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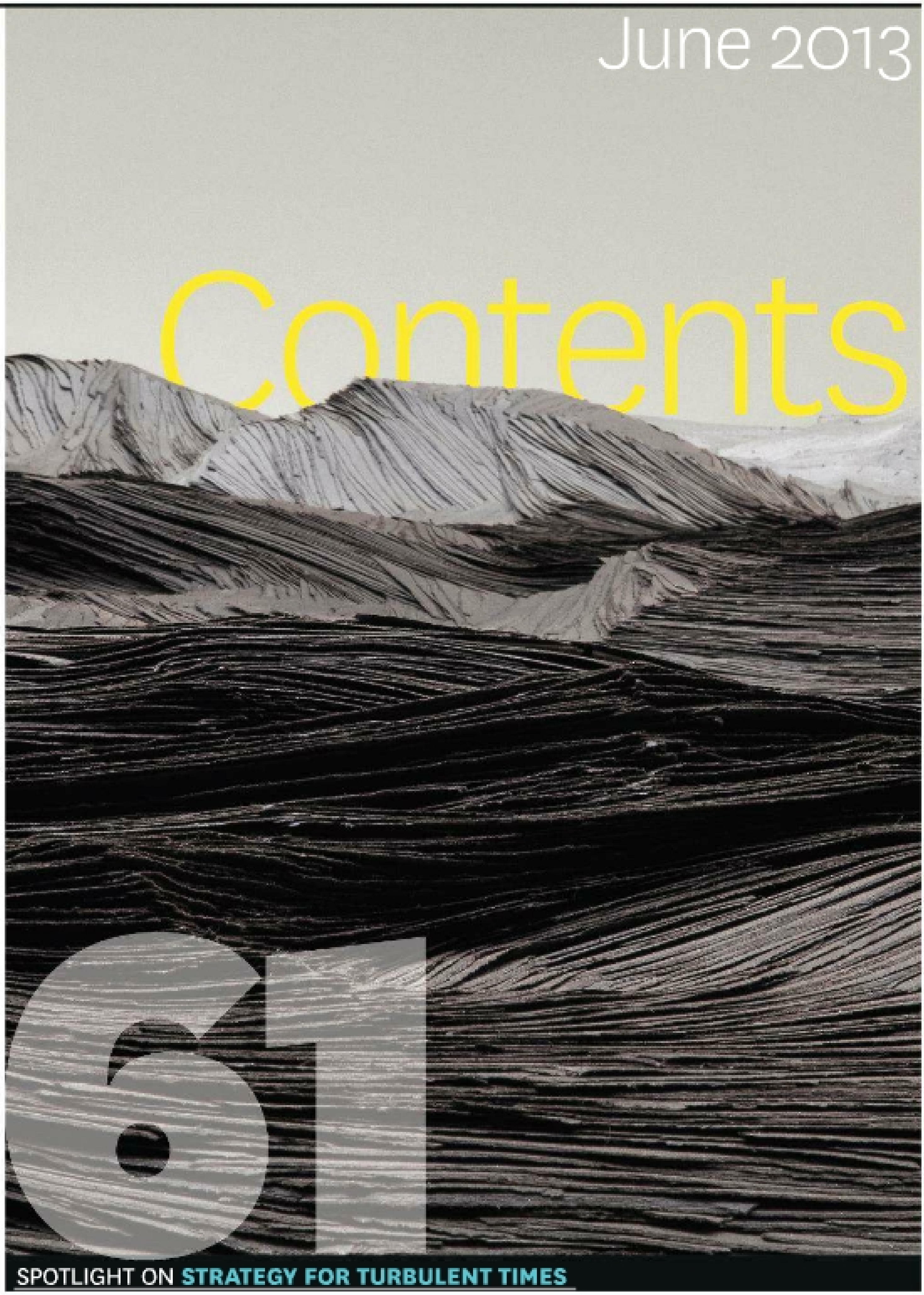

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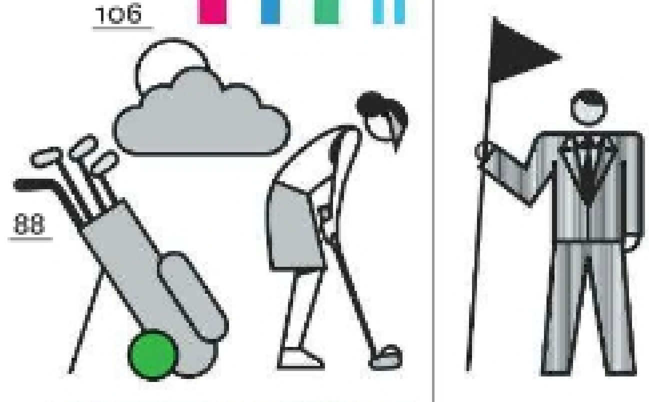

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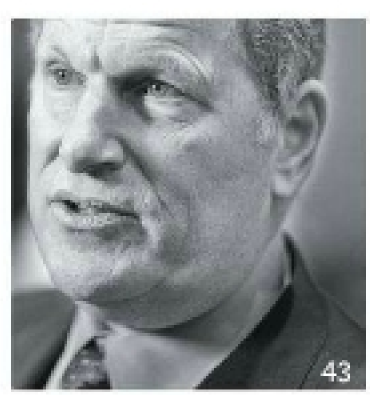

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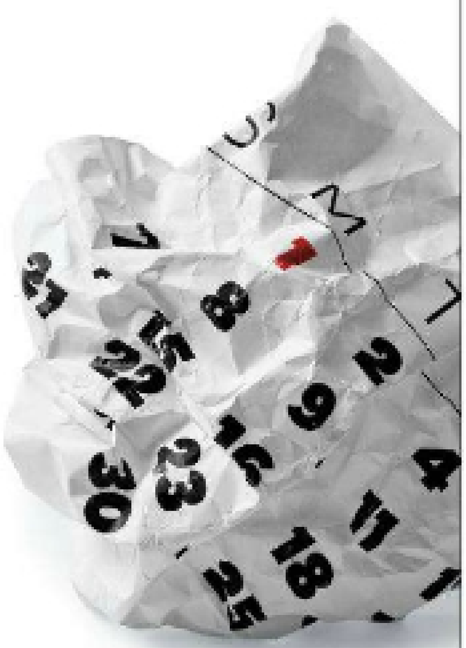

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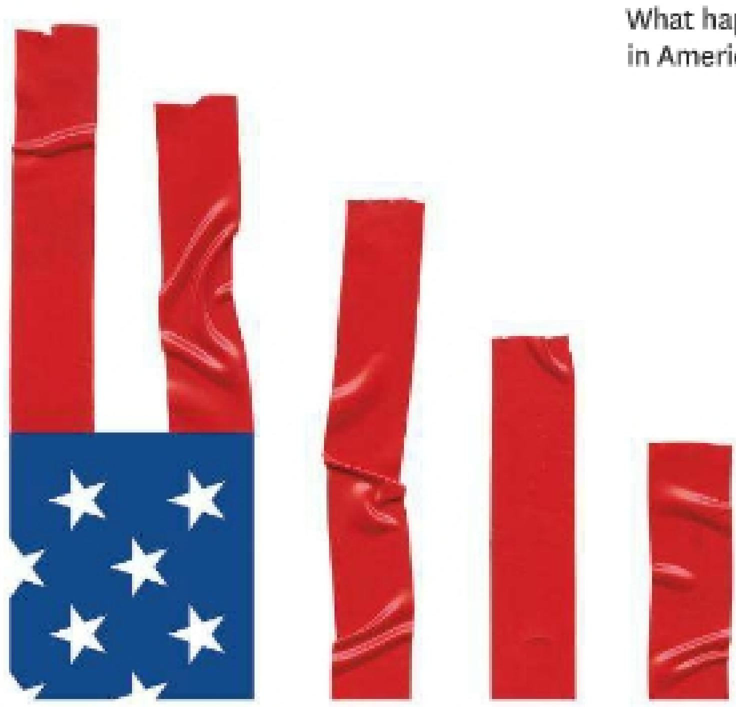

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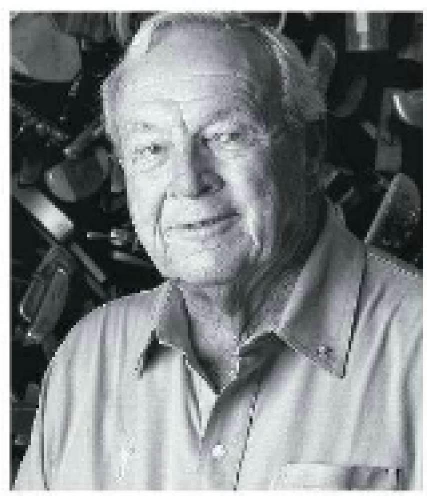

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From the Editor

Strategy for a World in Flux

Is the business world moving too fast for strategy to keep up?

Rita McGrath, of Columbia Business School, essentially asks that question in this month's Spotlight. The big shifts in the world economy—the digital revolution, lowered barriers to entry, globalization—combine to make it nearly impossible for companies to maintain truly lasting competitive advantage. As a result, she argues, companies need to constantly launch strategic initiatives so that they can exploit "transient" advantages before they disappear.

Stability, McGrath shows, is no longer the norm. In fact, it isn't even the goal. The imperative now is to perpetually innovate, creating a portfolio of advantages that can be built quickly and abandoned just as fast.

And what about Michael Porter's five forces? Michael Ryall, of the Rotman School of Management, contends that strategy is moving beyond Porter's 1979 framework. In fact, Ryall suggests that an even more enduring model could evolve from a relatively obscure 1996 academic paper that created the basis for predictive mathematical modeling of strategic decisions.

Also in the Spotlight, Todd Zenger, of Olin Business School, stresses that the aim of strategy isn't really to gain competitive advantage—it's to develop an approach for continually creating value. To illustrate his argument, Zenger reproduces a wonderful 1957 map (page 74) depicting the vision of Walt Disney himself, who saw that a big entertainment empire could best evolve by purposefully developing synergies among its various offerings.

The world may indeed be changing quickly, but sometimes the best insights just need to be refreshed for a new era.

Adi Ignatius, Editor in Chief

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What Sets Exceptional Companies Apart


THREE RULES FOR MAKING A COMPANY TRULY GREAT

HBR article by **Michael E. Raynor and Mumtaz Ahmed,** April

In a study of 25,000 companies, researchers Raynor and Ahmed uncovered three surprisingly simple rules that make companies great: (1) Better before cheaper, (2) revenue before cost, and (3) there are no other rules—so change anything you must to follow rules 1 and 2. Some readers wondered if that advice would hold up in a complex world.

If things were that simple, every company would be successful.
Alan Zhang, graduate, University of Chicago Booth School of Business

I appreciate the simplicity of the rules, but as a business owner I have to say that the things I need to do to make my company successful extend far beyond those listed. Although a focus on competing by being better and on increasing revenue underlies the majority of what I do to maintain our success, not everything can be categorized under those rules. To do so would devalue just how much work each moving part needs.
Ken C. Schmitt, president and founder, TurningPoint Executive Search

The authors respond: *Our inquiry was designed to identify behaviors that explain differences in performance among firms. We hope that this is not seen as a slight against all the other behaviors that are critical to survival. After all, a company must survive before it can be superior!*

Simple does not mean easy.
Patrick Green, blogger, 3 R's of Success

Has it occurred to anyone that the performance outliers might just be outliers? Sorting through 25,000 companies to find a handful of highly successful firms and then trying to articulate managerial reasons for why they are on the tail of the distribution curve seems like a stretch. The authors overlook many alternative explanations. Could these companies have stumbled upon growing markets, fortuitous acquisitions, or something else that we mistakenly attribute to managerial and strategic skill?
John W. Huppertz, associate professor of management and chair, MBA in Healthcare Management Program, Union Graduate College

The authors respond: *We actually spent a great deal of time determining how to quantify the likelihood that the companies were more than merely outliers. In our case studies we saw no evidence that the sorts of differences you mention were material explanations of the variations in performance we observed. Perhaps that's not surprising, because we selected our sample on the basis of performance levels*

HBR blog post by **Ron Ashkenas,** April

Change Management Needs to Change

When change is outsourced to consultants and "experts," it rarely works, Ashkenas points out, citing research showing that up to 70% of change initiatives fail.

I think the problem is baked in to the label "change management." Most people are afraid of change and resist it. We should think of it as "change leadership" instead. It's less about the nuts and bolts of systems and more about getting buy-in and cooperation, or at least nonresistance, from employees and stakeholders.
David Kaiser, executive coach, Dark Matter Consulting

I suggest supporting organizational change with navigation, not management. In times of change, keeping an eye on all the variables and elements while keeping your business moving forward is a challenge for even the best leaders. Having a good navigator, rather than a process manager, will increase your chances of success.
Karen Marie Simmons, transformation and change adviser

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that were so good for so long that lucky breaks were unlikely to feature in the explanations for them.

What about Honda, Toyota, and Datsun in the 1970s? As far as I know, they competed at the bottom of the market and distinguished themselves on price, while American car companies focused on distinguishing themselves in the upper part of the market and sealed their fates. Then the Japanese companies went upmarket.
Daniel Weitsman, commercial design team lead, SolarCity

The authors respond: *Disruptive innovators, like Toyota, very often do not have "better" offerings than incumbents, but then they don't really compete with incumbents at first. Because they're targeting unserved markets, they're competing against nothing, and in that case, they really are better before cheaper (what's cheaper than nothing?). Disrupters invade the mainstream once they've broken the long-standing trade-offs between cost and performance and are able to offer "better for cheaper" and enjoy superior profitability, thanks (not infrequently) to higher prices (or volume) and lower cost.*

When your organization needs "change management," you are already failing. If your company is so flexible that you naturally modify your structure in response to changes in the environment and iterate as part of your day-to-day operations, you won't need change management anymore.
Mario Caropreso, senior software engineer, Yammer

TED's Hard-Learned Lessons in Crowdsourcing

HBR article by **Nilofer Merchant,** April

How did the conference organizer TED lose control of its crowd—and its brand? By allowing TEDx satellite events to expand quickly, with little central oversight. Last year a few TEDx talks with questionable scientific credibility set off an expletive-laced PR debacle. Merchant explains what businesses can learn from TED's experiences opening up content contributions to the crowd—notably, that "open" does not mean "easy" or "free." Members of HBR's crowd weigh in with a few thoughts of their own.

One of the biggest problems in modern society is the erosion of authority. Merchant uses a great word here: "untethered." We are no longer attached to most of what passes for authority. We have access to more information than ever and can make up our own narratives, but without authority it's not clear which information is most reliable, and that makes our decisions much more difficult. In the end the problem is not TED but a public that finds itself untethered as media companies falter and information floods our digital devices. What we need is a general evolution in critical thought.

Eric Garland, trend analyst, author, and HBR blogger

One of the other issues that has shown up in the crowd dynamic is how difficult it is to get meaningful feedback about talks. Comments on the main TED site are for the most part the equivalent of backslapping and glad-handing. Most of us are just not that good at giving feedback in a constructive way.

Jason Kemp, managing partner, Dialog Ventures

The state of "science" in the media is terrible. Charismatic and persuasive people are celebrated by the media—even when they're wrong—because a good story sells. Real scientists tend to be nuanced and boring. The reality is that most of the things that affect your everyday life are well established; any "revolutionary" theories will be confined to the social sciences or a very specific subset of the hard sciences.

John Isaac Stone, software engineer 2, eBay Local

I hope TED leans back toward relaxing the rules for TEDx whilst encouraging public debate about quality and truth. The success of Wikipedia in tackling the issue of quality versus openness—and in building a solid reputation after initially being scorned and derided—might give TED's leaders the courage to continue being open.

Pascale Scheurer, founder and CEO, Intelligent Futures

As the article points out, the people at TED finally got ahead of the problem when they started to treat strategic marketing as a closed and protected function (they rolled out a manifesto and rules to protect the brand) and community engagement like the open and autonomous function it should be (allowing a voice of authority to speak authentically with the community and "listen loudly").

Lex Sisney, CEO coach, Organizational Physics

"Now Is Our Time"

HBR interview with **Sheryl Sandberg,** by **Adi Ignatius,** April

An outspoken advocate for female leaders in the workplace, Sandberg sat down with editor in chief Ignatius to discuss not only the institutional barriers women face but how women unintentionally hold themselves back. The interview drew both criticism and praise from our audience.

The tone of the questions was the only shocking part of the conversation, which seems to degrade many of Sandberg's ideas and suggest that her situation is somehow different. Her struggles are mine and those of a dozen of my female colleagues. She may have accomplished more than most women and may have an extrasupportive husband, but that in no way disqualifies her from speaking for the masses.

Rebecca Hoffman, sales operations manager, Mercedes-Benz USA

Ignatius responds: *The fact is, I have the utmost respect for Sandberg and her mission, and I wanted to give her ideas a great deal of space in HBR. My goal in the interview was to challenge her, to include some of the questions that our most skeptical readers would ask, so that her responses didn't merely repeat what's in her book but required her to leave her comfort zone and propel the discussion forward.*

Sandberg's stance on women as equals of men and her refusal to say "women are better" or "men are better" is an empowering one for feminism, which is not just for women—it is about making the world better for all of us. The best businesses, at their core, seek to achieve the same thing.

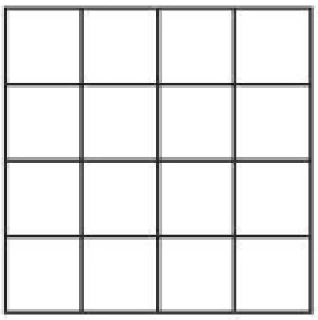
Becky Jewell, publisher relations, Graphicly

It's not that women are better than men. Women see different angles to situations and as a result encourage a more inclusive approach.

Fidelma Greene, change management expert, Fidelma Greene Associates

To Innovate, Find What's Hiding in Plain Sight

HBR blog post by **Vijay Govindarajan and Srikanth Srinivas,** April



How many squares are in a four-by-four grid? The obvious answer is 16—one for each box—but a closer look reveals many more squares of differing sizes. The authors' point? While systematic approaches help, only out-of-the-box thinking can bring about breakthrough innovation.

You're making a value judgment that finding a larger number of squares is better. Sometimes the innovation is not finding the maximum number of squares but finding a way to define the problem with sufficient clarity that two people looking at the same image will come up with the same answer. When different people make different assumptions, they get different counts.

Stephen D. Simon, independent statistical consultant, P.Mean Consulting

I see 16 white squares (absolutely and definitely there) and, by stretching the imagination, 25 small black intersecting ones. But stretching the imagination is not creative or innovative thinking, nor is it thinking out of the box. It's bending reality to suit what you want it to suit.

Mazen Khiami, HR consultant and trainer, director, Horizons Learning UK

Correction: *In the HBR Case Study "In Search of a Second Act" (April), the title of online commentator Joy Monsma was incorrect. It should have read "Instructor, The King's University College, Edmonton." HBR regrets the error.*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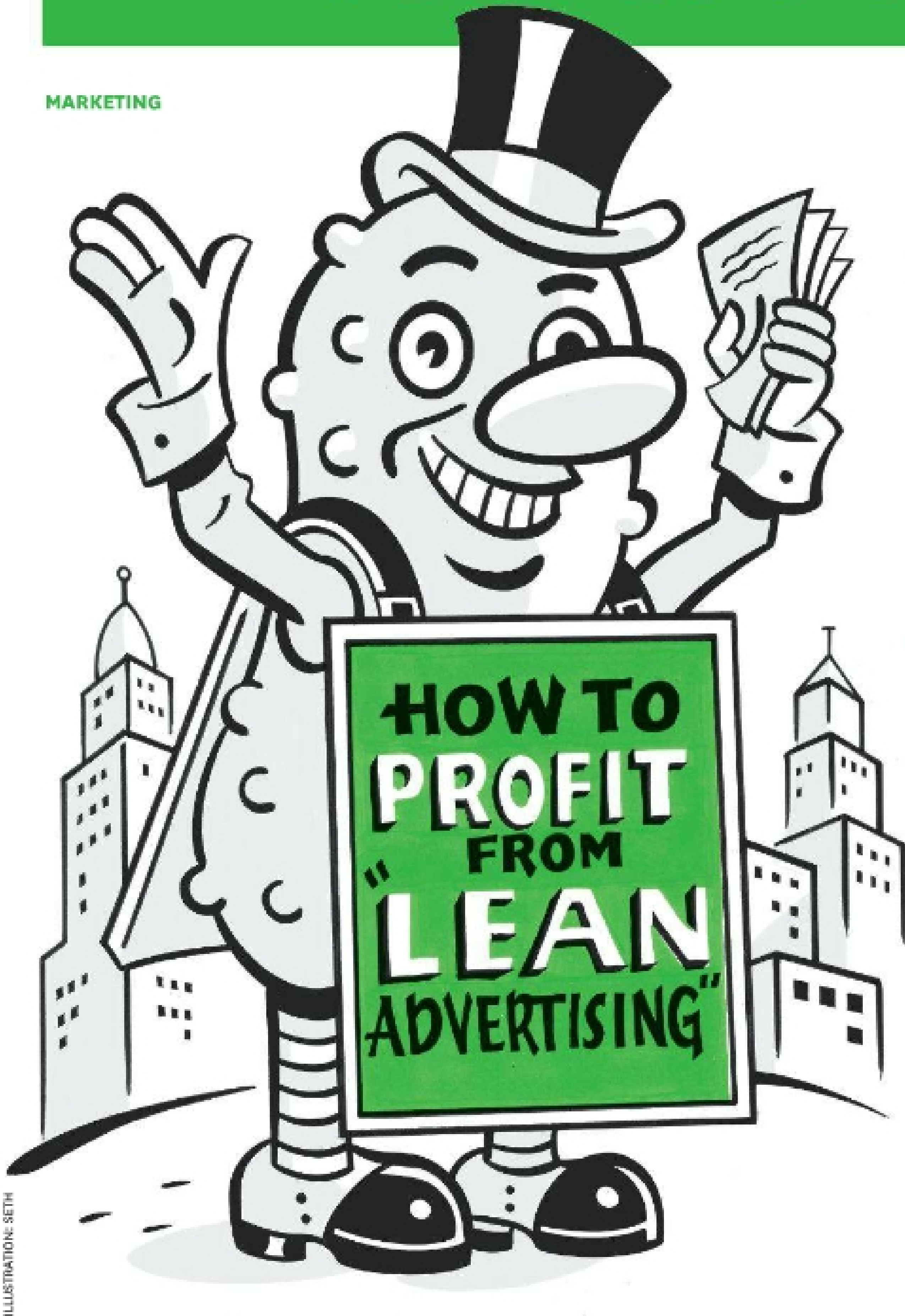


ILLUSTRATION: SETH

How to Profit from "Lean Advertising"

Online video offers a way to achieve higher engagement with consumers for far less money. *by Thales Teixeira*

The footwear industry has traditionally been a hotbed of memorable advertising, with brands such as Nike and Reebok spending millions to sign athlete-endorsers and hire ad agencies that create spectacular TV campaigns. But the approach taken by DC Shoes, which makes footwear for skateboarders, couldn't be more different. In 2009 the company began shooting videos featuring its cofounder Ken Block driving a tricked-out race car around closed-off airports, theme parks, and even the port of San Francisco. The videos last up to nine minutes and have almost no talking; the stunt driving is interspersed with glamour shots of footwear. Instead of buying expensive TV time, DC Shoes uploads the videos to YouTube. Over the past four years they have gotten more than 180 million views—and in 2011 alone, sales jumped 15%. One was YouTube's most-shared video of 2011; another garnered a million views in its first 24 hours. Paying online media for this type of exposure would cost upward of $5 million. Using "lean advertising," DC Shoes achieved it for a tiny fraction of that amount.

Many other companies would like to mimic this approach. In my research, I use eye-tracking technology, facial-expression analysis, and lab experiments to better understand why people choose to view online videos, what narrative techniques keep them watching, and what features prompt them to share videos with friends. Since writing about this work in HBR last year (see "The New Science of Viral Ads," March 2012), I've received a steady stream of requests from companies asking: How can we put that research to use? As a result, I've been studying how companies create and distribute online video advertisements, and I've examined some of the new firms that specialize in helping them do so. I've found many examples of companies that have produced effective campaigns for 10% or even 1% of what they would have spent on traditional ad agencies and paid mass media.

Lower cost isn't the only reason to consider online video. Because of channel surfing, DVRs, and the growing use of "second screens" (mainly smartphones and tablets), fewer people watch TV commercials than in the past. And online video is becoming more popular each year: In 2011, 83% of U.S. internet users regularly watched online videos, and the research company comScore estimated that 12% of the clips viewed were ads. Moreover, because viewers actively choose online videos, they tend to watch them more attentively than they watch TV ads. According to a 2010 survey by the research firm Vision Critical, 48% of those who watched an online ad at any point subsequently visited the brand's website, 11% shared the video with a friend, and 22% made a purchase.

Create It Yourself or Find Outside Talent?

Developing an ad campaign involves two main tasks: Creating content and distributing it. A traditional agency typically charges $100,000 to $1 million to produce a 30-second TV spot, and networks charge $14,000 to $545,000 each time a spot airs. Companies looking to cut those costs can take a do-it-yourself approach or outsource one or both of those tasks to lower-cost firms. Let's look at content creation first.

DIY content. As you'd expect, the do-it-yourself approach is the cheapest—and sometimes it works remarkably well. In the most celebrated example, in 2007 the kitchen appliance company Blendtec created a series of videos in which the founder, Tom Dickson, demonstrated the power of its products by blending such items as marbles, a rake handle, hockey pucks, and iPods. The videos went viral on YouTube, landing Dickson on the *Tonight Show* and the *Today Show,* and sales took off. The Blendtec videos have been viewed nearly 240 million times to date. But the odds of replicating that success are low: Just 3% of YouTube films are viewed more than 25,000 times. Inside the ad industry, relying on YouTube alone to get a message out is derided as "post it and pray."

Outsourced content. Many companies, including Duck Tape, Lego, Duracell, and Braun, have turned to Tongal, a four-year-old firm that, for a fee, posts specs for a project and matches it with freelance creative talent willing to work for relatively low pay. For instance, a company might want 90-second videos that mention the brand name at least twice and show the logo for two seconds. Tongal members submit 250-word proposals that meet those specs, and the brand company pays $500, on average, for the rights to the ideas it likes. Members then create clips based on the winning ideas, with those who produce the best ones typically receiving $5,000 to $20,000. Because Tongal draws on the skill sets of many professionals and competent amateurs, the ads tend to be of high quality.

Companies pay $10,000 to $50,000, on average, for ads from Tongal, and the most successful Tongal contributors have earned more than $150,000 from their work on dozens of projects. Companies generally use the ads online, but some go further: For example, Speed Stick paid $17,000 for a Tongal-produced ad and laid out $4 million to air it during the 2013 Super Bowl, whose viewers ranked it higher than conventionally produced ads for Coke, Pepsi, Subway, Lincoln, and Anheuser-Busch.

Engineered to Go Viral

High-quality content is not the only requirement for successful lean advertising; effective distribution matters, too. Companies can again choose to do it themselves or to contract outside help.

DIY distribution. Some companies that outsource content creation handle their own distribution, putting videos on their websites and posting them on YouTube. Most, however, enlist at least some help drawing in viewers—a service known as "inbound marketing" (to distinguish it from traditional, or outbound, marketing). For a relatively small fee (typically less than $10,000 a year), inbound-marketing companies such as HubSpot use search engine optimization and sophisticated analytics to help clients understand which of their content offerings draw viewers and which don't.

STEP ASIDE, MAD MEN

People watch more online videos each year, and savvy companies are taking advantage of that fact. Those with tiny budgets can create and distribute videos themselves at low cost; others can spend more to crowdsource content or hire expert distributors. Companies can also mix and match strategies—for example, crowdsourcing content but distributing it themselves.

	Do It Yourself	Others Do It for You	Traditional Approach
CONTENT CREATION	Companies are developing the ability to create their own commercials, ranging from simple product demos like Blendtec's to elaborate productions like DC Shoes'.	Even large companies that can afford agencies, such as Duck Tape and Lego, are tapping into low-cost creative talent and crowdsourcing ads via Tongal.	Large companies with big budgets hire full-service ad agencies to create TV spots.
	COST PER AD: **<$10,000**	**COST PER AD:** **$10,000–$50,000**	**COST PER AD:** **$100,000–$1,000,000**
CONTENT DISTRIBUTION	Instead of simply posting a video online and hoping people find it, companies hire inbound marketing firms such as Hubspot, which use low-cost strategies to drive traffic.	Newer ad agencies, such as Mekanism, have expertise in engineering ads to go viral; they use social media (and sometimes paid spots) to drive traffic.	Full-service agencies charge commissions when they buy time on television for traditional ads.
	ANNUAL COST PER CAMPAIGN: **$3,000–$6,000**	**COST PER CAMPAIGN:** **$250,000+**	**COST PER CAMPAIGN (PRIME TIME):** **$500,000**

NEW APPROACHES WITH LOWER BUDGETS

Outsourced distribution. Companies seeking more-aggressive distribution often look to social media syndication firms such as the San Francisco–based agency Mekanism. The firm does produce traditional ads, but since 2009 its forte has been making and disseminating blockbuster online ads; in 2010 its CEO asserted, "We guarantee we can create an online campaign and make it go viral." Mekanism's services include managing digital platforms (such as dedicated YouTube channels and, occasionally, paid online video) and building networks of high-profile digital influencers to spread campaigns. Its ability to tap into huge online audiences through those influencer networks is the reason the CEO is so confident of its viral reach. About 75% of Mekanism's online videos have garnered more than 1 million views (a commonly accepted threshold for "viral"), and the cost is far less than that of conventional distribution channels: Mekanism charges as little as $250,000 to run a campaign that doesn't involve traditional paid media.

Research by Michael Norton and colleagues has shown that people are more engaged in things they've had a hand in creating (see "The IKEA Effect: When Labor Leads to Love," HBR February 2009)—and Mekanism often involves consumers in the creation of its clients' ads. In a campaign for Golden Grahams aimed at recent college graduates, it posted a series of animated videos about job interviews gone comically awry. It then solicited viewers' own stories via Twitter, turning more than 50 of them into online videos. Together the videos got more than 2.5 million views (60% of which were the direct result of influencers' actions). Viewers remained engaged with the videos for four minutes and 10 seconds, on average, and each person typically watched multiple videos, with many later visiting the company's website.

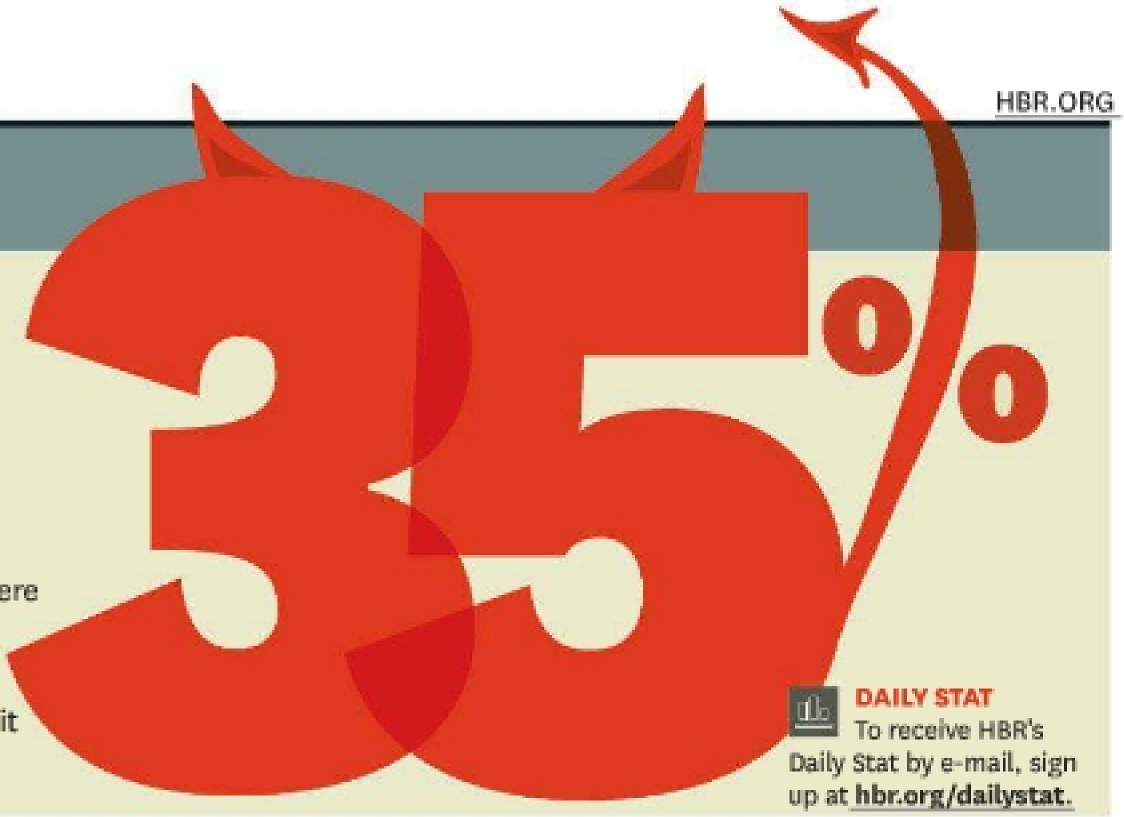
As ad viewership increasingly shifts online, traditional measures of cost and effectiveness, such as cost per impression—the dominant metric for print, radio, and TV ads—will become less relevant, and new metrics will be needed. I often discuss with my students potential ways to measure "cost per engagement." By tracking the amount of time a person spends viewing an online video and seeing whether she forwards it, visits the company website, or begins following the company on Twitter, you can quantify the benefits your company receives from a campaign. Looking at those benefits against your expenditures will give you a good sense of the efficiency of your campaign, allowing you to compare online lean advertising techniques with traditional media efforts.

Most online video advertisements today promote large, established brands. That's because big companies, blessed with hefty ad budgets, have begun aggressively allocating some of their spending to the web. Over time, smaller companies' ads will become an increasingly large part of the mix. Web video and novel distribution strategies are perfectly suited to rapidly building brands on limited budgets—the core of lean advertising. Whether companies create campaigns themselves or enlist outside help—or some mix of the two—there's growing evidence that this new approach can have a big payoff.

HBR Reprint F1306A

Thales Teixeira is an assistant professor in the marketing unit at Harvard Business School.

Stat Watch



THE FINE LINE BETWEEN COLLABORATION AND CONSPIRACY

Companies whose top four non-CEO executives are appointees of the current CEO are about 35% more likely to engage in fraud—and 20% less likely to get caught—than companies in which none of the four were appointed by the present CEO, according to a study led by **Vikramaditya S. Khanna,** of the University of Michigan Law School. It takes teamwork to commit fraud and keep it hidden, the researchers suggest.

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

DECISION MAKING *by Robin Hogarth and Emre Soyer*

A Picture's Worth a Thousand Numbers

Since the 1960s, researchers have explored the trouble humans have understanding probability. New studies by ourselves and others show that the way data are presented has a big impact—in particular, graphic representations and computer simulations can help.

In one experiment, we gave 257 economists a simple regression analysis and asked about the odds of various outcomes. Some were shown the data in the form customary in economics journals: the mean, the standard deviation, and so on. They got most of the answers wrong. Others were given a scatterplot, with no analysis. Although some of them complained about not having enough information, most did much better.

In complex problems where graphing is not an option, computer simulations let people "experience" odds by running numerous versions of the underlying statistical process and seeing the results. (Flipping a coin repeatedly is a simple example of a simulation.) We hypothesize that although probability theory is a fairly recent invention, people have been encoding and interpreting sequentially observed "frequency information" for eons—so the human brain has some experience with odds presented in that form. Our research bears the hypothesis out. We gave statistical puzzles to 62 undergraduate students who'd recently taken classes in statistics and 20 adults who were less statistically inclined. In both groups, people were much more likely to give correct answers after running simulations.

