess the damage in the field.

March 12, 2011

4 — **EARLY MORNING**
Unit 2 is at greatest risk. Naohiro Masuda, the site operator, maps a route for cables to draw power from the radioactive-waste building.

5 — **DURING THE DAY**
Awaiting additional supplies, teams begin laying the cables they have on hand.



and the waves it generated were three times as high as what Daini had been built to withstand. It was left with just one diesel generator and one power line intact. That single power line supplied electricity to the control rooms, where plant operators could monitor the water level, temperature, pressure, and other vital metrics for each reactor and containment vessel. But three of the four reactors lacked sufficient power to run a critical component of their cooling systems.

To achieve cooldown and prevent the kind of devastation that was unfolding at Daiichi, Masuda and his team had to connect those reactors to Daini's surviving power sources. But the team was still reeling from a natural disaster of almost supernatural dimensions. What had *happened* here? How could the workers move forward and take action when all their expectations had been so violently shattered? Hanging over these questions was an even scarier one: Was the worst really over?

Natural disasters aren't discrete events. The earthquake had been days in the making and would generate aftershocks for more than a year. The tsunami wasn't a single dreadful wave but a series of them.

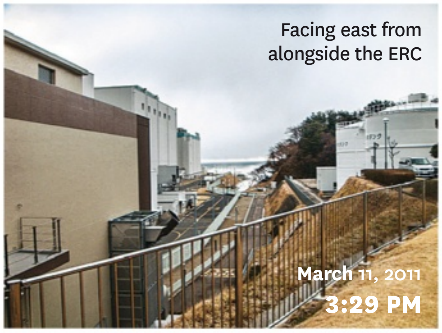
To assess the damage and begin the dangerous work of restoring power to the reactors, Masuda didn't simply make decisions and issue orders. He knew he had to persuade people to act—against their survival instincts. His technical competence, knowledge of the plant, and diligence helped him earn their trust. But more important, Masuda acknowledged the evolving reality in which they were operating. He shared the burden of uncertainty and doubt, engaging in what the organizational theorist Karl Weick and others have described as the "sensemaking" process: He arrived at a common understanding with his team members by revising and communicating what they "knew" so that they could together adapt to each twist and turn.

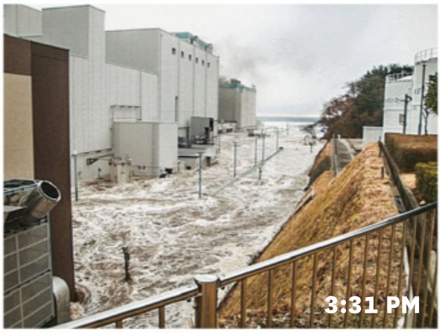
As a result, workers at Daini didn't lose focus or hope. While they acted, some things became more certain ("What's broken in the plant, and how can we fix it?"); some became less so ("Am I in danger from radiation?"); and some remained as unpredictable as ever ("Will these aftershocks lead to more flooding?"). Until the last reactor went into cold shutdown, Masuda and his team took nothing for granted. With each problem they encountered, they recalibrated, iteratively creating continuity and restoring order. As we describe below, they acted their way into a better understanding of the challenges they faced.

A Closer Look at Sensemaking

Sensemaking is adaptive behavior in which understanding and experience shape each other. We humans are attached to our expectations—we cling to the familiar. But a crisis disrupts the familiar. When past

March 13, 2011		March 14, 2011			March 15, 2011
6	7	8	9	10	
EARLY MORNING Masuda realizes that his team can't connect all the cables to the radioactive-waste building in time. He adds the Unit 3 generator as a power source.	**MIDNIGHT** Having learned that a different reactor—Unit 1—is at greatest risk, workers finish rerouting the heavy cable.	**1:24 AM** Cooling function is restored to Unit 1.	**7:13 AM** Cooling function is restored to Unit 2.	**3:42 PM** Cooling function is restored to Unit 4.	**7:15 AM** All four units are in cold shutdown.


Facing east from alongside the ERC
March 11, 2011
3:29 PM


3:31 PM

experience doesn't explain the current condition, we must revise our interpretation of events and our response to them. Bit by bit, we clarify an uncertain reality through action and subsequent reflection. Weick called this phenomenon "enactment."

Enactment isn't a linear process, however. In a crisis, people often need to venture down some wrong paths before finding their way. But the more publicly a leader commits to those paths, the more difficult it will be to seek out a new, better understanding. How to engage in sensemaking without becoming trapped by a flawed interpretation of events has been the subject of much research (such as Weick's analysis of the famous 1949 Mann Gulch wildfire in Montana). Masuda navigated that fine line as he pursued cold shutdown for the plant's four reactors.

Acting Decisively—Until Overtaken by Events

The earthquake hit on March 11 at 2:46 PM. It was the largest fault slip seismologists had ever seen: 50 meters of tectonic movement in two and a half terrifying minutes. Though Masuda had experienced countless earthquakes, this was the only one in his 29-year career that drove him under a table. When the violent rolling and shaking abated, he scrambled out from cover and grabbed a hard hat. He told all the workers to evacuate the administration building and gather in the plant's Emergency Response Center (ERC). On the upper story of that building, in a large room filled with evacuated workers, he located the manager of plant operations to request an update. The manager reported that all four of Daini's reactors had been shut down. With no evidence of damage to the plant as yet, Masuda and his team felt confident that they could carry out the next step—cooling down the reactors—without trouble.

But then, a little more than 20 minutes after the earthquake, Masuda saw the first tsunami alert. Initially the Japan Meteorological Agency (JMA) warned the Fukushima prefecture to prepare for a wave up to three meters high. Daini had been built to survive floodwaters up to 5.2 meters, so although Masuda didn't welcome this development, he didn't view it as disastrous. He dispatched a few members of his team to a bluff overlooking the ocean to watch for the tsunami.

At 3:14 PM, a new alert went out: The Fukushima prefecture should brace itself for a wave up to six meters high. Minutes later Masuda's lookouts sighted the tsunami. And at 3:22 PM, eight minutes before the JMA released its final tsunami estimate—more than 10 meters—the waters began to surge.

Crisis-management protocols had been serving Masuda and his workers well. But suddenly the second step on their checklist—cooldown—was in jeopardy. A tsunami higher than 5.2 meters ("beyond design-basis," in the parlance of the industry) would reach the pumps and perhaps even the reactor buildings.

Still, Masuda didn't expect the waters to hit the ERC, so he was shocked when its lights went out. He estimated that to knock out the lights, the waters must have been 17 meters high. He feared what might be happening to the plant's four reactor buildings, which lined the shore. Part of the cooling system sat only four meters above sea level; the reactors themselves were only eight meters higher than that. If those systems were damaged or their power supply was compromised, cooldown would be next to impossible.

When the waters began to recede, a few hours later, Masuda learned that three of the four reactors had indeed lost their cooling functions. Despite the pre-tsunami shutdown, the fuel rods inside each core continued to generate heat that would normally have been removed by the cooling system and absorbed by the sea. Workers could still inject each reactor core with cold water, but Masuda worried that even if the cores retained their integrity, a buildup of steam pressure might compromise full function of their containment vessels. Then, if conditions worsened and a meltdown did occur, it would be difficult to prevent a radioactive breach. With so many aftershocks and an ongoing tsunami alert, this was a possibility he could not afford to ignore.

Because Masuda had no witnesses in the field, he didn't know what was broken or how badly. The control room operators had weathered the tsunami at their posts, but hundreds of other workers had evacuated to the ERC at Masuda's direction. Until he could persuade his team to venture out

Outside the Unit 3 heat exchanger building, April 2, 2011

on the ground and examine the damage up close, he would not know exactly what had to be done to stabilize the plant.

Stepping Back to Make Sense

The workers Masuda needed to persuade were frantic for news of their families (most lived near the plant) and were operating beyond their training and experience. The tsunami waters had penetrated more deeply than anyone had expected, and frequent aftershocks, some greater than 7.0 in magnitude, continued to rock the plant.

"I was not sure if my team would go to the field if I asked, and if it was even safe to dispatch people there," Masuda says. But he didn't have time to be sure. If they couldn't rig up a cooling system in the next few days at the very most, they risked compromising containment. He had to move right away.

And yet he held back. Commandeering a whiteboard in a corner of the crowded ERC, Masuda began writing down numbers: the frequency and magnitude of the aftershocks. Marking a line for each new quake, he created a simple chart depicting—he hoped—the decreasing danger. "It was not convincing at all," he admits, "but I needed them to be convinced." As he added new lines to his chart, he refrained from making passionate speeches or issuing commands. He waited and he wrote.

Few would have been so patient in Masuda's position. Leaders often view themselves as intermediaries who digest the raw materials of the world—the unpredictable, the contingent—and transmute them into a more refined, reliable end product for their organizations. Even if Masuda had been so inclined, he could not have persuaded the Daini workers that way. They felt the instability of their position with the soles of their feet every time the earth trembled, and they saw it as they watched the sea heave sharks and cars across the plant's pavement. So he offered data, giving the workers an opportunity to confront and process the uncertainty for themselves. He prompted them to do their own sensemaking: to reflect on how their emerging reality fit their assessment of risk.

At 10 PM, standing face-to-face with his team leaders, Masuda finally asked them to pick four groups of 10 workers, one for each reactor unit, to go out and survey the damage. To his deep relief, no one refused.

Responding to a Shifting Reality

Masuda gave each group detailed instructions about where to go and what to do. (Having worked at the plant on and off for decades, he knew every nook.) Concerned about the effect that anxiety and fear might have on the workers' powers of recall, he made people repeat the instructions back to him before they went.