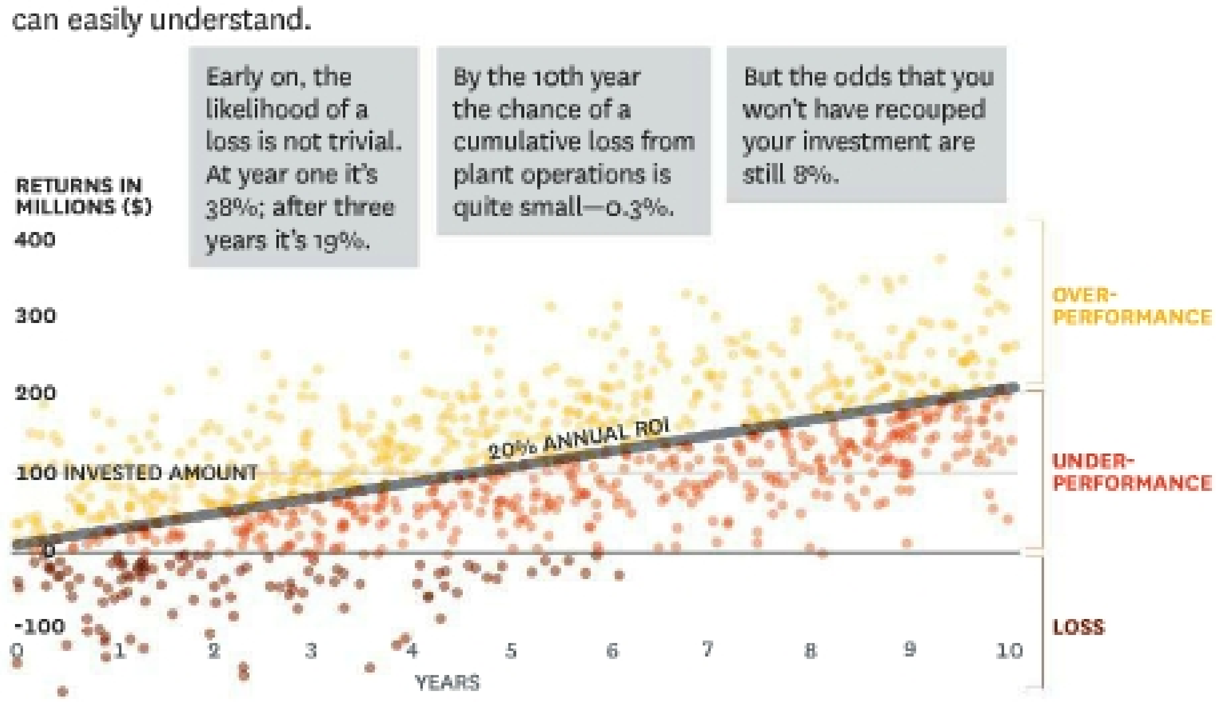
We believe these results hold great promise for improving statistical understanding in business, government, and other fields. For example, firms deciding whether to buy new equipment and individuals choosing retirement portfolios face considerable risk and uncertainty. Statistical analyses can estimate the risk and aid in decision making—but most of us struggle to make sense of those analyses. Graphs and simulations let people observe potential outcomes and effectively experience the risks, enabling them to make better choices. **HBR Reprint** F1306B

Robin Hogarth is an emeritus professor at Universitat Pompeu Fabra, in Barcelona. **Emre Soyer** is an assistant professor at Özyeğin University, in Istanbul.

PROBABILITY: A CLEARER VIEW

Your company is considering a $100 million investment in a new factory. The number crunchers estimate that the plant will generate an annual return of 20% over a 10-year lifespan. But they also say the estimate has a standard deviation of 70%. What are the chances things will go wrong?

STUMPED? If you run 1,000 simulations of the results and enter them on a scatterplot, the scenario becomes more intuitive. As companies increasingly rely on analytics and Big Data, it's important to use infographics to present information in ways decision makers can easily understand.



THERE'S A NEW EXHIBIT AT THE ZOO. IT'S CALLED ANALYTICS.

STARTING SMALL WITH BUSINESS ANALYTICS.

In the past, many midsize businesses viewed analytics as an all-or-nothing proposition—with "all" being well beyond their resources.

Now, however, with the right partner the opposite is true.

59% *of midsize business leaders say critical decisions rely too much on gut feelings.*

Midsize companies all over the world are honing their performance right now with analytics from IBM and its Business Partners. They're using a step-by-step approach, targeting areas that will yield immediate results, then adding capabilities as they go along.

A MEASURED APPROACH WITH REAL-WORLD RESULTS.

Take the Cincinnati Zoo. They needed to optimize operations in the face of shrinking budgets and falling attendance. They chose IBM and BrightStar, an IBM Business Partner, to deploy an incremental, three-step solution using IBM Business Analytics software.

Almost immediately, new insights generated results. With data-driven analysis, they tightened marketing segmentation and messaging, helping cut marketing costs by 43%. And after analyzing location, time and demand data, the zoo placed additional carts at exits during closing time, boosting ice cream sales by an average of $2,000 a day.

Each individual step added value, and every evolutionary improvement compounded the benefits, leading to an annual ROI of 411%.

The Cincinnati Zoo, powered by analytics.

WHAT ABOUT YOUR COMPANY?

The zoo is just one example. Today, thousands of midsize companies across industries are using IBM Business Analytics software to generate similar results by deploying what they need, when it makes sense—rather than doing it all at once, or not at all.

"We forecast a 5% increase in food sales. Getting 30% was incredible."
— John Lucas, The Cincinnati Zoo

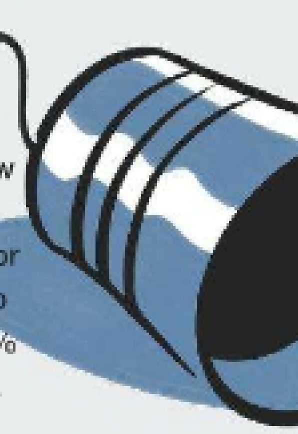
Take the first step. See how IBM and its Business Partners can help your midsize business prosper, one step at a time.
ibm.com/engines/analytics

LET'S BUILD A SMARTER PLANET.

IBM

Research Watch

WHEN CEOS TALK STRATEGY, IS ANYONE LISTENING?



Companies devote endless time communicating strategy to rank-and-file employees—but only a minority take it in, according to new research by **Timothy Devinney** and colleagues at the University of Technology in Sydney. The researchers asked employees of 20 major Australian corporations with clearly articulated public strategies to identify their employer's strategy from among six choices. Just 29% answered correctly. The good news: The firms in the sample are all high performers, suggesting that a company can thrive even if employees are clueless about its long-term vision.

ALLIANCES *by Henrich R. Greve, Timothy J. Rowley, and Andrew V. Shipilov*

How Partners Shape Strategy

Is your company the hub of a network of partners that don't interact with one another? If so, you may be well positioned to produce radical innovations, but you could be on your own if trouble strikes. Or are you part of a web of interconnected allies? Then you may be limited to incremental innovations—but you'll probably be much less isolated during a crisis.

In 12 years of research we've learned which kinds of alliance networks are best for which types of firms and how you can tailor your network to suit your strategy, position, and business environment.

Consider the alliances formed by Samsung and Sony with suppliers, sales channels, and R&D partners from 2008 to 2011. Samsung is at the center of its network—a vantage point from which it can combine insights from such diverse partners as DreamWorks and KT, which do interesting things with 3-D technologies but don't typically work together. Like Apple, which invented the iPhone after gleaning insights from Motorola and disparate other partners, Samsung is well placed to look to the future and conceive a breakthrough product—perhaps the first handheld device for watching 3-D movies without special glasses. (Its Galaxy S4 phone has cutting-edge gesture- and eye-tracking features.) But it risks the isolation experienced by another hub firm, Boeing, whose network did not foster the deeply integrated partnerships needed to tackle manufacturing problems on its innovative 787 Dreamliner and to avoid product launch delays.

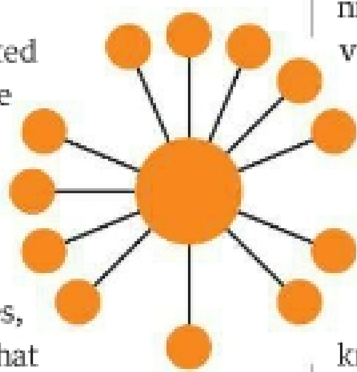
Sony is part of a web of allies, including Sharp and Toshiba, that work with one another. Although highly integrated networks like this one are less likely to yield breakthrough innovations, they have a big advantage on another front: Their members often reach out to partners in need. For example, after the March 2011 earthquake in Japan, customers and suppliers of Renesas Electronics sent 2,500 workers to help rebuild a damaged plant.

Consider, too, these insights from our research:

- In a fast-changing environment, it's crucial to be at the center of a hub-and-spoke network so that you're constantly exposed to new ideas. Firms in dynamic industries had higher returns on assets if they were part of this type of network.
- Highly diversified firms gain a lot from being hubs, because employees with different backgrounds can see more opportunities in diverse ideas coming in from the spokes.
- Integrated networks can be particularly beneficial for companies whose small size leaves them vulnerable to shocks.
- With either type of network, a company must ensure that information about partners flows freely so that an executive managing a relationship with one partner knows what others are learning from different partners.

Our analysis suggests that Sony—large, diversified, and in a fast-changing industry—would be better off with a hub-and-spoke network like Samsung's. The difference in network structures is one reason Samsung has outpaced Sony in creating innovative products in recent years.

Many companies fail to look beyond their own partner relationships to consider whether their partners are interacting with one another. This prevents them from gaining the greatest possible competitive advantage from their alliances.

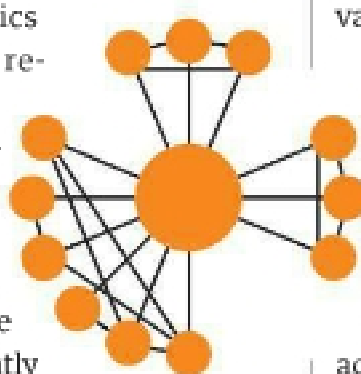


HUB AND SPOKE

(LIKE SAMSUNG)

RADICAL IDEAS?
YES

HELP IN A CRISIS?
PROBABLY NOT



INTEGRATED

(LIKE SONY)

RADICAL IDEAS?
NO

HELP IN A CRISIS?
LIKELY

HBR Reprint F1306C

Henrich R. Greve is a professor, and **Andrew V. Shipilov** is an associate professor, at Insead. **Timothy J. Rowley** is an associate professor at the University of Toronto. Their book, *The Network Advantage*, is forthcoming from Wiley in December 2013.

ILLUSTRATION: SETH

Defend Your Research

HBR puts some surprising findings to the test

Hal Hershfield (above left, with an image of his digitally aged avatar on the right) is an assistant professor of marketing at New York University's Leonard N. Stern School of Business.

You Make Better Decisions If You "See" Your Senior Self

The finding: Many people feel disconnected from the individuals they'll be in the future and, as a result, discount rewards that would later benefit them. But brief exposure to aged images of the self can change that behavior.

The research: Hal Hershfield ran fMRI scans on subjects and found that the neural patterns seen when they described themselves 10 years in the future were markedly different from those seen when they described their current selves (but similar to those seen when they talked about actors). In a later asset allocation task, people whose brain activity changed the most when they began discussing their future selves were the least likely to favor large long-term gains over small immediate ones. However, in follow-up experiments, when subjects were shown aged images of themselves, that tendency disappeared.

The challenge: Do we really think of our older selves as strangers? And can digitally altered photos really improve our judgment? **Professor Hershfield, defend your research.**

Interview by Alison Beard

Hershfield: This study, which I did with G. Elliott Wimmer and Brian Knutson at Stanford, was the first to use fMRI technology to document the disconnect people feel with their future selves. But it built on existing research. For example, one study asked people how many hours they'd be willing to spend tutoring someone immediately and in the future and how much time they thought their classmates could donate immediately. They were stingy with their own time in the present but more willing to volunteer their time in the future and their classmates' time in the present, which suggests they thought of their future selves and other people in the same way. Studies have also shown that we have a third-person perspective on ourselves in the distant future. So, if you imagine your birthday next year, you'll envision the scene as if you were looking out from your own eyes. But if you imagine it 20 years from now, you'll probably picture an older version of yourself blowing out the candles. This is true for most but not all people. The scans revealed that some subjects did think of their current and future selves as the same person, and in our asset allocation task, those people were more likely to delay their gains. That's why we wanted to see if we could change the attitudes of everyone else. Could we help people get to know—and show more regard for—their future selves?

HBR: Without using a time machine.

Right. There's a large body of literature showing that emotional responses are heightened when you give people vivid examples: Donors give more to charity when they hear from a victim; pulmonologists smoke less than other doctors because they see dirty lungs all day. So I partnered with Daniel Goldstein of Microsoft Research, Jeremy Bailenson of Stanford, and several other Stanford researchers to see if giving people vivid images of their older selves would change their spending and saving preferences. We took photos of our subjects and used software to create digital avatars—half of which were aged with jowls, bags under the eyes, and gray hair. Wearing goggles and sensors, participants explored a virtual environment and came to a mirror that reflected either their current-self or future-self avatar. Afterward, we asked them to allocate $1,000 among four options—buying something nice for someone special, investing in a retirement fund, planning a fun event, or putting money into a checking account. Subjects exposed to aged avatars put nearly twice as much money into the retirement fund as the other people. Later we had some people see the older avatars of other subjects to test if that affected their choices, but it didn't. Only those who saw their own future selves were more likely to favor long-term rewards.

That seems like a really complicated way to get people to save money.

It is, which is why we've tested lower-tech options. In a follow-up experiment we

The Power of Suggestion

took pictures of people with happy, sad, and neutral expressions and inserted them into a retirement-savings slider tool. The idea was to show users how their decisions affected both their future income and their well-being in old age. Some subjects used a tool with pictures of themselves that had been aged. They set aside 6.8% of their pay for retirement, on average, versus 5.2% for those using a tool with pictures of their current selves. After that, we ran the experiment using a national pool of online participants who uploaded their own head shots. Even with variable photo quality and static expressions, the "aged face" tools prompted people to save 6.2% on average, versus 4.4% for the "current self" tools. Merrill Lynch is already using some of this technology on its site.

So there are applications for financial services. What other behaviors might you change by making people feel more connected to their senior selves?

Ethics is one area. I've worked with Jean-Louis van Gelder of the Netherlands Institute for the Study of Crime and Law Enforcement and Loran Nordgren of the Kellogg School to test whether people act more ethically when they feel closer to their future selves. In one study young adults who'd been asked to write a letter to themselves 20 years in the future were less likely to say they'd make an amoral choice—buying a stolen laptop, for example—than people who'd been asked to write to themselves in three months' time. In a second study, using the virtual techniques I've described, we found that 18-to-26-year-olds presented with avatars of their 40-year-old selves were less likely than those who saw current-self avatars to cheat on a test. Typically, we try to prevent delinquency by scaring kids about the consequences—taking young offenders on tours of adult prisons, for example. But our findings suggest there might be a more subtle way to get them to behave better.

If something as simple as letter writing works as well as virtual reality, why not just do that?

I'd argue that the aged photos are more fun and engaging, and it's an experience you'll remember, which could heighten or prolong the effect. That's something we might study in the future.

What about health? Can you use this technology to get people to stop smoking, use sunscreen, and eat well?

Dan Goldstein and I are starting a study on weight loss; we're hoping to present people with full-body images of themselves in the future that show how diet and exercise will change them. I could see an antismoking application, too; instead of showing people diseased organs or strangers with tracheotomies, we could show them what the habit will do to their own faces and bodies, which our findings suggest would be more powerful. My aunt keeps telling me I should look into skin care, too.

Yes, if my 20-year-old self had met my current self, she would have used a lot more eye cream. So should we all hang pictures of our aged selves in our houses?

That could work, as long as you keep noticing the picture and recognizing that that future person is dependent on the current you and is ultimately the same you—just occupying a slightly different body. ⛉

HBR Reprint F1306D

ILLUSTRATION: JUDE BUFFUM

Vision Statement

E-Mail: Not Dead, Evolving

by **Barry Gill**

Periodically you may hear digital hipsters claim that e-mail is dead. Don't believe them. People still spend half their workday dealing with it, they trust it, and overall they're satisfied with it, according to our 2012 survey of 2,600 workers in the U.S., UK, and South Africa who use e-mail every day.

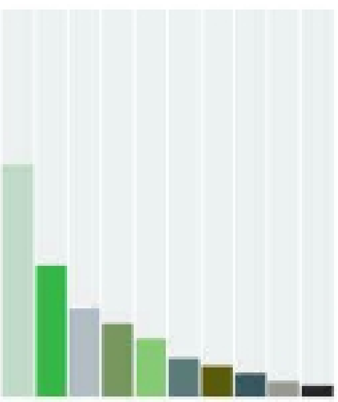
E-mail is not dead, it's just evolving. It's becoming a searchable archive, a manager's accountability source, a document courier. And for all the love social media get, e-mail is still workers' most effective collaboration tool.

It's far from perfect: Three-quarters of all e-mail is junk, and we're wasting lots of time dealing with less important messages. But it remains the mule of the information age—stubborn and strong.

HBR Reprint F1306Z

WHICH ARE THE MOST EFFECTIVE CHANNELS FOR COLLABORATION?

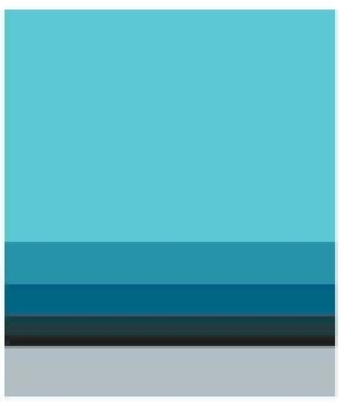
When asked to select all the tools they trust for collaboration, respondents chose e-mail as the best, by far. Workers use 19 distribution lists on average. But 22% would like to see e-mail adopt a more social construction, using self-selected "followers" and "friends."



60% E-mail to individuals
34 E-mail to lists
23 E-mail to teams
19 Teleconferencing
15 Video/web conferencing
10 Instant messaging
8 Facebook
6 Business collaboration tool
4 LinkedIn
3 Twitter/microblog

HOW DO WE ACCESS E-MAIL?

The desk is still where we spend most of our time chipping away at the in-box, but some 40% of respondents access work e-mail outside the office during off-hours. Here's the breakdown of how much of their e-mail workers access, on average, from each device.



60% Work PC/laptop
11 Home PC
8 Mobile
5 Home laptop
3 iPad/tablet
13 Other

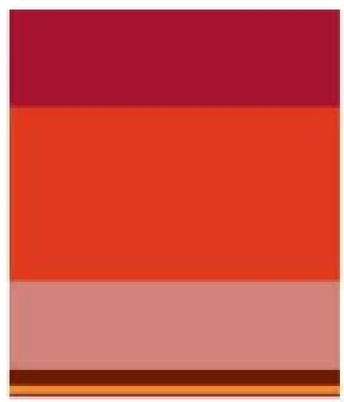
HOW MUCH TIME IS SPENT ON E-MAIL?

In a year workers spend, on average, the equivalent of 111 workdays dealing with e-mail. Most would like better search functions and document management, and there's good reason to make that happen: A 10% increase in efficiency would buy back more than two workweeks per year per employee.

13% Writing e-mails
15 Reading e-mails
22 Other e-mail activities (searching, archiving, managing)
50 Not spent on e-mail

HOW SATISFIED ARE WE WITH E-MAIL?

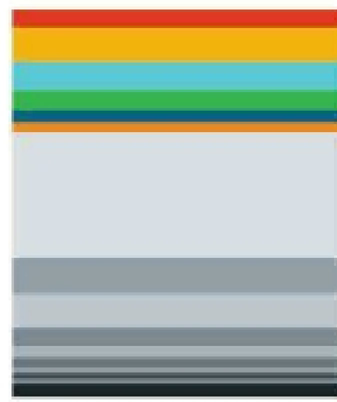
While people are satisfied overall, satisfaction is slightly lower for the searchability of e-mail, and significantly lower for archive management: Only 44% rate that highly. The lowest satisfaction is with mobile access to e-mail: Only 37% rate it highly.



25% Very satisfied
45 Satisfied
23 Somewhat satisfied
4 Somewhat dissatisfied
2 Dissatisfied
1 Don't know

WHAT DOES A YEAR'S WORTH OF E-MAIL LOOK LIKE?

Most of it is junk. Fortunately, workers see only a small portion of the malware, phishing scams, and promotional offers that bombard their accounts every day. Of the e-mails that make it into the in-box, 42% are essential or critical and just 8% are spam.



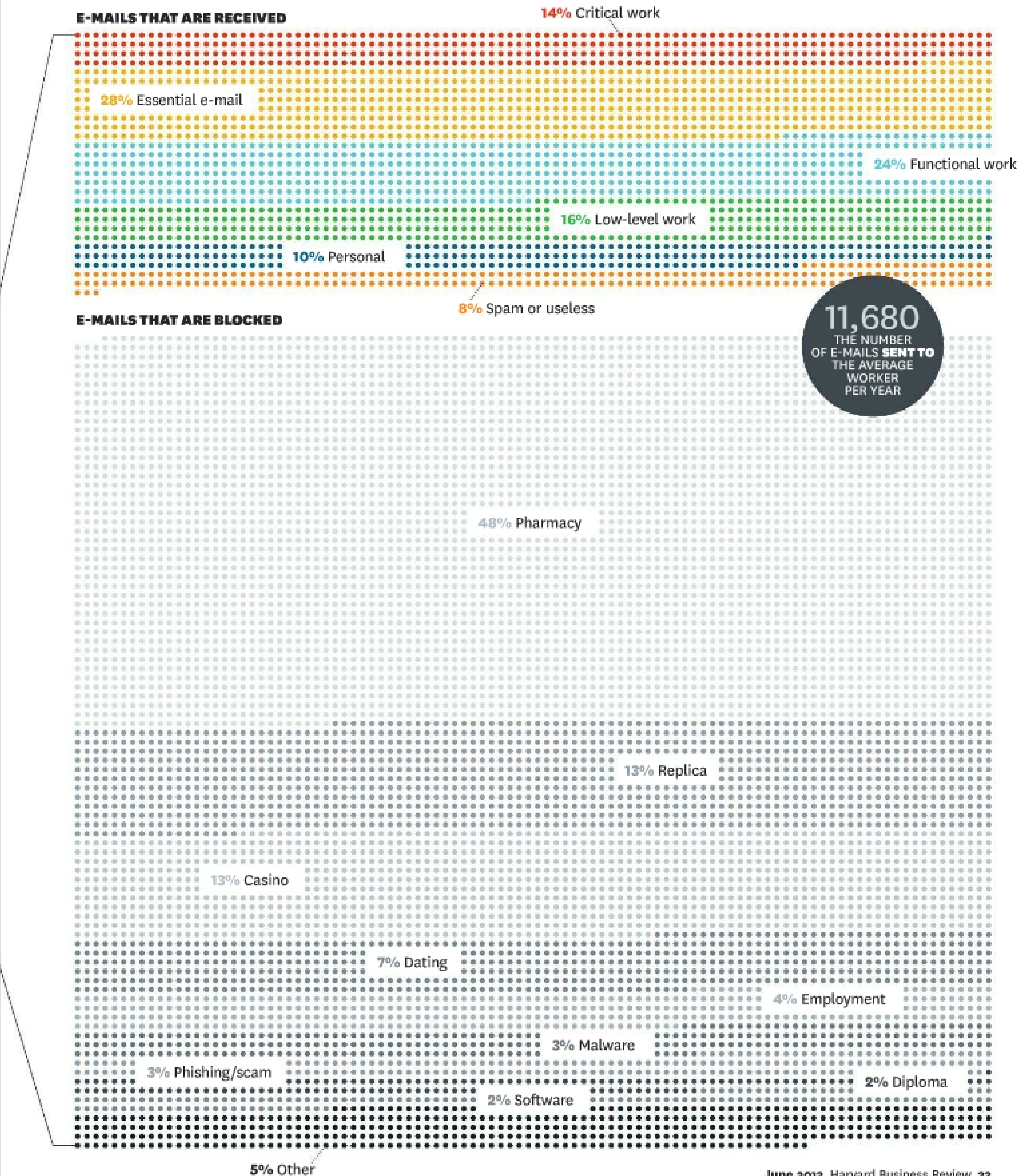
WHAT DO WE USE E-MAIL FOR?

Half of respondents believe that e-mail reduces the need for other file storage systems—meaning they are using it to archive important documents. Still, this function could improve. A third of users find e-mail search to be time-consuming and difficult to navigate. Average time to locate a document in e-mail is two minutes.

We asked respondents to list the tasks they use e-mail for. Note that communication between individuals—the original intent of e-mail—isn't even listed in the top five activities.

76% EXCHANGING DOCUMENTS
69 SENDING INFORMATION TO GROUPS
61 IMPROVING COMMUNICATION ACROSS TIME ZONES
60 ACCOUNTABILITY
59 SEARCHING FOR INFORMATION

Barry Gill is an enterprise consultant and product marketing manager with Mimecast.




Luxury, taken to a whole new level.


INTRODUCING THE RLX. Along with amenities you'd expect in a premium luxury sedan, the RLX also has features you'll find nowhere else. Like Jewel Eye™ LED headlights, designed to reproduce the spectrum of the sun, and Precision All-Wheel Steer,™ which puts all four wheels to use for unprecedented handling. These, and countless other refinements, mean the RLX is more than a new vehicle. It's also a new benchmark.
The new Acura RLX. Handsomely equipped at $54,450. Excludes $895 destination, tax, title, license and registration.
ACURA
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RLX with Technology Package shown. Learn more at acura.com or by calling 1-800-To-Acura. ©2013 Acura. Acura, RLX, Jewel Eye and Precision All-Wheel Steer are trademarks of Honda Motor Co., Ltd.

Strategic Humor

CAPTION CONTEST

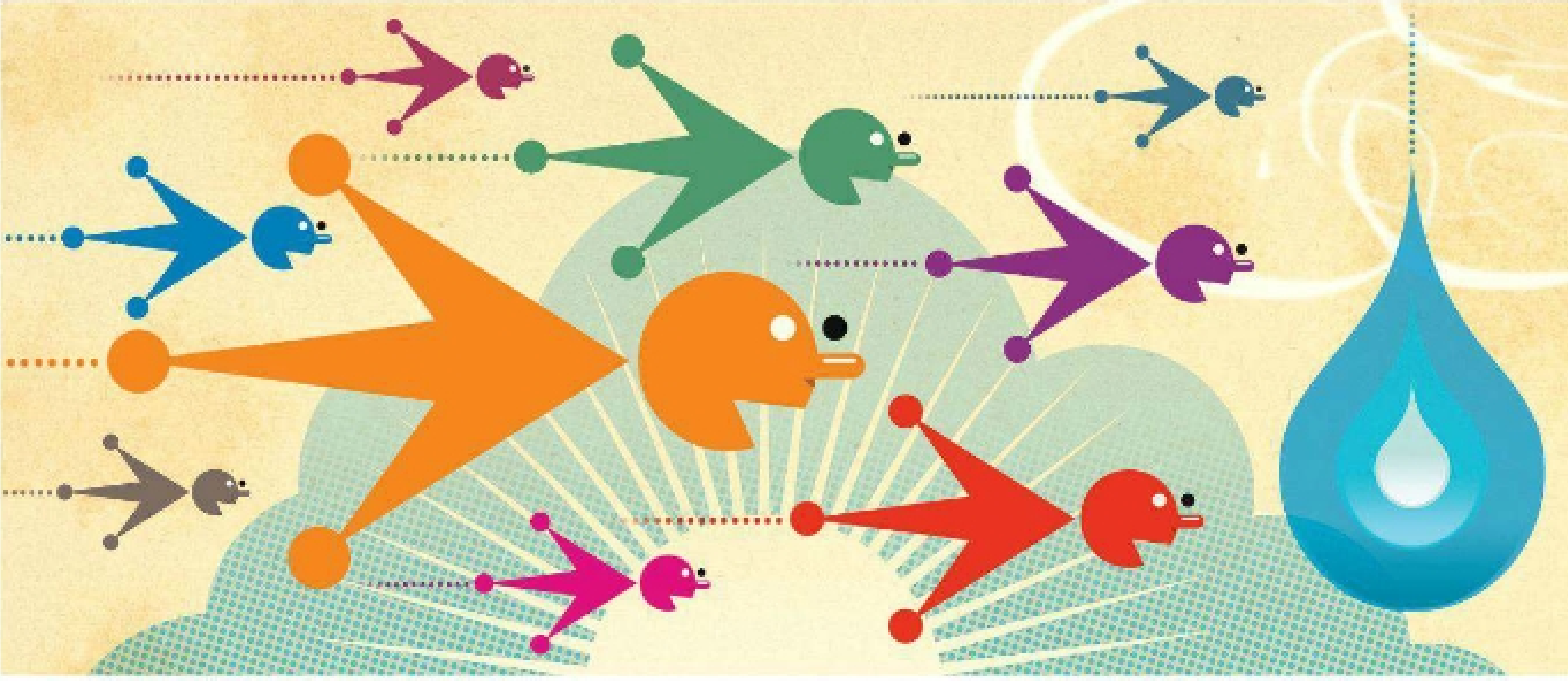
"I knew this Pamplona satellite office was a bad idea!"

This month's winning caption was submitted by **Terence McIver** of Cleveland, Ohio.

CARTOONS: KAAMRAN HAFEEZ, MICHAEL SHAW, BOB ECKSTEIN

Hewko

John Hewko is the general secretary of Rotary International and the Rotary Foundation.



If You Want to Do Something Really Big

Few Americans think about polio these days; for many it has gone the way of the steam locomotive and black-and-white TV. But this crippling viral disease still threatens children in parts of Africa and Asia. Twenty-five years ago my organization, Rotary International, joined with the World Health Organization, UNICEF, and the U.S. Centers for Disease Control and Prevention to try to bring an end to it once and for all. We're almost there: Last year saw only 223 new cases worldwide. That's a drop of more than 99% from the 350,000 cases reported annually in the 1980s.

Now that we're this close, perhaps the lessons we've learned can inspire other large-scale managerial endeavors. I'll offer three in broad strokes: (1) Don't be intimidated by sheer magnitude—break the job down. (2) Make sure the goal matches your mission, and make it personal for your people. (3) Recognize that you can't go it alone.

In retrospect, polio eradication might seem an obvious task to take on. But any initiative that ambitious is extremely daunting. As a goal, however, it did have three things going for it. There was a precedent—if only one: The eradication of smallpox, declared complete in 1979, established that a human disease could be conquered. A proven approach existed: Vaccines had been developed by Jonas Salk and Albert Sabin in the 1950s, and Sabin's oral vaccine was particularly well suited to mass immunization campaigns. And progress toward eradication could be reliably measured, literally week by week.

Polio eradication might seem an obvious task to take on. But any initiative that ambitious is extremely daunting.

You could say, then, that we were in the right place at the right time when the opportunity to make history came along. But the endeavor required substantial capabilities—and we had vital strengths to offer. Rotary's members, who currently number more than 1.2 million men and women in about 200 countries, have raised more than $1.2 billion to fight polio. We've also applied our advocacy skills, keeping positive pressure on national governments to provide sufficient resources.

Most important, the Global Polio Eradication Initiative resonated deeply with our mission as a humanitarian service organization and our members' personal priorities. If you're going to tackle a task that will take a quarter century to complete, I think this has to be the case.

It is hard for me to describe how I felt in Mumbai in November 2011, when my wife and I had our first opportunity to vaccinate children during an immunization drive. The first child I immunized was a little girl of about two. The memory of meeting her eyes as I placed the vaccine drops in her mouth will live with me forever. Our members have donated countless hours as volunteer vaccinators, and this hands-on involvement strengthens our determination. (Rotary clubs exist in polio-affected countries, too, so this work is not only about helping people thousands of miles away—it's about protecting "our" children as well as "theirs.")

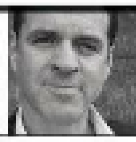
Our 25-year commitment is of course a source of pride, but it also reinforces a healthy humility. Our organization could not have come this far alone. And we had to work in cooperation with the world's governments. The original four partners have been joined by the Bill & Melinda Gates Foundation, the United Nations Foundation, and other private philanthropies. New York City Mayor Michael Bloomberg announced a sizable contribution from his own foundation in February.

With each partner bringing special capabilities and taking specific responsibilities, together we transformed a mind-boggling concept—the global eradication of a dread disease—into an achievable goal.

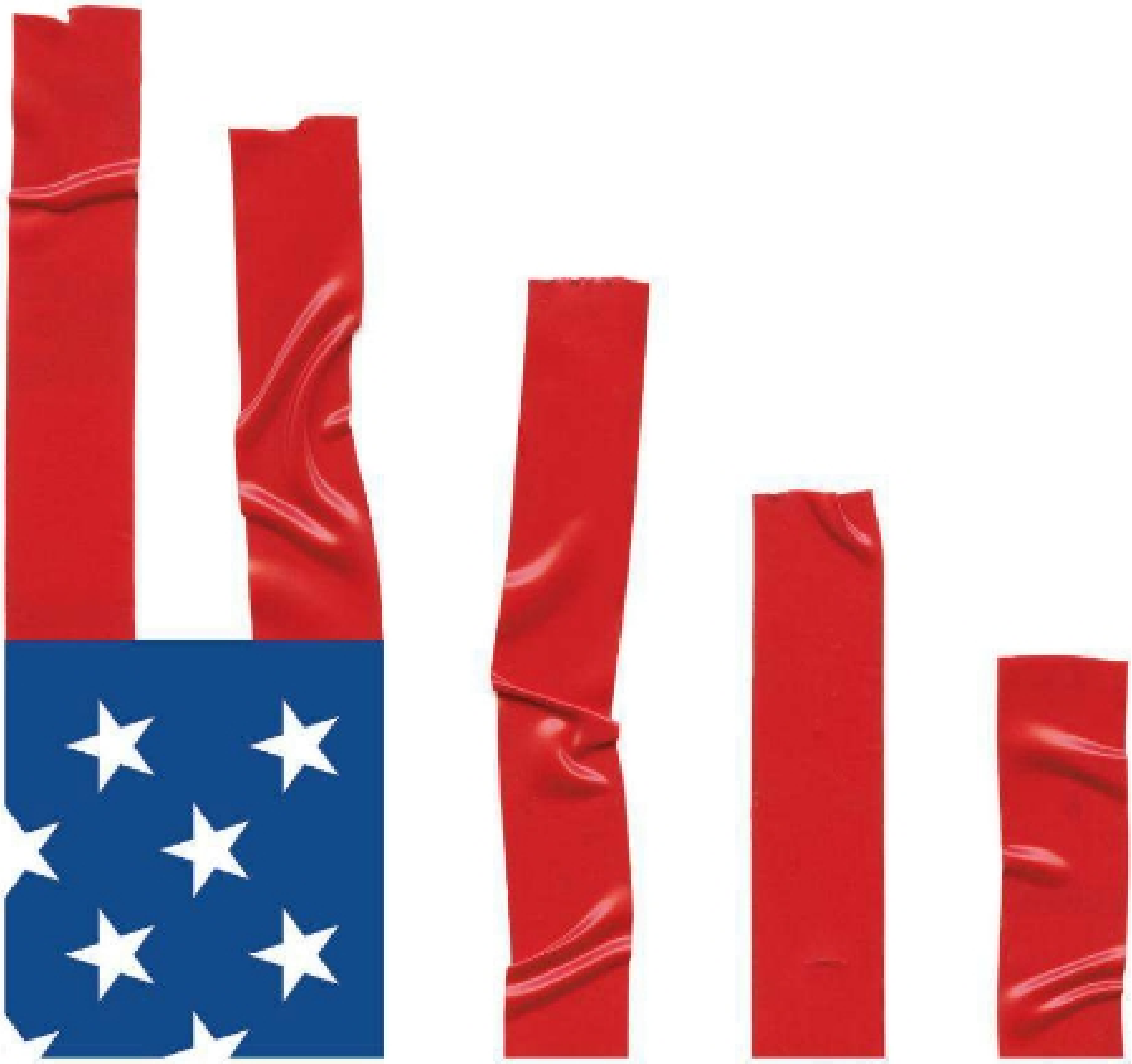
HBR Reprint F1306E

ILLUSTRATION: WALTER VASCONCELOS

Ferguson



Niall Ferguson is the Laurence A. Tisch Professor of History at Harvard University and a senior fellow at the Hoover Institution. His newest book is *The Great Degeneration: How Institutions Decay and Economies Die* (Penguin Books, 2012).