By 2 AM all four teams had returned to the ERC with an account of what still worked on the site and what didn't—and by dawn Masuda had made a list of operational priorities and the supplies needed to carry them out. What he had on hand was insufficient. With assistance from TEPCO headquarters and the Japan Self-Defense Forces, more supplies and cables would be brought in from off-site so that spoiled pump motors could be replaced and damaged parts of the cooling system could be connected to a building that was still drawing power. The cables came in 200-meter sections that weighed a ton each. Daini workers would have to lay more than nine kilometers' worth to hook up the three disabled units. Once the additional materials arrived, on the morning of March 13, they would have about 24 hours to complete the task. Under normal circumstances, a job like that would take 20 people using heavy machinery more than a month to finish.

Masuda returned to his whiteboard. He ordered a subordinate to write up the overall picture of the plant and an outline of the recovery strategy. He was determined to share information with his workers as it became available, slowly replacing uncertainty with meaning. But displaying those plans so openly had an unintended consequence: Workers interpreted that as a public commitment to seeing the plans through, which would (temporarily, anyway) reduce their ability to adapt to further surprises.

Masuda had initially chosen to use the radioactive-waste building as his power source, because its interior provided the least complicated pathway for the cables and he was loath to risk disabling his only operative generator. But he quickly saw that the building's remoteness made his plan unworkable. Each segment of cable would require 100 people to move it, so hooking everything up to the radioactive-waste building would take too long; they would need a supplementary, more convenient power source to hasten the process. Reluctantly he decided to use the generator.

This was not the last time Masuda had to revise something on his whiteboard. As unforeseen challenges emerged, the team members repeatedly had to act their way through them, making adjustments as they went. Masuda recalls several such obstacles: "First of all, a motor was delivered, but we could not get closer to the site because there was so much debris from the tsunami here. We needed to remove the debris with a bulldozer, but we did not have one, and no one knew how to use it even if we had. Once we managed to bring the motor to the site, then we could not take it down from the truck. Now it was down on the ground, but we could not bring it inside the building, or could not install it, and so on." With each complication the team had to adjust and readjust its joint understanding of what could—and must—be done.

Meanwhile, Daini faced a new danger: Owing in part to an explosion at Daiichi, radiation levels at the neighboring plant were spiking. If the radioactive front drifted farther south, it could endanger Daini's workers and stop their progress. By the evening of March 13 it had begun to look as if another core meltdown might occur at Daiichi, producing even higher levels of radiation.

In this tense atmosphere Masuda made the last and most difficult course change. The night after the earthquake, engineers had carefully calculated the sequence in which the reactors should be supplied with power. Unit 2, the first to show signs of rising pressure, had been given top priority. But as the hours passed, the engineers noticed that the pressure was rising faster in Unit 1. They brought their observation to Masuda and suggested that Unit 1's containment was now the most vulnerable.

At this point Daini workers had been carting cable around a wet and debris-strewn plant for many hours. Most of them, including Masuda, had not slept at all. Although a few had been able to speak to their families, the news they'd received was not necessarily good. (Eight of them would lose family members, and 23 would lose their homes.) Radiation threatened from the north, where Daiichi presented the specter of what could yet go wrong. And now Masuda told the crews, Do it over. Shift from Unit 2 to Unit 1.

The site layout made it impossible to reroute the cable immediately, and Masuda later learned that his directive had caused a good deal of confusion among the workers in the field. Even so, they executed the pivot with amazing efficiency. Barely two days earlier Masuda had been recording aftershock frequencies for a room full of overwhelmed men and women, trying to coax them into action. Now they required no grand appeal. In part this was a triumph of team discipline—but it was also a feat of sensemaking. Because Masuda had so calmly presented his people with the uncertainty of their situation, and because they themselves had confronted and conquered it time and again, they could embrace the unpredictable nature of their work.

Shortly before midnight on March 13, the workers finished laying the more than nine kilometers of cable that snaked through the site. Masuda led the entire workforce in a round of applause. And at 1:24 AM on March 14, two hours before Unit 1 would have exceeded its maximum pressure threshold, its cooling system came back online. At 7:13 AM the cooling system for Unit 2 went up, and at 3:42 PM Unit 4's was operating. By the morning of March 15—as Fukushima Daiichi was scrambling to deal with its third explosion—all four Daini reactors had achieved cold shutdown.

THE DAINI plant experienced one disruption after another: the earthquake, the tsunami, the flooding, the power loss, threats to the containment vessels' integrity, changes in priorities for restoring power. Masuda and his crew assembled fresh explanations and plans each time, projecting their revised understanding of the crisis back onto the past and forward onto the future, making what had already happened knowable and what hadn't yet happened a little more predictable.

The workers felt the earthquake through the soles of their feet as they watched the sea heave sharks and cars across the plant's pavement.

Masuda was not thinking about sensemaking in those sleepless March days. But in his handling of confusion and fear at Daini, he set a valuable standard. Though he felt tremendous pressure to manufacture a sense of physical and psychological security for his team, he did not make sweeping pronouncements and commitments in the critical early hours. He presented data and made and revised plans openly, investing in a shared understanding of the risks the workers faced and the actions they needed to take.

Without question, Masuda and his team were in a much better position than the workers at Daiichi, where greater physical damage had terrible consequences. Whereas Daini had at least a little electricity on its side, Daiichi lost all its off-site power sources and effectively all its emergency diesel generators. When the control rooms went dark, workers couldn't even monitor their deteriorating circumstances. The damage and the loss of power were the main contributors to the explosions. With containment breached, workers were potentially exposed to high levels of radiation. The Daiichi workforce at one point shrank to 69 people when employees sought safety, as recently released interviews with the site superintendent, Masao Yoshida, reportedly confirm. At Daini, Masuda had 400.

Still, unexpected challenges came at Masuda and his team thick and fast. In the heat of the crisis, problem by problem, they acted their way toward sense, purpose, and resolution. And three years later, Masuda continues to seek that resolution, now at Daini's sister plant: In April 2014 he was appointed Daiichi's chief decommissioning officer.

HBR Reprint R1407K

Ranjay Gulati is the Jaime and Josefina Chua Tiampo Professor at Harvard Business School and the author of *Reorganize for Resilience* (Harvard Business Review Press, 2010). **Charles Casto** was the Nuclear Regulatory Commission's senior executive responding to the Fukushima disaster and led U.S. government efforts in Japan for almost a year. **Charlotte Krontiris** is a researcher and a writer based in Boston.

Experience

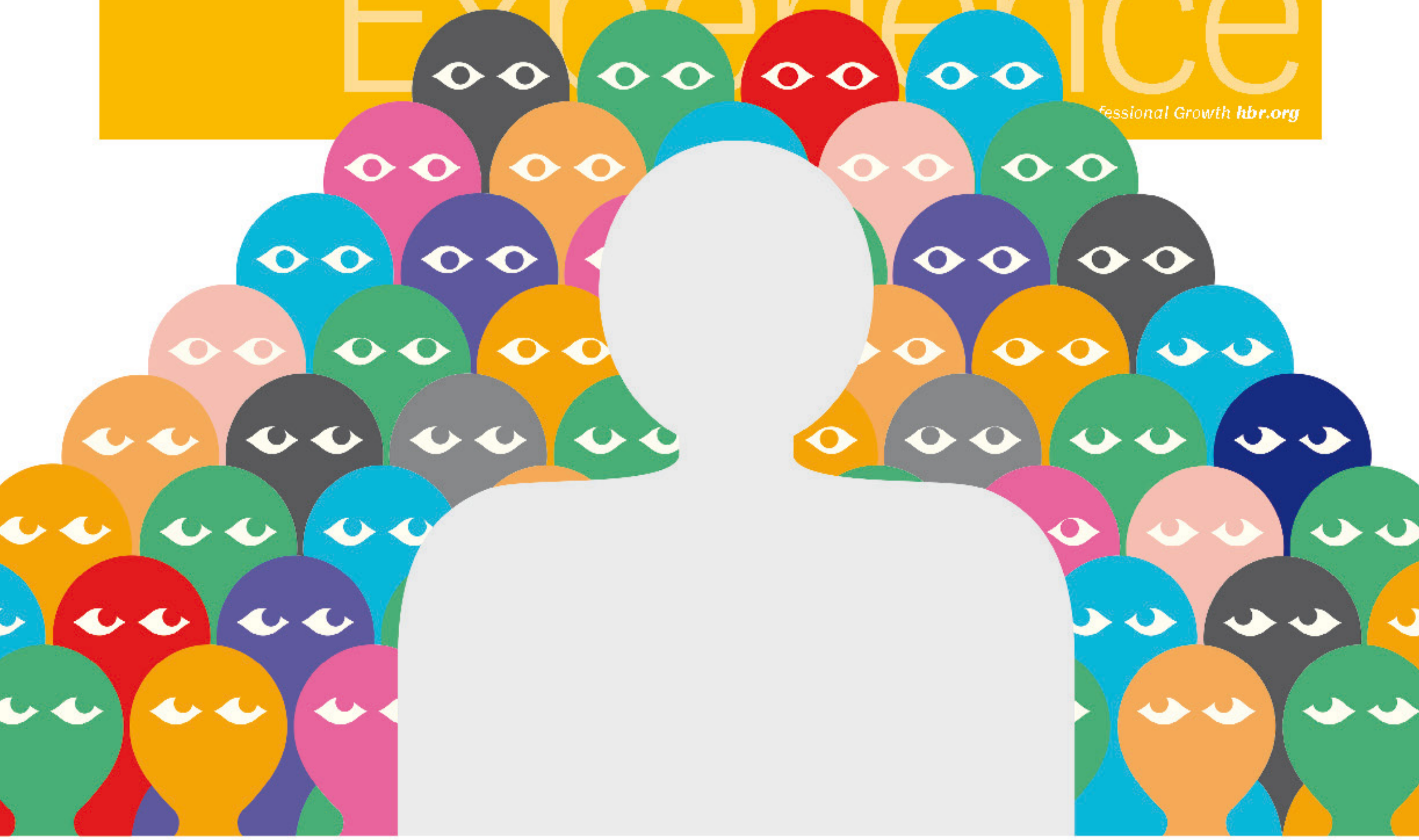


ILLUSTRATION: JAMES GRAHAM

MANAGING YOURSELF

Becoming a First-Class Noticer

How to spot and prevent ethical failures in your organization

by Max H. Bazerman

I've spent the past decade studying why some people notice and act on organizational threats and opportunities while others do not. The failure of leaders to notice ethical transgressions has been a key area of my research. How is it that smart, upstanding managers miss—or turn a blind eye to—wrongdoing that ultimately imperils their businesses? One of my personal learning moments came in 2005 when I witnessed what I later realized was an ethical breach and, in spite of my knowledge, experience, training, and values, initially did nothing about it.

I'd agreed to serve as an expert witness for the U.S. Department of Justice in its landmark case against the tobacco industry. My job was to suggest corrective actions should the defendants be found guilty of a conspiracy to commit multiple frauds to deceive the public about the risks associated with smoking. In my written testimony, I urged the court to make significant changes to the industry, such as appointing external monitors with the power to restructure the tobacco companies and remove executives from their roles. But four days before I was to testify in court, a member of the DOJ legal team asked me to amend those recommendations to state that many of them would not be appropriate if four conditions (that he read to me) existed. I didn't have the legal knowledge to evaluate the changes he was suggesting, but my on-the-spot assessment was that they would weaken my testimony. When I asked him why I would make the changes, he said that if I didn't, senior DOJ officials might not allow me to testify, which would result in more than 200 hours of wasted work, at taxpayers' expense. I told him I stood by my opinions, and on May 4, I gave them on the stand.

Still, at the time, I told no one in a position of authority about the interaction. A month later, the DOJ made an unexpected and stunning retreat, cutting its request for financial penalties against the tobacco firms (which would have helped fund smoking prevention efforts) from $130 billion to $10 billion, just as the trial was coming to a close. The government formally won its case, but in my view the remedies were trivial, and society missed an opportunity to save millions of lives. Members of Congress and consumer advocates protested the reversal, specifically questioning the impartiality of U.S. associate attorney general Robert D. McCallum Jr., a former partner of the Alston & Bird law firm, which had previously represented R.J. Reynolds Tobacco Company, a defendant in the case, on trademark and patent matters. In light of those reports, the request to change my testimony seemed (to me) more suspicious, and likely unethical.

I'm generally an inquisitive person. So why, in the spring of 2005, didn't I probe further into what had struck me as unusual conduct? Because I was susceptible to the same factors that prevent many well-intentioned people from recognizing and acting on questionable behavior. Warren Bennis said long ago that the best leaders are "first-class noticers" (a term borrowed from Saul Bellow's novel *The Actual*). That means they pay close attention to what is happening around them. They see things that others miss and understand when to dig deeper so that they can make informed decisions about whether action is appropriate. In this article, I describe six key obstacles to this type of noticing and offer insights into how to overcome them. Given the string of ethical failures we've seen in corporations around the world in recent years—from BP to GM to JPMorgan Chase—it's clear that leaders need to not only act more responsibly themselves but also develop keen noticing skills in their employees and across their organizations.

Identifying the Challenges

Let's take a look at the obstacles we all face in becoming first-class noticers. My research identifies key barriers that can cause even the most upstanding employee to ignore, overlook, or misinterpret important signals. Failure to "notice" and take action can mean losing an important customer, getting edged out of a market, or even going to jail.

AMBIGUITY

Important executive decisions rarely require deliberation among options that are clear and unambiguous. Often the data provide only strong hints, but not convincing evidence, that something is amiss. For example, I wasn't absolutely sure that something was wrong about my conversation with the DOJ lawyer in April 2005. My intuition that his request was unusual should have prompted me to learn more, but instead I tolerated the ambiguity, due to several factors, including my own exhaustion, the difficulty of getting useful advice from others on the DOJ team, and my awareness that all were concerned that media attention would hurt their cause.

MOTIVATED BLINDNESS

When we have a vested self-interest in a situation, we have difficulty approaching it without bias, no matter how well-calibrated our moral compasses may be. Motivated blindness helps explain why we want to think the best of our family members, friends, and colleagues and are disinclined to speak against those with influence in our offices and workplaces. It could also explain why, for decades, high-ranking officials in the Catholic Church failed to investigate complaints of child sexual abuse by priests, and why some Penn State University officials failed to report evidence of similar crimes committed by former assistant football coach Jerry Sandusky to the police. Because of their biases, some of these officials challenged the accounts of victims and witnesses, minimized the severity of the abuse, and overestimated their ability to address the crises on their own.

CONFLICTS OF INTEREST

Extensive research shows that our desires influence the way we interpret information, even when we are trying to be objective. This is particularly true when our responsibilities are not aligned with the actual incentives in place. Consider a lab experiment I conducted with Don Moore, of the University of California, Berkeley, and Lloyd Tanlu, of the University of Washington. We gave participants packets of information to help them estimate the value of a fictional company up for sale, and then assigned them to one of four roles: buyer, seller, buyer's auditor, or seller's auditor. Although everyone had the same data on the company, estimates from the sellers and the sellers' auditors came in significantly higher than those from participants on the buying side.

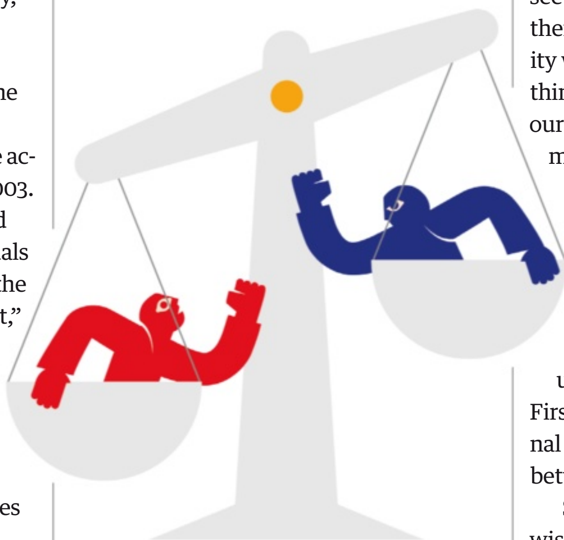
Consider how this phenomenon plays out in the real world. Even after the passage of Sarbanes-Oxley, U.S. auditors have strong financial incentives to please their clients and secure repeat business—motives at odds with the mandate to conduct independent audits. These firms also provide non-audit services, including consulting, to their clients, in essence influencing the very businesses they are supposed to impartially critique. When such conflicts of interest are present—whether at the industry, organization, or individual level—the ability to be a first-class noticer is clearly diminished.

THE SLIPPERY SLOPE

When ethical standards loosen gradually, the change is very often imperceptible. Catherine Schrand, of the University of Pennsylvania, and Sarah Zechman, of the University of Chicago, studied 49 firms sanctioned by the SEC for inappropriate accounting practices between 1996 and 2003. In about a quarter of the cases, the fraud was intentional, committed by individuals for personal gain. In the rest, however, the misreporting, or "earnings management," started with the desire of an executive or a group of executives to adjust for a weak performance period. Often, the people involved had planned to correct the manipulations in the following period, but when their fortunes did not improve, they escalated their misreporting instead. Their slide down the slippery slope often occurred without the company's auditors or board of directors even noticing it. The massive investment frauds committed in recent years—Bernie Madoff, Jérôme Kerviel at Société Générale, Kweku Adoboli at UBS—fit into this category as well. The transgressions started small and then mushroomed.

MISDIRECTION

It's important to remember, of course, that others may intentionally mislead you. Recently, I worked with a company that was negotiating an agreement to allow another company access to its intellectual property. As the contract was being written, the other side insisted that it be granted rights to use the IP beyond the scope of the specified work. My client didn't understand why, as the demand seemed outside the scope of the deal, but he agreed in good faith and didn't explore the issue any further. Several weeks later, he was inadvertently copied on an e-mail revealing that the other company had already used the intellectual property illegally. He now understood that he'd been misled: The last-minute demand was an effort to cover up past wrongdoing. Intentional misdirection designed to thwart noticing is all too common in the corporate world.



INDIRECT HARM

A garment factory in Bangladesh burns down, killing half of the 300 women and children employed there. Who is to blame? The factory owner, who repeatedly failed to make investments to ensure minimum safety standards? Officials in the Bangladeshi government, who provided little oversight? What about executives at Walmart and other major apparel brands, which sold clothes produced in the factory? The commitment to ultralow prices for consumers—and the pressure to keep supplier costs at rock bottom—means that the companies must share in the responsibility for the tragedy. But when we are several steps removed from an ethical failure such as this, we often fail to hold ourselves or those around us accountable.

Building Your Noticing Skills

Unfortunately, simply being aware of the factors that blind us to ethical failure isn't enough. Here are three concrete actions, rooted in research, that can help you improve your noticing skills:

LOOK INWARD TO ANALYZE PREVIOUS MISTAKES

When companies are in crisis, I often hear executives say "No one could have predicted that" or "It wasn't my job to see the warning signs." Rarely do you hear them acknowledge their own responsibility with comments such as "I didn't think about how that policy could affect our organization" or "I didn't ask for more information."

To be sure, strategic threats or ethical land mines certainly arise from factors outside a leader's or an organization's control. But most failures have both internal and external causes, and too often, people use external attributions exclusively. First-class noticers always consider internal causes as well, which allows them to better learn from experience.