Is the Business of America Still Business?

It was his only one-liner. In January 1925 President Calvin Coolidge—nicknamed "Silent Cal" for his taciturnity—declared, "The chief business of the American people is business." Is that still true? When I moved from the United Kingdom to the United States, I certainly assumed so.

Yet evidence to the contrary is accumulating. In 2012 Michael Porter and Jan Rivkin showed that graduates of Harvard Business School overwhelmingly favor foreign over U.S. locations for new investment. They asked HBS alumni about 607 decisions in which they'd been involved on whether or not to offshore operations. The U.S. retained the business in only 16% of those cases. Asked why they favored foreign locations, the respondents listed the areas in which they saw America falling behind the rest of the world. The top 10 included effectiveness of the political system, simplicity of the tax code, regulation, efficiency of the legal framework, and flexibility in hiring and firing.

Such survey data would be less disturbing if they weren't corroborated elsewhere. In the World Economic Forum's most recent Global Competitiveness Report, the U.S. doesn't make the top 20 on 21 out of 22 measures of institutional quality. On eight it doesn't make even the top 50. Example: It ranks 59th on the basis of executives' answers to the question "To what extent do

Today only lawyers think the United States has the world's best legal system.

government officials in your country show favoritism to well-connected firms and individuals when deciding upon policies and contracts?" Crony capitalism used to be what Americans complained about in Asia. No longer. At least seven Asian countries now score above the U.S. on this measure.

Many development economists argue that poor countries can get richer if they improve their institutions, particularly the rule of law. The converse also applies: Rich countries can get poorer if their institutions deteriorate, particularly the rule of law. Today only lawyers think the United States has the world's best legal system. Everyone else knows it has become a nightmare of impossibly complicated statutes (example: Dodd-Frank), open-ended liability (tort costs are the highest in the industrialized world relative to GDP), and eye-watering billable hours.

The evidence is all around. According to the Fraser Institute, the U.S. has seen a sharp decline in the quality of its legal system and property rights since 2000. World Bank data on governance tell the same story. The World Justice Project's Rule of Law Index for 2012–2013 ranks the U.S. 26th out of 97 countries on effectiveness of the criminal justice system, 25th on fundamental rights, and 22nd on access to civil justice.

Nor is all this based only on subjective surveys. For the past decade, the International Finance Corporation has compiled data annually on various burdens of conducting business in different countries, such as the number of days and procedures it takes to get a construction permit or register property and the time consumed by paying taxes. Since 2006 most countries have significantly reduced these hurdles. In only 21 countries has the ease of doing business declined. The sixth-worst decline—not as bad as Zimbabwe's but worse than Burundi's, Congo-Brazzaville's, and Yemen's—is that of the United States.

The political debate in America today is all about symptoms, from slow growth to large deficits, when it should be about the underlying malaise. Face it: The country that used to have the best institutions in the world is suffering a great degeneration. The chief business of the American people is no longer business. I fear it may be bureaucracy.

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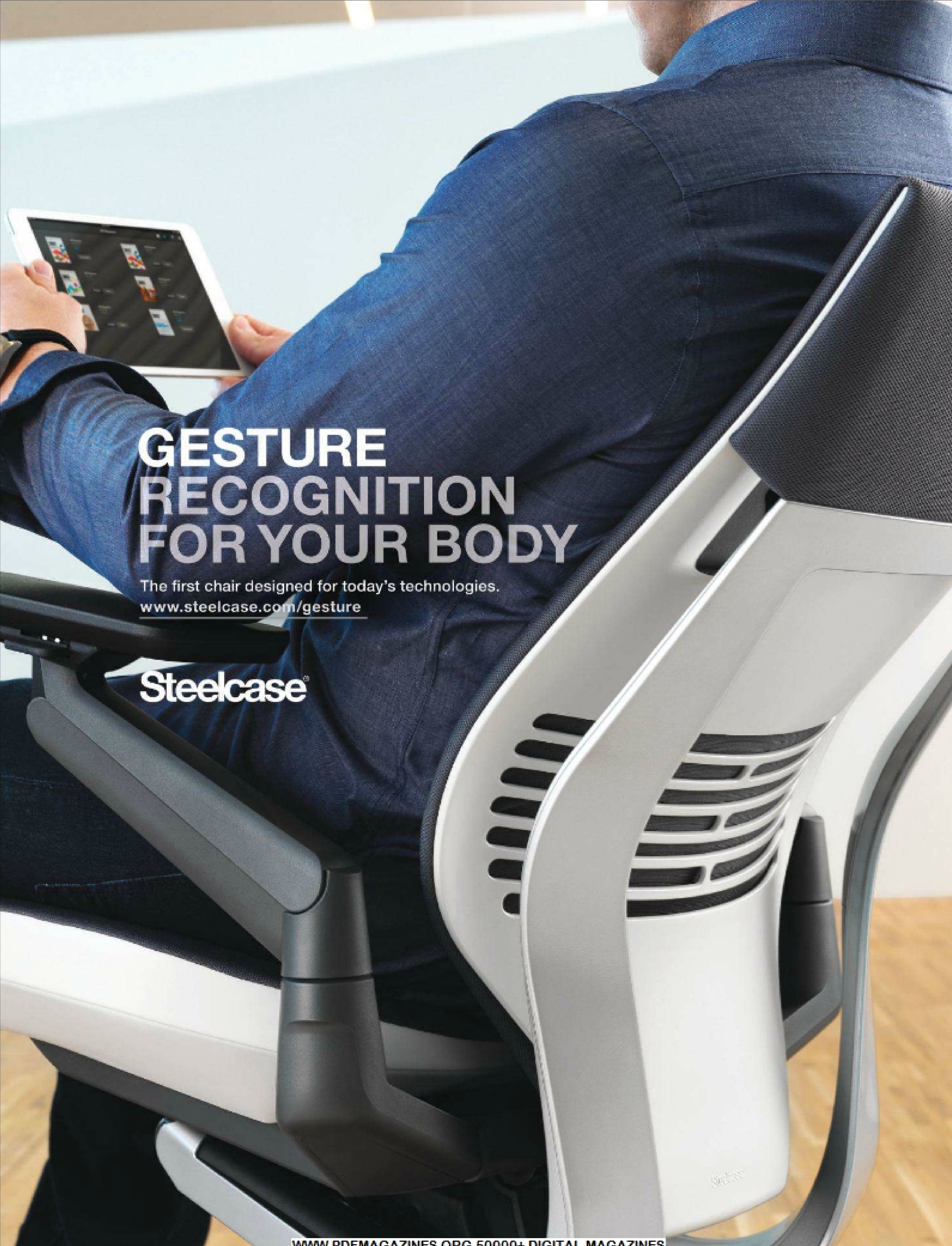
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How I Did It…

David Cote is the chairman and CEO of Honeywell.

Honeywell's CEO on How He Avoided Layoffs

by David Cote

THE IDEA

When the Great Recession hit, many companies "restructured" and laid off thousands of workers. By asking employees to take unpaid leaves instead, Honeywell positioned itself for the recovery.

When I arrived at Honeywell, in 2002, the company had gone through a challenging period. In 1999 it merged with AlliedSignal and shortly afterward closed on the acquisition of a company called Pittway. The three cultures were never integrated, Honeywell had repeatedly missed earnings, and the company had announced cumulative write-offs of $8 billion. Having been in the chemical industry for more than 100 years, it had environmental liabilities that had never been dealt with. Honeywell had gone through three CEOs in four years and had had a lot of turnover at the managerial level as well. Virtually no pipeline of new products existed, because managers had been disinvesting to boost profits.

In my first five years here, we worked to fix many of those problems. We instituted more-conservative bookkeeping and addressed our environmental liabilities. We invested in new products and services, and we expanded abroad. The share of our revenue coming from outside the United States increased from 41% in 2002 to 54% in 2012. We built our management bench strength to the point where 85% to 90% of our top-level vacancies are filled by internal candidates; previously only 50% had been. Most important, we established a "One Honeywell" culture in which we focus

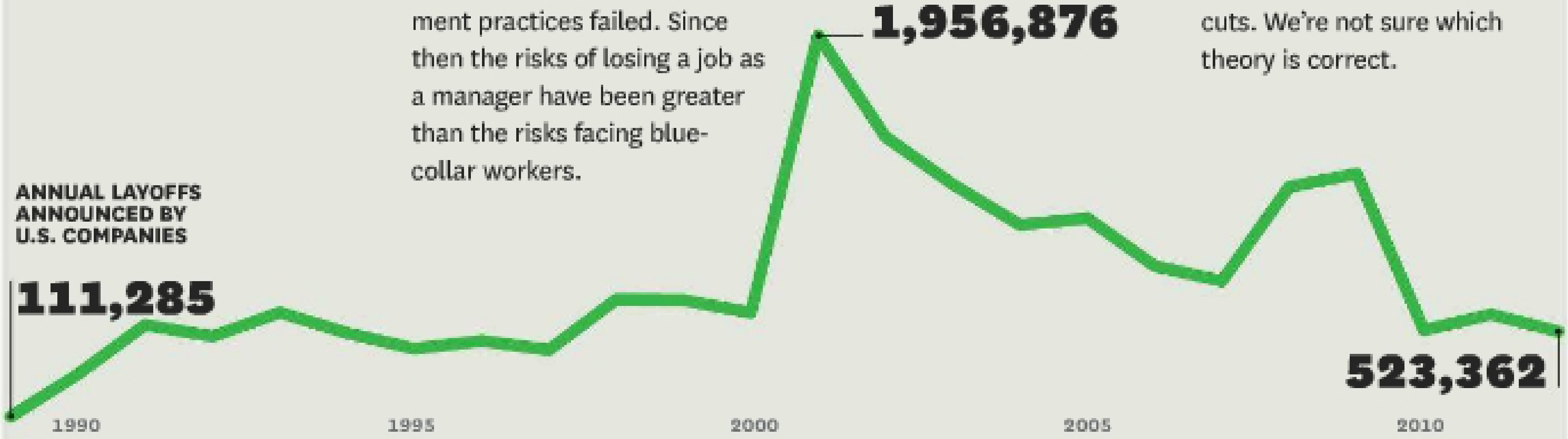
Why Layoffs Replaced Furloughs

Peter Cappelli is the George W. Taylor Professor of Management at The Wharton School and the author of *Why Good People Can't Get Jobs: The Skills Gap and What Companies Can Do About It* (Wharton Digital Press, 2012). He spoke with HBR about why furloughs have become unusual.

Historically, most companies used furloughs to reduce payroll costs during recessions. When did layoffs replace furloughs?
More recently than you might think. Until 1985 the U.S. Bureau of Labor Statistics didn't even have a category for permanent job loss. Until then the assumption was that if a company laid you off, it would rehire you when the economy picked up. That changed during the 1981–1982 recession. Companies had become bloated with managers during the slow growth of the 1970s, as talent management practices failed. Since then the risks of losing a job as a manager have been greater than the risks facing blue-collar workers.

Do managers tend to underestimate the costs of layoffs?
Yes. Most organizations have almost no idea of their turnover costs, their hiring costs, or the costs of keeping a job vacant. They do know what it costs when someone is in the job—the amount they're paying that person—so they know how much they'll save if they get rid of him or her. That's one of the big problems in talent management: CFOs can give us labor costs to the penny, but they can't measure the value of employee contributions, which creates a bias toward cutting.

Since the 1990s Wall Street has reacted positively to layoff announcements. Are there any signs that attitude is changing?
Researchers have begun looking at that question lately. It's true that companies don't see big payoffs (in stock price) from layoff announcements anymore. One theory is that the investment community has gotten smarter and knows that layoffs often aren't worth the costs. The other is that investors have realized that companies making big layoff announcements often fail to follow through with all the job cuts. We're not sure which theory is correct.



SOURCE CHALLENGER, GRAY & CHRISTMAS

on business acumen, listening to the customer, and doing what we say we're going to do. By the end of 2007 we had reestablished our credibility with investors, our share price had more than doubled, and we were significantly outperforming the S&P 500 and our peer group averages.

In September 2008, though, we began to see a shift in our business. Suddenly orders were being canceled, and no new ones were being placed. It soon became obvious that the U.S. was in a recession and that we, as a big industrial company, were going to see our results soften. The only businesses in our portfolio that held up well were defense, aerospace, and energy efficiency. Everything else was down.

Businesses like ours have two primary costs: the material we use to make products, and people. In a recession, material costs (direct costs) drop naturally—you just buy less stuff as your incoming orders decline. You can also work around the edges by seeking opportunities to lower indirect costs such as travel and other non-business-critical expenses. Cutting the costs of people, which in an industrial company usually account for 30% to 40% of total costs, is more difficult. Companies typically react by "restructuring": They cut, say, 10% of the workforce, take a big charge against earnings, and move on. We did do some restructuring in 2008–2009, but I've never been fond of that approach to a recession. So we made sure that any restructuring we agreed to during that period would be permanent—in other words, not solely in response to the recession but, rather, what was best for business efficiency and profitability over the long term—and would have no impact on our ability to outperform in recovery.

As my leadership team began looking at options, we kept coming back to the idea of furloughs: Workers take unpaid leaves but remain employed. The conventional wisdom is that because furloughs spread the pain across the entire workforce, they hurt everyone's morale, loyalty, and retention, so you'd do better to lay off a smaller number, focusing on weak performers. They're also a challenge logistically. To implement them, we needed to comply with individual state laws and also laws in other countries where we do business. The process didn't go perfectly. Looking back, I recognize some clear mistakes we made, and if I had to do it again, I'd do a few things differently. But on the whole, our decision to use furloughs rather than layoffs was a success.

The False Promise of Layoffs

When I arrived at the company, I thought we had too many people. Over the next five years we managed to keep employee numbers flat—even as sales increased at a compound annual growth rate of 10%—and we eliminated some lower-performing employees by doing more-rigorous performance reviews and not filling jobs that were vacated through normal attrition. When the recession hit, our head count still wasn't as low as it could have been, so if we did layoffs, we wouldn't be "cutting into bone." But we opted for furloughs, for several reasons. Most managers underestimate how much disruption layoffs create; they consume everyone in the organization for at least a year. Managers also typically overestimate the savings they will achieve and fail to understand that even bad recessions usually end more quickly than people expect. We wanted to be ready for recovery as soon as it came, whether it was soft or V-shaped, and furloughs were one way of positioning us for any outcome.

To understand that reasoning, look at what really happens when you do layoffs. Each person laid off gets, on average, about six months' worth of severance pay and outplacement services. So in essence, it takes six months to start saving money. Recessions usually last 12 to 18 months, after which demand picks up, so it's pretty common for a company to have to start hiring people about a year or so after its big layoff, undoing the savings it began realizing just six months earlier. Think for a minute about the costs of a layoff the way you'd think about a traditional investment in a plant or equipment. Imagine going to your boss and saying, "I want to spend $10 million on a new factory. It will take us six months to break even on it, and then we'll get to run the factory for six months. But at that point we're going to need to shut it down." You'd never do that—yet when it comes to restructuring costs to lay off employees, everyone seems to think it makes sense.

That's because when faced with a recession, managers find it hard to look ahead toward recovery. If you worry that a recession is going to last forever, you may believe that the savings achieved by a layoff will be permanent. But that's not really how it works. I've been a leader during three recessions, and I've never heard a management team talk about how the choices they make during a downturn will affect performance during the recovery. But in 2008 and 2009 I kept reiterating that point: There will be a recovery, and we need to be prepared for it.

Both layoffs and furloughs can create behavioral issues and costs, and you could argue that furloughs are tougher in some ways. But one fact remains: Layoffs are much more disruptive to an organization in both the short and the long term. Even employees who stay are extremely distracted, because they've lost friends and are worried about their own jobs. To me, that's no way to run a railroad.

The Challenges of Furloughs

We told our businesses to ask every worker to take a series of unpaid weeks off during the first half of 2009. The number of weeks varied by business—the average furlough was three to five weeks, taken in one-week blocks—and business leaders reassessed their situations every few weeks to see if additional furloughs were necessary. This approach presented its own difficulties. Some states have very strict laws about what constitutes work, so we sometimes had to take away people's smartphones and laptops to ensure that they didn't check office e-mail during a furlough. In some foreign countries, government regulations and approvals prevented us from doing furloughs at all. But in most places the program went pretty smoothly, at least in the beginning. During the first week or two we received positive feedback: People felt good about making sacrifices, because they knew they were helping to save jobs—maybe their own, maybe a colleague's. As the furloughs kept going, however, their attitude began to change. Some people complained, "I can't live on this salary." Some concluded that they wouldn't have been among the people laid off, so they started to resent the sacrifice.

We also faced challenges when our top executives—my direct reports—felt that they, too, should be furloughed, as a symbolic gesture. To me this was mistaken solidarity and shortsighted. I told them we couldn't afford to have leaders absent during this period. I also reminded them (and our employees) that as leaders, they received more than half their annual compensation in the form of a bonus, so although employees were losing five weeks' pay, on average, leaders would be losing far more. "Trust me—on a percentage basis, you're going to be severely affected," I told them. The bottom line was that we needed them to stay at work.

By the summer of 2009 people were pretty anxious. They wanted to know how many more weeks of furloughs might be necessary. We still didn't consider layoffs, but we did begin looking at benefits costs, to see if we could find ways to save more money without putting people out of work. I tried to explain to everyone—both employees and my top executives—that we had three constituencies whose interests we needed to balance: customers, investors, and employees. Penalizing customers wasn't an option, and product programs had to go forward. So the pain would have to be divided between investors (in the form of lower returns) and employees (in the form of reduced pay). Finding the right balance was a challenge, but I think we accomplished that.

Prepared for Recovery

The economy stayed soft for most of 2009. During the first nine months of the year, our unit leaders had difficulty making their sales forecasts because demand kept weakening. However, despite lower sales in 2008–2009, the company stayed highly profitable and held its segment margin rates, which is very difficult to do in a recession.

The rap on furloughs is that they penalize top performers and cause them to leave. But our "regrettable turnover" decreased significantly.

During the fourth quarter of 2009 our sales forecasts stopped going down, and by January of 2010 my team and I were starting to talk about a recovery. As orders began to pick up, it was clear that we were well prepared in comparison with our competitors: Our inventory and delivery times were better, and because we had held on to our people, we found it easier to win new business.

We watched our turnover very carefully as the economy rallied. The rap on furloughs is that they penalize top performers and cause them to leave. But in fact our "regrettable turnover" (the number of employees we'd like to retain who nevertheless choose to leave) decreased significantly. That makes sense to me. Generally speaking, not everything is about money: People aren't mercenary, and they want to be part of something successful that is bigger than themselves. We'd had a good track record since 2002, we had a lot of employees who believed in what we were doing, and we communicated it clearly. People could see that things wouldn't stay awful forever, so they hung in.

Even so, I believe that we made two mistakes in implementing our furlough program. The first was how we let employees know about the sacrifices I would be making. Very early in the recession I decided that I would not take a bonus for 2009. At the time, my annual bonus was around $4 million, so that was significant. When employees asked me in town hall meetings how the recession would affect my compensation, I always gave the politic corporate governance response: "That's not my decision—it's up to the board." Everyone would have been better served if I'd just said that I'd already decided to forgo my bonus.

The second mistake was that when we decided to let individual units determine how many weeks of furlough they needed, we should have made it clear that we didn't want them imposing standardized furloughs across their businesses. For example, some of our units furloughed workers in China, where revenue was still growing. Employees in emerging markets have a lot of opportunities, and ordering furloughs in a fast-growing market created some HR problems and organizational angst that we could have avoided.

Still, I believe that our decision to use furloughs instead of layoffs was the right one and that we managed to get about 90% of the implementation right. I hope we never have to do it again—but if we do, I'll make sure we hit 100%.

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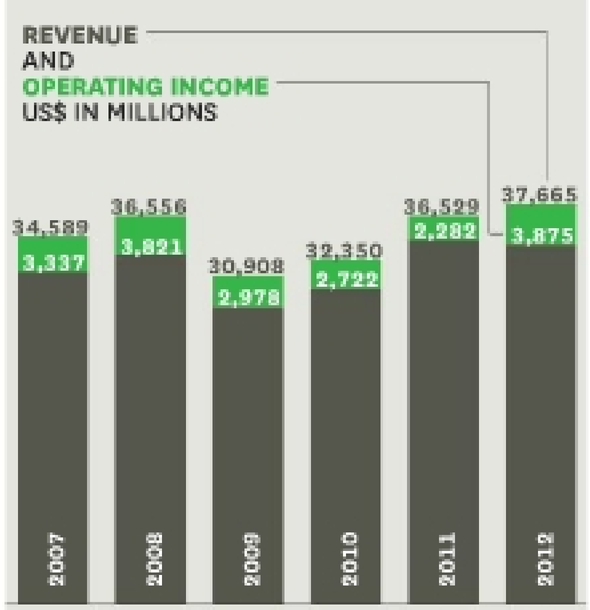
Honeywell International Facts & Financials

FOUNDED: 1885
HEADQUARTERS: Morristown, New Jersey
EMPLOYEES: 132,000



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The Big Idea

TOURS OF DUTY

THE NEW EMPLOYER-EMPLOYEE COMPACT

BY REID HOFFMAN, BEN CASNOCHA, AND CHRIS YEH

FOR MOST OF THE 20TH CENTURY, the compact between employers and employees in the developed world was all about stability. Jobs at big corporations were secure: As long as the company did OK financially and the employee did his or her job, that job wouldn't go away. And in the white-collar world, careers progressed along an escalator of sorts, offering predictable advancement to employees who followed the rules. Corporations, for their part, enjoyed employee loyalty and low turnover.

PHOTOGRAPHY: FREDRIK BRODÉN

Then came globalization and the Information Age. Stability gave way to rapid, unpredictable change. Adaptability and entrepreneurship became key to achieving and sustaining success. These changes demolished the traditional employer-employee compact and its accompanying career escalator in the U.S. private sector; they are in varying degrees of disarray elsewhere.

We are not the first to point this out or to propose solutions. But none of the new approaches offered so far have really taken hold. Instead of developing a better compact, many—probably most—companies have tried to become more adaptable by minimizing the existing one. Need to cut costs? Lay off employees. Need new skills? Hire different employees. Under this laissez-faire arrangement, employees are encouraged to think of themselves as "free agents," looking to other companies for opportunities for growth and changing jobs whenever better ones beckon. The result is a winner-take-all economy that may strike top management as fair but generates widespread disillusionment among the rest of the workforce.

Even companies that have succeeded using minimalist compacts experience negative fallout, because the compacts encourage turnover and hamper employee productivity. More important, although the lack of job security indirectly creates incentives for employees to become more adaptable and entrepreneurial, the lack of mutual benefit encourages the most adaptable and entrepreneurial to take their talents elsewhere. The company reaps some cost savings but gains little in the way of innovation and adaptability.

The time has come, we believe, for a new employer-employee compact. You can't have an agile company if you give employees lifetime contracts—and the best people don't want one employer for life anyway. But you can build a better compact than "every man for himself." In fact, some companies are doing so.

We three come from an environment where the employer-employee relationship has already taken new forms—the high-tech start-up community of Silicon Valley. In this world, adaptability and risk taking are acknowledged as crucial to success, and individual entrepreneurs can have a big impact if the networks they've built are strong enough.

Two of us (Reid and Ben) recently wrote a book, *The Start-up of You*, that applied the habits of successful tech entrepreneurs to the work of building a fulfilling career in any field. Obviously, not every industry works like a start-up business. But most firms today operate in a similar environment of rapid change and disruptive innovation.

Tiny start-ups out-execute corporate giants all the time, despite seemingly huge disadvantages in resources and competitive position. Start-ups succeed in large part because their founders, executives, and early employees are highly adaptable, entrepreneurial types who are motivated to out-hustle, out-network, and out-risk their competitors—and who thus generate outsize rewards.

Recruiting, training, and relying on such a workforce can be scary. After all, if you encourage your employees to be entrepreneurial, they might leave you for the competition—or worse, they might *become* the competition. This is an everyday reality in Silicon Valley. But smart managers here have realized that they can encourage entrepreneurial mindsets and increase retention by rethinking how they relate to talent within their organizations. What's more, many have come to understand that they can benefit from employees who do leave for other opportunities.

This is the beginning, we think, of the new kind of compact that's needed today. Although it is most evident in the tech world, we've seen elements of it elsewhere—at consulting firms, for example. The chief principle underlying it is reciprocity: Both parties understand and acknowledge that they've entered into a voluntary relationship that benefits both sides.

Mutual investment was implicit in the old lifetime employment compact, to be sure. Because both sides expected the relationship to be permanent, both sides were willing to invest in it. Companies provided training, advancement, and an unspoken guarantee of employment, while employees provided loyalty and a moderation of wage demands. The new compact acknowledges the probable impermanence of the relationship yet seeks to build trust and investment anyway. Instead of entering into strict bonds of loyalty, both sides seek the mutual benefits of *alliance*.

As allies, employer and employee try to add value to each other. The employer says, "If you make us more valuable, we'll make *you* more valuable." The employee says, "If you help me grow and flourish,

Idea in Brief

For most of the 20th century the compact between employers and employees was based on loyalty. That is now gone, replaced in the U.S. by a transactional, laissez-faire approach that serves neither party well.

A workable new compact must recognize that jobs are unlikely to be permanent but encourage lasting alliances nonetheless. The key is that both the employer and the employee seek to add value to each other. Employees invest in the company's *adaptability;* the company invests in employees' *employability.*

Three simple policies can make this new compact tangible. They are (1) hiring employees for explicit "tours of duty," (2) encouraging employees to build networks and expertise outside the organization, and (3) establishing active alumni networks to maintain career-long relationships.

YOU CAN'T BUILD AN AGILE COMPANY WITH LIFETIME EMPLOYMENT CONTRACTS. BUT YOU CAN CREATE A BETTER COMPACT THAN "EVERY MAN FOR HIMSELF."

I'll help the company grow and flourish." Employees invest in the company's *adaptability;* the company invests in employees' *employability.* As former Bain CEO Tom Tierney used to tell recruits and consultants, "We are going to make you more marketable."

The reciprocal compact may be unsentimental, but it depends on trust nonetheless. Because the parties are seeking an alliance rather than just exchanging money for time, it can build a stronger relationship between them even as it acknowledges that relationship's finite life in the organization. This allows both sides to take more risks, investing time and resources to find global maxima rather than simply seeking local peaks.

Netflix's compact with its employees is an example of what these new arrangements can look like. In a famous presentation on his company's culture, CEO Reed Hastings declared, "We're a team, not a family." He gave managers this advice: "Which of my people, if they told me they were leaving in two months for a similar job at a peer company, would I fight hard to keep at Netflix? The other people should get a generous severance now, so we can open a slot to try to find a star for that role." The new compact isn't about being nice. It's based on an understanding that a company is its talent, that low performers will be cut, and that the way to attract talent is to offer appealing opportunities.

We've found three simple, straightforward ways in which organizations have made the new compact tangible and workable. They are (1) hiring employees for defined "tours of duty," (2) encouraging, even subsidizing, the building of employee networks outside the organization, and (3) creating active alumni networks that facilitate career-long relationships between employers and former employees. Let's look at each in turn.

Establishing a "Tour of Duty"

If you think all your people will give you lifetime loyalty, think again: Sooner or later, most employees will pivot into a new opportunity. Recognizing this fact, companies can strike incremental alliances. When Reid founded LinkedIn, he set the initial employee compact as a four-year tour of duty, with a discussion at two years. If an employee moved the needle on the business during the four years, the company would help advance his career. Ideally this would entail another tour of duty at the company, but it could also mean a position elsewhere.

The tour-of-duty approach works: The company gets an engaged employee who's striving to produce tangible achievements for the firm and who can be an important advocate and resource at the end of his tour or tours. The employee may not get lifetime *employment,* but he takes a significant step toward lifetime *employability.* A tour of duty also establishes a realistic zone of trust. Lifelong employment and loyalty are simply not part of today's world; pre-

Don't Be Afraid of Entrepreneurial Employees

With a new compact, you can attract entrepreneurial, adaptive people. But relying on entrepreneurial employees can be terrifying: They restlessly search for new, high-learning career opportunities, and other companies are always looking to poach them. Still, it's crucial to have them aboard, even temporarily, so you should put your fears aside. Here's why.

Do entrepreneurial employees really benefit their employers?

They can be extremely valuable, as John Lasseter's story demonstrates. In the early 1980s Lasseter, then a young animator at Disney, pitched his superiors on the new technology of computer-generated animation—and was promptly fired. He ended up in Lucasfilm's computer graphics division, which Steve Jobs acquired and, with Lasseter's help, built into the computer-generated-animation powerhouse Pixar. In 2006 Disney paid $7.4 billion for Pixar and named Lasseter chief creative officer of both Pixar and Walt Disney Animation Studios. Disney learned an expensive lesson: It would have been much cheaper to let Lasseter exercise his creative and entrepreneurial genius in-house.

Quantifying the benefits of entrepreneurial employees is hard, but Global Entrepreneurship Monitor, which studies in-company entrepreneurship, has made some intriguing findings. In a 2011 study it compared the frequency of individuals' "creating and developing new business activities for the organizations they work for" in different nations. It found that "the prevalence of entrepreneurial employee activity as a percentage of the adult population" in economies classified as innovation-driven was more than ten times as high as in factor-driven economies and more than twice as high as in efficiency-driven economies. In other words, entrepreneurial employees are highly correlated with corporate innovation.

If I encourage employees to be entrepreneurial, won't they leave?

Some will. But retaining them for even a limited time can bring enormous benefits.

tending that they are decreases trust by forcing both sides to lie.

Why two to four years? That time period seems to have nearly universal appeal. In the software business, it syncs with a typical product development cycle, allowing an employee to see a major project through. Consumer goods companies such as P&G rotate their brand managers so that each spends two to four years in a particular role. Investment banks and management consultancies have two- to four-year analyst programs. The cycle applies even outside the business world—think of U.S. presidential elections and the Olympics.

Properly implemented, the tour-of-duty approach can boost both recruiting and retention. The key is that it gives employer and employee a clear basis for working together. Both sides agree in advance on the purpose of the relationship, the expected benefits for each, and a planned end.

The problem with most employee retention programs is that they have a fuzzy goal (retain "good" employees) and a fuzzy time frame (indefinitely). Both types of fuzziness destroy trust: The company is asking an employee to commit to it but makes no commitment in return. In contrast, a tour of duty serves as a personalized retention plan that gives a valued employee concrete, compelling reasons to finish her tour and that establishes a clear time frame for discussing the future of the relationship.

The Wharton School polls its students about their satisfaction with their pre–business school jobs. It has found that students who came to it from "terminal jobs"—two-year analyst programs, for example—are more positive about their work experience than their peers are. Terminal jobs are generic versions of tours of duty; personalized tours would probably produce even more positive feelings.

In 2003 Matt Cohler was a management consultant who wanted to become a venture capitalist, although he lacked start-up experience. He began working for Reid at LinkedIn, where the two mapped out a two-year tour of duty. After that time was up, he and Reid agreed to extend the tour while they figured out what Matt could do next. Six months later Matt had the opportunity to join Facebook as one of its first five employees. Although Reid didn't want to lose Matt, he advised him to take the position, which would bring diversity to his start-up experience and move him closer to his goal. After three years at Facebook Matt became the youngest general partner at Benchmark, a prominent venture capital firm.

Action item: Construct personalized, mutually beneficial tours. Work with key employees to establish explicit terms of their tours of duty, developing firm but time-limited mutual commitments with focused goals and clear expectations. Ask, "In this alliance, how will both parties benefit and progress?"

Amazon became a leader in cloud computing thanks to Amazon Web Services, which allows companies to rent storage and computing power rather than having to buy and operate their own servers. The idea for AWS came from Benjamin Black, a website engineering manager at the company, and his manager, Chris Pinkham. In 2003 they realized that the operational expertise that made Amazon an efficient retailer could be repurposed to serve the general market for computing power. They pitched Jeff Bezos on the concept, and after a few iterations Bezos put Pinkham in charge of developing what would become AWS.

Both Black and Pinkham eventually left Amazon to start their own companies. But they left behind a business unit that contributed some $2 billion to Amazon's revenue in 2012.

Won't tours of duty shorten employee tenure?

A tour of duty has a defined end, but that doesn't have to be the end of an employee's tenure. One successful tour is likely to lead to another. Each strengthens the bonds of trust and mutual benefit. And if an employee wants change, an appealing new tour of duty can provide it within your company rather than at a competitor. This is a more effective retention strategy than appealing to vague notions of loyalty.

Do *all* my employees need to be entrepreneurial?

You don't need or even want 100% of your employees to be hard-core entrepreneurs. Silicon Valley start-ups like to brag about hiring "rock stars," but a company composed of only rock stars would be a nightmare. Every company needs a mix of types that's appropriate for its competitive environment. Companies in relatively stable industries, for example, may do best with fewer entrepreneurial employees.

Still, the chances that your organization is *too* entrepreneurial are pretty low.

When possible, a tour of duty should offer an employee the possibility of a breakout entrepreneurial opportunity. This might involve building and launching a new product, reengineering an existing business process, or introducing an organizational innovation.

This approach can't be executed by a central HR function; you're making a compact, not drawing up a contract. We're not suggesting that you negotiate a guaranteed arrangement that spells out all the specifics—a rigid approach is the opposite of an entrepreneurial mind-set. You're building a trust relationship that's based on the employee's actual job, so the conversations must be handled by direct managers.

Engaging Beyond the Company's Boundaries

Henry Ford once complained, "Why is it that every time I ask for a pair of hands, they come with a mind attached?" But these days, of course, minds dramatically amplify the value of hands—and they become even more powerful when they're able to engage with minds outside the company.

No matter how many smart employees you have, there are always more smart people outside your company than within it. This is true of all organizations, from one-person start-ups to the Googles of the world.

You can engage with smart minds outside your company through the network intelligence of your employees. The wider an employee's network, the more he or she will be able to contribute to innovation. Martin Ruef, of Duke University, has found that entrepreneurs with diverse friends scored three times as high as others on measures of innovation. To maximize diversity and thus innovation, you need networks both inside and outside your company.

Therefore, employers should encourage employees to build and maintain professional networks that involve the outside world. Essentially, you want to tell your workers, "We will provide you with time to build your network and will pay for you to attend events where you can extend it. In exchange, we ask that you leverage that network to help the company." This is a great example of mutual trust and investment: You're trusting your employees by giving them the resources to build their networks, and they're investing in your business by deploying some of their relationship capital in your company's behalf.

Those networks should encompass the entire environment in which your business operates, including customers and competitors alike and serving as platforms for information on new technology and other trends. For example, at the venture capital firm Greylock, where Reid is a partner, tapping the investment professionals' external networks is an important part of product review meetings. Someone might ask, "What new technologies are you hearing about? Which ones should we investigate?" The insights gained translate into better decision making and more value for Greylock's portfolio companies. The partners at another top venture capital firm, Andreessen Horowitz, have their own creative spin: At the beginning of every meeting, they award a cash prize for the best industry rumor someone has heard. You don't have to be in venture capital to adapt such techniques for your company.

The power of external engagement helped define the history of Silicon Valley high tech, as chronicled in AnnaLee Saxenian's 1994 book on technology clusters, *Regional Advantage*. In 1970 some of the world's largest technology firms were located in Boston's Route 128 corridor. Today none of the 10 largest tech firms are; Boston's primacy has been snatched away by Silicon Valley. What made that possible? External networks.

Massachusetts companies typically preferred secrecy to openness and rigorously enforced noncompete clauses to prevent employees from jumping to rival firms or starting their own. Silicon Valley has long had a more open culture (and lacks enforceable noncompete clauses), and this has permitted the development of much denser and more highly interconnected networks—which make it easier for people to innovate. The area even gave rise to a term, "coopetition," that reflects the fact that working with competitors can be mutually beneficial. Consider Netflix again: It runs its streaming video service on Amazon's cloud platform, even though Amazon's Instant Video is a direct competitor.

Action item: Encourage network development. In *The Start-up of You* we wrote, "Your career success depends on both your individual capabilities and your network's ability to magnify them. Think of it as I^{We}. An individual's power is raised exponentially with the help of a team (a network)."