So when a problem—ethical or otherwise—arises at your company, consider the role you and your team played. Which warning signs did you miss? Do you or your team members have an incentive to overlook a questionable behavior? Are you susceptible to being misled or thinking too highly of people? What are your weak spots and how can you fix them to prevent future lapses?

TAKE AN OUTSIDER'S VIEW

When clients hire me to help solve problems, I often encounter the "things aren't done that way" response to new solutions. My approach is to push harder. Often, there is no logical reason why a change can't be made. The organization or the industry has simply developed a bad habit that needs to be broken.

I recently had a conversation with an executive who was frustrated that her sales team was bringing in lots of poor-quality accounts. I asked her how the employees were rewarded. She told me that commissions were based on booked, rather than collected, sales, which meant that salespeople got their money whether their customers paid their bills or not. Their annual objectives—tied to increases in sales and to satisfaction scores—reinforced the incentive to ignore signs that customers were undesirable. My outsider position made it easy for me to notice and highlight the fact that the company had created a system that encouraged the salespeople to do the wrong thing.

Have you stepped back and asked yourself whether your human resource policies are fostering motivated blindness or conflicts of interest? Would external advisers say that your risk managers have enough contact with operations to ensure that no one is sliding down a slippery slope? Outsiders are better than insiders at noticing vulnerabilities and suggesting solutions to address them. Consider having an outsider look at your employees, structures, systems, and processes with fresh eyes for an unbiased opinion.

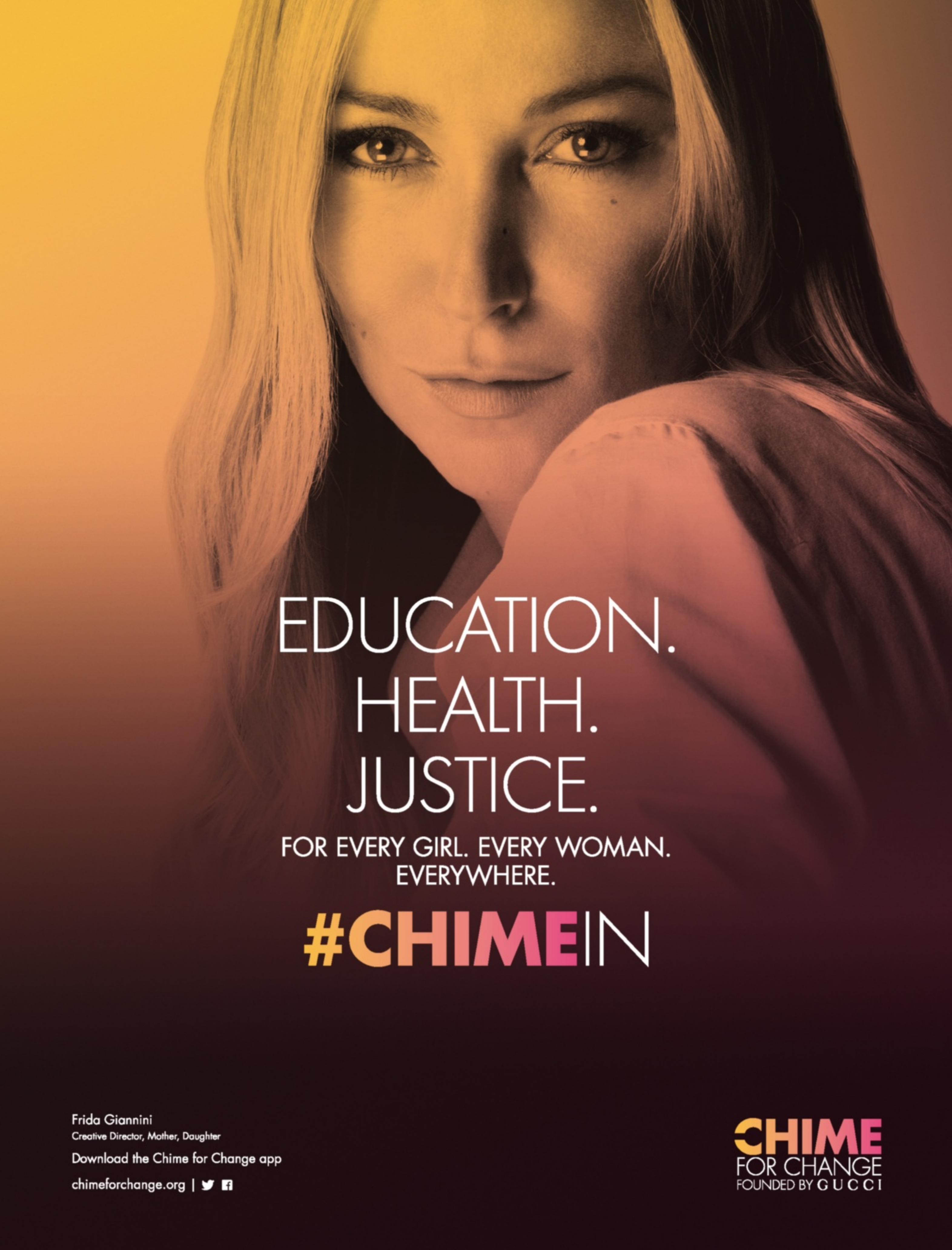
CREATING A NOTICING ORGANIZATION

As a leader, it's not enough to work just on your own noticing skills; you must also help others in your organization overcome the obstacles to seeing and rooting out bad behavior. Start by encouraging the practices I've described above. Explain that you expect all employees to become first-class noticers, to look into suspicious behavior, and to speak up or dig deeper when they believe something is amiss. And set an example by calling out transgressions and, when needed, reacting to murky situations with transparency, speed, and compassion.

Matt Myers, president of the Campaign for Tobacco-Free Kids, served as that kind of role model for me. In late June 2005, he went to the *New York Times* with a story of how the DOJ had tried to corrupt his Big Tobacco trial testimony. His experience seemed virtually identical to mine, but in his case, he had pushed through ambiguity to identify what was wrong and had acted on it. This prompted me to tell my own story, which was reported by the *Washington Post* and investigated by Congress. I greatly admire Myers's decision to speak up, and I have aspired to notice and act more quickly on wrongdoing ever since. I encourage you to do the same.

HBR Reprint R1407L

Max H. Bazerman is the Jesse Isidor Straus Professor of Business Administration at Harvard Business School and a codirector of the Center for Public Leadership at Harvard's Kennedy School of Government. He is the author of *The Power of Noticing: What the Best Leaders See* (Simon & Schuster, forthcoming).


EDUCATION.
HEALTH.
JUSTICE.
FOR EVERY GIRL. EVERY WOMAN.
EVERYWHERE.
#CHIMEIN
Frida Giannini
Creative Director, Mother, Daughter
Download the Chime for Change app
chimeforchange.org |
CHIME
FOR CHANGE
FOUNDED BY GUCCI

Case Study

Eugene Soltes is an assistant professor of business administration at Harvard Business School.

Should an entrepreneur scale up his business across several countries or focus on the largest one? *by Eugene Soltes*

Where to Launch in Africa?

The Experts

Ashish J. Thakkar, founder, Mara Group

Iqbal Survé, founder and chairman, the Sekunjalo Group

ILLUSTRATION: FEDERICO JORDAN

HBR's fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "Mara Group" (case no. 114060-PDF-ENG), by Eugene Soltes and Sara Hess, which is available at **hbr.org**.

Benard Kenani spotted his uncle as soon as he walked into the hotel lobby. Uncle Michael was sitting at a corner table with two other men, also in suits, both of whom were laughing at one of his jokes. That was typical of Michael, a successful executive in Nigeria. Everyone loved his affable disposition. He quickly stood up when he saw his nephew.

"Welcome to Lagos!" he shouted across the room. He proudly introduced Benard to the others, referring to him as "one of Nigeria's up-and-coming entrepreneurs."

Right after the men left, Benard corrected his uncle. "You know I haven't decided if Nigeria is the place to start my business yet."

Michael shrugged off the comment. "What matters to me most is that you're finally going out on your own, *achimwene*. It's what you've always wanted."

Michael, like Benard, had been born and raised in Lilongwe, the capital of Malawi. Like many talented Malawians, he had left the country as a young man to seek opportunities elsewhere, settling in Nigeria a decade earlier. He now ran a thriving manufacturing enterprise.

Benard had left Malawi, too, after winning a scholarship to study in the UK, where he'd completed both his university degree in economics and an MBA. But he'd been drawn back to Africa by the burgeoning opportunities there and a desire to be closer to home. After six years as a manager at a packaging company in Kenya, he now felt that he had enough experience to start his own business. His uncle, along with several other friends and family members, had committed to investing in it.

Benard was in Lagos to see his uncle and seek advice about where to establish himself. Though Benard had an ambitious vision of someday running a venture that spanned the continent, he knew he needed to focus on one country at the start.

"But you're seriously considering Nigeria, I hope," Michael said.

"Yes, of course." Benard nodded as he opened his laptop. "The market is competitive, but my research suggests that there are still opportunities in some specialty packaging markets. I've run some projections."

Michael interrupted Benard, closing his computer. "You just need to look around! The BBC, the *New York Times*, the *Economist*—the whole world is talking about how fast Nigeria is growing. We're on the cusp of joining the G20. If you want to be on the forefront of Africa's growth right now, Nigeria is the place to be."

"I agree. There are lots of factors that make it an attractive market. If everything continues at this pace, I'm confident that I can be profitable in the next year or two," Benard said. "But I'm also worried."

"The political environment makes me nervous," he continued. "It seems so volatile. The growing instability could threaten the country's prosperity."

"Sure, those are risks, but you're going to find risks everywhere," Michael replied. "You also need to think about the upside of basing yourself in Africa's largest economy. Where else are you considering?" He quickly added, "Wait—don't tell me Malawi."

Benard gave his uncle a nervous smile. He had known this was coming.

"Benard, when did you become so sentimental? Your vision is so much bigger!"

"With the expertise I can bring to the business, within a year I'll be the number one packaging manufacturer there—"

Michael stopped him. "But what does that matter? Number one in Malawi?"

"That's just the start. Malawi will give me a base to launch into other East African markets—Zambia, Mozambique, Rwanda, even Tanzania—and then move into other businesses. I don't want to be stuck in one place. I want to build across markets to achieve scale," Benard said.

"Everyone will tell you to go to a big market like Nigeria. But it's so competitive there. Malawi is low-hanging fruit by comparison."

The apprehension on Michael's face made Benard realize he should try a different approach. "*Abambo,* remember, when you started out here in Nigeria, it wasn't such an enormous economy. As the country has grown, so has your business. There are other, smaller African economies poised for growth, and I can be a part of it. I already have a potential business partner in Lilongwe that can help me get started."

"If that's what you're concerned about," Michael interjected, "I can line you up with three potential partners here tomorrow. Just say the word." He asked Benard when he expected to make a decision.

"Soon," Benard said. He explained that he had told his boss that he'd be leaving to start a new venture and had taken the week off to finalize his plans for it.

"I will support your business no matter what you decide," Michael said. "But you need to think about where the money is now. That's where you want to be."

The Potential of Malawi

The following day, Benard flew to Lilongwe. He was eager to meet with Amara Desta, his potential business partner in Malawi. She had inherited a small packaging business from her father. Because she'd been preoccupied with several other successful entrepreneurial ventures, she'd done little to develop it. For the past year, Amara had been looking for ways to divest the business, ideally by finding someone to buy a majority stake from her. Benard's father had introduced them during his last visit home.

"I simply haven't had the time to put into it," Amara explained as she showed Benard around the manufacturing facility. Indeed, many of the machines were outdated, and several were no longer functioning. "Luckily, we're still in the enviable position of often having more orders than we can fill. Your father probably mentioned that our customers are primarily tobacco producers."

Tobacco accounted for more than 70% of Malawi's exports, and tobacco packaging offered some of the most attractive margins among the products sold by Benard's current employer in Kenya. If Benard just made a few equipment purchases and built off Amara's existing relationships, he could get started right away. But he also realized that it was risky to set up a business where almost all the demand would come from one sector.

"You must enjoy being back home," Amara said.

"Yes, I would love to spend more time here," Benard responded, thinking about his childhood in Lilongwe. His family and many of his friends were still nearby. "But I want to make this decision objectively, based on the economics."

"Malawi has more to offer than most people think," Amara said, proudly

HBR.ORG
Tell us what you'd do.
Go to **hbr.org**.

rattling off a list of the country's recent improvements as if she were addressing a visitor, not a native. Though the 10 years Benard had been away from Malawi hadn't felt long, he understood why those who'd stayed now treated him like an outsider.

"And the demand is there," Amara continued. "The tobacco growers would love to buy packaging in country. Right now the costs to import are exorbitant. Producing domestically would dramatically lower them, and we'd quickly capture much of the market. We're perfectly situated for later expansion into other markets in East Africa too, if that's of interest to you."

Benard agreed to be in touch with Amara in the coming week and excused himself to go meet his father, Kwende, for lunch.

Kwende was eager to hear about the earlier meeting with Amara. "There's lots of potential there, right?" Kwende asked enthusiastically. "It seems like a good partnership. You both bring such assets to the table."

"It's true. But, *abambo,* I know you want me here, and I think that's clouding your judgment."

"Listen, I'm not as successful as your uncle Michael, but I've been looking into this. Start in Malawi, and after you've succeeded here move into other countries. Focusing on one of the bigger markets like Nigeria or Kenya may seem safer now, but that can always change. If you diversify into several smaller markets, you'll still have a business if there is political or economic upheaval in one place."

"I've thought about that. In fact, the woman I spoke to in Rwanda argued the same thing." Benard had been in touch with the head of the Rwanda Development Board, a government agency that was providing incentives for small-business owners as part of its postgenocide rebuilding efforts. She'd made several compelling arguments for establishing the business there, including a growing economy and reduced bureaucracy.

"She's right. While some of these other markets might be less lucrative today, as they continue to grow, so too will your business," Kwende said.

"Uncle Michael also raised the issue of a skilled labor shortage here," Benard said. "It looks like Amara has struggled with that. I need to be sure I can hire people with the right skills. If I can't find my employees locally, it's going to really increase my costs."

"Benard, everyone is going to tell you to go to a big market like Nigeria, South Africa, or Kenya. There's money to be made there, no doubt, but it's also so competitive. Malawi, Rwanda, Mozambique—they are low-hanging fruit by comparison. Sure, you're going to face some challenges—labor problems this month, infrastructure ones the next. But you're ambitious! Don't you want to be a leader and put back into the country what it gave you?"

Back in Nairobi

One week later, in Kenya, Benard knocked on his boss's office door. After inviting Benard in, Peter Agambu, the CEO of the company, quickly got to the point: "I'm sorry that you're going to be leaving us to go out on your own. Have you decided where you'll be setting up your business?"

"I met with my uncle in Nigeria and a potential partner in Malawi. There are good opportunities in both markets. I also spoke with a government agency in Rwanda, and they've set up a 'one-stop shop' to help new businesses get all their permits. It's now one of the easiest places to start a company on the continent. So there are a lot of options, but it's hard to see the clear front-runner."

"For me it was easy," Peter said. "Kenya was a big market, and I'm originally from Nairobi, so I knew the place well. I just had to learn about packaging."

Peter had hired Benard right out of business school and had been his mentor ever since. In Peter's view, entrepreneurs needed to focus on one country to succeed in the African marketplace. Africa was so culturally and politically diverse that a business that spanned multiple markets would need a huge centralized infrastructure. "Dreaming of a successful pan-African business is just that—a dream," he'd once told Benard.

Benard recognized the challenges. There were unquestionably significant hurdles associated with expanding into multiple markets. Nations in Africa might be geographically close, but differences in language, culture, and political systems often made them seem much farther apart. Even getting from one place to another was difficult. Countries that were practically neighbors might involve several plane connections, and travel could consume an entire day.

Still, Benard believed Africa was changing and that many smaller markets that had historically been overlooked by ambitious entrepreneurs like himself were now among the most attractive.

"I bet your uncle encouraged you to strongly consider Nigeria," Peter said. "There's certainly a lot of excitement about its growth and potential. Even those of us outside Nigeria are talking about it. While you might be fighting for a smaller piece of market share, it can still be very profitable to be a relatively small player in a big market."

"That's certainly true," Benard replied. "But there's no reason I can't build a profitable business by launching in a smaller market. Of course, the trouble is, if I start off there, I'll need to expand into other countries to gain scale. I'll be creating exactly the type of business you always cautioned against because it'll be difficult to manage."

"My strategy was my strategy, Benard. What's yours?"

Should Benard begin his new packaging business in Nigeria or Malawi?

See commentaries on the next page.

The Experts Respond

Ashish J. Thakkar is the founder of Mara Group, a pan-African conglomerate, and Mara Foundation, a social enterprise that supports African entrepreneurs.

BENARD NEEDN'T choose between Malawi and Nigeria—he should go after both markets as soon as possible. He has relationships and connections in both places, and that's how entrepreneurs build value in Africa.

Peter, Benard's mentor, is spot-on with his assessment of how varied the 50-plus African countries are. Even neighboring states are so different; you can never just copy and paste a business from one place to the next. But Peter couldn't be more wrong when he says that a pan-African company is just a dream. In fact, that's where the opportunity lies on our continent—in creating distinct value by showing that you can successfully operate in multiple markets despite the obstacles.

Benard is doing several things right, beginning with focusing on his connections in these markets. Partnerships are the way to go. I know this from my own experience expanding one of my companies, Riley Packaging (on which this case is loosely based), into other markets. In our case, Mara Group, Riley's parent company, would act as the local expert in a geographic market and find an industry expert to operate as its partner. Benard is taking the opposite approach: He knows packaging and is relying on people like Amara and Michael to be the local experts. This is an equally successful way to combine on-the-ground expertise and global know-how.

He's also right to think about quickly entering many countries. The more markets you're in, the more your business is worth. Mara Group is now in 22 countries in Africa, and that's what sets us apart. Even though it wasn't our initial intention to have such a large footprint, entrepreneurs like Benard can learn from the success of this strategy.

> **He's right to think about quickly entering many markets. The more you're in, the more your business is worth.**

I'm a big proponent of setting up in small markets. I agree with Benard that they often get overlooked in favor of larger ones like Nigeria. Some of my businesses are now focusing on second-tier markets, like Burkina Faso. I think it's an advantage to get in early and establish yourself before anyone else arrives. Because of this, and if all things were equal, I'd recommend that Benard seriously consider Rwanda. It's a fantastic market with a strong economy, lots of transparency, and a stable government that is receptive to new ideas. And because it's relatively small, he could dominate it early on. But he doesn't have a business partner or a helpful family member there, which could prove problematic.

When I was starting out, I chose Uganda because it was home. But I wouldn't recommend that Benard begin in Malawi, because it would leave him so dependent on one sector—tobacco—for customers. I've always tried to stay away from markets where my company's success would rely on any one type of business.

Still, Benard has to start somewhere, so if resources are scarce, I'd advise him to set up shop first in a larger market—such as Nigeria—and then quickly expand to several others, including Malawi and Rwanda. That will give him a more compelling story to tell third-party investors about his ability to grow in both East and West Africa.

It's a smart strategy to go with what you know, but it's even smarter to leverage your relationships and set up operations in as many locations as possible.