Just as an individual's power rises with the strength of her network (I^{We}), a company's power rises with the strength of its employees' networks. Value each person's network and her ability to tap it for intelligence; make it an explicit, acknowledged asset. An employee who keeps her LinkedIn profile current or builds a big personal following on Twitter is doing right by your company, not being disloyal to it. And make a candidate's network strength and diversity a priority when hiring. Bringing in employees with strong networks is good; hiring people whose networks complement rather than overlap those of existing employees is even better.

One of the techniques we recommend for individuals is to maintain an "interesting-person fund" to take people in their networks out to coffee. The corporate equivalent is a "networking fund" for employees. To make sure your company reaps the full benefits, establish two requirements for tapping the fund. First, employees have to leave your corporate campus; you want them to get "outside the building" to build a more diverse external network. Second, they must report back about what they learn so that the gains are shared. Most companies allow employees to expense business lunches, but few allow them to expense networking lunches. Yet if you're a top executive, you probably have such lunches all the time, and your company benefits as a result. Make it not just acceptable but *expected* for your people to do the same.

HubSpot, a Massachusetts-based marketing software company that, in its words, believes in "invest[ing] in [the] individual mastery and market value" of every HubSpotter, keeps it even simpler than that. Interested in a book? Mention it on the internal company wiki, and the book will show up on your Kindle. Want to take somebody smart to lunch? Company policy is: "Expense it. No approval needed."

The network intelligence flowing into your company needs to be a top management concern, with specific programs to strengthen and extend it. For highly networked and entrepreneurial employees, this is one of the primary criteria for judging your attractiveness as an employer.

Building Alumni Networks

The first thing you should do when a valuable employee tells you he is leaving is try to change his mind. The second is congratulate him on the new job and welcome him to your company's alumni network.

Just because a job ends, your relationship with your employee doesn't have to. Corporate alumni networks are a prime way to maintain long-term relationships with your best people. As Cindy Lewiton Jackson noted while she was the global director of career development and alumni relations at Bain, "The goal is not to retain employees. The goal is to build lifelong affiliation."

Some industries and firms have long understood this. McKinsey & Company has operated an alumni network since the 1960s; the group now has upwards of 24,000 members (including more than 230 CEOs of companies with at least $1 billion in annual revenue). Booz Allen Hamilton's network has 38,000 people.

One obvious benefit of alumni networks is the opportunity to rehire former employees. The Corporate Executive Board reports that rolling out the CEB Alumni Network doubled its rehire rate in just two years. But the value goes far beyond that. Your alumni are among your most effective means of external engagement. They can share competitive information, effective business practices, emerging industry trends, and more. They understand how your organization works and are generally inclined to help you if they can. Bain's Tom Tierney has observed, "Our number one source of high-quality new business is our alumni."

It may be that management consultancies have pioneered corporate alumni networks because the organizational practices of those firms (two-year analyst programs, "up or out" advancement, encouragement of consultants to take positions with clients) align so well with the concept—but the practice is spreading. LinkedIn now hosts thousands of corporate alumni groups, including those of 98% of the *Fortune* 500 companies. Such groups are often informal, not official; they spring up because alumni want to stay in touch with and help one another. In a study from the University of Twente, in the Netherlands, only 15% of the companies surveyed had official alumni networks, but 67% had independently organized, informal groups.

You might fear that running an alumni network is an admission of failure—a sign that your company can't retain its best people. But your alumni are likely to form a network anyway; the only real question is whether your company will have a voice in it. Alumni are fallow resources waiting for you to tap them. So why don't you?

AN EMPLOYEE WHO NETWORKS ENERGETICALLY AND THINKS ABOUT OTHER OPPORTUNITIES IS *NOT* A LIABILITY.

Action item: Utilize your exit interviews. The traditional exit interview represents a lost opportunity. Instead of collecting perfunctory feedback that they'll probably just ignore, your managers should gather information that can help you maintain long-term relationships with departing employees (and induct them into your alumni network!). Keep a database of information on all former employees: personal e-mail and phone, LinkedIn profile, Twitter handle, blog URL, areas of expertise, and so on.

The exit interview is also a trust-building opportunity. Many employees have sat through grimly polite or even resentful parting talks. You can make your company stand out by emphasizing the ongoing nature of the relationship. This is also, of course, an opportunity to learn about ways the company and you can do better. Departing employees are more likely than current ones to be honest,

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and the flaws in your business and organizational practices may be on their minds. Listen closely to what they say.

If the employee who's leaving is one of your stars, you should provide an even higher level of service (assuming he handles his departure professionally and doesn't take the rest of the organization with him). Such folks are likely to go on to great things and to be the hubs of their networks, which could prove very valuable to you. As with the tour of duty, aim for a two-way flow of value; you need to provide benefits if you expect to receive them. The benefits you offer may depend on the business you're in. For example, management consultancies often give free insights to alumni who have joined industry clients. If you're a consumer company, offer alumni discounts in addition to the customary employee discounts. The cost is minimal, and the trust and goodwill gained can be substantial. Some might consider it extravagant to "reward" employees who have left, but that view misses the point. Most employees don't leave because they're disloyal; they leave because you can't match the opportunity offered by another company.

If you don't have the resources to set up a formal alumni network, you can support the informal networks that arise on LinkedIn or Facebook. Your assistance can cover the gamut, from giving financial rewards to alumni who help your firm to handing out company swag or paying for pizza during a meetup. Even distributing an alumni newsletter can contribute to an ongoing cordial relationship at practically no cost.

The Virtuous Circle

An employee who is networking energetically, keeping her LinkedIn profile up to date, and thinking about other opportunities is *not* a liability. In fact, such entrepreneurial, outward-oriented, forward-looking people are probably just what your company needs more of.

How do you square the need for such people with the reality that many of them won't stick around forever? First, by accepting that reality. A CEB study of 20,000 workers identified by their employers as "high potentials" found that one in four of them planned to be working elsewhere within the year (see "How to Keep Your Top Talent," HBR May 2010). Once you get past this scary truth, you'll find it easier to achieve honest, productive relationships that support your employees' ambitions. This will make your employees more effective on the job and may actually keep them around longer.

The key to the new employer-employee compact we envision is that although it's not based on loyalty, it's not purely transactional, either. It's an alliance between an organization and an individual that's aimed at helping both succeed.

In the war for talent, such a pact can be the secret weapon that helps you fill your ranks with the creative, adaptive superstars everyone wants. These are the entrepreneurial employees who drive business success—and business success makes you even more attractive to entrepreneurial employees. This virtuous circle has created a competitive advantage in talent for Silicon Valley companies. It can work for your company, too.

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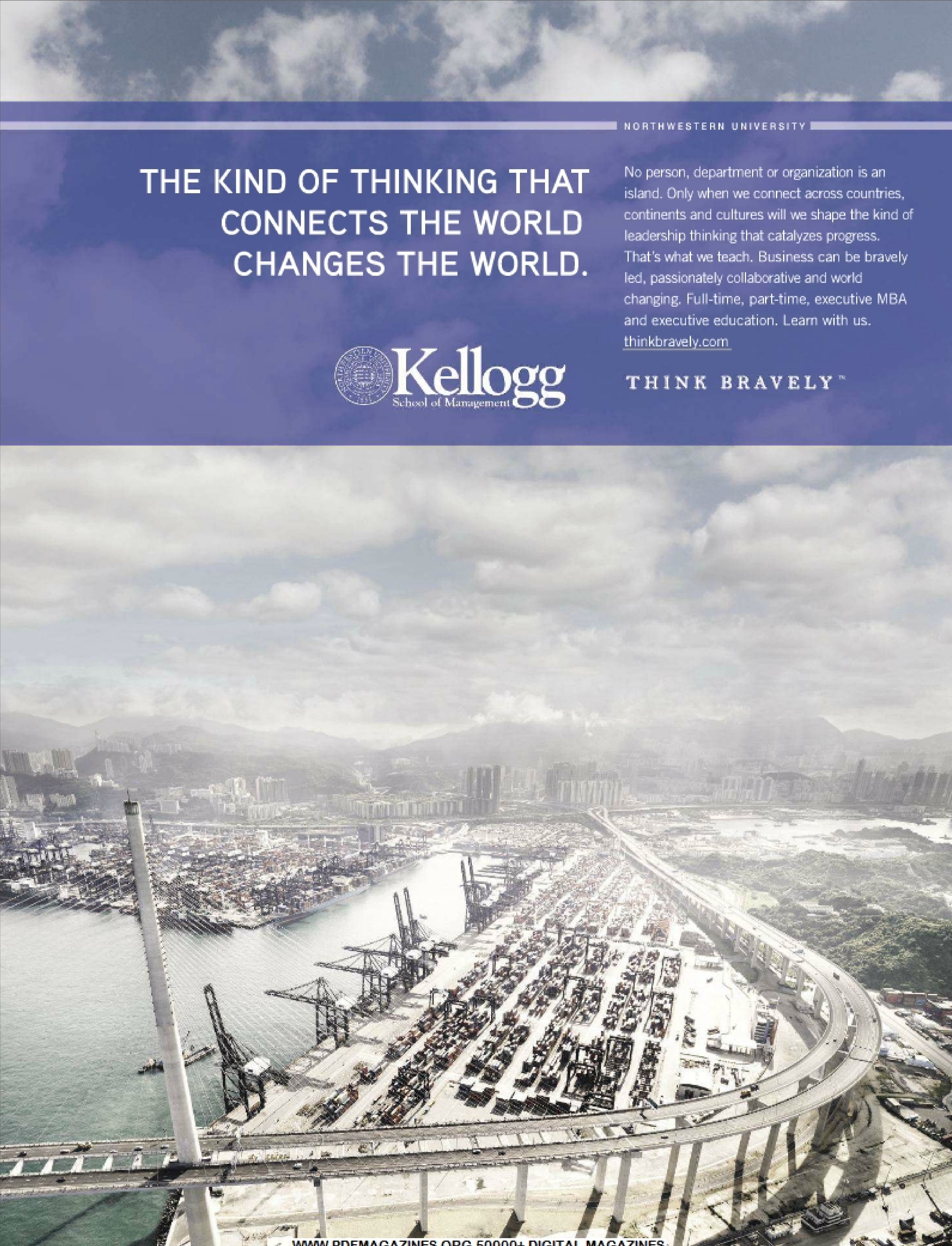
"Interns."

CARTOON: KAAMRAN HAFEEZ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Spotlight

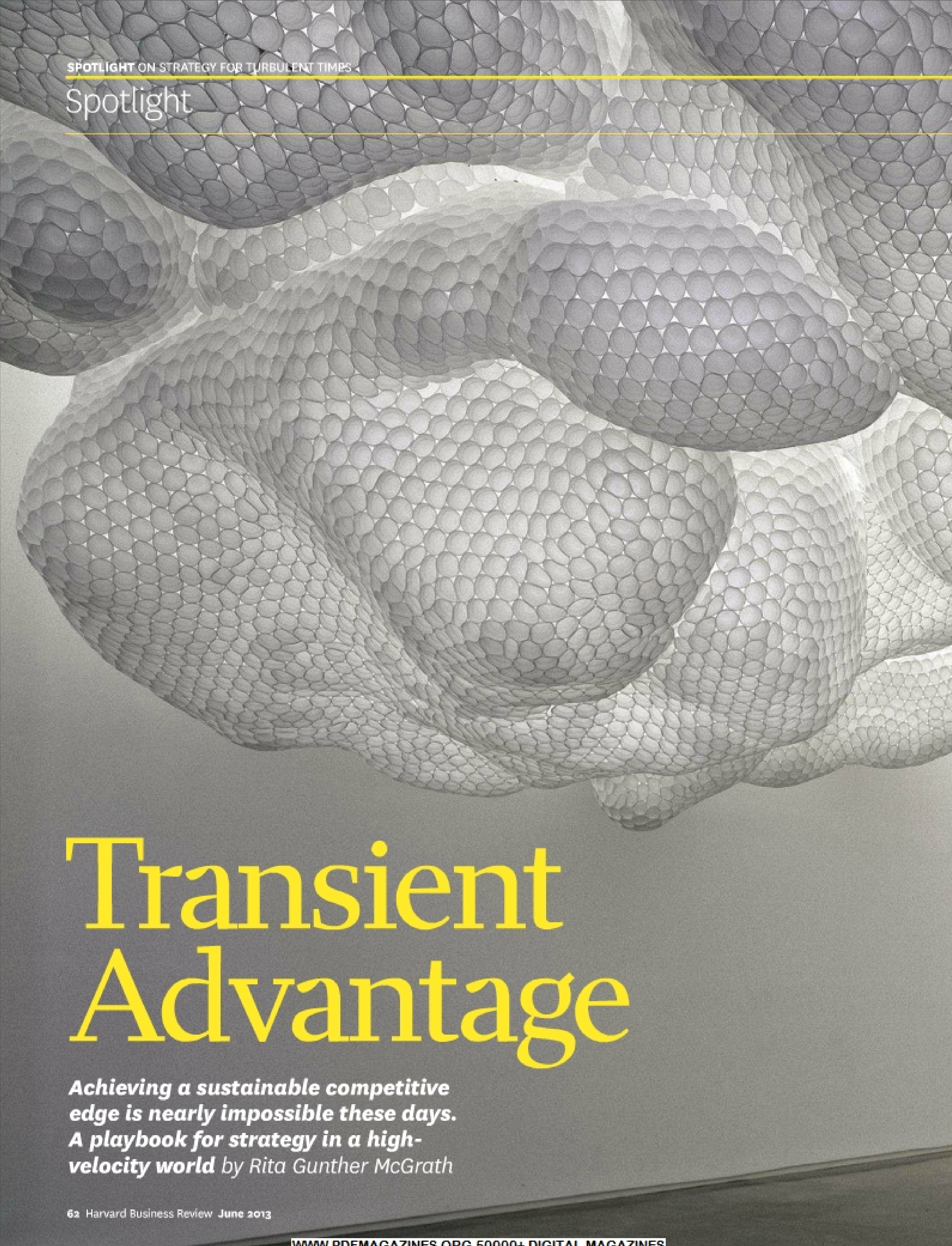
Strategy for Turbulent Times

Strategy needs an update. Here are three new perspectives on seizing and maintaining competitive advantage.

ARTWORK Tara Donovan
Untitled (Toothpicks), 2000
wooden toothpicks, 36" x 36" x 36"

PHOTOGRAPHY: COURTESY OF PACE GALLERY

Spotlight



Transient Advantage

Achieving a sustainable competitive edge is nearly impossible these days. A playbook for strategy in a high-velocity world *by Rita Gunther McGrath*

ARTWORK Tara Donovan, *Untitled (Styrofoam Cups)*, 2008, Styrofoam cups and glue, installation dimensions variable

PHOTOGRAPHY: COURTESY OF PACE GALLERY

STRATEGY IS STUCK. For too long the business world has been obsessed with the notion of building a sustainable competitive advantage. That idea is at the core of most strategy textbooks; it forms the basis of Warren Buffett's investment strategy; it's central to the success of companies on the "most admired" lists. I'm not arguing that it's a bad idea—obviously, it's marvelous to compete in a way that others can't imitate. And even today there are companies that create a strong position and defend it for extended periods of time—firms such as GE, IKEA, Unilever, Julius Berger, and Swiss Re. But it's now rare for a company to maintain a truly lasting advantage. Competitors and customers have become too unpredictable, and industries too amorphous. The forces at work here are familiar: the digital revolution, a "flat" world, fewer barriers to entry, globalization.

Strategy *is* still useful in turbulent industries like consumer electronics, fast-moving consumer goods, television, publishing, photography, and... well, you get the idea. Leaders in these businesses can compete effectively—but not by sticking to the same old playbook. In a world where a competitive advantage often evaporates in less than a year, companies can't afford to spend months at a time crafting a single long-term strategy. To stay ahead, they need to constantly start new strategic initiatives, building and exploiting many *transient competitive advantages* at once. Though individually temporary, these advantages, as a portfolio, can keep companies in the lead over the long run. Firms that have figured this out—such as Milliken & Company, a U.S.-based textiles and chemicals company; Cognizant, a global IT services company; and Brambles, a logistics company based in Australia—have abandoned the assumption that stability in business is the norm. They don't even think it should be a goal. Instead, they work to spark continuous change, avoiding dangerous rigidity. They view strategy differently—as more fluid, more customer-centric, less industry-bound. And the ways they formulate it—the lens they use to define the competitive playing field, their methods for evaluating new business opportunities, their approach to innovation—are different as well.

I'm hardly the first person to write about how fast-moving competition changes strategy; indeed, I'm building on the work of Ian MacMillan (a longtime coauthor), Kathleen Eisenhardt, Yves Doz, George Stalk, Mikko Kosonen, Richard D'Aveni, Paul Nunes, and others. However, the thinking in this area—and the reality on the ground—has reached an inflection point. The field of strategy needs to acknowledge what a multitude of practitioners already know: Sustainable competitive advantage is now the exception, not the rule. Transient advantage is the new normal.

The Anatomy of a Transient Advantage

Any competitive advantage—whether it lasts two seasons or two decades—goes through the same life cycle. (See "The Wave of Transient Advantage.") But when advantages are fleeting, firms must rotate through the cycle much more quickly and more often, so they need a deeper understanding of the early and late stages than they would if they were able to maintain one strong position for many years.

A competitive advantage begins with a *launch* process, in which the organization identifies an opportunity and mobilizes resources to capitalize on it. In this phase a company needs people who are capable of filling in blank sheets of paper with ideas, who are comfortable with experimentation and iteration, and who probably get bored with the kind of structure required to manage a large, complex organization.

In the next phase, *ramp up,* the business idea is brought to scale. This period calls for people who can assemble the right resources at the right time with the right quality and deliver on the promise of the idea.

Then, if a firm is fortunate, it begins a period of *exploitation,* in which it captures profits and share, and forces competitors to react. At this point a company needs people who are good at M&A, analytical decision making, and efficiency. Traditional established companies have plenty of talent with this skill set.

Often, the very success of the initiative spawns competition, weakening the advantage. So the firm has to *reconfigure* what it's doing to keep the advantage fresh. For reconfigurations, a firm needs people who aren't afraid to radically rethink business models or resources.

In some cases the advantage is completely eroded, compelling the company to begin a *disengagement* process in which resources are extracted and reallocated to the next-generation advantage. To manage this process, you need people who can be candid and tough-minded and can make emotionally difficult decisions.

For sensible reasons, companies with any degree of maturity tend to be oriented toward the exploitation phase of the life cycle. But as I've suggested, they need different skills, metrics, and people to manage

About the Spotlight Artist

Each month we illustrate our Spotlight package with works from an accomplished artist. We hope that the lively, cerebral creations of these photographers, painters, and installation artists will infuse the pages with additional energy and intelligence and amplify what are often complex and abstract concepts.

This month we showcase **Tara Donovan,** a Brooklyn-based artist known for her large sculptures and installations. Donovan, whose work is composed of everyday objects like pencils and toothpicks, has explained, "It's all about perceiving this material from a distance and close up and how the light interacts with it."

View more of the artist's work at pacegallery.com.

PHOTOGRAPHY: COURTESY OF PACE GALLERY

Idea in Brief

The dominant idea in the field of strategy—that success consists of establishing a unique competitive position, sustained for long periods of time—is no longer relevant for most businesses. They need to embrace the notion of transient advantage instead, learning to launch new strategic initiatives again and again, and creating a portfolio of advantages that can be built quickly and abandoned just as rapidly. Success will require a new set of operational capabilities.

the tasks inherent in each stage of an advantage's development. And if they're creating a pipeline of competitive advantages, the challenge is even more complex, because they'll need to orchestrate many activities that are inconsistent with one another.

Milliken & Company is a fascinating example of an organization that managed to overcome the competitive forces that annihilated its industry (albeit over a longer time period than some companies today will be granted). By 1991 virtually all of Milliken's traditional competitors had vanished, victims of a surge in global competition that moved the entire business of textile manufacturing to Asia. In Milliken, ones sees very clearly the pattern of entering new, more promising arenas while disengaging from older, exhausted ones. Ultimately, the company exited most of its textile lines, but it did not do so suddenly. It gradually shut down American plants, starting in the 1980s and continuing through 2009. (Every effort was made, as best I can tell, to reallocate workers who might have suffered as a result.) At the same time the company was investing in international expansion, new technologies, and new markets, including forays into new arenas to which its capabilities provided access. As a result, a company that had been largely focused on textiles and chemicals through the 1960s, and advanced materials and flameproof products through the 1990s, had become a leader in specialty materials and high-IP specialty chemicals by the 2000s.

Facing the Brutal Truth

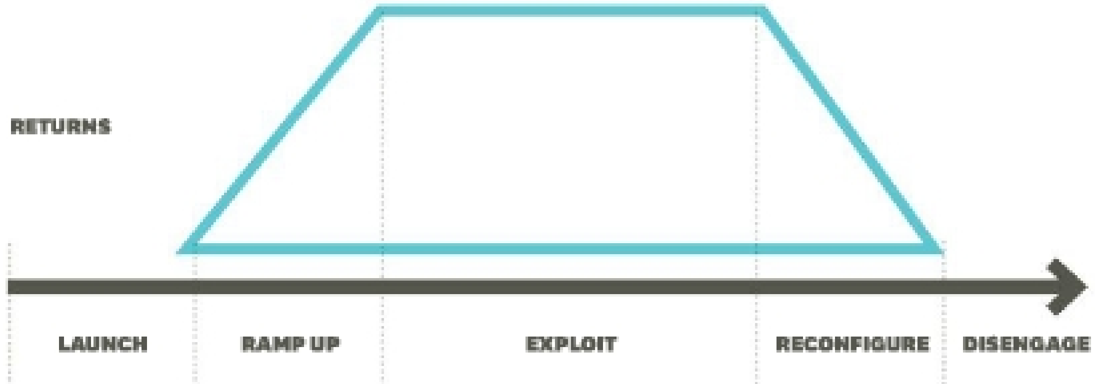
In a world that values exploitation, people on the front lines are rarely rewarded for telling powerful senior executives that a competitive advantage is fading away. Better to shore up an existing advantage for as long as possible, until the pain becomes so obvious that there is no choice. That's what happened at IBM, Sony, Nokia, Kodak, and a host of other firms that got themselves into terrible trouble, despite ample early warnings from those working with customers.

To compete in a transient-advantage economy, you must be willing to honestly assess whether current advantages are at risk. Ask yourself which of these statements is true of your company:

- I don't buy my own company's products or services.
- We're investing at the same or higher levels and not getting better margins or growth in return.
- Customers are finding cheaper or simpler solutions to be "good enough."
- Competition is emerging from places we didn't expect.
- Customers are no longer excited about what we have to offer.
- We're not considered a top place to work by the people we'd like to hire.
- Some of our very best people are leaving.
- Our stock is perpetually undervalued.

THE WAVE OF TRANSIENT ADVANTAGE

Companies in high-velocity industries must learn to cycle rapidly through the stages of competitive advantage. They also need the capacity to develop and manage a pipeline of initiatives, since many will be short-lived.



If you nodded in agreement with four or more of these, that's a clear warning that you may be facing imminent erosion.

But it isn't enough to recognize a problem. You also have to abandon many of the traditional notions about competitive strategy that will exacerbate the challenge of strategy reinvention.

Seven Dangerous Misconceptions

Most executives working in a high-velocity setting know perfectly well that they need to change their mode of operation. Often, though, deeply embedded assumptions can lead companies into traps. Here are the ones I see most often.

The first-mover trap. This is the belief that being first to market and owning assets create a sustainable position. In some businesses—like aircraft engines or mining—that's still true. But in most industries a first-mover advantage doesn't last.

The superiority trap. Almost any early-stage technology, process, or product won't be as effective as something that's been honed and polished for years. Because of that disparity, many companies don't see the need to invest in improving their established offerings—until the upstart innovations mature, by which time it's often too late for the incumbents.

The quality trap. Many businesses in exploit mode stick with a level of quality higher than customers are prepared to pay for. When a cheaper, simpler offer is good enough, customers will abandon the incumbent.

The hostage-resources trap. In most companies, executives running big, profitable businesses get to call the shots. These people have no incentive to shift resources to new ventures. I remember holding a Nokia product that was remarkably similar to today's iPad—in about 2004. It hooked up to the internet, accessed web pages, and even had a rudimentary app constellation. Why did Nokia never capitalize on this groundbreaking innovation? Because the company's emphasis was on mass-market phones, and resource allocation decisions were made accordingly.

The white-space trap. When I ask executives about the biggest barriers to innovation, I often hear, "Well, these things fall between the cracks of our organizational structure." When opportunities don't fit their structure, firms often simply forgo them instead of making the effort to reorganize. For instance, a product manufacturer might pass up potentially profitable moves into services because they require coordination of activities along a customer's experience, rather than by product line.

The empire-building trap. In a lot of companies, the more assets and employees you manage, the better. This system promotes hoarding, bureaucracy building, and fierce defense of the status quo; it inhibits experimentation, iterative learning, and risk taking. And it causes employees who like to do new things to leave.

The sporadic-innovation trap. Many companies do not have a system for creating a pipeline of new advantages. As a result, innovation is an on-again, off-again process that is driven by individuals, making it extraordinarily vulnerable to swings in the business cycle.

The assessment "Is Your Company Prepared for the Transient-Advantage Economy?" will give you a sense of whether your organization is vulnerable to these traps.

Strategy for Transient Advantage: The New Playbook

Companies that want to create a portfolio of transient advantages need to make eight major shifts in the way that they operate.

1 **Think about arenas, not industries.** One of the more cherished ideas in traditional management is that by looking at data about other firms like yours, you can uncover the right strategy for your organization. Indeed, one of the most influential strategy frameworks, Michael Porter's five forces model, assumes that you are mainly comparing your company to others in a similar industry. In today's environment, where industry lines are quickly blurring, this can blindside you.

I've seen untraditional competitors take companies by surprise over and over again. In the 1980s, for instance, no money-center bank even saw the threat posed by Merrill Lynch's new cash-management accounts, because they weren't offered by any bank. Millions in deposits flew out the door before the banks realized what was going on. But in recent years, the phenomenon has become more common. Google's moves into phone operating systems and online video have created consternation in traditional phone businesses; retailers like Walmart have begun edging into health care; and the entire activity of making payments is being disrupted by players from a variety of industries, including mobile phone operators, internet credit providers, and swipe-card makers.

Today strategy involves orchestrating competitive moves in what I call "arenas." An arena is a combination of a customer segment, an offer, and a place in which that offer is delivered. It isn't that industries aren't relevant anymore; it's just that industry-level analysis doesn't give you the full picture. Indeed, the very notion of a transient competitive advantage is less about making more money than your industry peers, as conventional definitions would have it, and more about responding to customers' "jobs to be done" (as Tony Ulwick would call it) in a given space.

2 Set broad themes, and then let people experiment. The shift to a focus on arenas means that you can't analyze your way to an advantage with armies of junior staffers or consultants anymore. Today's gifted strategists examine the data, certainly, but they also use advanced pattern recognition, direct observation, and the interpretation of weak signals in the environment to set broad themes. Within those themes, they free people to try different approaches and business models. Cognizant, for instance, clearly spells out the competitive terrain it would like to claim but permits people on the ground considerable latitude within that framework. "The Future of Work" is Cognizant's umbrella term for a host of services intended to help clients rethink their business models, reinvent their workforces, and rewire their operations—all with the firm's assistance, of course.

3 Adopt metrics that support entrepreneurial growth. When advantages come and go, conventional metrics can effectively kill off innovations by imposing decision rules that make no sense. The net present value rule, for instance, assumes that you will complete every project you start, that advantages will last for quite a while, and that there will even be a "terminal value" left once they are gone. It leads companies to underinvest in new opportunities.

Instead, firms can use the logic of "real options" to evaluate new moves. A real option is a small investment that conveys the right, but not the obligation, to make a more significant commitment in the future. It allows the organization to learn through trial and error. Consider the way Intuit has made experimentation a core strategic process, amplifying by orders of magnitude its ability to venture into new spaces and try new things. As Kaaren Hanson, the company's vice president of design innovation, said at a recent conference at Columbia Business School, the important thing is to "fall in love with the problem you are trying to solve" rather than with the solution, and to be comfortable with iteration as you work toward the answer.

4 Focus on experiences and solutions to problems. As barriers to entry tumble, product features can be copied in an instant. Even service offerings in many industries have become commoditized. Once a company has demonstrated that demand for something exists, competitors quickly move in. What customers crave—and few companies provide—are well-designed experiences and complete solutions to their problems. Unfortunately, many companies are so internally focused that they're oblivious to the customer's experience. You call up your friendly local cable company or telephone provider and get connected to a robot. The robot wants to know your customer number, which you dutifully provide. Eventually, the robot decides that your particular problem is too difficult and hands you over to a live person. What's the first thing the person wants to know? Yup, your customer number. It's symptomatic of the disjointed and fragmented way most complex organizations handle customers.

Companies skilled at exploiting transient advantage put themselves in their customers' place and consider the outcome customers are trying to achieve. Australia's Brambles has done a really great job of this even though it is in a seemingly dull industry (managing the logistics of pallets and other containers). The company realized that one of grocers' biggest costs was the labor required to shelve goods delivered to their stores. Brambles designed a solution: plastic bins that can be filled by growers right in the fields and lifted directly from pallets and placed on shelves, from which customers can help themselves. It has cut labor costs significantly. Better yet, fruits and vegetables arrive at the point of purchase in better shape because they aren't manhandled repeatedly as they go from field to box to truck to warehouse to storage room to shelf. Although seemingly low-tech, this initiative and others like it have generated substantial profits and steady growth for the company—not to mention customers' appreciation.

5 Build strong relationships and networks. One of the few barriers to entry that remain powerful in a transient-advantage context has to do with people and their personal networks. Indeed, evidence suggests that the most successful and sought-after employees are those with the most robust networks. Realizing that strong relationships with customers are a profound source of advantage, many companies have begun to invest in communities and networks as a way of deepening ties with customers. Intuit, for example, has created a space on its website where customers can interact, solve one another's problems, and share ideas. The company goes so far as to recognize exemplary problem solvers with special titles and short profiles of them on the site. Amazon and TripAdvisor both make contributions from their communities a core part of the value they offer customers. And of course, social networks have the power to enhance or destroy a firm's credibility in nanoseconds as customers enjoy an unprecedented ability to connect with one another.

Firms that are skilled at managing networks are also notable for the way they preserve important relationships. Infosys, for instance, is choosy about which customers it will serve, but it maintains a 97% customer retention rate. Sagentia, a technical consultancy in the UK, is extremely conscientious about making sure that people who are let go remain on good terms with the firm and land well in new positions. Even at a large industrial company like GE, the senior leaders spend inordinate amounts of time building and preserving relationships with other firms.

Transient-advantage firms seldom engage in restructuring, downsizing, or mass firings.

6 Avoid brutal restructuring; learn healthy disengagement. In researching firms that effectively navigate the transient-advantage economy, I was struck by how seldom they engaged in restructuring, downsizing, or mass firings. Instead, many of them seemed to continually adjust and readjust their resources. At Infosys, I was told, people don't really believe in "chopping things off." Rather, when an initiative is wound down, they say it "finds its way to insignificance."

Sometimes, of course, downsizing or sudden shifts can't be avoided. The challenge then is disengaging from a business in the least destructive, most beneficial way. Netflix's efforts to get out of the DVD-shipping business and into streaming movies, which its management passionately believes represents the future, offer an interesting lesson in the wrong way to do this. In 2011 the company's management made two decisions that infuriated customers. It imposed a massive price increase across the board, and it split the DVD and streaming businesses into two separate organizations, which forced customers to duplicate their efforts to find and purchase movies. Let's assume that Netflix's leaders are right that eventually the DVD part of the business will shrivel up. How might the firm have exited more gracefully?

Preparing customers to transition away from old advantages is a lot like getting them to adopt a new product, but in reverse. Not all customers will be prepared to move at the same rate. There is a sequence to which customers you should transition first, second, and so on.

If, rather than raising prices for everybody, Netflix had selectively offered price discounts to those who would drop the DVD service, it would have moved that segment over to the new model. Then it could have gone to the "light user" DVD consumers and suggested that instead of getting a new DVD anytime they wanted it, they would get one once a month, say, for the same price. If they wanted the instant service, their prices would go up. That would shift another group to lower DVD usage. Then when those segments started to realize that all-streaming wasn't so bad, Netflix could have instituted the big price increase for the mainstream buyer. The point is that in trying to force many customers to move faster than they were prepared to, the company enraged them.

7 Get systematic about early-stage innovation. If advantages eventually disappear, it only makes sense to have a process for filling your pipeline with new ones. This in turn means that, rather than being an on-again, off-again mishmash of projects, your innovation process needs to be carefully orchestrated.

Companies that innovate proficiently manage the process in similar ways. They have a governance structure suitable for innovation: They set aside a separate budget and staff for innovation and allow senior leaders to make go or no-go decisions about it outside the planning processes for individual businesses. The earmarked innovation budget, which gets allocated across projects, means that new initiatives don't have to compete with established businesses for resources. Such companies also have a strong sense of how innovations fit into the larger portfolio, and a line of sight to initiatives in all different stages. They hunt systematically for opportuni-

Is Your Company Prepared for the Transient-Advantage Economy?

To seize transient advantages, companies need a new mode of operations. The diagnostic below can help pinpoint areas where change is required. Simply position your organization's current way of working between the two statements in the assessment. If you score in the lower part of the range in an area, you might want to take a hard look at it.

Focused on extending existing advantages								Capable of coping with transient advantage
Budgets, people, and other resources are largely controlled by heads of established businesses	1	2	3	4	5	6	7	Critical resources are controlled by a separate group that doesn't run businesses
We tend to extend our established advantages if we can	1	2	3	4	5	6	7	We tend to move out of an established advantage early, with the goal of moving on to something new
We don't have a process for disengaging from a business	1	2	3	4	5	6	7	We have a systematic way of exiting businesses
Disengagements tend to be painful and difficult	1	2	3	4	5	6	7	Disengagements are just part of the normal business cycle
We try to avoid failures, even in uncertain situations	1	2	3	4	5	6	7	We recognize that failures are unavoidable and try to learn from them
We budget annually or for even longer	1	2	3	4	5	6	7	We budget in quick cycles, either quarterly or on a rolling basis
We like to stick to plans once they are formulated	1	2	3	4	5	6	7	We are comfortable changing our plans as new information comes in
We emphasize optimization in our approach to asset utilization	1	2	3	4	5	6	7	We emphasize flexibility in our approach to asset utilization
Innovation is an on-again, off-again process	1	2	3	4	5	6	7	Innovation is an ongoing, systematic core process for us
It's difficult for us to pull resources from a successful business to fund more uncertain opportunities	1	2	3	4	5	6	7	It's quite normal for us to pull resources from a successful business to fund more uncertain opportunities
Our best people spend most of their time solving problems and handling crises	1	2	3	4	5	6	7	Our best people spend most of their time working on new opportunities for our organization
We try to keep our organizational structure relatively stable and to fit new ideas into the existing structure	1	2	3	4	5	6	7	We reorganize when new opportunities require a different structure
We tend to emphasize analysis over experimentation	1	2	3	4	5	6	7	We tend to emphasize experimentation over analysis
It isn't easy to be candid with our senior leaders when something goes wrong	1	2	3	4	5	6	7	We find it very easy to be candid with senior leaders when something goes wrong

Speed is paramount. Fast and roughly right decision making must replace deliberations that are precise but slow.

ties, usually searching beyond the boundaries of the firm and its R&D department and figuring out what customers are trying to accomplish and how the firm can help them do it.

8 Experiment, iterate, learn. As I've said for many years, a big mistake companies make all the time is planning new ventures with the same approaches they use for more-established businesses. Instead, they need to focus on experimentation and learning, and be prepared to make a shift or change emphasis as new discoveries happen. The discovery phase is followed by business model definition and incubation, in which a project takes the shape of an actual business and may begin pilot tests or serving customers. Only once the initiative is relatively stable and healthy is it ramped up. All too often, in their haste to get commercial traction, companies rush through this phase; as a result whatever product they introduce has critical flaws. They also spend way too much money before testing the critical assumptions that will spell success or failure.

"Oh, so you're homing from work today."

CARTOON: KAAMRAN HAFEEZ

Leadership as Orchestration

No leader could cognitively handle the complexity of scores of individual arenas, all at slightly different stages of development. What great leaders do is figure out some key directional guidelines, put in place good processes for core activities such as innovation, and use their influence over a few crucial inflection points to direct the flow of activities in the organization. This requires a new kind of leader—one who initiates conversations that question, rather than reinforce, the status quo. A strong leader seeks contrasting opinions and honest disagreement. Diversity increasingly becomes a tool for picking up signals that things may be changing. Broader constituencies may well become involved in the strategy process.

Finally, transient-advantage leaders recognize the need for speed. Fast and roughly right decision making will replace deliberations that are precise but slow. In a world where advantages last for five minutes, you can blink and miss the window of opportunity.

ONE THING ABOUT STRATEGY HASN'T CHANGED: It still requires making tough choices about what to do and, even more important, what not to do. Even though you are orchestrating scores of arenas, you can do only so many things. So defining where you want to compete, how you intend to win, and how you are going to move from advantage to advantage is critical. While we might be tempted to throw up our hands and say that strategy is no longer useful, I think the opposite conclusion is called for. It's more important than ever. It just isn't about the status quo any longer.

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Rita Gunther McGrath, a professor at Columbia Business School, researches strategy in uncertain and volatile environments. She is the author of the book *The End of Competitive Advantage* (Harvard Business Review Press, June 2013), from which this article is adapted.

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Spotlight

ARTWORK Tara Donovan
Untitled, 2008, polyester film

PHOTOGRAPHY: COURTESY OF PACE GALLERY

What Is the Theory of Your Firm?

Focus less on competitive advantage and more on growth that creates value. *by Todd Zenger*

If asked to define strategy, most executives would probably come up with something like this: Strategy involves discovering and targeting attractive markets and then crafting positions that deliver sustained competitive advantage in them. Companies achieve these positions by configuring and arranging resources and activities to provide either unique value to customers or common value at a uniquely low cost. This view of strategy as position remains central in business school curricula around the globe: Valuable positions, protected from imitation and appropriation, provide sustained profit streams.

Unfortunately, investors don't reward senior managers for simply occupying and defending positions. Equity markets are full of companies with powerful positions and sluggish stock prices. The retail giant Walmart is a case in point. Few people would dispute that it remains a remarkable firm. Its early focus on building a regionally dense network of stores in small towns delivered a strong positional advantage. Complementary choices regarding advertising, pricing, and information technology all continue to support its low-cost and flexibly merchandised stores.

Despite this strong position and a successful strategic rollout, Walmart's equity price has seen little growth for most of the past 12 or 13 years. That's because the ongoing rollout was anticipated long ago, and investors seek evidence of newly discovered value—value of compounding magnitude. Merely sustaining prior financial returns, even if they are outstanding, does not significantly increase share price; tomorrow's positive surprises must be worth more than yesterday's.

Not surprisingly, I consistently advise MBA students that if they're confronted with a choice between leading a poorly run company and leading a well-run one, they should choose the former. Imagine assuming the reins of GE from Jack Welch in September 2001 with shareholders' having enjoyed a 40-fold increase in value over the prior two decades. The expectations baked into the share price of a company like that are daunting, to say the least.

To make matters worse, attempts to grow often undermine a company's current market position. As Michael Porter, the leading proponent of strategy as positioning, has argued, "Efforts to grow blur uniqueness, create compromises, reduce fit, and ultimately undermine competitive advantage. In fact, the growth imperative is hazardous to strategy." Quite simply, the logic of this perspective not only provides little guidance about how to sustain value creation but also discourages growth that might in any way move a company away from its current strategic position. Though it recognizes the dilemma, it offers no real advice beyond "Dig in."

Essentially, a leader's most vexing strategic challenge is not how to obtain or sustain competitive advantage—which has been the field of strategy's primary focus—but, rather, how to keep finding new, unexpected ways to create value. In the following pages I offer what I call the *corporate theory,* which reveals how a given company can continue to create value. It is more than a strategy, more than a map to a position—it is a guide to the selection of strategies. The better its theory, the more successful an organization will be at recognizing and composing strategic choices that fuel sustained growth in value.

The Greatest Theory Ever Told

Value creation in all realms, from product development to strategy, involves recombining a large number of existing elements. But picking the right combinations out of a vast array is like being a blind explorer on a rugged mountain range. The strategist cannot see the topography of the surrounding landscape—the true value of various combinations. All he or she can do is try to imagine what it is like.

In other words, leaders must draw from available knowledge and prior experience to develop a cognitive, theoretical model of the landscape and then make an educated guess about where to find valuable configurations of capabilities, activities, and resources. Actually composing the configurations will put the theory to the test. If it's good, the leader will gain a refined vision of some portion of the adjacent topography—perhaps revealing other valuable configurations and extensions.

Companies that enjoy sustained success are typically founded on a coherent theory of value creation. All too often such companies get into trouble when the founders' successors lose sight of that theory—whereas turnarounds, when they occur, often involve a return to it. The history of the Walt Disney Company provides a case in point. Its founder had a very clear theory about how his company created value, which was captured in an image held in the company's archives and reproduced here (see the exhibit "Walt Disney's Theory of Value Creation in Entertainment").

The image depicts a range of entertainment-related assets—books and comic books, music, TV, a magazine, a theme park, merchandise licensing—surrounding a core of theatrical films. It illustrates a dense web of synergistic connections, primarily between the core and other assets. Thus, as precisely labeled, comic strips promote films; films "feed material to" comic strips. The theme park, Disneyland, plugs movies, and movies plug the park. TV publicizes products of the music division, and the film division feeds "tunes and talent" to the music division. Walt's theory in words might read: "Disney sustains value-creating growth by developing an unrivaled capability in family-friendly animated (and live-action)

Walt Disney's Theory of Value Creation in Entertainment

This 1957 map of Walt Disney's vision defined his company's key assets, including a valuable and unique core, and identified patterns of complementarity among them. It implicitly revealed the industry's future evolution and provided guidance concerning adjacent competitive terrain that Disney might explore. The asset and capability combinations that emerged from the theory have evolved with time, but the theory itself has not fundamentally changed.

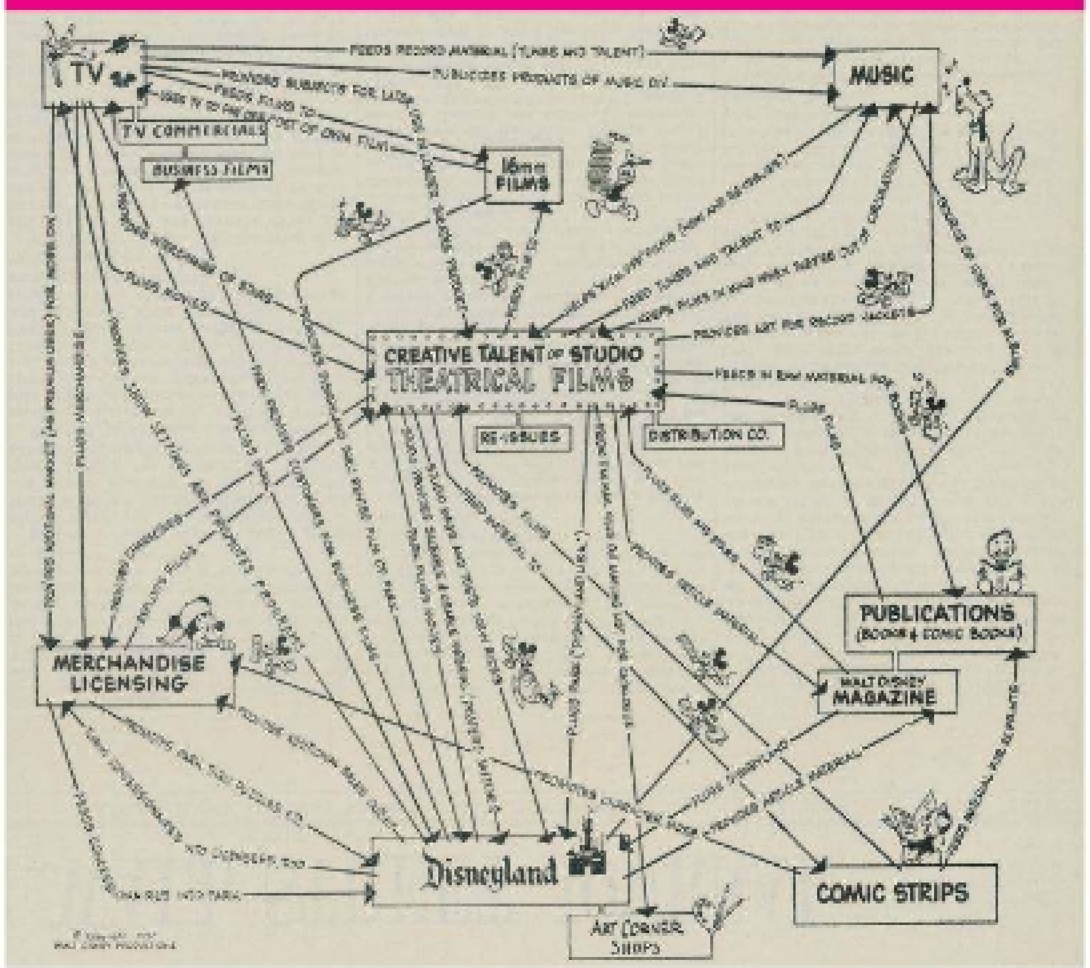

ILLUSTRATION: © 1957 DISNEY

Idea in Brief

Traditionally, practitioners see strategy as the process of discovering and targeting attractive markets and then crafting positions that will deliver sustained advantage in them.

Unfortunately, investors don't reward senior managers for simply occupying and defending market positions. They look for evidence that the company can continually find new competitive advantages.

To do that, managers need a *corporate theory* that explains how they can create value by combining the company's unique resources and capabilities with other assets.

A good theory incorporates *foresight* about an industry's future, *insight* into which internal capabilities can optimize that future, and *cross-sight* into which assets can be configured to create value.

The successes of the Walt Disney Company and Mittal Steel were driven by good corporate theories. In contrast, AT&T's strategic actions after the spin-off of the Baby Bells provide a cautionary tale about what can happen when a large company lacks a coherent theory.

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films and then assembling other entertainment assets that both support and draw value from the characters and images in those films."

The power of this theory was perhaps most vividly revealed following Walt's death. Within 15 years leadership at Disney seemed to lose sight of his vision. As the company's films markedly shifted away from the core capability of animation, the engine of value creation ground to a halt. Film revenues declined. Gate receipts at Disneyland flattened. Character licensing slipped. *The Wonderful World of Disney,* the TV show that American families had gathered to watch every Sunday evening, in a nationwide embrace, was dropped from network broadcast. By the time I entered college, in the late 1970s, the Disney franchise many of us had grown to love as children had all but disappeared.

Attesting to the depths of Disney's disarray, corporate raiders in 1984 attempted the unthinkable: a hostile acquisition of the company with a view to selling off key assets, including the film library and prime real estate surrounding the theme parks. The capital markets embraced this idea, leaving the board with a critical choice: sell Disney to the raiders, who would pay a significant price premium but dismantle the company, or find new management. The board chose the latter and hired Michael Eisner.

Eisner rediscovered Walt's original theory and used it to guide a heavy investment in animated productions, generating a string of hits that included *The Little Mermaid, Beauty and the Beast,* and *The Lion King*. Over the next 10 years Disney's box office share jumped from 4% to 19%. Character licensing grew by a factor of eight. Attendance and margins at the theme parks rose dramatically. Disney's share of income from video rental and sales soared from 5.5% to 21%. Eisner opened new theme parks, made further investments in live-action films, and expanded into adjacent businesses consistent with the theory, including retail stores, cruise ships, Saturday morning cartoons, and Broadway shows. By essentially dusting off Walt's theory and aggressively pursuing strategic actions consistent with it, Disney won growth in its market capitalization from $1.9 billion in 1984 to $28 billion in 1994.

That cycle has repeated itself in the years since: Although the move into Broadway shows was complementary to animated films, character licensing, and theme parks, other strategic moves, such as the 1988 acquisition of a Los Angeles TV station, the 1995 purchase of Cap Cities/ABC, and the 1996 purchase of the Anaheim Angels, failed to reflect the theory's logic. Meanwhile, Eisner allowed the core animation asset to atrophy again as the company failed to keep up with technology trends and the best-in-the-world animators migrated from Disney to Pixar. Disney gained access to their skills through a contract, but the relationship between Disney and Pixar grew contentious and was finally severed just before Eisner stepped down, in October 2005.

His successor, Robert Iger, quickly moved not merely to repair the Pixar relationship but to acquire the company, for more than $7 billion. Disney's recent acquisitions of Marvel and Lucasfilm fuel this central asset, although they carry the company into somewhat unfamiliar terrain: The Marvel and *Star Wars* casts are quite different from Disney's traditionally princess-heavy character set. Whether this strategic experiment proves to be value-creating remains to be seen. But Walt Disney's road map for growth has clearly endured long past his death, providing a remarkable illustration of posthumous leadership.

The Three "Sights" of Strategy

The Disney strategy has all the hallmarks of a powerful corporate theory. It has consistently given senior managers enhanced vision—a tool they repeatedly used to select, acquire, and organize complementary

Steve Jobs's Corporate Theory of Value Creation

On August 10, 2011, Apple surpassed ExxonMobil to become the world's most valuable corporation—a remarkable feat for a company left for dead in 1997. Although credit for Apple's success correctly goes to Steve Jobs, the real substance of his genius has often been misunderstood. Like Walt Disney's, his greatest contribution was not a product, a plan, or a managerial attribute; it was a corporate theory of value creation—one that nearly every purported industry or strategy expert consistently encouraged him and his successors at Apple to abandon.

Jobs's theory was apparent in the famous Apple II computer, launched in 1977. Although its inner workings were the brainchild of Apple's cofounder, Steve Wozniak, Jobs was responsible for the friendly packaging, the sleek casing, and the marketing-focused company that brought the product to consumers with tremendous fanfare. A wave of entries into the personal computing space followed, each introducing a unique software and hardware platform.

But in 1981 the industry was transformed when IBM introduced the IBM PC. It was an instant success, widely applauded for its open architecture. The industry rapidly moved toward generating IBM-compatible software and hardware. Cheaper, faster, and greater storage capacity quickly came to define competitive success. Competing platforms rapidly disappeared and 15 years of intense competition ensued, until Dell eventually discovered a powerful position.

Jobs, however, continued managing to a very different set of performance criteria, reflecting his theory of value creation. That theory not only guided Apple's strategy in computing but defined a succession of future moves and choices. It took on greater clarity with time, but essentially it held that consumers would pay a premium for ease of use, reliability, and elegance in computing and other digital devices, and that the best means for delivering these was relatively closed systems, significant vertical integration, and tight control over design.

Like Disney's, Jobs's theory incorporated all three strategic "sights." It was inspired by *foresight* about the evolution of customer tastes. Jobs recognized that computers would become a consumer good, akin to the Sony Walkman. He believed that consumers would appreciate aesthetics and aspired to create a device with the elegance of a Porsche or a well-designed kitchen appliance.

His *insight* was that the internal capability most critical to value creation in this

bundles of assets, activities, and resources. How can you tell if your own corporate theory is as good? The answer depends on the extent to which it provides what I call the strategic "sights": foresight, insight, and cross-sight. Let's look at these a bit more closely.

Foresight. An effective corporate theory articulates beliefs and expectations regarding an industry's evolution, predicts future customer tastes or consumer demand, foresees the development of relevant technologies, and perhaps even forecasts the competitive actions of rivals. Foresight suggests which asset acquisitions, investments, or strategic actions will prove valuable in predicted future states of the world. It should be both relatively specific and somewhat different from received wisdom. If it is too generic, it won't identify which assets are valuable. If it is too widely shared, the desired assets and capabilities will be expensive to acquire (because competed for) or else not unique (and therefore unlikely to create sustained value). Walt Disney's foresight was that family-friendly visual fantasy worlds had vast appeal.

Insight. If competing companies own assets identical to yours, they can replicate your strategic actions with equal or perhaps even refined capacity, thus undermining any superior foresight in your theory. An effective corporate theory is therefore company-specific, reflecting a deep understanding of the organization's existing assets and activities. It identifies those that are rare, distinctive, and valuable. Disney's key insight was recognizing the value of the company's early lead and substantial investment in animation and its capacity to create timeless, unique characters that, unlike real actors, required no agents.

Cross-sight. A well-crafted corporate theory identifies complementarity that the company is singularly able to assemble or pursue by acquiring assets that can be combined with existing ones to create value. Disney's theory suggested a broad array of entertainment assets that could draw value from a core of animation.

Together these three sights enable leaders to compose a succession of value-creating actions. Foresight regarding future demand, technology, and consumer tastes highlights domains in which to search for cross-sight. Insight regarding unique assets focuses the search for foresight and cross-sight. Cross-sight reveals valuable complementarities, highlighting the domain of foresight.

competitive terrain was design. Of course, that was in part a reflection of his personality: Jobs was a self-proclaimed artist, obsessed with color, finish, and shape; but he transferred this obsession to the technology as well. Walter Isaacson, Jobs's biographer, wrote, "He got hives, or worse, when contemplating great Apple software running on another company's crappy hardware, and he likewise was allergic to the thought of unapproved apps or content polluting the perfection of an Apple device." In pursuing Jobs's focus on design, Apple made heavy R&D investments, much larger in percentage terms than those of any of its competitors.

His theory also provided *cross-sight*, in that it helped Jobs identify external assets through which value could be created, including the graphical user interface (GUI) technology that Apple obtained from Xerox. During his famous visit to Xerox, Jobs repeatedly expressed incredulity that the company was not aggressively commercializing the technology. He saw that GUI perfectly fit his theory, because it made a computer easy to use and attractive to engage with. Some regard what next transpired as one of the greatest technology transfers in history.

The Macintosh was the first fully formed embodiment of Jobs's theory, and it garnered wide acclaim and remarkably high margins (as Jobs had predicted). But the IBM standard was already well established, and the opposing network economics were overwhelming. Although the Mac survived as a very profitable niche product, Bill Gates and others exerted enormous pressure to port the look and feel of the Macintosh operating system to the IBM platform. Jobs, however, refused to countenance any such experiment.

For years academics and journalists derided this strategic refusal. Jobs was banished from Apple for more than a decade, in part for his dogged insistence on sticking to his theory. His subsequent vindication has become the stuff of legend. He returned to Apple in 1996, shortly after the struggling enterprise had been shopped unsuccessfully to HP, Sun, and even IBM. Most people anticipated that he would simply dress the company up for sale. Instead he reimposed his theory with a vengeance, trimming the product range and introducing a new line of Macintosh products, not available for license. More important, he used it to explore adjacent terrain, producing a remarkably successful series of strategic moves across a wide range of product categories.

Apple was not the first to design a digital music library, manufacture an MP3 player, or market a smartphone. But it was the first to craft and configure those devices and their user environment with elegant, easy-to-use designs and with tight control of complementary products, infrastructure, and market image. Apple has shown that Jobs's theory has broad application beyond computing, with industries and product categories ranging from TV, video systems, home entertainment, portable readers, information delivery, and even automotive systems as possible targets. In contrast, the well-positioned Dell has struggled to find a way out of a declining PC industry.

When Strategy Lacks a Theory

Not all corporate theories are created equal, however, and some companies never discover valuable ones. The story of AT&T is a case in point.

In 1984 the seven regional Bell Operating Companies were spun off from AT&T, eliminating Ma Bell from local telephone service and slashing assets from $150 billion to $34 billion. AT&T was left with its long-distance business, its manufacturing arm (Western Electric), and its R&D organization, Bell Labs. With no clear path for growth, the company needed a new theory of value creation.

Its first strategic actions after the breakup suggest that its leaders had composed a theory whereby they would leverage what they perceived as broad managerial competence to invest large cash flows from long-distance service in diverse acquisitions and new businesses. Over the next several years the company got into data networking, financial services, computing, and an internet portal. The market was distinctly unimpressed, and in 1995 AT&T abandoned its diversification theory, announcing that it would divest two key assets, NCR and Lucent Technologies—essentially carving itself into three distinct companies.

Management quickly composed a new theory that reflected its belief in the value of acquiring the "last mile" connection to local customers and providing a bundled package of telephone, broadband internet, and cable services. This theory drove a series of costly cable-industry acquisitions in 1998–1999, totaling more than $80 billion. Unfortunately, the theory was rather widely shared by other companies and investors, and purchase prices reflected this (the cost per subscriber exceeded $4,000). Nevertheless, the market initially applauded these moves, driving AT&T's share price to an all-time high of $60. But by May 2000 the stock had dropped back close to $40 a share. In response, AT&T again began questioning its theory—or at least its ability to sell that theory to Wall Street. In October 2000 the company announced that it would spin off the wireless and cable units, and five years later it put itself up for sale.

The moral of the AT&T story is clear: It pays to invest a lot of time and energy in crafting a robust theory that, like Disney's, is quite specific as to how combinations of assets create value. AT&T's first theory following the breakup never made clear how the company's supposed managerial competence could be uniquely applied to new types of assets; it lacked insight and cross-sight and certainly any vision of the future. The company's second theory was equally flawed: It contained foresight, but in a form that was already widely shared and thus could not generate unique cross-sights.

Bargain Hunting with a Corporate Theory

The real power of a well-crafted corporate theory becomes particularly evident when companies go shopping. Value creation in markets always comes down to prices paid, and a good corporate theory enables the acquirer to spot bargains that are uniquely available to it.

Mittal Steel is a good example. From its origin, in 1976, until 1989, it was a very small player in an industry consistently ranked at the bottom in financial performance. Mittal began as a small mill in Indonesia, where it developed a capability in a new iron ore input technology called direct reduced iron (DRI), which provided mini-mills with a high-quality alternative to scrap metal.

Mittal simply grew with Indonesia's emergence as a tiger economy. But in 1989 it made its first major expansion move by acquiring a troubled steel operation owned by the government of Trinidad and Tobago—a mill that was operating at 25% capacity and losing $1 million a week. Mittal quickly proceeded to turn this business around as it transferred knowledge, deployed DRI, and increased sales. A succession of significant acquisitions followed over the next 15 years, primarily of assets in the former Soviet bloc; each proved to be a gold mine.

A clear and simple corporate theory guided this acquisition program: Mittal knew how to create value from poorly understood and poorly managed state-owned steel operations in developing economies where demand for the product was growing fast. To other steel companies, many of which were focused on improving their internal operations, acquiring such assets—especially ones with integrated technology and large iron ore deposits—was unthinkable, so the field was wide open for Mittal.

Mittal's insight was its understanding of the value of DRI and its own ability to lead turnarounds in formerly state-owned enterprises. Its foresight was an early recognition of the value of iron ore assets—given the strong growth in demand for steel in emerging economies—and the virtues of industry consolidation. Its cross-sight was to recognize the types of assets that could benefit from the company's distinct capabilities.

By 2004 Mittal had emerged as the world's largest and lowest-cost steel producer. Lakshmi Niwas Mittal, the company's owner, is now one of the world's wealthiest people. This success came from having a corporate theory that functioned as a rather remarkable treasure map, one that continues to reveal assets uniquely valuable to Mittal.

An effective corporate theory is company-specific; it identifies those assets and activities that are rare, distinctive, and valuable.

THE PSYCHOLOGIST Kurt Lewin famously commented, "There is nothing so practical as a good theory." Theories define expectations about causal relationships. They enable counterfactual reasoning: If my theory accurately describes my world, then when I choose this, the following will occur. They are dynamic and can be updated on the basis of contrary evidence or feedback. Just as academic theories enable scientists to generate breakthrough knowledge, corporate theories are the genesis of value-creating strategic actions. They provide the vision necessary to step into uncharted terrain, guiding the selection of what are necessarily uncertain strategic experiments. A better theory yields better choices. Only when your company is armed with a well-crafted corporate theory will its search for value be more than a random walk.

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Spotlight

The New Dynamics of Competition

An emerging science for modeling strategic moves *by Michael D. Ryall*

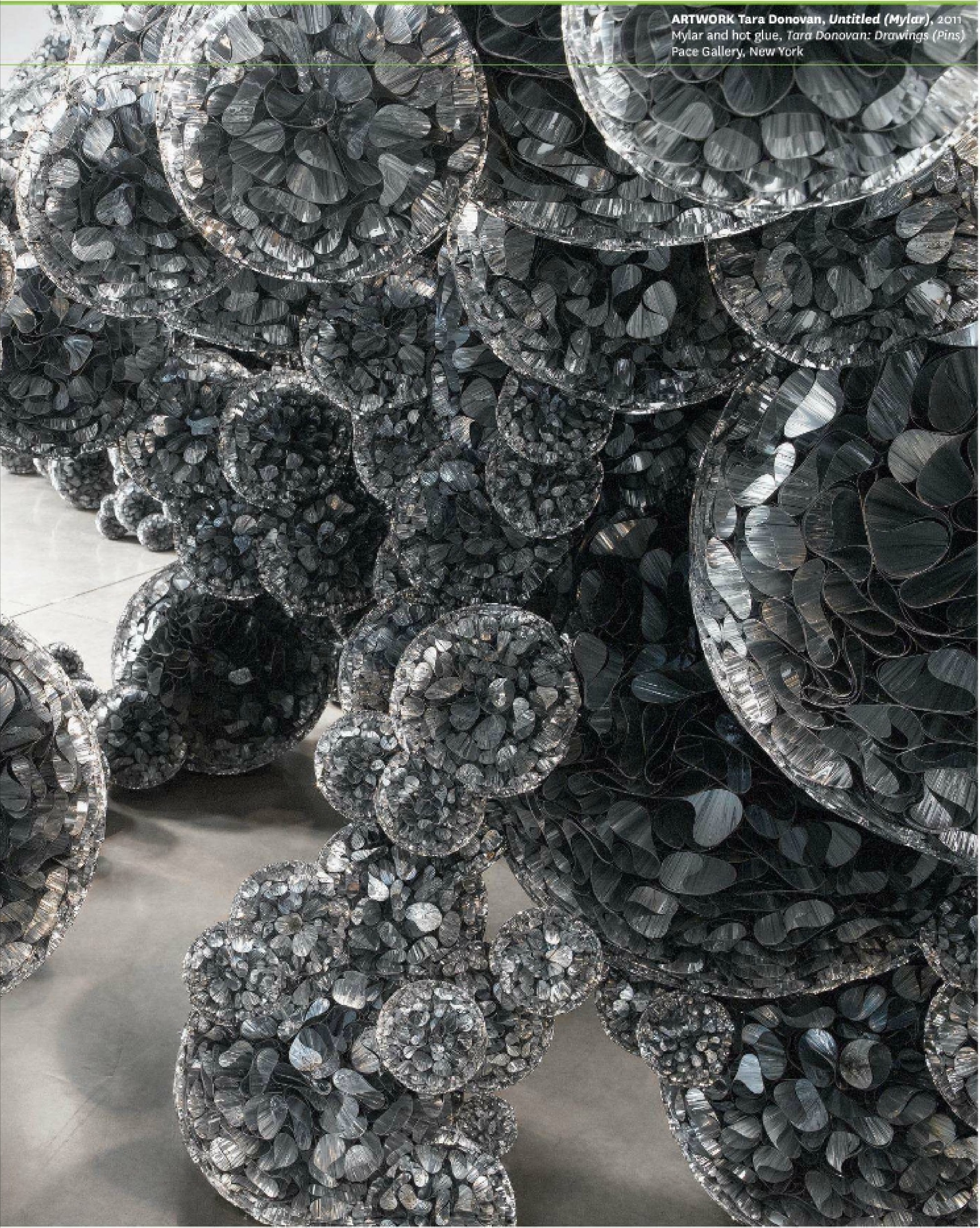
PHOTOGRAPHY: COURTESY OF PACE GALLERY

In his book *Innovation and Entrepreneurship,* Peter Drucker made this observation about industries that rely on knowledge-based innovation: "For a long time, there is awareness of an innovation about to happen....Then suddenly there is a near-explosion, followed by a few short years of tremendous excitement, tremendous start-up activity, tremendous publicity....Later comes a 'shakeout,' which few survive."

The problem, Drucker argues, is that knowledge-driven innovations are "almost never based on one factor but on the convergence of several different kinds of knowledge." The initial breakthrough generates a spate of activity, but meaningful progress occurs only after all the pieces are in place.

I cannot attest to the scientific merit of Drucker's claim, but I consider it to be a remarkably accurate description of the field of strategy. In its early days strategy was a loose affair. Content originated either from commonsense approaches such as SWOT analysis or from frameworks like the Boston Consulting Group's growth-share matrix. In 1979, however, Michael Porter's five forces model changed the field forever. It masterfully synthesized the practical implications of economic research on industrial organizations from the 1960s and 1970s. Knowledge-based innovation put strategy on the map as a field of study, virtually overnight. *Competitive Strategy,* Porter's practitioner-oriented book, became an enormous success.

Porter's ideas generated immediate excitement. They prompted interest from researchers in other fields and the establishment of the Strategic Manage-



ARTWORK Tara Donovan, *Untitled (Mylar)*, 2011
Mylar and hot glue, *Tara Donovan: Drawings (Pins)*
Pace Gallery, New York

ment Society and the peer-reviewed *Strategic Management Journal*. A flurry of papers made informally reasoned claims about the causes of persistent performance differences across firms. Theories such as the resource-based view, dynamic capabilities, and transaction-cost economics appeared, and an avalanche of empirical work quickly followed. Another seminal concept, though not as popular with practitioners as Porter's proved to be, came in 1996, when Harvard Business School's Adam Brandenburger and Harborne Stuart Jr. proposed "value-based business strategy." That work has bred an extensive body of literature on strategy by mathematical economists.

From that backdrop, a general model of competitive strategy, which I call the *value capture model* (VCM), has emerged. It uniquely applies the mathematical concept of cooperative game theory to research on business strategy. ("Cooperative" is a misnomer, as the math focuses on competitive dynamics.) As such, the VCM has an explanatory, predictive potential that no other theory of competitive strategy, including Porter's, can claim. The model is a work in progress, but scholars are starting to use it to explain the dynamics of competition and to identify practical implications for strategic decision making. At the VCM's core is this axiom: "The value that any party can capture from engaging in transactions with a given set of parties is bounded by the value each of them can add to parties outside the set."

In this article I will explain the axiom and its implications for how we need to think about strategy.

Redefining Competition: From Five Forces to One

In most industries, a firm, its suppliers, and its customers all have choices about how and with whom they create value. To produce more value, they may change how they engage in transactions with existing suppliers and customers or may switch to other suppliers and customers. Those agents, in turn, have similar alternatives in how they transact with the original firm and with their own suppliers and customers.

That reality suggests a formal definition of competitiveness that applies equally to all the firms, suppliers, and customers in an industry: a tension between the value generated from transactions that a firm undertakes with a given set of agents and the forgone value it *could have* generated from transactions with other agents. That definition enables you to assign formal identities to the agents involved; to place them in a mathematical game-theory model; and, with given measures of competitive tension, to examine the payoffs from their investments in resources and capabilities. You can also bring big data—from enormous databases that track consumer behavior and spending, stock prices, company accounts, and so on—to bear on this work. No

Strategy's Missing Link

The first generation of strategy scholars after Michael Porter raised many interesting questions yet did not move much beyond relatively informal reasoning. Lacking a complementary body of unambiguous, analytically sophisticated theory, empirical researchers were unable to discover more than broad correlations between firm performance and the variables thought to be related to it. The inability to identify causal relationships or define general principles about firm performance in the face of competition reduced the field to a perpetual "in search of excellence" syndrome, with one "next big idea" giving way to another.

The field lacked a general mathematical model capable of synthesizing and refining the jumble of early theoretical ideas. Why the lack of convergence? The real-world causes of persistent performance heterogeneity are complex, subtle, and difficult to articulate. A mathematical model that captures highly interactive, dynamic competitive environments—with realistic constraints on agents' rationality—is a tall order. It was not obvious precisely which mathematical techniques were up to the task,

Idea in Brief

In 1979 Michael Porter's five forces model transformed the field of strategy. But the 1996 article "Value-Based Business Strategy," by Adam Brandenburger and Harborne Stuart Jr. may prove to be even more significant, as it applied mathematics to the evaluation of strategic decisions.

The value capture model (VCM), based on that mathematical work, has an explanatory, predictive power that no other theory of competitive strategy can claim. It defines competition in an industry as a tension between the value generated from transactions that a firm undertakes with a given set of agents and the forgone value it *could have* generated from transactions with other agents. An important implication is that strategists must shift from looking at how a firm competes with other players to examining how players compete for a firm.

Work on the VCM is already revealing important insights to leaders who chart the strategic direction of their firms. A streamlined version with a reasonably full complement of input variables, bolstered by empirical research and further refinements, could illuminate the way to better business practices.

other current theory of strategy offers the ability to model the effect of strategic decisions so precisely or to use data to test hypotheses about what kinds of management processes or investments improve a given firm's ability to capture value in its industry. (See the sidebar "Strategy's Missing Link.")

The VCM model differs from Porter's framework in two significant ways. First, Porter defines the opportunities of a firm largely by the power that other agents may or may not have over it (buyer power, supplier power, threat of entry by new agents, threat of substitute products brought by existing or other agents, and rivalry from other similar firms). The idea that other agents might compete for the firm remains buried as a moderating factor of each agent's power over that firm. By bundling competition with different types of players, Porter creates unnecessary complexity. The VCM definition, by contrast, has only one force of competition that works transparently in multiple directions: Suppliers compete for firms, and vice versa; firms compete for customers, and vice versa. In sum, each player in an industry (whether a firm, a customer, or a supplier) experiences a single force of competition for itself. The intensity of that force is measured by the tension between the value the player creates with a given set of parties and the value it *could* create with others. The greater the alternative value relative to the value actually created, the greater the intensity. The relative intensities of the force determine how much value each player stands to win.

Second, the VCM makes a clear distinction between the value *created* by the transactions of market participants and the value *appropriated* by each

nor was there a critical mass of mathematically trained theorists who were up to the job.

Contrast this state of affairs with what was happening in finance, where many technologies converged at once. Finance was revolutionized in the 1970s by the introduction of the (mathematical) capital-asset-pricing model and the Black-Scholes-Merton option-pricing model. Virtually simultaneously, the Center for Research in Security Prices database was established. A healthy interplay between theory and empirical verification quickly arose, creating a robust, general understanding of variation in returns on stocks and their derivatives. That led to refinement of models that boast explanatory accuracy of well over 90%. Similar progress was made in operations science and in some areas of marketing science.

In 1996 Adam Brandenburger and Harborne Stuart Jr. uncovered the missing mathematical link in the field of strategy: Cooperative game theory could be applied effectively in studying competitive dynamics. Built on that finding, the value capture model (VCM) of competition allows you to identify potential payoffs to investments in resources and capabilities, bolstered by the power of big data. The field of strategy is now on the cusp of a productive interplay between theory and data, just as we have seen in finance, with all the value-creating possibilities that such progress portends.

participant. To be sure, a VCM analysis relies on the former to derive implications about the latter, but the distinction is crucial. Again, Porter buries the distinction so deeply that it is almost lost. Indeed, many people perceive his framework (probably unfairly) as a value-appropriation model, which may explain why many competing informal theories of strategy (such as Christensen's disruptive innovation or Kim and Mauborgne's blue ocean strategy) emphasize value creation rather than value appropriation.

From Value Chain to Value Network

The VCM offers a new way for practitioners to map a firm's competitive landscape. Traditionally, and certainly in Porter's framework, value is seen as the product of a chain of activities: A firm takes material from suppliers, adds some value, and sells a product to customers. It haggles with suppliers and customers over price, and its profitability depends on the appeal of its value-price proposition to customers relative to that of other companies.

The value capture model has only one force of competition that works in multiple directions.

The VCM framework replaces the firm's value chain with what I call a *value network map*—essentially, a productive social network with linkages defined by actual and potential transactions. The map has two major components, as shown in the left panel of the exhibit "A Different View of Value Appropriation." The first is the firm's value network, which comprises the agents (typically, suppliers and customers) who conduct actual, value-creating transactions with the firm. If no opportunities to create value exist beyond the network itself, there is no competition. Competition renders undeniable certain claims on the value produced. Without competition, the parties are left haggling among themselves, each attempting to persuade the others of the value they merit.