WHAT WOULD YOU DO?

SOME ADVICE FROM THE HBR.ORG COMMUNITY

I'D RECOMMEND Rwanda over Malawi because of the huge strides in infrastructure and economic development that Kagame's government has made. Rwanda is closer to the larger consumer manufacturing markets in East Africa, especially Kenya, which Benard is already familiar with. The East African Community is rapidly becoming one large economic zone. Single visas, cross-border payments, cargo movement, and banking are already being—or have been—integrated. And a single currency is on the horizon.

Niti Bhan, *founder, Emerging Futures Lab*

I WAS in a similar situation when trying to expand my company beyond East Africa. While Malawi is a small market, I'd suggest Benard start there to get some Africa set-up experience. Then, before going to Nigeria, he should look at Ethiopia, which has cheap power, a corridor into East Africa, and a government that supports start-up manufacturing.

Neil Ribeiro, *group CEO, EAGM*

BENARD SHOULD start in Nigeria. I've seen enterprises start here and grow into large businesses in just a few years. The middle class—and its purchasing power—is increasing by the day. Infrastructure is improving. The government policies supporting business are the strongest in Africa. Entrepreneurs ignore Nigeria at their peril.

Dr. Olugbemiga Adelakin, *monitoring and evaluation officer, United Nations Population Fund, Nigeria*

Iqbal Survé is the founder and chairman of the Sekunjalo Group, a holding company with investments in more than 130 private and public companies in Africa, including South Africa's largest printing group.

NORMALLY I'D suggest that a young, ambitious entrepreneur set up his business in his home country, establish it as number one or two in that market, and then expand. But in this case, Benard shouldn't waste his time in Malawi. He should focus on Nigeria.

Nigeria is the perfect place to launch a new business. The country is where South Africa was 10 years ago: on the cusp of enormous growth. Its large, increasing population—already half the size of the U.S. population—will demand more and more products as the economy expands. When the retail industry grows, so will the packaging industry.

But it's not just that Nigeria is attractive. The other approach that Benard is considering—start in a small market and quickly expand into others—has several drawbacks. First, operating, and even winning, in Malawi most likely won't provide him with enough capital to move into other countries. Capital is crucial for African entrepreneurs. It's very expensive to set up a business in an African country that you're not from, and not just because of the bureaucracy. Look at Nigeria: It has some of the highest hotel rates in the world. And flying between countries in Africa can be costly as well.

Another problem is that the logistics of running a business across several countries are complex. Traveling from South Africa to Eritrea is not as easy as flying from Germany to France. There are more and more direct flights, but sometimes you have to make an absurd trip to Europe just to get from one African country to another. And while dealing with governance issues in one country is tough, it's even harder in multiple locations. Businesses will encounter visa restrictions, cross-border taxes, and corruption, and each country has its own currency.

The third issue that Benard will confront in Malawi is managerial capacity. When you're working across borders, you need skilled managers to help you. We've found that the best approach is to develop people from the ground up in your base country and then transplant them. I doubt that he will find enough people with the right capabilities in Malawi, whereas Nigeria will have a large pool from which to choose.

Many entrepreneurs fear that if they don't expand fast enough or don't get into a country first, they'll miss a huge opportunity. But often the opposite is true. When you move into a market later, after others have already attempted to establish businesses there, you have the advantage of learning from their mistakes. It can be beneficial to follow rather than lead the way.

Nigeria is the perfect place to launch a new business. The country is on the cusp of enormous growth.

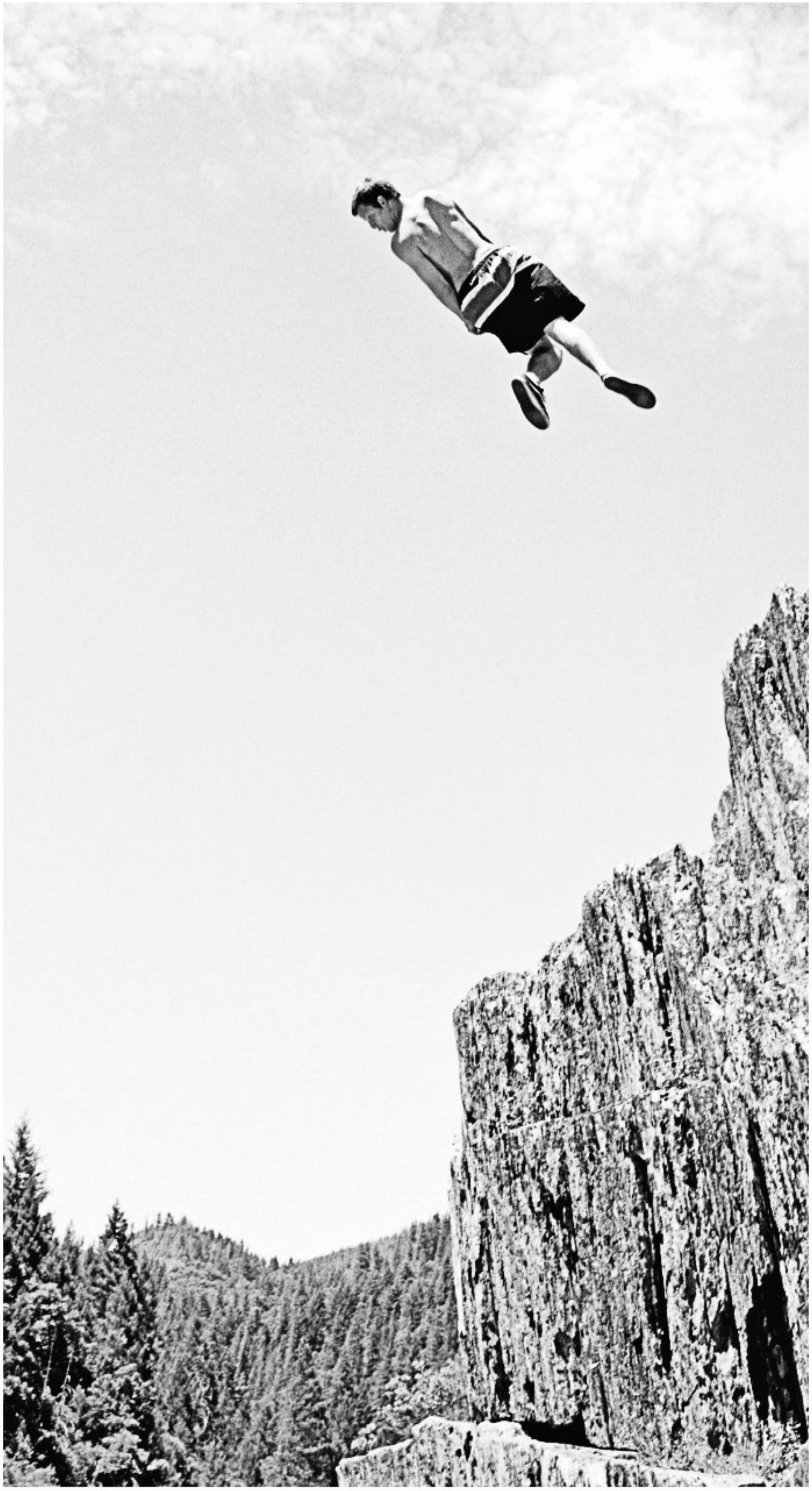
My holding company has tried both the approaches that Benard is contemplating, and the larger markets have worked out better for us. We started the most successful ventures in places like South Africa, Kenya, and Nigeria; we got a foothold there and only then moved on to other countries. We've found the smaller markets to be more difficult. When we've tried to launch businesses there, they've often failed.

I can see why Benard wants to go toward what he knows—his home country, a known business partner, and a familiar industry. And he's right to consider the risks in Nigeria. (Though in my experience business goes on despite the political turmoil, no matter how extreme it seems to those outside the country.) But if Benard can make his business work in Nigeria, he can make it work in Malawi. The opposite is not true. If he starts in Malawi, he may be wasting five years of his life. To realize his ambitious vision, he should go to Nigeria, accept his uncle's help, and prove himself there before expanding.

HBR Reprint R1407M
Reprint Case only R1407X
Reprint Commentary only R1407Z

Synthesis

A review of emerging ideas in the media



Do You Really Have to Fail to Succeed?

by Daniel McGinn

What's the best thing that's ever happened to you? Meeting your spouse? Becoming a parent? Some breakthrough moment of career success? When journalist Megan McArdle conducted a web survey on the topic, most respondents offered some variation on the love/kids/job theme. But then she turned to Google and found some surprises. Getting divorced ranks high. So does being diagnosed with cancer. And being fired. Rounding out the search results: Going to prison.

That list is evidence of society's reverence for difficult experiences that, when viewed from the proper perspective, lead to revelatory transformation. Although few of us actively wish for trauma, we recognize that it can offer an opportunity to test our resilience and then celebrate our mettle.

In a way, this is nothing new. Since the biblical story of Job, many literary works have examined human beings' ability to endure repeated hardship. And for decades now, psychologists have been studying why some people bounce back from adversity more easily than others—and what they gain in the process.

In the past few years, however, resilience has emerged as perhaps the foremost emotional virtue—a characteristic we seek in employees, nurture in children, and hope to build in ourselves. No surprise, then, that bookshelves are filling up with treatises on how to achieve it.

PHOTOGRAPHY: GETTY IMAGES

HBR.ORG We don't review our own books, but check out our latest releases—and the management classics—at **hbr.org/books**.