Competition arises from the second component of the value network map: agents outside the network that wish to transact with agents inside the network but that, for some reason, are not currently allowed to engage in such activity. For example, suppose that manufacturer A wants to sell through retail outlet B, but scarce shelf space prevents the transaction from occurring. In the VCM, the collection of all such agents is the value network's competitive periphery. When agents in the periphery wish to transact with a firm, that firm's capture of the value created by the network is likely to increase. That's because if the firm is offered too little in return for its activities within the network, it can choose to cut its transactional ties and form a new network with agents in the periphery.

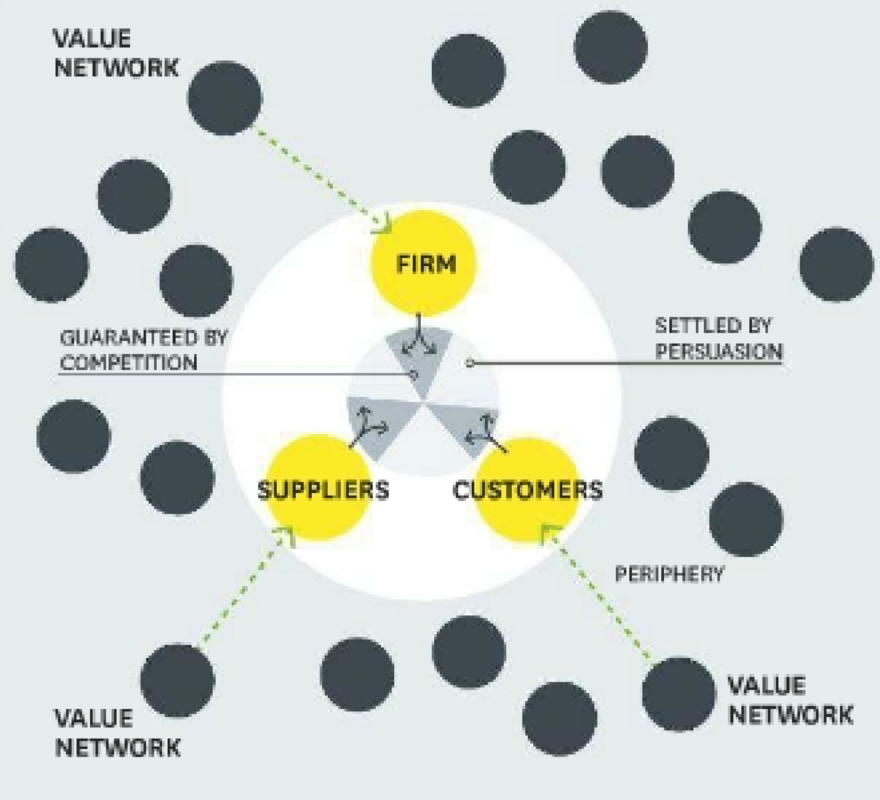
Who occupies the competitive periphery? All the entities identified by Porter are certainly there: A firm's rivals offer alternative opportunities to its suppliers and its customers, as do potential entrants and substitute firms in nearby industries. That reality erodes the firm's ability to appropriate value, as Porter emphasized. But the periphery also includes the rivals of current suppliers and customers (those the firm does not deal with now but could) and potential entrants and firms from nearby industries. The credible threat to replace a supplier or customer with a well-poised substitute increases the firm's appropriation from its suppliers and customers.

Consider Amazon in the early years of online book retailing (1994–2001), when it experienced persistent losses despite rapid sales growth and revolutionary technology. (See the right panel of the exhibit "A Different View of Value Appropriation.") Any buyer who cared to transact with Amazon could do that, so Amazon's competitive periphery (the agents that might compete *for* it) was empty. Interestingly, this problem stemmed directly from Amazon's innovation: The shift from brick-and-mortar to online retailing effectively eliminated capacity constraints. For example, I was an early Amazon customer, as it was a terrific source of mathematics monographs not typically stocked by its brick-and-mortar rivals. I never had to stand in line to buy a book, put in a bid for a limited customer slot, or worry that another Amazon enthusiast might jostle me out of my relationship with the company.

To make matters worse, the online arm of Barnes & Noble happily offered Amazon's customers alternative transactions of comparable value. Back then, so little differentiation between the online book retailers existed that small price discrepancies could induce switching within seconds, a few mouse clicks away. Thus, the periphery of the buyers provided

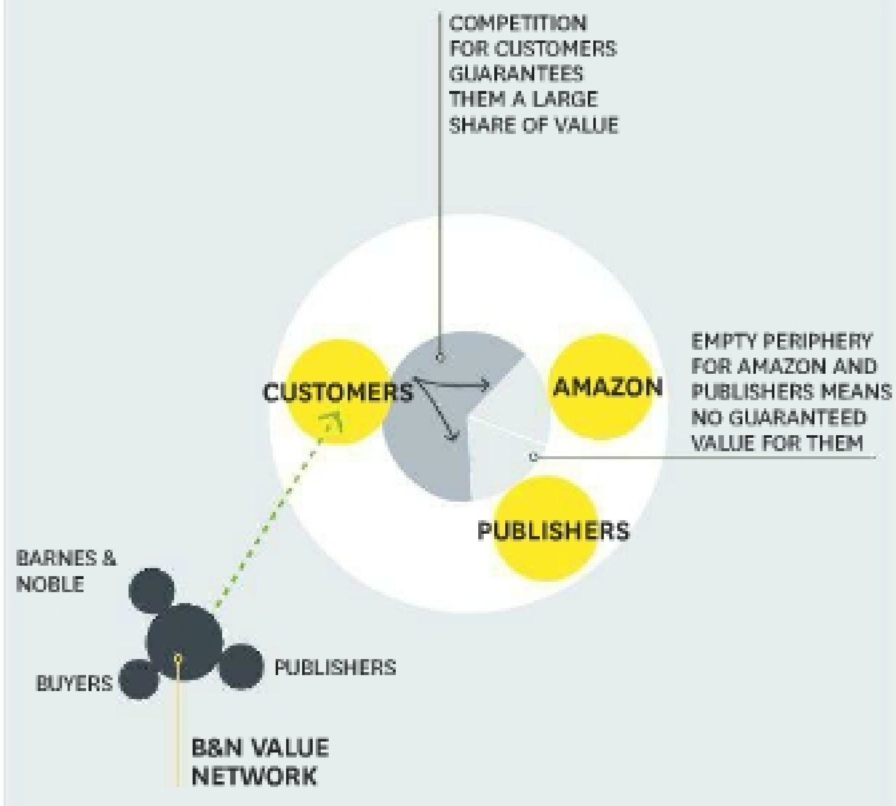
A Different View of Value Appropriation

A value network map illustrates the relationship among the players involved in creating and delivering a product or service: a firm, its suppliers, and its customers.



HOW A VALUE NETWORK MAP WORKS

Value creation is traditionally conceived as a chain of activities. Instead, think of a value network—one in which a firm, its suppliers, and its customers engage in transactions that create a given amount of value (represented by the pie at the center of the network). How much value each player captures depends on the level of interest in each player from parties outside the network (the competitive periphery) and on how well a given player persuades others in its network to part with value.



AMAZON'S EARLY VALUE NETWORK

In the early days of online book retailing (1994–2001), Amazon's value network comprised the company, its suppliers (publishers), and its customers. Amazon's customers had other places to buy books, most notably from Barnes & Noble online. Those customers were therefore guaranteed a hefty slice of the value pie. But because Amazon dealt with everybody who wanted to deal with it, no unsatisfied demand for Amazon's services remained. Therefore, Amazon was not guaranteed a slice of the pie; the best it could hope for was to appropriate a share of the meager amount left over by competition.

strong competition for *them*. Not surprisingly, markups for Amazon's service were low, allowing customers to appropriate the lion's share of the value in the market at that time.

Factoring In the Strategic Decision

So far, my description of the VCM has focused on variables beyond the control of individual firms—specifically, the agents in their existing value networks and the degree of competition for those agents as determined by the presence of alternative network partners. But those variables rarely dictate the exact value a firm ends up capturing. Rather, they set an upper and a lower limit for the share of value in a network that a firm can capture. Although the effects of competition can sometimes be subtle, the intensity of competition for the firm's partners in the network determines the upper boundary, and the intensity of competition for the firm dictates the lower boundary.

The value actually captured is, of course, a consequence of the firm's strategic decisions. We all intuitively know that firms can affect competitive opportunities and outcomes through their choices about which capabilities and resources to invest in. Formal applications of cooperative game theory mathematics to VCM-type strategy models not only confirm that intuition but also allow us to understand and predict *how* strategic decisions affect outcomes. That's where the VCM's distinction between value creation and value appropriation becomes important.

A firm's strategic investments in capabilities and resources can be measured on two dimensions: the effect of the capabilities and resources on the actual and potential value that partners in a network create, and the extent to which they enhance the ability of a firm to pry value from its transaction partners. Resources and capabilities that influence value, whether actual or potential, are deployed with *competitive intent*. By contrast, resources and capabilities developed to persuade a firm's transaction partners to give up value, beyond what competition dictates, are deployed with *persuasive intent*.

Typically, a firm uses competitive capabilities and resources to increase the range of value (the minimum, the maximum, or both) that is available for capture, consistent with the competitive intensities of its situation. So a deployment of resources that drives a minimum value up to the level of a maximum value benefits the firm, especially if its persuasive resources are weak. Competitive resources are usually easy to identify. A firm's products and services, productive assets, innovation skills, and customer service quality all affect the value that the firm creates within its network and that it could create with agents in its competitive periphery.

Advertising is also competitive: It may be designed to increase customers' willingness to pay for the firm's own product (by enhancing brand image, for instance) or to reduce customers' willingness to pay for a competitor's product, thereby weakening competition for the customers from entities in their peripheries. Such activity usually increases a firm's maximum *capturable value*. Alternatively, comparative advertising may increase the willingness to pay of potential buyers who are not current customers of the firm, thereby intensifying competition for the firm from the periphery and increasing the firm's minimum capturable value.

In practice, ads are often designed to achieve both effects. For instance, when General Motors touts its OnStar service in an advertisement and points out that other automakers don't offer it, the company is aiming to increase the attractiveness of its cars and decrease that of its rivals' vehicles. Similarly, ads for a sleep aid that mention the product is "not habit-forming" provide a not-so-subtle dig at rival products.

Persuasive resources and capabilities become relevant when competitive intensity is sufficiently loose to create a gap between a firm's minimum and maximum levels of capturable value. In such situations, a firm may make investments in resources and capabilities to get network partners to relinquish value; such activity may even be the prime driver of profits. For example, car dealers often use elaborate sales techniques to get buyers to part with value.

Armed with the value capture model, managers can more precisely estimate the effects of strategic choices on a firm's value network.

To see how these types of resources come together, consider Apple, whose own foray into online sales yielded a very different outcome from Amazon's. Apple launched iTunes in 2001, and by 2010 it was the largest global music vendor. According to some estimates, the company earned a 30% gross margin on $1.4 billion in iTunes revenue for 2011.

When it comes to physical goods, like those sold by Apple, firms can use capacity as a competitive resource to keep their peripheries populated by limiting the number of agents with which the firm can transact. For example, Apple limited the supply of iPods when it introduced them in 2001 and thereby ensured competition for itself. The proprietary iTunes song format also linked the scarcity of Apple's physical devices to its digital content, and the appeal of the design of Apple's products kept buyers unusually loyal. The buyers' own peripheries were populated with other digital music and device providers, but loyalty to Apple lowered the relative value of transacting with them, thereby weakening competition for Apple's customers. The complementary nature of Apple's product ecosystem has been much discussed; in VCM terms, the increased value from the iTunes store, particularly for buyers with multiple Apple devices, and the weakening of Apple's competitive periphery increased the company's maximum value available for capture.

The stories of Amazon and Apple illustrate an important contrast. In Amazon's case, book suppliers shipped physical products that were limited in number through a distributor with more or less unlimited transaction capacity. In Apple's case, the content suppliers provided licenses for music, an activity with no inherent capacity, so the suppliers' commitments to keep their peripheries populated were not credible. Meanwhile, Apple capped distribution by tying its digital content to its own products using proprietary file formats.

Apple established some distance between its minimum and maximum quantities of capturable value, and its persuasive resources also came into play. Persuasive resources get a firm's transaction partners to relinquish value beyond the amount proscribed by competition. One way to achieve this aim in a mass retail market is to control pricing at the point of sale, which permits the firm to make credible take-it-or-leave-it offers to its buyers. That technique unravels when it becomes economically attractive for buyers to haggle, as with big-ticket purchases like cars, or if the gap between the minimum and the maximum appropriable value decreases. Indeed, Amazon's control of the point of sale had little advantage because the similarity of Barnes & Noble's online offering kept the gap very narrow.

Quantifying the Outcome

The exact effects of strategic choices on a firm's value network and competitive periphery are hard to predict. But armed with a VCM-based mathematical model, managers can estimate those effects more precisely. Indeed, in the VCM model, a firm's minimum and maximum value-appropriation levels (defining the range of value the firm can capture) are the solutions to problems in linear programming, a very well understood analytical technique that can be conducted in Excel.

A useful real-world example comes from a case study, which I am coauthoring, on Evan Kristen Specialty Foods (EKSF). In it, a venture capitalist must evaluate a business plan from EKSF, a start-up that plans to sell washed, de-stemmed, fresh herbs in the produce section of retail grocery stores year-round. EKSF aims to create a value network with nontraditional participants. Those include FedEx as the distributor (bypassing standard produce warehousing and shipping requirements), original equipment manufacturers as suppliers of custom processing equipment and in-store refrigerated displays, the maker of an IP-protected shipping refrigerant, an in-house staff of retail merchandisers (unheard of in produce), and a collection of growers in a location amenable to year-round production, near Watsonville, California.

Standard industry rules of thumb do not apply in this unusual scenario. The VCM, however, allows the venture capitalist to assess competitive intensity for all players in EKSF's innovative value network. Comparing the resulting analysis with the financial projections in the business plan enables the potential investor to distinguish the amount of projected profit, given the predictable competition, from the amount that would come from persuasive resources. (Investors usually perceive profits locked in by competitive forces as less risky.)

The analysis provides insight into the balance and evolution of competitive intensities affecting all the agents in the value network. Tight capacity constraints for the start-up imply strong competition for it from customers in its competitive periphery. Upstream, the periphery is essentially empty for several of the nontraditional suppliers mentioned above, as it is (on the supply side) for EKSF. In other words, EKSF and the suppliers have no alternative but to form a network with each other.

However, a medium-term threat emerges, just as the venture capitalist is thinking about an exit strategy. Specifically, the VCM reveals that if EKSF succeeds, the efficacy of its innovative value network will be proven, and the competitive peripheries of its unusual suppliers will fill up more quickly than its own, thereby squeezing profits. Planning for that possibility is therefore important, and that means acquiring a patent license from the refrigerant supplier.

STRATEGY IS A COMPLEX DOMAIN, and social science progresses in fits and starts. Therefore, it might be a decade before the VCM can provide practitioners with a turnkey managerial tool. Nevertheless, work on the VCM is already revealing important insights for leaders who aim to chart a strategic direction for their firms. If scholars in the field of strategy do succeed in creating a streamlined version of the model with a reasonably full complement of input variables, it will become an important theoretical paradigm. Empirical research findings will then refine the model, which will illuminate the way to better business practices in a virtuous, recursive cycle of discovery and innovation. ▽

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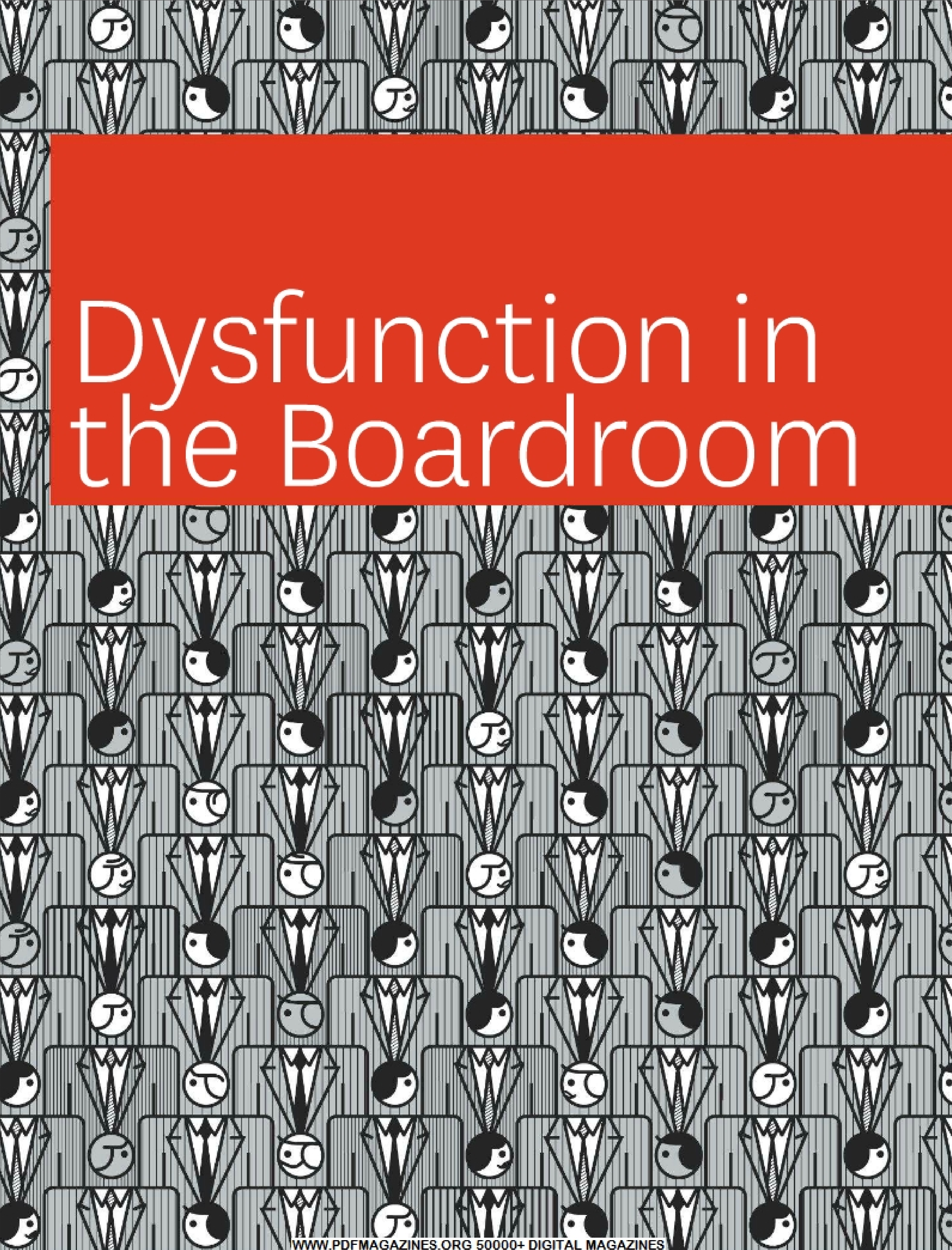
Dysfunction in the Boardroom



Understanding the persistent gender gap at the highest levels *by Boris Groysberg and Deborah Bell*

FOR YEARS women have sought greater representation on corporate boards. And most boards say they want more diversity. So why did women hold only 16.6% of *Fortune* 500 board seats in 2012? And why, for the past six years, has that percentage been relatively flat, increasing by just two points, according to data from the research firm Catalyst?

Patience has started to wear thin, especially in Europe. Having seen little progress with voluntary efforts, several countries, including Belgium, France, Iceland, Italy, Norway, Spain, and the Netherlands, have enacted legislation that calls for a minimum percentage of female directors on boards. The European Union is considering mandating quotas as well.

It's unclear why women have not made greater inroads. Board appointments and dynamics remain largely a black box; not much research has been done on the selection and appointment process or on the differences between women's and men's experiences as directors. To learn more, in 2010 we began a series of annual surveys in partnership with WomenCorporateDirectors and Heidrick & Struggles. In this article we reveal the findings of an analysis of qualitative data from the first survey.

We were especially interested in the backgrounds, trajectories, and interactions of female directors—who are the women who get onto boards, and what do they encounter there? So our sample was drawn mainly from female corporate directors; we included a smaller number of male directors as a benchmark. (Overall the survey had a response rate of 42%, with 294 women and 104 men from private and public companies participating.) Also, because the vast majority of the sample consisted of U.S. directors (80% of the women and 83% of the men), the findings largely present a picture of American boards. While our survey has these and other limitations, it still offers several interesting perspectives.

In the following pages, we'll share a profile of the female board member that emerged; what the directors surveyed had to say about the benefits of diversity and about the dynamics between men and women on boards; and some best practices for recruiting and managing diverse boards. In the process, we'll discuss three key themes we discovered in the data:

- Women had to be more qualified than men to be considered for directorships. Women also seemed to pay a higher personal price to become board members than men did.
- Although boards say they like diversity, they don't know how to take advantage of it. We found a stark disconnect between female directors' experiences and their male colleagues' perceptions. Women told us they were not treated as full members of the group, though the male directors were largely oblivious to their female colleagues' experience in this regard.
- Great talent alone is not enough to create a well-functioning board. Boards need formal processes and cultures that leverage each individual member's contribution as well as the directors' collective intellect.

ILLUSTRATION: JAMES GRAHAM

Portrait of the Female Director

IN OUR STUDY, we observed some distinct patterns. The female directors tended to be younger than the male directors—probably because, on average, the women had joined boards relatively recently, whereas the men had served on boards longer. Seventy-six percent of the female directors (versus 69% of the male directors) were employed in an operational role; 68% (versus 51% of the male directors) were in a lead role, like CEO, president, or partner. These findings suggest that to receive invitations to boards, women might need to be more accomplished than men. They also contradict the popular belief that female board members have mostly nonoperational or support-function experience.

Another distinction we discovered between the backgrounds of female and male directors was that by and large, the women on boards worked for private corporations, not public ones. A majority of the male board members worked for private corporations as well, but a higher percentage of the men worked for public companies—likely a reflection of the fact that fewer women occupy the C-suites of public companies.

The data also indicate that female board members may have made different trade-offs on their way to the top. In comparison with male directors, fewer female directors were married and had children. A larger percentage of the women were divorced—suggesting they may have incurred greater personal costs. We found similar patterns in our 2012 survey.

We were curious to learn about the aspirations of corporate directors, who by most standards have reached the pinnacle of career success. We found that a somewhat higher proportion of women than men (92% and 86%, respectively) described themselves as ambitious. In addition, contrary to gender stereotypes, 91% of the women versus 70% of the men reported that they enjoyed having power and influence.

On average, the women in our survey were serving on two boards and the men on three. Given that, it wasn't surprising that over half the female directors wanted to serve on more boards. (A smaller percentage of the men did.) But the women also expressed greater overall career aspirations. Twenty-seven percent of the female directors wanted to lead or continue leading a company, compared with 19% of the men. Although female directors' younger age may account for some of the difference, it doesn't fully explain it: Twenty-nine percent of the women who actively aspired to the top job were age 60 to 70, whereas only 10% of the men with similar aspirations were. Such ambition at a time of life when most professionals are winding down their careers suggests that women, whose opportunities have consistently been more restricted, may wish to extend the length of their careers with an eye to finally attaining the most-coveted roles.

We also wanted to know what strengths directors would say they brought to their boards and, by implication, what skill sets and areas of expertise they thought were most important to board operations and dynamics. Asked to write in their strengths, the men and women gave remarkably similar answers. One significant difference was that a lot more women than men cited the ability to communicate effectively. Many female directors noted that they were more likely than their male counterparts to ask tough questions or move boardroom discussions forward in skilled and effective ways. (See the chart "How Female and Male Directors Perceive Their Strengths.")

Another notable difference was the greater percentage of men who cited global experience as a strength. In our work with directors and high-level executives, we've found that women are often not considered for international assignments, because of the assumption that women with families find it more difficult than men with families to relocate or travel for extended periods. The unfortunate consequence is that women don't get equal access to international roles.

Curiously, more men than women listed operations experience as a strength, even though a greater percentage of the women held operational roles or were leading a company. We cannot say why with certainty, but their answers indicate that women may place a higher value on personal skills, such as leadership and communication, than on role-related experience.

To learn more about the factors that may inform directors' perspectives, we asked about their outside interests. We found substantial differences between women and men. Though both named sports most frequently, men did so at a much higher rate. (See the sidebar "Golf, Anyone?") What was also striking was the higher percentage of women than men who named arts and culture, travel, and philanthropy and community service as outside interests. (See the chart "Directors' Outside Interests.")

How might these differences affect the way female and male directors form and maintain connections with other directors? Could the lack of common interests make it harder for female and male board members to identify with and relate to one another? Or could these differences be enriching? »

HOW FEMALE AND MALE DIRECTORS PERCEIVE THEIR STRENGTHS

We asked survey respondents to write in what their strengths as board members were. Here are the traits and skills they noted.

	% of Women	% of Men
Industry and business experience	38	43
Leadership and strategic vision	30	27
Board and governance experience	25	24
Communication	25	17
Finance and investment expertise	24	29
Relationship skills and people management	18	16
Operations experience	14	22
Marketing and sales	13	9
Preparation and organization	10	1
Risk management	5	1
Global experience	5	16
M&A	3	5
Technology expertise	3	3
HR and talent management	3	5
Commitment and passion	3	6

DIRECTORS' OUTSIDE INTERESTS

To learn what shaped board members' perspectives, we asked directors about their nonwork interests and activities.

	% of Women	% of Men
Sports	70	90
Travel	49	30
Arts and culture	42	17
Reading	39	38
Philanthropy and community service	26	16
Family and friends	24	22
Food and wine	12	6
Gardening	10	2
Education	4	11

The Benefits of Diversity

ACCORDING TO RESEARCH by our HBS colleagues Robin Ely and David Thomas, organizations have three major approaches to diversity. We've found that boards' approaches to diversity are similar. They may pursue it as a way to:

1. Institute fairness and rebuke discrimination. Government interventions, whether mandatory (quotas) or voluntary (targets or disclosure reporting recommended by the SEC), have sensitized most boards to the fairness argument for diversity.

2. Build a deeper understanding of and access to desirable customer bases and markets, such as female consumers.

3. Incorporate new perspectives and generate learning. When this is the goal of a board, diversity is integrated into all its practices and informs all discussions and decisions, producing the greatest impact.

To better understand what directors think gender diversity can offer boards, we asked respondents whether women bring special attributes to the role. Ninety percent of the female directors thought they did, compared with 56% of the male directors. At right are the attributes respondents cited, along with representative comments.

34% OF WOMEN AND 57% OF MEN SAY

Women bring fresh perspectives and diversity of thought.

"Our experiences as mothers and daughters provide a different view of issues."
—A FEMALE DIRECTOR

"Women have a different perspective on life and therefore on how to conduct business."
—A MALE DIRECTOR

"Women bring knowledge of female buyers' behavior."
—A FEMALE DIRECTOR

29% OF WOMEN AND 3% OF MEN SAY

Women are more willing than men to ask questions and challenge the status quo.

"We're not afraid to call a cat a cat and bring up difficult questions. And we can't leave the room without resolving an issue."
—A FEMALE DIRECTOR

"Many senior businesswomen have overcome challenges on their path to success, more so than men. Maybe because of this, many women bring a stronger sense of objectivity to the boardroom. In my experience, it is more often the women who are courageous in difficult conversations and difficult decisions."
—A FEMALE DIRECTOR

20% OF WOMEN AND 3% OF MEN SAY

Women are more collaborative and inclusive.

"Women tend to be more inclusive and work to be sure everyone is heard."
—A FEMALE DIRECTOR

"Women bring consensus-building skills."
—A MALE DIRECTOR

"Women start negotiations at point 40 or 60 and achieve results; men start at point 0 or 100 and argue to argue."
—A FEMALE DIRECTOR

8% OF WOMEN AND
11% OF MEN SAY

Women have greater empathy and interpersonal skills.

"Women tend to be more sensitive to cultural dynamics and to people's strengths, weaknesses, motivations, and potential."
—A FEMALE DIRECTOR

"Women have more emotional intelligence."
—A MALE DIRECTOR

"Women think about the people behind the numbers."
—A FEMALE DIRECTOR

While slightly more than half of the male directors said that women bring a fresh perspective to the boardroom, 19% said that gender should not be a factor when selecting directors; instead, selection should be based solely on qualifications and experience. One male director explained, "Women—and any board member—should be judged on their background and skills, not because they have attributes based on gender, race, etc." Another stated, "People bring special attributes, and they are not related to diversity." And a third offered this view: "Any shareholder wants the most qualified board members they can get. Diversity is a plus."

Many people have no doubt that women account for more than 16.6% of the pool of highly qualified potential directors, so the question remains: Why aren't more women on boards? One female director offered this explanation: "Women are not thought of first as candidates unless a board is looking for gender diversity specifically." Another shared her experience: "I'm not part of the old boys' network. Directorships go to people who are known. I've been so busy leading my company and raising my family that I'm less well known." And a third lamented, "Boards still prefer pale, stale, and male!"

Golf, Anyone?

Men have long built and perpetuated networks through informal social gatherings and activities—like golf—at which they can cultivate beneficial relationships and make business deals.

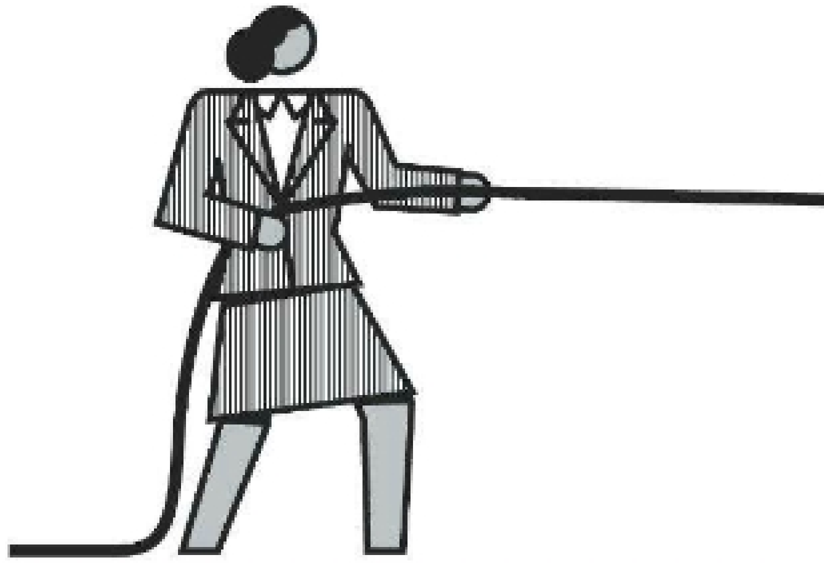
We found that the percentage of male directors who golfed (40%) was twice that of female directors who did (20%). Among the CEOs in the study, the difference was slightly greater: 40% of the men and 17% of the women played the game. We also saw that among the women, the percentage of non-CEOs who golfed was higher than the percentage of CEOs who did.

Those data, in combination with our findings on board members' perspectives, suggest that some women who play golf may feel compelled to do so to help advance their careers. Up-and-coming female professionals may take up the sport to increase their visibility and thus the chances they'll be considered for promotions and board positions. And women who already occupy the CEO's office may play to avoid being left out of important discussions that happen outside the executive suite and the boardroom.

Although there are women who enjoy golf, we have also heard many stories that support this hypothesis. One female board member said that when she achieved her first C-suite role, several of her male colleagues advised her: "If you don't want to be excluded from some of the things we do, you're going to need to learn how to golf and start golfing with us." Other women reported that their male colleagues made a lot of important decisions together on the golf course—preempting the opportunity to discuss them at formal meetings. Another female director underscored the point: "Golf was amazingly helpful to my career. I would be the only woman on a men's golf trip. It built great camaraderie and relationships—and respect. It put me on the same playing field as everybody else."

Women shouldn't *have* to take up a sport just to be treated as equals, however. This is not a productive dynamic. Golf reinforces the tradition of the old boys' club. Boards will not become more inclusive if women are forced to play it in order to be selected, heard, and consulted in decision making. Boards must cultivate inclusive, collegial, and respectful relationships among members. Backroom decision making should not be tolerated.

Gender and Board Dynamics



Four types of obstacles women say they face

21% OF WOMEN SAY

Not being heard and listened to

"I often feel that I'm not heard and that I need to put more effort into making sure that others hear and understand my point of view."

"I have to yell for them to hear me."

20% OF WOMEN SAY

Not being accepted as an equal or as part of the "in" group

"It's been a challenge earning respect and being treated as an equal member, particularly with older board members."

"I'm consistently not included in informal gatherings, such as golf games and dinner, by some male board members."

20% OF WOMEN SAY

Establishing credibility

"As a woman, you have a longer road to build credibility."

"I have to establish my credentials over and over; it never stops."

"It's work to make sure the male members feel there is value in my opinion."

5% OF WOMEN SAY

Stereotyped expectations of women's behavior

"I'm always seen as 'the voice of women.'"

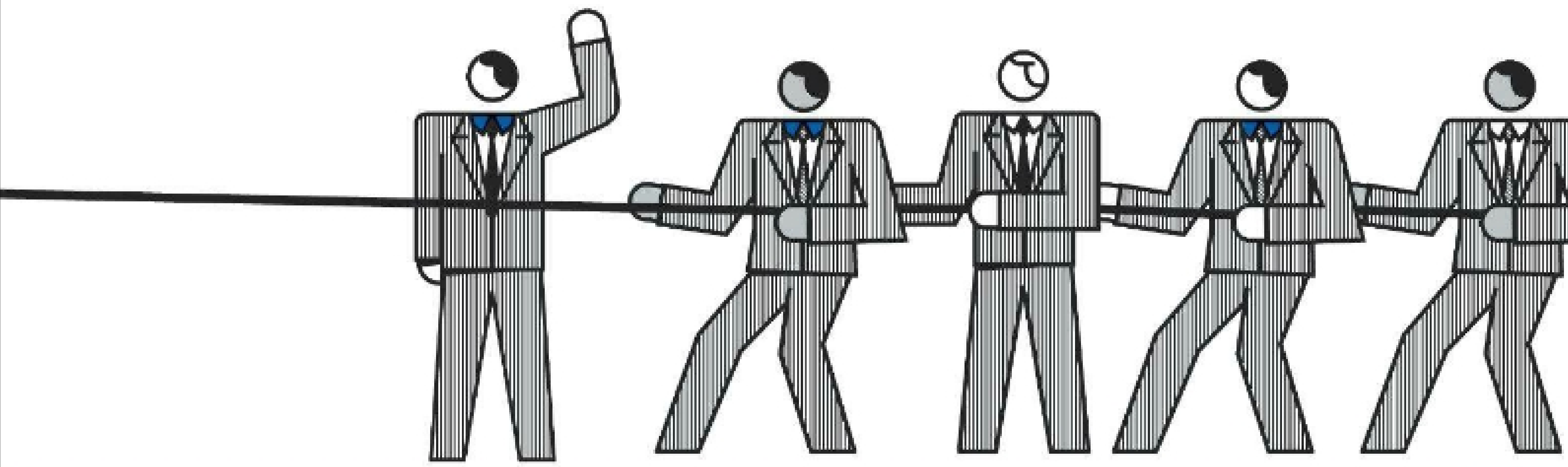
"I'm expected to hold the ethical compass for the board and lead on women's initiatives."

THOUGH BOARDS say they want diversity, what happens once women get on them? Eighty-seven percent of female directors reported facing gender-related hurdles. The obstacles fell into four major categories, listed above along with examples of the types of comments we heard most.

We also asked the male directors if female directors face hurdles that men do not. The majority—56%—said no. Those who answered yes named the four types of barriers listed at right (with a sampling of their comments).

According to some women's accounts, many male directors seem unaware that they may create hostile board cultures, fail to listen to female directors or accept them as equals, and require them to continually reestablish their credentials.

One female board member gave the following example: A highly successful and accomplished woman in financial services was asked to join the board of a growing multibillion-dollar public company. She was its first and, for many years, only woman director. She brought greatly needed financial expertise to the board as well as a deep understanding of the company's industry, yet she routinely felt shut out and stifled during meetings. Her questions were greeted not with respectful collegiality but as intrusions into the "real" conversation among the male board members.



Four types of obstacles men say women face

33% OF MEN SAY

Limited access to and acceptance on boards because of weaker networks and the old boys' club

"The good old boys' network remains."

"Women's more-limited networks have hurt their ability to gain access to boards."

28% OF MEN SAY

Lack of experience and industry knowledge

"In tech there aren't many women with the relevant leadership and experience qualifications."

"Highly qualified women directors are in great demand and tend to stretch themselves very thin. Minorities are the same."

22% OF MEN SAY

Bias and prejudice

"Women do better on boards when they behave more like men."

"There's a perspective that women's experiences aren't as valuable."

14% OF MEN SAY

Having to work harder to prove themselves

"Women must spend a longer time than men do earning the trust of men."

"Older male directors tend not to listen as closely to female input."

In fact, the CEO and chairman and other male directors had taken her aside many times and asked her to be "less vocal" and to "stop arguing her point" during meetings. She related how this behavior surfaced during meetings, too, recalling one in particular at which she was pursuing a line of questions about a strategic decision when a male director interrupted her and exclaimed, "You're behaving just like my daughter! You're arguing too much—just stop!"

This story illustrates the kind of experience that may have led female directors to cite the failure of their board colleagues to listen to them more often than any other barrier. The fact that few men recognized this dynamic suggests a stark disconnect between female directors' experiences and their male colleagues' perceptions.

In addition, far more male than female directors (28% versus 4%) pointed to a lack of board experience and industry knowledge as a handicap for women, but our findings indicate that men and women may come at the qualifications question from very different perspectives. Men seemed to view inexperience as a fixed and disqualifying trait, whereas women saw it as surmountable—something that could be addressed through learning and development. The high percentage of female directors who held operational roles and were leading organizations implies another disconnect—this one between women's qualifications and men's perceptions. »

The View Outside the U.S.

Though this article is based on our 2010 survey results, which focused mostly on boards in the United States, we have since expanded the geographic reach of our survey. In 2012 it covered 59 countries, and 44% of the female directors and 71% of the male directors who responded were from outside the United States.

When we compared the U.S. and non-U.S. female directors from 2012, we found many similarities and a few notable differences. (The profile of the 2012 U.S. female board member looked a lot like the general profile of the 2010 female director described in this article.) In 2012, both U.S. and non-U.S. female directors cited industry knowledge, strategy, and financial experience as their top three strengths. Both groups had previously served on similar numbers and types (public versus private) of boards. The typical non-U.S. woman director, however, was currently sitting on a greater number of boards—twice as many as her U.S. counterpart. The female directors from outside the United States were also younger than the Americans. One possible explanation for these differences is that opportunities and demand for female directors may be greater in countries with quotas.

There were also notable variations in the two groups' personal profiles: A greater percentage of female directors outside the U.S. were married and had children, and those with children had slightly more. And more female directors from the U.S were divorced, even after adjusting for country differences in divorce rates. While there are no simple explanations for these differences, we can't help wondering if the fact that the U.S. lags behind other countries in providing paid maternity and parental leave and access to affordable, high-quality child care plays a role. In fact, the U.S. is among a handful of countries that do not mandate paid maternity or parental leave. What would happen if parents were able to take paid leave at the birth of a child and have greater access to quality and affordable care as their children grew? What would be the outcome not only for family life and health but also for both women's and men's careers?

Diversity in Practice

IN THEIR RESPONSES to our survey, both male and female directors repeatedly named open communication, well-run general meetings, a candid but collegial tenor, and productive relationships with senior management as attributes of a successful board. Yet research suggests that too many boards ignore the need for those qualities, and recent efforts to overhaul governance have clearly failed to address the question of how to compose a knowledgeable, inclusive body that possesses them.

We studied a large company that was being split into two public companies for which two new boards had to be created. The chairman, who had long championed diversity, was spearheading the process. He appointed a special team to create an objective, transparent method for selecting the directors. After reviewing the roles and responsibilities of each board and the natures of the new businesses, the team derived lists of the skill sets each board needed. Then it created a model containing the dimensions critical to a high-performing board, from func-

1. Build and strengthen group dynamics.

Provide communication and team-building training for members, especially new directors.

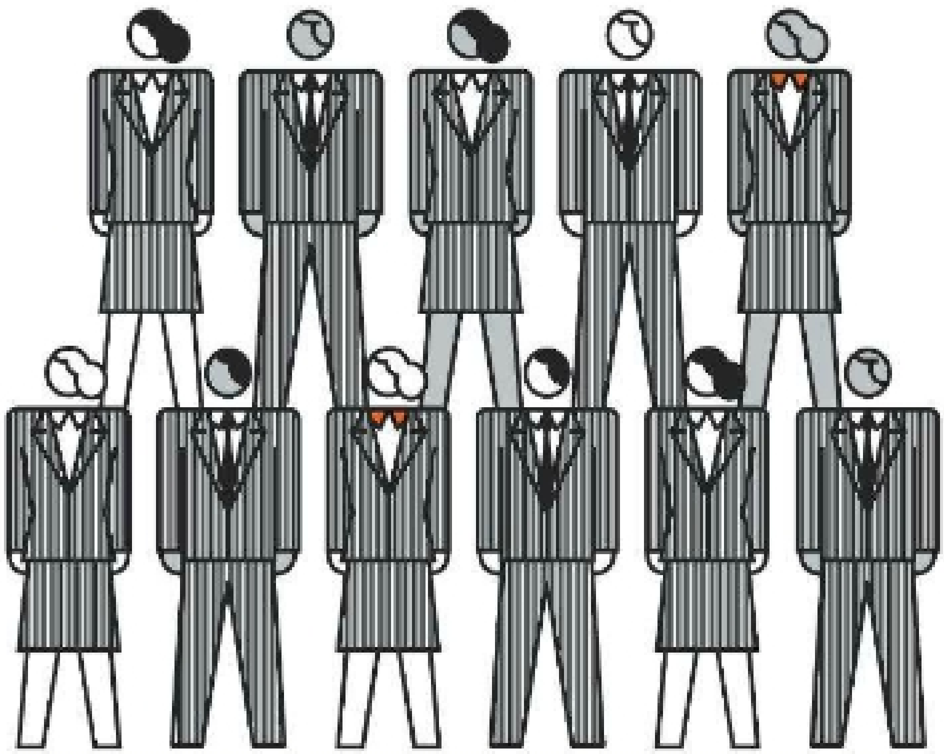
Engage all members in regular social activities like board dinners and annual retreats.

Add conference calls, video chats, and opportunities for additional reporting between meetings.

2. Recruit more female and diverse director candidates.

Establish a strategic plan for board succession that includes deep discussions of diversity.

Broaden the definition of diversity to include experience, skills, capabilities, perspectives, and behavioral attributes needed by the board, and institute rigorous, objective selection processes based on them.



tional and industry expertise to behavioral attributes. This approach led both companies to recruit boards that were diverse not only in gender but also in skills—demonstrating that when a firm builds a board using a rigorous assessment of the qualities it needs to carry out its governance task, rather than personal networks, the board is better equipped to execute its functions.

Though more research is needed to measure the impact of different practices on board performance, we have encountered several (detailed below) that boards have used to become more effective. Practices like these help break down obstacles that hinder directors from being fully integrated into boards and contributing to their potential.

After all, as our data suggest, it takes more than great talent to make a great board. Talent alone cannot overcome dysfunctional dynamics. Companies increasingly recognize the distinction between diversity and inclusiveness: Diversity is counting the numbers; inclusiveness is making the numbers count. Boards need to improve on both dimensions.

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3. Develop more female and diverse candidates internally.

Make talent management part of the board's strategic focus to ensure that the company's most important assets are maximized.

Recruit, develop, and promote a diverse set of candidates at every level of the organization.

Develop a pipeline of future leaders and board members through director advocacy, mentorship, and training.

4. Conduct rigorous and regular board assessments and evaluations.

Establish a culture of accountability and responsibility.

Implement consistent and transparent processes to address conflicts between members.

Deal with undesirable behavior of board members.

Act on board reviews and remove poorly performing directors.

Quotas and the Men Who Like Them

While several countries have passed legislation requiring boards to meet certain thresholds for female membership and others are considering such mandates, quotas remain a contentious and controversial subject. A central question is whether they have an overall positive or negative effect on board and company performance and under what conditions. The fact is, we do not yet truly know the effects of quotas. What we do know is that many myths and misconceptions infuse the debate, and more in-depth research is critically needed.

Our 2012 survey results reveal that—contrary to popular belief—men in countries with quotas supported them in higher numbers than men in countries without them. The women's response was even more emphatic: Nearly all the female directors from countries with quotas agreed they were effective, versus about half of the female directors from countries without quotas.

We are currently conducting additional research to help us better understand these findings and the experiences of boards and directors in countries with quotas. One dynamic that may be at play: Satisfaction levels are higher for both women and men in work groups with greater gender balance. Furthermore, in some cases, lower-performing board members may be managed out to create room for new female directors, increasing the board's effectiveness. Men may initially oppose or be highly wary of quotas, but once they're enacted, some men might experience the benefits and satisfaction levels associated with gender-balanced groups.

PERCENTAGE OF DIRECTORS WHO BELIEVE QUOTAS ARE AN EFFECTIVE TOOL FOR INCREASING DIVERSITY

	% of Women	% of Men
In countries with quotas	95	43
In countries without quotas	48	23

Boris Groysberg is a professor of business administration in the organizational behavior unit at Harvard Business School, and the coauthor, with Michael Slind, of *Talk, Inc.* (Harvard Business Review Press, 2012). **Deborah Bell** is a researcher of organizational behavior whose work focuses on leadership and organizational effectiveness.

It's All About **Day One**

How to give a new executive the best possible start

by Suzanne de Janasz, Kees van der Graaf, and Michael Watkins

Some years ago Kees van der Graaf, one of the authors of this article, was promoted to lead Unilever's food division, succeeding the man who'd just been appointed CEO. He was thrilled that his achievements merited rising two levels in Unilever's hierarchy to head its largest unit. News of his appointment was made public immediately, in accordance with British and American exchange regulations. That morning a meeting was scheduled to introduce Van der Graaf to his new management team. Just before it started, he got a call informing him that the incoming CEO was tied up in press interviews and would not be there to introduce him.

When Van der Graaf walked into the room, his new direct reports were clotted in groups and involved in heated debate. He received stunned looks and ice-cold acknowledgments. None of the people there had known before that morning's announcement that he'd been the one selected. They were astonished by what seemed an unlikely pick. Van der Graaf was not a member of the food division's leadership team or of any other division's leadership team. In fact, until that day he'd been one of their subordinates.

As Van der Graaf and his new direct reports took their seats, he realized that they were all sitting as far away from him as possible. They were closing ranks, isolating him to show their strength. He had become Public Enemy Number One.

The appointment of a new leader is a defining moment for an organization. Leaders find transitions into new roles the most challenging times in their professional lives, when they either build credibility and create momentum or stumble and sow doubts about their effectiveness. Much consideration has therefore been given to how leaders should take charge in their early days. But far too little attention has been paid to how the organization should set them up for success as they enter their new roles.

It's easy to see why. In making leadership appointments, companies invest most of their time, energy, and attention in choosing the right person for the job. Only secondarily (if at all) do decision makers consider what message the appointment will send (or should send) to the organization and how it will affect those passed over and those who must now work with the new boss. But failure to announce appointments in the right way can undo all the work that went into the selection and hobble even the strongest leader from the start.

What's Everyone Thinking?

Understanding that a transition can set off an emotional storm is the first step toward effectively managing the process. Prior to an appointment, many people in the organization think they know who will be selected. If their expectations pan out, getting the new executive started is relatively straightforward: It consists primarily of confirming that he

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or she will pick up where the old leader left off, by establishing goals and putting a implementation plan in place.

But when someone as unexpected as Van der Graaf is appointed, the surprise creates dissonance. Some of the people on whom the new leader will depend most may feel that he or she hasn't earned the right to lead or, worse, has somehow stolen the post from a more deserving candidate. Then any small, early misstep becomes "proof" of a poor choice, further undermining the new leader.

At the same time, those who were passed over worry, understandably, about the implications for their careers, prompting thoughts of moving on. A badly orchestrated appointment increases the odds that the organization will hemorrhage valuable talent, because the most capable executives are the most likely to be wooed away.

What to do, then? Responsibility for making appointments in the right way rests with the leader who made the selection, his or her HR partner, and the communications, investor relations, and legal professionals who advise them. This "appointment team" must devise good answers to four fundamental questions: (1) What message is this appointment meant to convey? (2) Why is this person the right one for the job? (3) Which members of the organization need to be informed? (4) What should they be told and when? The first two questions are linked, and so are the second two, so we consider them in pairs.

The Message and the Messenger

A clear explanation of why an appointment was made and why the chosen person is right for the job will go a long way toward countering doubts or conspiracy theories and setting the new leader up for success. The goal isn't necessarily to keep things on an even keel and make everyone happy. When an organization wants to initiate a turnaround, open new areas for growth, or pick up the pace in executing the current strategy, a surprising or even shocking appointment can create an appropriate sense of urgency and thrust things forward.

Consider the case of Malcolm Currie, a past CEO and chairman of Hughes Aircraft Company. As Currie neared mandatory retirement, in the early 1990s, Hughes was an engineering-driven, defense-focused company. It had a history of promoting top engineers and scientists, and employees were abuzz about who would be Currie's successor. Several Hughes

Advice for New Leaders

An organization has an obligation to position its new leaders for success. But if you're a new appointee, you should take steps to prepare yourself—emotionally and personally as well as professionally. Between your acceptance of the position and your start date, take time to:

1. **Reflect on what this new role means in terms of how you see yourself.** How will this job connect to your personal values and wider interests? What, exactly, do you want from it? How can you shape your responsibilities to align with your values and interests?

2. **Manage your own expectations.** Increased responsibilities will require you to make trade-offs in allocating your time and energy. Think in advance about what matters to you, what you're prepared to do, and what you're not.

3. **Consider what this means for your family.** Have an honest conversation about what they expect well before you start. Attempts to justify unwelcome surprises by pointing out the increase in your prestige, opportunity, or salary will only heighten your loved ones' perception that you're benefiting at their expense.

4. **Expect conflict, both professional and personal.** Just because you don't foresee any conflict in the new role doesn't mean that others won't. Plan the time for candid conversations both at home and at work.

5. **Engage in periodic assessments and offer (or negotiate) adjustments if necessary.** It's easy to get trapped in a hamster wheel of doing, doing, doing. But to learn and develop, you must set aside time to reflect on what's going well and what isn't. Some top leaders block off two hours every week to do this.

Idea in Brief

The appointment of a new leader is a defining moment for an organization, sending a powerful message about where it intends to go. But unless attention is given to how the new leader is introduced into the organization, that message may be lost and the new leader hobbled even before day one.

A well-crafted appointment process must devise and communicate clear answers to four fundamental questions:

1. What message is this appointment meant to convey?
2. Why is this person the right one for the job?
3. Which members of the organization need to be informed?
4. What should they be told and when?

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executives with science backgrounds, one of them a former air force general, were seen as contenders.

But shrinking defense budgets and commercial missteps had led to declining growth, and the board was looking for more than someone to simply carry on. In February 1992 it selected C. Michael Armstrong, then the number three executive at IBM, for the job. Neither an insider nor a scientist, Armstrong had a track record of success in marketing and sales throughout Europe, the Middle East, and Africa.

Predictably, the appointment sent shock waves throughout the organization. Rumors spread that the "C" in Armstrong's name stood for "chain saw." Employees feared that this outsider wouldn't understand or appreciate the Hughes way. His appointment was meant to signal that business as usual couldn't continue at Hughes—but not that everything Hughes stood for and everyone who worked there would be swept away.

Accordingly, in a public statement made on the day of the announcement and duly recorded in the *Los Angeles Times,* Currie himself presented the rationale for Armstrong's appointment, pitching it as an acceleration of his own ongoing strategy rather than a radical departure from Hughes's government-contracting past. He reminded his audience that his strategy was to turn Hughes into a balanced high-tech company by the end of the decade, shifting its revenue base so that 50% of its business came from nondefense work—up from just 15% previously. This statement of purpose was as strong as it could be. It described a specific strategy, clearly related it to the familiar way of doing things, laid out a definition of success, and presented a timetable for achieving it.

Then Currie turned to why Armstrong was the right person for the job. The *Times* reported: "Currie said Hughes has significant commercial opportunities, but capturing them will require a new emphasis on marketing, a financial restructuring and an improvement of business skills—all of which were ingredients that led to Armstrong's selection." By saying "Mike comes along at an extremely opportune moment in the corporation's history," Currie positioned Armstrong within the tradition of the company and as a force for constructive change.

The announcement was also notable for what Currie did not say: How Armstrong might choose to reach the stated goals. Armstrong, too, kept his options open. At a press conference on the day of the announcement he praised Hughes's technological abilities, declined to specify what changes he had in mind, and said he would begin by visiting as many company plants and customers as possible. In this both Currie and Armstrong were wise. To ensure that the intended signals are sent, senior leaders must strike the right balance between being clear about what the new executive has been appointed to do and leaving him or her flexibility to do it. Oftentimes what needs to be done is not obvious. Sometimes valid disagreements must be worked out after an appointment is made. When the anticipated scope of change is very large, decisions about how to implement it may best be left to the new leader.

Generally speaking, people will need to know more about the qualifications of an external hire like Armstrong than of an internal one. In particular, they should be told why seemingly unrelated experience from another industry may apply in their organization—why, for example, someone from the financial services industry will be able to lead a pharmaceutical company through the challenges presented by major regulatory changes.

But when a surprising selection is made from within the organization, it's important to remember that people think they already know the candidate—that is, they think they know what disqualifies him or her for the position. (If it were otherwise, the choice wouldn't be a surprise.) Many on Van

Senior leaders must strike the right balance between being clear about what the new executive has been appointed to do and leaving him or her flexibility to do it.

der Graaf's new team, for instance, thought his career experience was insufficiently broad for the divisional CEO role. Unilever's senior leaders should have assumed that his accomplishments were not widely known and taken care to highlight them. As the business group president of the European ice cream and frozen food division, Van der Graaf had recently presided over an ambitious complexity-reduction program that set up a new supply chain and procurement system, centralized several support functions, streamlined the product offerings, and concentrated innovation in a single center in Rome. Both revenue and profits substantially increased, bringing him to the attention of senior management, but those results had been hidden from general view in the overall food division numbers.

When a surprising selection is made from within the organization, it's important to remember that people think they already know the candidate—that is, they think they know what disqualifies him or her for the position.

One caveat: Using a surprising appointment to focus the organization on the need for change works only if that need is supported by the facts and viewed as legitimate. Justifying an unexpected selection by saying a turnaround is required when everyone knows it's really a political appointment of a business-as-usual successor is a sure formula for failure.

Who Should Know What When?

The planning for every major appointment must take into consideration the expectations and current state of knowledge of three distinct audiences: the leader's new unit, other employees in the company, and external stakeholders.

Everyone should be told the strategic rationale for the appointment and the appointee's qualifications. Beyond that, each group needs something a little different: Those passed over should be informed why they were not selected and what kind of future they have in the organization. Direct reports and other subordinates will want to know if this appointment signals a change for them. Peers and other colleagues may wonder if they should expect to work with the appointee in a different way. External audiences should understand how the appointment aligns with the strategy and what the new leader is going to do to create business value.

In an ideal world, no one on the new leader's team would be surprised by the formal announcement. Expectations would have been shaped for months or even years, as part of a robust succession and employee development program. In that world, where company communication would routinely be open and honest, everyone would already know of a serious situation that required a strategic or operational shift—and of the heir apparent's qualifications. Would-be contenders would have long since tempered their aspirations and set their sights on opportunities for which they were better suited.

In a more realistic world, employees would at least have heard the rationale—first in a companywide communiqué and then through a series of small-group and individual meetings—before any public announcement was made. Direct reports would get a sense of the changes in the offing; peers and other colleagues could anticipate how they might work with the new person. Individual conversations could reassure valuable contenders that their talents and strengths were appreciated and that they remained on track for advancement and could give them a sense of when the next opening might arise. The appointment team in a privately held company can do exactly this so that no one is surprised or anxious when the public announcement is made.

But in publicly held companies like Unilever and Hughes, appointments that have the potential to affect the stock price must by law be announced both inside and outside the company as soon as the formal decision is reached. This can be tricky when the decision comes during a crisis or as a prelude to a strategic shift about which your employees should be told far more than your competitors. Because news of a senior appointment travels fast, leaders have very little time to shape the process.

In such a case, internal memos and external press releases are typically launched simultaneously on the day of the appointment to provide the high-level rationale, as happened at Hughes. In a well-designed announcement process, further information would be available internally through briefing papers or video and externally through media materials and interviews. These could be tailored to the needs of individual constituencies—as could follow-up, which

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So now, instead of learning which customers it has lost, a company can learn which customers it might lose and present timely offers or products motivating those customers to stay. Using IBM Smarter Analytics to identify which customers were most likely to switch to another communications carrier, XO Communications was able to predict likely customer defections within 90 days, reducing churn by 35 percent the first year.

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Patrick Neeley
Chief Business Officer, Chickasaw Nation Division of Commerce

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LET'S BUILD A SMARTER PLANET.

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Recovering From Disaster

You've just been promoted, but rather than greeting you with enthusiasm, your direct reports are obviously hostile. You were clearly not the person they expected. You can take steps to fix the damage. First, don't wait. Time won't heal these wounds. Feelings have been hurt. Resentment will build.

As soon as is practical, call in your new team and explain in detail what happened. (Not everyone will know, for instance, that by law some announcements cannot be made internally in advance.) Do this with humility and empathy, demonstrating in your tone and manner that you understand how people are feeling. "Some of you are surprised by my appointment," you might say. "If I were in your shoes, I'd be too. Besides wondering why I hadn't been selected, I'd be thinking, 'Who is this guy, and how is he going to lead us?' How many of you are wondering and thinking the same things?" If no one has laid out your credentials, present them yourself, as if your team were interviewing you. By showing some vulnerability, you can begin to build credibility.

Then offer the members of the team an opportunity to share their concerns individually and confidentially with someone outside the group whom they all trust. That person will create a list of unattributed complaints and questions for a second, extended group conversation, ideally to be held after work in a setting such as a quiet restaurant, where people can feel comfortable and unrushed.

Have the trusted person read the complaints and questions aloud to ensure that all team members have been heard. Acknowledge mistakes in the appointment process without being defensive or blaming others. Then respond to each question fully; ask for clarification if necessary (assuming that whoever raised the issue is willing to own it); and allow a deep conversation to emerge. Finally, invite additional questions. Be very open—this is your opportunity to give the team insight into your way of thinking, motives, and values as an individual. The hope is that everyone will come away from this gathering with a clear understanding of what happened and how you will begin to move forward together. The relationship building will take time, as the team watches you incorporate its feedback—interpersonal and strategic—into your actions.

might include investor calls, more media interviews, town hall meetings, individual or team meetings, and conference calls. The key is to be speedy and thorough. Nothing signals an organization's priorities more vividly than how quickly (or slowly) a particular group or individual is included in the process. You don't want valuable people walking out the door because you took too long to loop them in.

Following Through

A formal announcement is the end of the beginning—and, one hopes, not the beginning of the end. In the critical days following an appointment, senior leaders must continue to communicate the rationale for the appointment and signal their support in words and deeds. That support must be consistent, enthusiastic, credible, and authentic. (There are always people who look for signs of weakness in a story or hesitation in the speaker's body language.)

Assuming that all this goes well, responsibility for creating momentum then falls on the new leader. Armstrong named his top management team within days of his appointment, in one bold stroke eliminating uncertainty and the rumors, anxiety, and distractions that go with it. In a few short weeks he and his team reorganized the company to focus more on customers than on projects and articulated clear goals for each business segment in service of the strategy Currie had laid out on that first day.

Armstrong thus demonstrated that he was well prepared for the role, having arrived with a plan to get up to speed quickly, clarify expectations, assess and reshape his teams, and identify and lay the groundwork for securing early results—a textbook example of the right approach to take in the first 90 days of a leadership transition.

And if an appointment has not gone well? Not all is necessarily lost. Van der Graaf took steps right away to get back on track with his team. (See the sidebar "Recovering from Disaster.") But a bad start leaves a new leader to clamber out of a hole and perhaps face unnecessary uphill battles. Too much is at stake to neglect the fundamentals of making appointments right. When you've taken so much care to select someone, make sure you give that person a good start.

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Creativity in Advertising

When It Works and When It Doesn't

by Werner Reinartz and Peter Saffert

ASK A PROFESSIONAL in the business what the key to success is in advertising, and you'll most likely get an answer that echoes the mantra of Stephan Vogel, Ogilvy & Mather Germany's chief creative officer: "Nothing is more efficient than creative advertising. Creative advertising is more memorable, longer lasting, works with less media spending, and builds a fan community...faster."

But are creative ads more effective in inspiring people to buy products than ads that simply catalogue product attributes or benefits? Numerous laboratory experiments have found that creative messages get more attention and lead to positive attitudes about the products being marketed, but there's no firm evidence that shows how those messages influence purchase behavior. Similarly, there is remarkably little empirical research that ties creative messaging to actual sales revenues. Because product and brand managers—and the agencies pitching to them—have lacked a systematic way to assess the effectiveness of their ads, creative advertising has been a crapshoot.

Drawing on research in communications psychology, we have developed a consumer survey approach for measuring perceived creativity along five dimensions. We applied this approach in a study of 437 TV advertising campaigns for 90 fast-moving consumer goods brands in Germany from January 2005 to October 2010. We asked a panel of trained consumer raters to assess the creativity of the ads, and we examined the relationships between their perceptions and sales figures for the products. All the product categories we studied—body lotion, chewing gum, coffee, cola and lemonade, detergent, facial care, shampoo, shavers, and yogurt—are highly competitive and invest heavily in advertising.

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Our findings confirm the conventional wisdom that creativity matters: Overall, more-creative campaigns were more effective—considerably so. We also found that certain dimensions of creativity are more effective than others in influencing purchasing behavior—and that many companies focus on the wrong dimensions in their campaigns. Moreover, we believe that by tailoring the survey model to reflect the cultural preferences and triggers of consumers in different geographic markets, companies the world over can dramatically improve their ability to predict the likely effectiveness of their creative ads and thus make smarter investments.

What Is Creativity?

In coming up with dimensions along which to measure creativity, we drew on social and educational psychology literature that defines creativity as divergent thinking—namely, the ability to find unusual and nonobvious solutions to a problem. One of the pioneers in the field was Ellis Paul Torrance, an American psychologist, who developed the Torrance Tests of Creative Thinking (TTCT), a battery of measures used to assess individuals' capacity for divergent thinking in the business world and in education. Torrance scored responses to test questions along five dimensions: fluency, originality, and elaboration (borrowed from the work of Joy Paul Guilford, another American psychologist) as well as abstractness and what he called resistance to premature closure.

Fluency refers to the number of relevant ideas proposed in response to a given question (such as "list as many uses as you can for a paper clip"), and originality measures how uncommon or unique the responses are. Elaboration refers to the amount of detail given in a response, and abstractness measures the degree to which a slogan or a word moves beyond being a label for something concrete. Resistance to premature closure measures the ability to consider a variety of factors when processing information.

In the early 2000s Torrance's measures were adapted for advertising by the Indiana University communications researcher Robert Smith and his colleagues. They adjusted the definition of creativity to refer to "the extent to which an ad contains brand or executional elements that are different, novel, unusual, original, unique, etc." Their goal was to measure creativity using only those factors most relevant to an advertising context. They came up with five dimensions of advertising creativity, which form the basis for our survey.

Originality. An original ad comprises elements that are rare or surprising, or that move away from the obvious and commonplace. The focus is on the uniqueness of the ideas or features contained in the ad. An ad can diverge from norms or experiences by applying unique visual or verbal solutions, for instance. Many advertising campaigns are anything but original. The prototypical detergent spot shows a homemaker satisfied with an even whiter wash; perfumes feature picture-perfect models; and cars cruise through beautiful landscapes free of traffic. One campaign we studied that excelled in the originality dimension was the surprising visualization of the inside of a vending machine in the Coca-Cola commercial "Happiness Factory."

Flexibility. An ad scoring high on flexibility smoothly links the product to a range of different uses or ideas. For example, a commercial for the Kraft Foods coffee brand Jacobs Krönung, which aired in Germany in 2011 and 2012, showed a man facing various domestic challenges (washing dishes, sewing a button on a jacket, dicing an onion, and making a bed) while a group of women enjoyed a cup of coffee together.

Elaboration. Many ads contain unexpected details or extend simple ideas so that they become

Choosing the Right Model

In analyzing the relationship between creativity and advertising effectiveness, companies typically use sales response models that are based on conventional regression analyses. We have found, however, that such regression is problematic because it assumes that the input variables (creativity and ad budget, say) are independent of one another in their effect. **In the real world, the longer a creative ad is aired, the more impact the creativity has on sales.**

That's why we use a hierarchical sales response model. Hierarchical models get around the problem by nesting one regression model within another. This allows us to see both the direct impact of creativity on sales and the amplifying effect of the budget, and thus arrive at a more accurate overall estimate of the effect of creativity on sales.

Idea in Brief

Numerous lab experiments have found that creative advertisements get attention and lead to positive attitudes about the products being marketed. But there's no firm evidence showing how those messages influence purchase behavior.

A new consumer survey approach addresses that problem by measuring perceived creativity along five dimensions: originality, flexibility, elaboration, synthesis, and artistic value.

The authors applied their model in a study of 437 TV advertising campaigns for 90 fast-moving consumer goods brands in Germany.

An analysis of the survey assessments relative to sales figures confirmed that more-creative campaigns were, on average, more effective. The results also showed that certain dimensions of creativity are more effective than others, and that the dimensions often work better in combination.

The findings suggest that by focusing on the wrong dimensions in their campaigns, many companies are failing to make the most of their ad investments.

more intricate and complicated. One good example is an ad for Ehrmann fruit yogurt—one of the leading brands in Germany—in which a woman eating yogurt licks her lips to reveal that her tongue looks just like a strawberry (Ehrmann made different versions of the spot for different flavors), considerably deepening the idea of fruitiness in yogurt. In another example, an ad for Wrigley's 5 gum, a man is submerged in tiny metal balls that bounce off his skin to represent the tingle one feels while chewing the gum.

Synthesis. This dimension of creativity is about blending or connecting normally unrelated objects or ideas. For example, Wrigley aired a commercial that featured rabbits corralled like cattle and fed bananas, berries, and melon, making their buckteeth grow in as Juicy Fruit Squish chewing gum. The commercial combines unrelated objects (rabbits and chewing gum) to create a divergent story line.

Artistic value. Ads with a high level of artistic creativity contain aesthetically appealing verbal, visual, or sound elements. Their production quality is high, their dialogue is clever, their color palette is original, or their music is memorable. As a result, consumers often view the ads as almost a piece of art rather than a blatant sales pitch. One ad we studied, which scored among the highest in artistic value, was an animated commercial for Danone's Fantasia yogurt that aired at the end of 2009. It showed a woman floating on a flower petal through a sea of Fantasia yogurt, surrounded by flowers laden with fruits.

In our study, we asked a panel of trained consumer raters to score the German TV ad campaigns on each of these dimensions, on a scale of 1 to 7; the campaign's overall creativity rating was the average of its scores. We then looked for relationships between each campaign's score, its advertising budget, and the campaign's relative sales effectiveness. (For a brief discussion of the statistical methods we used in our study, see the sidebar "Choosing the Right Model.")

What We Found

Our study revealed dramatic variation in overall creativity scores across the campaigns. The average score for overall creativity was 2.98 (again, on a scale of 1 to 7). The lowest score was 1.0, and the highest 6.2. Only 11 of the 437 campaigns received an overall score above 5 (five of them were cola campaigns). At the other end of the spectrum, 10 campaigns had an overall score below 1.5. The scores mattered a lot, we found. A euro invested in a highly creative ad campaign had, on average, nearly double the sales impact of a euro spent on a noncreative campaign. The impact of creativity was initially relatively small but typically gathered momentum as the campaign rolled out.

We uncovered two interesting insights about how creativity enhances sales numbers.

The dimensions have varying levels of influence on sales. Companies have plenty of room for

A euro invested in a highly creative ad campaign had nearly double the sales impact of a euro spent on a noncreative campaign.

What Creativity Combinations Work Best?

When used in combination, creativity dimensions had widely varying effects. Relative effectiveness here shows the sales uplift a particular pairing enjoyed relative to average effectiveness. Despite the disparities, however, companies in our study used the 10 combinations in roughly equal proportion (shown here as a percentage of total usage), suggesting that many firms are not getting the most out of their advertising investments.

The most-used pairing, **flexibility plus elaboration,** is one of the least effective. The most effective pairing, **originality plus elaboration,** had almost double the impact.

LESS EFFECTIVE

Flexibility + Artistic Value	Flexibility + Elaboration	Synthesis + Artistic Value	Flexibility + Synthesis	Synthesis + Elaboration
RELATIVE EFFECTIVENESS –99%	**RELATIVE EFFECTIVENESS –59%**	**RELATIVE EFFECTIVENESS –29%**	**RELATIVE EFFECTIVENESS –20%**	**RELATIVE EFFECTIVENESS –5%**
USAGE 8.7%	USAGE 11.6%	USAGE 8.8%	USAGE 9.4%	USAGE 9.7%

improvement in the creativity of ad campaigns. For instance, the types of creativity that agencies currently emphasize are often not the most effective ones at driving sales. In our research, we quantified the impact that each dimension has on sales. Although all of them had a positive impact, elaboration had by far the most powerful one (1.32 when indexed relative to the overall average creativity of 1.0), followed by artistic value (1.19). Trailing behind were originality (1.06) and flexibility (1.03), with synthesis a distant fifth (0.45). Yet the study shows that ad agencies use originality and artistic value more than they use elaboration. Possibly, companies think primarily of originality when trying to be creative.

We also looked at campaigns that scored above the median on at least two dimensions and found that the variation in sales impact among the combinations was even greater than the variation between individual dimensions. Out of 10 possible pairs, we found that the most-used combination—flexibility and elaboration, accounting for nearly 12% of all combinations—is one of the lowest-performing: 0.41 indexed relative to the average of all pairs of 1.0. In sharp contrast, combining elaboration with originality (accounting for nearly 10% of all combos identified) had almost double the average impact on sales (1.96), closely followed by the combination of artistic value and originality (1.89, accounting for almost 11% of all combos).

Interestingly, originality is often part of the most effective combinations, suggesting that this type of creativity plays an important enabling role. In essence, being original is not enough—originality boosts sales only in the presence of additional creative dimensions. Indeed, originality's power to enable may be another reason that so many companies use it in ad campaigns, despite its mediocre individual effectiveness.

Predicting an Ad's Effectiveness

To assess the creativity of your ad campaign, ask consumer respondents to score the ads on each dimension, on a scale of 1 to 7, by considering the questions listed below. (These questions, based on communications researcher Robert Smith's construct for measuring advertising creativity, are meant to be somewhat overlapping.)

Your campaign's overall creativity rating is the average of the scores of each dimension. By comparing the scores of different campaigns, and analyzing the budget and sales effectiveness for each, you can improve your ability to predict the likely effectiveness of your creative ads and make smarter investments.

Originality

- Is the ad "out of the ordinary"?
- Does it depart from stereotypical thinking?
- Is it unique?

COCA COLA "HAPPINESS FACTORY"

Flexibility

- Does the ad contain ideas that move from one subject to another?
- Does it contain different ideas?
- Does it shift from one idea to another?

JACOBS KRÖNUNG "TIME FOR CHATTING"

Flexibility is one of the least effective dimensions, whether used alone or in combination.

Although **originality** has little impact on sales on its own, it appears to play an important enabling role, appearing in three of the four most effective pairings.

Originality + Flexibility	Originality + Synthesis	Elaboration + Artistic Value	Originality + Artistic Value	Originality + Elaboration
RELATIVE EFFECTIVENESS −1%	RELATIVE EFFECTIVENESS +1%	RELATIVE EFFECTIVENESS +28%	RELATIVE EFFECTIVENESS +89%	RELATIVE EFFECTIVENESS +96%
USAGE 9.8%	USAGE 10.7%	USAGE 10.5%	USAGE 10.9%	USAGE 9.9%

MORE EFFECTIVE →

Elaboration

- Does the ad contain numerous details?
- Does it extend basic ideas and make them more intricate?
- Does it contain more details than expected?