McArdle presents her findings in *The Up Side of Down: Why Failing Well Is the Key to Success.* In addition, we have *Supersurvivors: The Surprising Link Between Suffering and Success,* by psychology professor David B. Feldman and journalist Lee Daniel Kravetz. *Supersurvivors* relates the stories of people whose significant traumas—near-fatal cancer, limb amputation, severe brain injury, the loss of a child—become catalyzing events. "These people don't just grow; they revolutionize their lives," the authors write. "They transform and transcend their suffering even while enduring it."

These books follow the deeply reported best seller *How Children Succeed: Grit, Curiosity, and the Hidden Power of Character,* in which Paul Tough surveys the academic research and takes readers inside innovative educational programs that prioritize the development of character traits instead of cognitive skills.

This genre of nonfiction certainly enriches the literature about success. Tough's book deserves its acclaim, and it may change the way parents think about their children's emotional makeup and the qualities they hope to instill in them. If you read Feldman and Kravetz, you will come away inspired and more attuned to the factors that influence resilience—including religious faith, the ability to forgive, and awareness of mortality—although you won't get a clear road map for rebounding from calamity. McArdle's book is engaging and at times insightful.

Yet I worry that the narrative of surmounting adversity is becoming too idealized. Triumph over disaster is rightly seen as a laudable part of a person's experiences, but it's now sometimes presented as a requirement. "Peek into the basement of any successful life and you'll see that they, too, are founded on failure," McArdle writes. That argument overreaches. In fact, I am more taken by her observation that many of the things we consider "failures" are really accidents (driven by random events) or simple mistakes, and often there's no lesson to be learned or silver lining to be found.

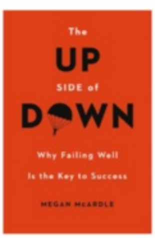
> "Supersurvivors radically deviate from their previous life paths, often transforming the worst thing that's happened to them into the best."
> Feldman and Kravetz, *Supersurvivors*

Indeed, the more I read about resilience, the more I'm seeing the early signs of a correction to the excessive hype surrounding this idea. In the entrepreneurship world, some people are decrying a "failure fetish," arguing that one's ability to "fail fast" and abandon one start-up for the next has become too much of a badge of honor. "Taking the stigma out of failure is very exciting," says Marc Andreessen, a leading venture capitalist. "But we see founders who give up too quickly.... Maybe it's time to add a bit more stigma."

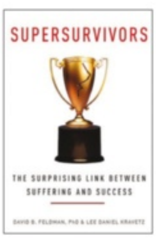
In education, at least a few thinkers are starting to question whether resilience and persistence are really the most important qualities to instill in kids. In *The Myth of the Spoiled Child,* Alfie Kohn, a prominent writer and lecturer, argues that emphasizing diligence and self-control often undercuts creativity and self-awareness and promotes bland conformity. He sees a circularity in the logic of resilience research. For instance, a study of West Point cadets found that those who rated themselves high in grit were most likely to complete an arduous summer training course. "[This] seems to prove only that people who are persistent persist," he writes. He has a point: So long as we define "success" as the pot of gold that's the reward for hard work, isn't it common sense that by plugging away, despite obstacles, you are most likely to obtain it?

It's impossible to argue against resilience as a virtue—who wouldn't want some measure of that quality in themselves or their loved ones? But instead of viewing it as the be-all and end-all of our emotional makeup, I expect that over time we will give it a less central place within the broader mosaic of desirable personal attributes. I aspire to be resilient and persistent and gritty—but I also hope to minimize trauma (to the extent possible) by taking smart, reasonable risks.

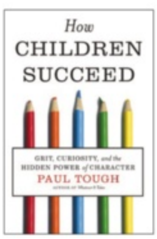
It's a sentiment that Conan O'Brien captured in his commencement address at Dartmouth College shortly after being fired as host of *The Tonight Show:* "Though you should not fear failure, you should do your very best to avoid it. Nietzsche famously said, 'Whatever doesn't kill you makes you stronger.' But what he failed to stress is that *it almost kills you.*" What we really need is a pathway toward strength and success that doesn't require a near-death experience—and a future in which fewer people rank prison as the best thing that's ever happened to them.



The Up Side of Down: Why Failing Well Is the Key to Success
Megan McArdle
Viking, 2014



Supersurvivors: The Surprising Link Between Suffering and Success
David B. Feldman and Lee Daniel Kravetz
HarperWave, 2014



How Children Succeed: Grit, Curiosity, and the Hidden Power of Character
Paul Tough
Houghton Mifflin Harcourt, 2012

The Myth of the Spoiled Child: Challenging the Conventional Wisdom About Children and Parenting
Alfie Kohn
Da Capo Press, 2014

Daniel McGinn is a senior editor at *Harvard Business Review*.

Executive Summaries July–August 2014

SPOTLIGHT ON THE NEW MARKETING ORGANIZATION

Marketing has changed profoundly in the past 10 years in response to the digital revolution. To keep up, organizational structures, decision-making processes, roles, and responsibilities all need to change as well. In most companies, that hasn't happened.

MARKETING

The Ultimate Marketing Machine

Marc de Swaan Arons, Frank van den Driest, and Keith Weed | page 54

Though social and digital media are rapidly transforming marketing and new tools emerge daily, in most firms the organization of the function hasn't changed in 40 years. How should marketers revamp their strategies, structures, and capabilities to meet the new realities? To find out, the consultancy Effective-Brands and its partners conducted a study involving 10,000 marketers from 92 countries, which examined what separated high-performing marketers from the pack.

High performers, the study showed, excelled in three areas: integrating data about what customers are doing with an understanding of *why* they are doing it; communicating a brand purpose (the functional, emotional, and societal benefits of the offering); and delivering a "total experience" to customers. To provide this kind of experience, high performers break down silos and enlist the help of the entire organization. That means they must link marketing strategy tightly to business strategy and to other functions; inspire employees across the company with the brand's purpose; focus and align around a few key priorities; set up nimble, cross-functional teams; and build internal capabilities through extensive training at all levels.

Surprisingly, few companies have been able to put all these pieces together. Only half of even high-performing organizations excel on some of these capabilities. But that shouldn't be discouraging; rather, it just illuminates where there's work to do. **HBR Reprint** R1407C

DECISION MAKING

Decision-Driven Marketing

Aditya Joshi and Eduardo Giménez
page 64

The gap between marketers' aspirations and what their organizations can accomplish creates intense pressure to reshape how marketing is done. In recent years some leading companies have developed an innovative approach that focuses on the seams between marketing and the other functions it interacts with—the C-suite, IT, sales, finance, and so on. It is at these seams that communication most often breaks down and processes stall.

Typically, three categories of marketing-related decisions cross organizational seams: strategy and planning; execution; and operations and infrastructure. When marketing works closely with other units to execute key decisions, it can get things done far more quickly and effectively than in the past. But divergent assumptions or a lack of alignment and shared commitment between functions can get in the way. When the authors asked people in marketing and other relevant units what roles they played in a decision, the answers were all over the map. In a classic example, both marketers and product developers in one automaker's European division believed that they had the final say on which features to include in a new model.

The authors provide a tool for revamping the decision process at the boundaries between functions and describe how Target, Nordstrom, and other large companies have identified important decisions at the seams and increased the impact of their marketing organizations. **HBR Reprint** R1407D

CUSTOMER RELATIONS

Unlock the Mysteries of Your Customer Relationships

Jill Avery, Susan Fournier, and John Wittenbraker | page 72

Despite the $11 billion spent on CRM software annually, many consumer companies don't understand customer relationships at all. They aren't aware of the variety of relationship types and don't understand what kind their customers want.

Through research in a wide variety of consumer industries, the authors have identified 29 types of relationships. For example, some customers want to be *best friends* with a brand; others are looking for a passionate *fling;* still others find themselves as *ex-friends* and would welcome a closer bond.

To understand the current portfolio of relationships, companies must pick up on signals from multiple sources. Companies can then build a strategic mix of connections by bolstering desired relationships and shifting customers to more-valuable types. There are many issues to consider: For example, some relationship types are more profitable than others.

No actions will bear fruit unless a relationship orientation pervades not just the marketing function but every aspect of the company that touches customers or affects interactions with them. Customers don't just represent the next upsell or cross-sell opportunity; they are individuals looking for a certain kind of interaction. Companies need to respond accordingly. **HBR Reprint** R1407E

MANAGING TECHNOLOGY

The Rise of the Chief Marketing Technologist

Scott Brinker and Laura McLellan
page 82

Marketing is rapidly becoming one of the most technology-dependent functions in business. In response, a new type of executive is emerging—the chief marketing technologist. CMTs are part strategist, part creative director, part technology leader, and part teacher. They go by various titles, but they share a common job, intersecting with four key stakeholders in the organization:

The CMO and other senior marketing executives. Here, the CMT supports strategy by ensuring technical capabilities and advocating for approaches enabled by new technologies.

The CIO and IT. The chief marketing technologist facilitates and prioritizes technology requests from marketing, translating between technical and marketing requirements and making sure that marketing's systems adhere to IT policies.

The marketing team. The task here is to ensure that the marketing staff has the right software and training.

Software and service providers. The CMT assesses how well outside vendors' technical capabilities meet marketing's needs, helps integrate the systems, and monitors their performance.

A thumbnail profile of Mayur Gupta, the global head of marketing technology and operations at Kimberly-Clark, shows just how open-ended the CMT role is and why an executive fully at home in both marketing and IT is essential for the job. **HBR Reprint** R1407F

Features

THE BIG IDEA

POLITICAL ECONOMY

The Crisis in Retirement Planning

Robert C. Merton | page 42

Corporate America began to really take notice of the looming retirement crisis in the wake of the dot-com crash, when companies in major industries went bankrupt in large part because of their inability to meet their pension obligations. The result was an acceleration of America's shift away from employer-sponsored pension plans toward defined-contribution plans—epitomized by the ubiquitous 401(k)—which transfer the investment risk from the company to the employee.

With that transfer has come a dangerous shift in investment focus, argues Nobel Laureate Robert C. Merton. Traditional pension plans were conceived and managed to provide members with a *guaranteed income*. And because that objective filtered right through the scheme, members thought of their benefits in those terms. Ask a member what her pension is worth and she'll reply with an income figure: "two-thirds of my final salary," for example. Most DC schemes, however, are designed and managed as investment accounts with the goal of accumulating the largest possible pot of savings. Communication with savers is framed entirely in terms of assets and returns. Ask a saver what his 401(k) is worth and you'll hear a cash amount and perhaps a lament to the value lost in the financial crisis.

The trouble is that investment value and asset volatility are simply the wrong measures if your goal is to secure a particular future income. In this article, Merton explains a liability-driven investment strategy whose aim is to improve the probability of achieving a desired retirement income rather than to maximize the capital value of the savings.

HBR Reprint R1407B

GOVERNANCE

Sustainability in the Boardroom

Lynn S. Paine | page 86

One surprising role of Nike's committee is to provide support for innovation.

More and more companies recognize the importance of corporate responsibility to their long-term success—and yet the matter gets short shrift in most boardrooms, consistently ranking at the bottom of some two dozen possible priorities. Many years ago labor conditions in Asian contract factories prompted Nike board member Jill Ker Conway to lobby for a board-level corporate responsibility committee, which the company created in 2001. In the years since, the committee has steadily broadened its purview, now advising on a broad range of issues including innovation and acquisitions in addition to labor practices and resource sustainability.

A close examination of Nike's experience has led HBS professor Lynn S. Paine to conclude that a dedicated board-level committee of this sort could be a valuable addition to many if not most companies in at least five ways: as a source of knowledge and expertise, as a sounding board and constructive critic, as a driver of accountability, as a stimulus for innovation, and as a resource for the full board.

In an accompanying interview with Paine, Conway discusses the committee's creation and provides an insider's perspective on what has made it so effective.

HBR Reprint R1407G

STRATEGY & COMPETITION

Four Paths to Business Model Innovation

Karan Girotra and Serguei Netessine | page 96

Drawing on the idea that any business model is essentially a set of key decisions that collectively determine how a business earns its revenue, incurs its costs, and manages its risks, the authors view innovations to the model as changes to those decisions: *What* mix of products or services should you offer? *When* should you make your key decisions? *Who* are your best decision makers? and *Why* do key decision makers choose as they do? In this article they present a framework to help managers take business model innovation to the level of a reliable and improvable discipline. Companies can use the framework to make their innovation processes more systematic and open so that business model reinvention becomes a continual, inclusive process rather than a series of isolated, internally focused events.

HBR Reprint R1407H

LEADERSHIP

"I Came Back Because the Company Needed Me"

Lenovo CEO Yang Yuanqing, interviewed by Adi Ignatius
page 104

Yang assumed the reins at Lenovo (formerly known as Legend) in 2001, when the company's founder, Liu Chuanzhi, moved on to become chairman. He served as CEO for three years before succeeding Liu as chairman, and he and Liu engineered the stunning 2005 acquisition of IBM's personal computer business, which suddenly made Lenovo the world's third-largest computer maker. In 2009, after the company had begun to falter during the global recession, the board asked Yang to return as CEO, a post he's held ever since.

Pursuing a strategy the company calls "protect and attack"—defending its core market in PCs (Lenovo is now the world's number one manufacturer) while moving into new growth areas such as mobile and the cloud—Yang has turned things around. Earlier this year Lenovo spent $2.3 billion to acquire IBM's low-end server business and $2.9 billion for Google's Motorola Mobility unit.

He talks here with HBR's editor in chief about Lenovo's innovations, competitors, acquisitions, and more.

HBR Reprint R1407J

POSTMASTER
Send domestic address changes, orders, and inquiries to:
Harvard Business Review, Subscription Service, P.O. Box 62270, Tampa, FL 33662. GST Registration No. 1247384345. Periodical postage paid at Boston, Massachusetts, and additional mailing offices.

Printed in the U.S.A.
Harvard Business Review (ISSN 0017-8012; USPS 0236-520), published monthly with combined issues in January–February and July–August for professional managers, is an education program of Harvard Business School, Harvard University; Nitin Nohria, dean.

Published by Harvard Business School Publishing Corporation, 60 Harvard Way, Boston, MA 02163.

How We Did It

GLOBALIZATION

The CEO of Ozon on Building an e-Commerce Giant in a Cash-Only Economy

Maelle Gavet | page 38

The author left the Boston Consulting Group to join Ozon in part because she had once been an entrepreneur and missed the excitement—but mostly because she saw the company's potential to become the Amazon of Russia. Russians were going online at an extraordinary rate; if Ozon could figure out how to deliver goods in an e-commerce market, despite the country's shaky distribution systems, its growth would skyrocket.

The company's success in e-commerce would hinge on logistics and customer support. Ozon had to persuade people that they could get their goods more quickly and reliably by ordering them online and having them delivered than by hoping to find them in stock at a shop. It needed a way to safely take and process the cash that Russians usually pay with. And it had to provide personal contact with customers and harvest data about their purchases and preferences. This is the story of how Gavet and her team met those challenges.

HBR Reprint R1407A

Managing Yourself

Becoming a First-Class Noticer

Max H. Bazerman | page 116

We'd like to think that no smart, upstanding manager would ever overlook or turn a blind eye to threats or wrongdoing that ultimately imperil his or her business. Yet it happens all the time. We fall prey to obstacles that obscure or drown out important signals that things are amiss.

Becoming a "first-class noticer," says Max H. Bazerman, a professor at Harvard Business School, requires conscious effort to fight ambiguity, motivated blindness, conflicts of interest, the slippery slope, and efforts of others to mislead us.

As a manager, you can develop your noticing skills by acknowledging responsibility when things go wrong rather than blaming external forces beyond your control. Bazerman also advises taking an outsider's view to challenge the status quo.

Given the string of ethical failures of corporations around the world in recent years—from BP to GM to JPMorgan Chase—it's clear that leaders not only need to act more responsibly themselves but also must develop keen noticing skills in their employees and across their organizations.

HBR Reprint R1407L

THE GLOBE

LEADERSHIP

How the *Other* Fukushima Plant Survived

Ranjay Gulati, Charles Casto, and Charlotte Krontiris | page 111

In March 2011 Japan's Fukushima Daiichi nuclear power plant was devastated by three reactor explosions and two core meltdowns in the days following a 9.0 earthquake and a tsunami that produced waves as high as 17 meters. The world is familiar with Daiichi's fate; less well known is the crisis at its sister plant, Daini, about 10 kilometers to the south.

As a result of nature's onslaught, three of Daini's four reactors lacked sufficient power to achieve cooldown. To prevent the disaster experienced up north, the site superintendent, Naohiro Masuda, and his team had to connect them to the plant's surviving power sources. In a volatile environment, Masuda and Daini's hundreds of employees responded to each unexpected event in turn. Luck played a part, but so did smart leadership and sensemaking.

Until the last reactor went into cold shutdown, Masuda's team took nothing for granted. With each new problem they encountered, it recalibrated, iteratively creating continuity and restoring order. Daini survived the crisis without an explosion or a meltdown. **HBR Reprint** R1407K

Life's Work

HBR.ORG For Pelé's views on commercial endorsements, go to **hbr.org/pele**.

Pelé was a soccer star at age 16 and became a sports legend over the next four World Cup tournaments, scoring 12 goals and leading Brazil (this year's host country) to three victories. Now 73, he says he still has three loves: family, *fútbol,* and the public. *Interviewed by Alison Beard*

HBR: You were the star of all your teams. Did you also see yourself as their leader?

Pele: I never wanted to be a leader. It came naturally. All the focus was on me. I just tried to pass on my best to the other players, to tell them what I thought was important in my life. We had our coaches off the field, and I had very good relationships with them because they gave me the freedom to work. But sometimes the field is so big they can't talk to the players, so you have to help pass the message, organize the team, be the leader.

But you were never a team captain.

No. Reporters at press conferences would always ask me about that, and I would tell them, "Listen, I don't need to be captain. If we have another player as captain, then there are two leaders in the game."

How did you go about helping to coach your teammates?

In my first year with the New York Cosmos, we had a lot of young players. I don't know if they wanted to make me happy or they were afraid to stay with the ball, but I had to tell them, "Don't give every ball to me. We have to play as a team."

Why did you come out of retirement to play for the Cosmos?

The first time I retired, Brazil had won the 1970 World Cup, and I was the best player in the tournament. But the next World Cup was a few years away, so I said, "No, I'm not going to play any more." Then I started to get lots of invitations—from Real Madrid, Barcelona, Milan, Bayern Munich. In the United States, football was just starting, and my friend Steve Ross, the president of Warner Communications, wanted to help. They called me, and I said OK because it was different from playing in Europe. It was coming back to promote football in this country.

When you finally stopped playing professionally, how hard was it to adjust?

It was a little difficult for the first two years to be off the field, out of the crowd. Even if I was playing with the kids at camps or universities or clinics, I missed it a lot because it was all my life. But I did a lot, God help me, and I think I stopped at my best.

But you've remained active. How do you relax?

I have a little farm in a small town away from São Paulo. We have a lake, a river, agriculture, a horse. When I'm tired, I spend a week there. It's perfect.

Many people complain about money in sports today. Should top players make such high salaries?

Yes, because football is not a normal profession, where you can work until you're 80. The good players can play only until 34, 35, maximum 40. But then they have to live. The problem is how the money is spent. Now, with TV and sponsors, some teams and players make a lot; others, nothing.

HBR Reprint R1407N


432
What's going on ?
Well, the CEO asked George to take the pulse of the company...
saposaraso