EHRMANN YOGURT "STRAWBERRY TONGUE"

Synthesis

- Does the ad connect objects that are usually unrelated?
- Does it contain unusual connections?
- Does it bring unusual items together?

WRIGLEY'S JUICY FRUIT SQUISH "JUICY FRUIT RANCH"

Artistic Value

- Is the ad visually or verbally distinctive?
- Does it make ideas come to life graphically or verbally?
- Is it artistic in its production?

DANONE FANTASIA "FLAVOR TRIP"

Use of creativity differs by category. Levels of creativity vary significantly across product categories, with the overall scores ranging from 2.62 for shampoo to 3.60 for cola. In categories such as cola and coffee, advertisers and customers tend to favor higher levels of creativity, whereas in categories such as shampoo, body care, and facial care, campaigns focus on showing the actual use of the product, albeit in an idealized environment. One reason could be that it is still important in certain categories to deliver factual proof points of performance features. When products are functional and oriented toward clear consumer goals (cleaning garments with detergents, protecting skin with body lotion), unorthodox approaches are less preferred. In contrast, when products are easily understood, similar, and tied to personal preferences (quenching thirst with a soda, for instance, or enjoying a cup of coffee), an out-of-the-ordinary approach can be more effective in stimulating sales.

We also looked at whether investing in additional creativity pays off and found that it depends entirely on the category. As the exhibit "Is More Creativity Better?" shows, in traditionally low-creativity categories, adding creativity can pay off; according to our study, a one-point increase in creativity scores for shampoo and detergent ad campaigns boosted sales impact by 4%. However, the body lotion and face care categories, which also tend to feature low levels of creativity, were harmed by additional creativity: Sales impact fell by nearly 2%. We see variation across categories with high levels of creativity. Investing in additional creativity has a nearly 8% impact on sales in shavers and coffee but boosts impact by less than 1% for colas and yogurts. So make sure you understand your category's sensitivity to creativity before you commission that high-priced category-redefining campaign.

The conservative approaches adopted in many product categories are leaving money on the table.

Measuring Campaign Effectiveness

Our research has big implications for advertising agencies and the companies that engage them. Advertising professionals can use methods like ours to identify where to direct their creative energies to best effect. Companies can use the models to estimate the financial impact their creative investments will produce.

In many—indeed, most—cases, companies will find that they are underinvesting in creativity. Our research clearly shows that the conservative approaches adopted in many product categories are leaving money on the table. Increased investment will usually pay for itself: More-effective creative ads will allow other parts of the ad budget to be significantly reduced.

For example, suppose a company plans to air two TV campaigns: Campaign A has a creativity index rating of 3, and it has allocated a TV budget of €500,000 per week. Campaign B has a rating of 3.5, but because it costs more to create the campaign, it plans to spend only €400,000 per week for airtime. (The company establishes creativity ratings by asking consumer panels to evaluate campaign drafts and storyboards along the five dimensions.)

After feeding the scores and budgets into a hierarchical sales response model (for this hypothetical example, we used data from our study), the company estimates that the sales impact for Campaign B will be 1.07% higher in the first week of airing than that of Campaign A. In the subsequent weeks, the gap increases to 1.93% (week 2), 2.63% (week 3), and 3.19% (week 4), thanks to carryover and buildup of consumer knowledge and goodwill. That means that diverting money from the airtime budget to creative will in this case result in a more effective ad. In fact, the model shows that the company could cut airtime spending to €330,000 before the negative impact of reduced airtime outweighed the positive effect of creativity.

Companies can also use a survey approach to estimate the impact of particular creative choices. Let's say that your product category is coffee, and you have to choose between two creative pitches that both scored 4.0, each with a €400,000 weekly airtime budget. Campaign C emphasizes elaboration and originality, and Campaign D emphasizes artistic value and synthesis. Our findings suggest that Campaign C would be the better bet, since that combination of creativity dimensions produces a positive effect on sales nearly three times as great as that of the combo used in Campaign D.

CREATIVITY ISN'T easily engineered—and it is still largely measurable only after the fact. What's more, a focus-group assessment of an unaired campaign's creativity levels may well be off the mark. Nonetheless, companies can use a model like ours, coupled with sound baseline data, to better ground the process of creating advertising ideas and assessing their value. And in so doing, they can put to good use quite a bit more than the famous half of their ad budgets.

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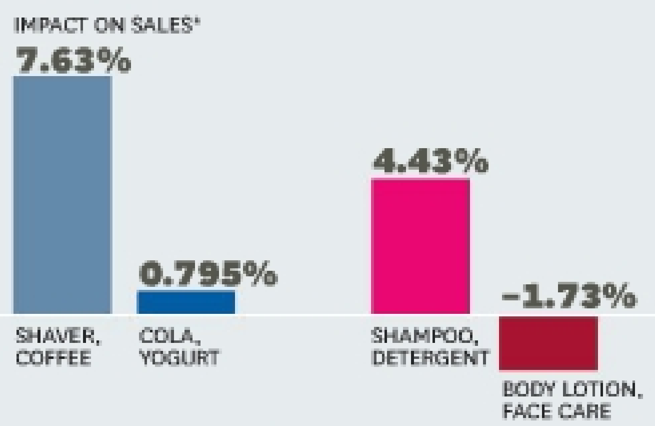
Is More Creativity Better?

If creative ads can inspire consumers to buy, does amping up the creativity level drive even more purchases? Not necessarily. According to our study of German ads, the relative effectiveness of adding creativity to a campaign can vary significantly.

Categories usually associated with highly creative ads—such as coffee or cola—do not always get a big boost when more creativity is added to campaigns...

...and among **categories associated with low creativity**—such as detergents and body lotions—getting creative is not always a bad idea.



*PERCENTAGE IMPACT ON SALES OF A ONE-POINT INCREASE IN A CAMPAIGN'S CREATIVITY SCORES

L'Oréal Masters Multiculturalism

The cosmetics giant manages to be very global—yet very French. *by Hae-Jung Hong and Yves Doz*

ABOVE CEO Jean-Paul Agon speaks at the January 2013 opening of L'Oréal's first research and innovation center in India.

At the heart of every global business lies a tension that is never fully resolved: Achieving economies of scale and scope demands some uniformity and integration of activities across markets. However, serving regional and national markets requires the adaptation of products, services, and business models to local conditions. As U.S. and European companies increasingly look for customers in emerging economies, both the advantages of global scale and the need for local differentiation will only increase.

It's easy to get the balance wrong. Some offerings may feel like commodities—think refrigerators and washing machines—yet there are often important variations in the way people use them. An Italian washing machine, for instance, has to be made to rather different specs than a Swedish one. Others, such as restaurants and cafés, come across as intrinsically local, yet global formulas and brands do succeed—think Benihana, Wagamama, and Starbucks.

The tension between global integration and local responsiveness is especially high when product development and marketing require complex knowledge. This kind of knowledge—usually tacit and collective, revealed only in action and interaction—is often the mainspring of a company's competitive advantage. The trouble is that tacit knowledge functions best within national boundaries, where workers share a lan-

PHOTOGRAPHY: GETTY IMAGES

guage and cultural and institutional norms and can draw on strong interpersonal networks. Without close, face-to-face interaction between knowledge creators and users, an understanding of how bits of information fit together may be lost and the knowledge may become unusable. Further, when tacit knowledge must cross borders, it is often reduced to information that moves easily (words and numbers, for instance) but may then fall prey to local misinterpretations that are difficult to detect from afar.

The French cosmetics giant L'Oréal exemplifies this global-local tension. It has built a portfolio of brands from many cultures—French, of course (L'Oréal Paris, Garnier, Lancôme), but also American (Maybelline, Kiehl's, SoftSheen-Carson), British (The Body Shop), Italian (Giorgio Armani), and Japanese (Shu Uemura). The company now has offices in more than 130 countries, and in 2012 over half its sales came from new markets outside Europe and North America, mostly in emerging economies, up from only a third as recently as 2009.

In 2012, sales grew in the Asia Pacific region by 18.4% and in Africa and the Middle East by 17.6%, without significant acquisitions. Despite the financial crises in Europe and North America, L'Oréal has been growing and gaining market share, mostly at the expense of its competitors. It is the uncontested world leader in skin care, makeup, and hair color and a close second to P&G in hair care worldwide. Since 2004 L'Oréal's revenue has increased by half and its profits have almost doubled, with an increase in net profits of 17.6% in 2012 alone.

Yet this remarkable global success was built largely by a management team strongly rooted in its home culture. Traditionally employees became part of management over many years, weaving a dense network of relationships through which knowledge about products, cultures, and how to work together was internalized. Since its inception, more than a century ago, L'Oréal has had only five CEOs (including the founder), all but one with long tenures and all promoted from within. Only a few foreigners have become senior executives. Lindsay Owen-Jones, who was CEO from 1988 to 2006, was one of them. Although an Englishman, he was described by members of L'Oréal's founding family as *Français dans l'âme* ("French in his soul"). For decades, L'Oréal recruited few senior executives from outside. After several years the exceptions took pains to explain that they had worked for L'Oréal for a long time and prided themselves on their perfect French.

As its global-local tensions have mounted, L'Oréal has managed them by deploying professionals with multicultural backgrounds in new-product development, the company's most critical source of competitive advantage. That strategy, according to top management, is the main reason for L'Oréal's impressive success in emerging markets. As the company has transformed itself from a very French beauty products business to a global leader, multicultural executives have come to play a critical role in product development not just in Paris but also in New York, Tokyo, Shanghai, Rio, and Mumbai.

Achieving Global-Local Balance

L'Oréal's main consumer-products categories are all highly sensitive to global economies of scale and scope, yet to win customers they must also be responsive to local preferences. This tension is perhaps most critical in the L'Oréal Paris brand, which is sold in mass markets worldwide and accounts for half the sales of the consumer products division.

L'Oréal also has to maintain a steady stream of new products (every year, roughly 20% are new) in order to extend market share in the face of stiff competition from rivals such as Estée Lauder and Revlon and units of global giants such as Unilever and P&G. L'Oréal, which invests 3.5% of its revenue in R&D, outspends all its major competitors: Revlon, for instance, spends 1.7% on R&D, and Estée Lauder about 1%.

As L'Oréal managers confront those challenges, they must be mindful that their products are much more than chemical mixes. They are global symbols of fashion and sophistication, appealing to the idealized self-image of customers. Technical innovation and responsiveness to local tastes must not undermine the brand.

Traditional approaches to internationalization probably would not have resolved L'Oréal's global-local tensions. Structural solutions, such as setting up largely autonomous subsidiaries and regional entities (which might have compromised economies of scale) or global business units (which might have ignored the richness of cultural differences across markets), would not have worked for most L'Oréal products, given their need for both local responsiveness and global integration. Refocusing the company on either a more local or a more global portfolio would have been tantamount to letting the tail wag the dog, forfeiting L'Oréal's many marketing and distribution advantages.

The only alternative to internationalizing the structure was to internationalize the management team. That is what L'Oréal did, but with a twist. The rapid infusion of foreign executives would have disrupted the tightly knit community of senior managers so critical to L'Oréal's success. Relying on global teams—whether function- or project-based—would have been equally difficult. Culturally diverse teams often experience the so-called Tower of Babel syndrome: Their members talk past one another, and teamwork breaks down. Companies quickly realize that little knowledge is actually shared; even seemingly universal and explicit knowledge, such as mathematics, is open to interpretation.

L'Oréal has dealt with these shortcomings by recruiting and building teams around individual managers, who by virtue of their upbringing and experience have gained familiarity with the norms and behaviors of multiple cultures and can switch easily among them.

International Talent

Since the late 1990s, when L'Oréal started to recruit internationally for positions at headquarters, L'Oréal Paris—the unit where we conducted our research—has placed executives from mixed cultural backgrounds in its most critical activity: new-product development. These managers account for a small proportion of L'Oréal Paris employees but for more than a third of the unit's product development team managers—a balance the unit has maintained for more than 10 years.

L'Oréal Paris generally has about 40 product development teams, each working on a different concept. A team consists of three or four people, two of whom may be multicultural. For example, in a team we spoke with that is working on women's hair-care products for Latin America, a Lebanese-Spanish-American manager was in charge of hair color while a French-Irish-Cambodian was in charge of hair care. They shared an office so that they could exchange ideas.

graduates of leading international business schools. The recruits undergo a 12-month training program in Paris, New York, Singapore, or Rio, followed by management development programs at Cedep, an executive education consortium in France.

After spending two or three years in global product development at headquarters, the more experienced managers usually return to their home regions as directors, responsible for managing a brand or function. Most of those recruited from business schools remain for another few years in product development at headquarters. After this second tour they, too, usually go to a regional office at the director level, though some remain in Paris. Their promotion prospects, like those of all employees, depend on performance.

Since the late 1990s, L'Oréal Paris has placed executives from mixed cultural backgrounds in its most critical activity: new-product development.

Developing a new product takes at least a year of knowledge exchanges among the product development team, regional subsidiaries, and functional units in France, such as R&D. In addition to interacting with their peers, who may come from different cultures, team managers must discuss their work with top management, formally and informally, as it progresses.

Once a new-product concept is ready, the team presents it at Réunion Internationale, the consumer products division's annual event, held at the Paris headquarters. The teams pitch their launch action plans to regional directors from around the globe, who come looking for ideas that might be ready to hit the market in one or two years.

The multicultural managers are drawn from three pools. The most seasoned come from the company's international subsidiaries and have at least five years of experience in sales and marketing. A few are recruited from other global companies. The third and youngest group consists of

An increasing number of multiculturals are starting to find their way into senior management in the company—a sign of the success of the approach. Among the people we met, one Hong Kong–British–French project manager (recruited at headquarters) was subsequently promoted to lead the team developing all facial products for the East Asian market, and an Indian-American-French project manager (recruited from the Indian subsidiary) moved to another division with a significant promotion.

In sum—and there is an important message here for other multinational companies—L'Oréal nurtures a pool of multicultural managers, placing them at the center of knowledge-based interactions among brands, regions, and functions. Let's look at what these young men and women offer the company in return.

The Advantages of Multiculturals

A person rooted in more than one culture is usually able to spot and reconcile differences in understanding and communication, serving as a buffer both within teams and more broadly in the organization. In addition, he or she will probably be more open to adapting to multiple mind-sets and communication modes; it's well known that people find it easier to learn new languages if they have grown up speaking more than one. These skills equip L'Oréal's multiculturals to play five critical roles.

Recognizing new-product opportunities. L'Oréal Paris finds that multiculturals are better placed than others to draw analogies among cultural groups. According to a director who worked with multiculturals for five years, "Their background is a kind of master class in holding more than one idea at the same time. They think as if they were French, American, or Chinese, and all of these together at once."

This very flexible perspective can lead to unexpected opportunities for product innovation. For instance, a French-Irish-Cambodian manager working on skin care noticed that many tinted face creams in Asia had a lifting effect, which minimizes wrinkles. In Europe, creams tended to be either tinted (and considered as makeup) or lifting (and considered as skin care). Drawing on his knowledge of Asian beauty trends and their increasing popularity in Europe, he and his team developed a tinted cream with lifting effects for the French market, which proved to be a success.

Although people rooted in one culture can also uncover such opportunities, multiculturals are more likely to do so—and to do so faster—because they have been dealing with cultural complexities since childhood. As an Indian-American-French manager in a team that launched a men's skin care line in Southeast Asia explained, "I am able to do this because I have a stock of references in different languages: English, Hindi, and French. I read books in three different languages, meet people from different countries, eat food from different countries, and so on. I cannot think about things in one way."

Preventing losses in translation. Even when there's a common syntax or language, as in mathematical and chemical formulas, cross-cultural semantic differences can cause confusion. What the person initiating a communication means is not necessarily what the person receiving the communication hears. The problem thus shifts to who interprets what, and how accurately—a critical issue in the design of new products.

For instance, a French manager's product test failed because he asked a German colleague in the laboratory to translate the characterization of some hair features. Through conversations with an English-French-German manager, the French manager discovered that there had been a gap between what he meant and what the German heard. It was a nuanced difference: The words were the same, but their meaning was not. He had to run the test again, at significant cost. Since then, the multicultural manager who spotted the difference has been called on frequently to decode communications between headquarters and the German office.

Integrating outsiders. Teams staffed with people who are not multicultural find it hard to assimilate newcomers with different behaviors and modes of communication, particularly when the team has developed its own norms or its members belong predominantly to one culture. Given the intensity of a team's internal interactions, incumbent team members can quickly resort to stereotypes about a newcomer, and the situation can become toxic. The presence of a multicultural member can help prevent this dynamic from taking hold.

Consider the experience of a Hong Kong–British–French director: "After a new person joined my team from the Shanghai office, a member complained that she was 'very rude.' I said, 'Let's give her more time to adjust. Maybe she's not being rude and that's just how she expresses herself. Why don't you also try to adapt to her?' When I went to Shanghai, I had a meeting with my new team member and found she was not being rude. The way she expressed herself was direct, without bad intention. I didn't tell her about the complaints but gave some advice on how to better work with people whose cultures are different. When I returned to HQ, I told my group about my experience with the new member. Things became much better."

If a newcomer is disruptive because of personal style or personality, there may be little anyone can do. But if the issue originates in cultural differences, which it often does, multiculturals can help integrate the outsider. They can perform this function because they are adept at moving from one mode of interaction to another. They grew up doing so—switching from one parent to another, or from school to home.

Mediating with bosses. The role of cultural buffer is important at L'Oréal Paris, especially for reducing the potential for conflicts between the multicultural product-development teams and the people they report to, who are, for the most part, French. Here's how a multicultural manager explained one aspect of his role as team leader: "My French boss never starts meetings on time. So whenever we have a meeting planned with him, we can get frustrated if we are not flexible. If I am running behind myself, I make sure to tell my team members in advance why I am behind and ask them for their next availabilities. Conflicts may still exist in my team, but we handle them more tolerantly."

Bridging differences between subsidiaries and headquarters. Multicultural managers have frequently defused acrimonious communications between a subsidiary and L'Oréal Paris. For example, on a project to develop an organic shampoo

Emulating Multicultural Managers

Managers rooted in more than one culture have many skills that allow them to fill five crucial roles. Other managers can learn to play the first two roles through training and management development programs. But the final three roles are based on skills acquired through early life experiences and are therefore more difficult for others to learn. The careful management of international assignments can help. Be cautious about short-term rotations: Without deep exposure to national contexts, managers concentrate on what's common across cultures instead of what's different. As a result, their cultural sensitivity is dulled rather than sharpened.

ROLE	How multiculturals do it	How others can learn
1 RECOGNIZING NEW-PRODUCT OPPORTUNITIES	Sensitivity to one's own and others' cultures	Training with multiculturals and repatriates
2 PREVENTING LOSSES IN TRANSLATION	Cultural awareness and curiosity	One-on-one coaching by multiculturals
3 INTEGRATING OUTSIDERS	Cultural empathy	Regular evaluation by an HR specialist knowledgeable about multiculturals' competence and skills
4 MEDIATING WITH BOSSES	Multilingual skills	Foreign language and semantics training
5 BRIDGING DIFFERENCES BETWEEN SUBSIDIARIES AND HEADQUARTERS	Contextual understanding and sensitivity	Enhanced promotion prospects for foreign language speakers
	Semantic awareness	Opportunities to carry out leadership responsibilities in a foreign language
	Ability to switch among cultural frames of reference and communication modes	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LED LOUISIANA ECONOMIC DEVELOPMENT

An increasing number of multiculturals are starting to find their way into senior management—a sign of the success of the approach.

for the European market, the product development team in Paris asked the Indian unit to find a rare local plant that would provide a key ingredient. The Indians told the team that they would "do their best" but sat on the request. As the team's Indian-American-French leader told us, "Eventually the Indian manager said, 'We need confirmation that this ingredient can really please consumers.'"

At this point, the team leader understood that the initial "We'll do our best" (which the French interpreted as a clear yes) was actually a polite way of saying that they wouldn't do anything. The "We need confirmation" follow-up signaled that the request was too difficult—but the Indians did not want to come out and say that and thus fail to honor a commitment. The leader realized that if he told headquarters that India wouldn't come up with the goods, he risked triggering open conflict between the two parties. Instead, he worked with both to explore other ingredients that would not be so challenging to source.

The team leader grasped that there had not yet been enough collaboration or social interaction between the two teams to allow them to decode each other's expressions of expectations. He could also see that this particular misunderstanding might undermine trust and make more-important tasks harder. (Ultimately he found a substitute ingredient and dropped the matter.) This manager could play a bridging role because he had deep knowledge about both Indian and French ways of expressing commitment, strong communication skills, intense cultural sensitivity, and high flexibility—a bundle of qualities seldom found among managers rooted in just one culture.

For a global company to deploy multiculturals strategically, HR should appoint a manager to lead a program for developing and nurturing them. This manager should obviously be knowledgeable about the competence and skills of these individuals and how they differ from those of other employees. Because of considerable variation among multiculturals themselves, the manager needs to tailor a training system to each one. With this support, commitment to the program from top managers, and the granting of some autonomy in their work, multicultural managers can make a huge difference in whether a company is able to balance global and local imperatives by learning from cultural differences—or instead suffers from them.

AS MARKETS AND COMPETENCIES have become more dispersed and differentiated with the strategic thrust into emerging regions, companies need to reverse the old knowledge flows (from their home country to far-flung subsidiaries) and instead learn how to learn from their peripheries. Culturally this is difficult. It calls for a shift from an ethnocentric approach to a truly global network. L'Oréal's strategic use of multicultural managers provides a shortcut: These managers can integrate knowledge from many locations to develop successful new products and minimize conflict between home-country and international executives. It's an approach that can transfer easily to other industry and functional contexts in which complex knowledge from multiple cultures must be coordinated and shared.

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MANAGING YOURSELF

How to Give a Killer Presentation

Lessons from TED *by Chris Anderson*

ILLUSTRATION: SERGE BLOCH

A little more than a year ago, on a trip to Nairobi, Kenya, some colleagues and I met a 12-year-old Masai boy named Richard Turere, who told us a fascinating story. His family raises livestock on the edge of a vast national park, and one of the biggest challenges is protecting the animals from lions—especially at night. Richard had noticed that placing lamps in a field didn't deter lion attacks, but when he walked the field with a torch, the lions stayed away. From a young age, he'd been interested in electronics, teaching himself by, for example, taking apart his parents' radio. He used that experience to devise a system of lights that would turn on and off in sequence—using solar panels, a car battery, and a motorcycle indicator box—and thereby create a sense of movement that he hoped would scare off the lions. He installed the lights, and the lions stopped attacking. Soon villages elsewhere in Kenya began installing Richard's "lion lights."

The story was inspiring and worthy of the broader audience that our TED conference could offer, but on the surface, Richard seemed an unlikely candidate to give a TED Talk. He was painfully shy. His English was halting. When he tried to describe his invention, the sentences tumbled out incoherently. And frankly, it was hard to imagine a preteenager standing on a stage in front of 1,400 people accustomed to hearing from polished speakers such as Bill Gates, Sir Ken Robinson, and Jill Bolte Taylor.

But Richard's story was so compelling that we invited him to speak. In the months before the 2013 conference, we worked with him to frame his story—to find the right place to begin, and to develop a succinct and logical arc of events. On the back of his invention Richard had won a scholarship to one of Kenya's best schools, and there he had the chance to practice the talk several times in front of a live audience. It was critical that he build his confidence to the point where his personality could shine through. When he finally gave his talk at TED, in Long Beach, you could tell he was nervous, but that only made him more engaging—people were hanging on his every word. The confidence was there, and every time Richard smiled, the audience melted. When he finished, the response was instantaneous: a sustained standing ovation.

Since the first TED conference, 30 years ago, speakers have run the gamut from political figures, musicians, and TV personalities who are completely at ease before a crowd to lesser-known academics, scientists, and writers—some of whom feel deeply uncomfortable giving presentations. Over the years, we've sought to develop a process for helping inexperienced presenters to frame, practice, and deliver talks that people enjoy watching. It typically begins six to nine months before the event, and involves cycles of devising (and revising) a script, repeated rehearsals, and plenty of fine-tuning. We're continually tweaking our approach—because the art of public speaking is evolving in real time—but judging by public response, our basic regimen works well: Since we began putting TED Talks online, in 2006, they've been viewed more than one billion times.

On the basis of this experience, I'm convinced that giving a good talk is highly coachable. In a matter of hours, a speaker's content and delivery can be transformed from muddled to mesmerizing. And while my team's experience has focused on TED's 18-minutes-or-shorter format, the lessons we've learned are surely useful to other presenters—whether it's a CEO doing an IPO road show, a brand manager unveiling a new product, or a start-up pitching to VCs.

Frame Your Story

There's no way you can give a good talk unless you have something worth talking about. Conceptualizing and framing what you want to say is the most vital part of preparation.

We all know that humans are wired to listen to stories, and metaphors abound for the narrative structures that work best to engage people. When I think about compelling presentations, I think about taking an audience on a journey. A successful talk is a little miracle—people see the world differently afterward.

If you frame the talk as a journey, the biggest decisions are figuring out where to start and where to end. To find the right place to start, consider what people in the audience already know about your subject—and how much they care about it. If you assume they have more knowledge or interest than they do, or if you start using jargon or get too technical, you'll lose them. The most engaging speakers do a superb job of very quickly introducing the topic, explaining why they care so deeply about it, and convincing the audience members that they should, too.

The biggest problem I see in first drafts of presentations is that they try to cover too much ground. You can't summarize an entire career in a single talk. If you try to cram in everything you know, you won't have time to include key details, and your talk will disappear into abstract language that may make sense if your listeners are familiar with the subject matter but will be completely opaque if they're new to it. You need specific examples to flesh out your ideas. So limit the scope of your talk to that which can be explained, and brought to life with examples, in the available time. Much of the early feedback we give aims to correct the impulse to sweep too broadly. Instead, go deeper. Give more detail. Don't tell us about your entire field of study—tell us about your unique contribution.

> A successful talk is a little miracle—people see the world differently afterward.

Of course, it can be just as damaging to overexplain or painstakingly draw out the implications of a talk. And there the remedy is different: Remember that the people in the audience are intelligent. Let them figure some things out for themselves. Let them draw their own conclusions.

Many of the best talks have a narrative structure that loosely follows a detective story. The speaker starts out by presenting a problem and then describes the search for a solution. There's an "aha" moment, and the audience's perspective shifts in a meaningful way.

If a talk fails, it's almost always because the speaker didn't frame it correctly, misjudged the audience's level of interest, or neglected to tell a story. Even if the topic is important, random pontification without narrative is always deeply unsatisfying. There's no progression, and you don't feel that you're learning.

I was at an energy conference recently where two people—a city mayor and a former governor—gave back-to-back talks. The mayor's talk was essentially a list of impressive projects his city had undertaken. It came off as boasting, like a report card or an advertisement for his reelection. It quickly got boring. When the governor spoke, she didn't list achievements; instead, she shared an idea. Yes, she recounted anecdotes from her time in office, but the idea was central—and the stories explanatory or illustrative (and also funny). It was so much more interesting. The mayor's underlying point seemed to be how great he was, while the governor's message was "Here's a compelling idea that would benefit us all."

As a general rule, people are not very interested in talks about organizations or institutions (unless they're members of them). Ideas and stories fascinate us; organizations bore us—they're much harder to relate to. (Businesspeople especially take note: Don't boast about your company; rather, tell us about the problem you're solving.)

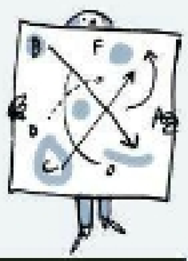
Plan Your Delivery

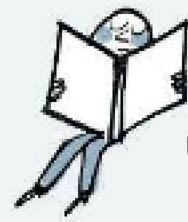
Once you've got the framing down, it's time to focus on your delivery. There are three main ways to deliver a talk. You can read it directly off a script or a teleprompter. You can develop a set of bullet points that map out what you're going to say in each section rather than scripting the whole thing word for word. Or you can memorize your talk, which entails rehearsing it to the point where you internalize every word—verbatim.

Find the Perfect Mix of Data and Narrative *by Nancy Duarte*

Most presentations lie somewhere on the continuum between a report and a story. A report is data-rich, exhaustive, and informative—but not very engaging. Stories help a speaker connect with an audience, but listeners often want facts and information, too. Great presenters layer story and information like a cake, and understand that different types of talks require differing ingredients.

Report
Literal, Informational, Factual, Exhaustive





Story
Dramatic, Experiential, Evocative, Persuasive

Research Findings
If your goal is to communicate information from a written report, send the full document to the audience in advance, and limit the presentation to key takeaways. Don't do a long slide show that repeats all your findings. Anyone who's really interested can read the report; everyone else will appreciate brevity.

Financial Presentation
Financial audiences love data, and they'll want the details. Satisfy their analytical appetite with facts, but add a thread of narrative to appeal to their emotional side. Then present the key takeaways visually, to help them find meaning in the numbers.

Product Launch
Instead of covering only specs and features, focus on the value your product brings to the world. Tell stories that show how real people will use it and why it will change their lives.

VC Pitch
For 30 minutes with a VC, prepare a crisp, well-structured story arc that conveys your idea compellingly in 10 minutes or less; then let Q&A drive the rest of the meeting. Anticipate questions and rehearse clear and concise answers.

Keynote Address
Formal talks at big events are high-stakes, high-impact opportunities to take your listeners on a transformative journey. Use a clear story framework and aim to engage them emotionally.

Nancy Duarte is the author of *HBR Guide to Persuasive Presentations*, *Slide:ology*, and *Resonate*. She is the CEO of Duarte, Inc., which designs presentations and teaches presentation development.

My advice: Don't read it, and don't use a teleprompter. It's usually just too distancing—people will know you're reading. And as soon as they sense it, the way they receive your talk will shift. Suddenly your intimate connection evaporates, and everything feels a lot more formal. We generally outlaw reading approaches of any kind at TED, though we made an exception a few years ago for a man who insisted on using a monitor. We set up a screen at the back of the auditorium, in the hope that the audience wouldn't notice it. At first he spoke naturally. But soon he stiffened up, and you could see this horrible sinking feeling pass through the audience as people realized, "Oh, no, he's reading to us!" The words were great, but the talk got poor ratings.

Many of our best and most popular TED Talks have been memorized word for word. If you're giving an important talk and you have the time to do this, it's the best way to go. But don't underestimate the work involved. One of our most memorable speakers was Jill Bolte Taylor, a brain researcher who had suffered a stroke. She talked about what she learned during the eight years it took her to recover. After crafting her story and undertaking many hours of solo practice, she rehearsed her talk dozens of times in front of an audience to be sure she had it down.

Obviously, not every presentation is worth that kind of investment of time. But if you do decide to memorize your talk, be aware that there's a predictable arc to the learning curve. Most people go through what I call the "valley of awkwardness," where they haven't quite memorized the talk. If they give the talk while stuck in that valley, the audience will sense it. Their words will sound recited, or there will be painful moments where they stare into the middle distance, or cast their eyes upward, as they struggle to remember their lines. This creates distance between the speaker and the audience.

Getting past this point is simple, fortunately. It's just a matter of rehearsing enough times that the flow of words becomes second nature. Then you can focus on delivering the talk with meaning and authenticity. Don't worry—you'll get there.

But if you don't have time to learn a speech thoroughly and get past that awkward valley, don't try. Go with bullet points on note cards. As long as you know what you want to say for each one, you'll be fine. Focus on remembering the transitions from one bullet point to the next.

Also pay attention to your tone. Some speakers may want to come across as authoritative or wise or powerful or passionate, but it's usually much better to just sound conversational. Don't force it. Don't orate. Just be you.

If a successful talk is a journey, make sure you don't start to annoy your travel companions along the way. Some speakers project too much ego. They sound condescending or full of themselves, and the audience shuts down. Don't let that happen.

Develop Stage Presence

For inexperienced speakers, the physical act of being onstage can be the most difficult part of giving a presentation—but people tend to overestimate its importance. Getting the words, story, and substance right is a much bigger determinant of success or failure than how you stand or whether you're visibly nervous. And when it comes to stage presence, a little coaching can go a long way.

The biggest mistake we see in early rehearsals is that people move their bodies too much. They sway from side to side, or shift their weight from one leg to the other. People do this naturally when they're nervous, but it's distracting and makes the speaker seem weak. Simply getting a person to keep his or her lower body motionless can dramatically improve stage presence. There are some people who are able to walk around a stage during a presentation, and that's fine if it comes naturally. But the vast majority are better off standing still and relying on hand gestures for emphasis.

Perhaps the most important physical act onstage is making eye contact. Find five or six friendly-looking people in different parts of the audience and look them in the eye as you speak. Think of them as friends you haven't seen in a year, whom you're bringing up to date on your work. That eye contact is incredibly powerful, and it will do more than anything else to help your talk land. Even if you don't have time to prepare fully and have to read from a script, looking up and making eye contact will make a huge difference.

Another big hurdle for inexperienced speakers is nervousness—both in advance of the talk and while they're onstage. People deal with this in different ways. Many speakers stay out in the audience until the moment they go on; this can work well, because keeping your mind engaged in the earlier speakers can distract you and limit nervousness. Amy Cuddy, a Harvard Business School professor who studies how certain body poses can affect power, utilized one of the more unusual preparation techniques I've seen. She recommends that people spend time before a talk striding around, standing tall, and extending their bodies; these poses make you feel more powerful. It's what she did before going onstage, and she delivered a phenomenal talk. But I think the single best advice is simply to breathe deeply before you go onstage. It works.

In general, people worry too much about nervousness. Nerves are not a disaster. The audience *expects* you to be nervous. It's a natural body response that can actually improve your performance: It gives you energy to perform and keeps your mind sharp. Just keep breathing, and you'll be fine.

Acknowledging nervousness can also create engagement. Showing your vulnerability, whether through nerves or tone of voice, is one of the most powerful ways to win over an audience, provided it is authentic. Susan Cain, who wrote a book about introverts and spoke at our 2012 conference, was terrified about giving her talk. You could feel her fragility onstage, and it created this dynamic where the audience was rooting for her—everybody wanted to hug her afterward. The fact that we knew she was fighting to keep herself up there made it beautiful, and it was the most popular talk that year.

Nerves are not a disaster. The audience *expects* you to be nervous.

Plan the Multimedia

With so much technology at our disposal, it may feel almost mandatory to use, at a minimum, presentation slides. By now most people have heard the advice about PowerPoint: Keep it simple; don't use a slide deck as a substitute for notes (by, say, listing the bullet points you'll discuss—those are best put on note cards); and don't repeat out loud words that are on the slide. Not only is reciting slides a variation of the teleprompter problem—"Oh, no, she's reading to us, too!"—but information is interesting only once, and hearing and seeing the same words feels repetitive. That advice may seem universal by now, but go into any company and you'll see presenters violating it every day.

Many of the best TED speakers don't use slides at all, and many talks don't require them. If you have photographs or illustrations that make the topic come alive, then yes, show them. If not, consider doing without, at least for some parts of the presentation. And if you're going to use slides, it's worth exploring alternatives to PowerPoint. For instance, TED has invested in the company Prezi, which makes presentation software that offers a camera's-eye view of a two-dimensional landscape. Instead of a flat sequence of images, you can move around the landscape and zoom in to it if need be. Used properly, such techniques can dramatically boost the visual punch of a talk and enhance its meaning.

Artists, architects, photographers, and designers have the best opportunity to use visuals. Slides can help frame and pace a talk and help speakers avoid getting lost in jargon or overly intellectual language. (Art can be hard to talk about—better to experience it visually.) I've seen great presentations in which the artist or designer put slides on an automatic timer so that the image changed every 15 seconds. I've also seen presenters give a talk accompanied by video, speaking along to it. That can help sustain momentum. The industrial designer Ross Lovegrove's highly visual TED Talk, for instance, used this technique to bring the audience along on a remarkable creative journey.

Another approach creative types might consider is to build silence into their talks, and just let the work speak for itself. The kinetic sculptor Reuben Margolin used that approach to powerful effect. The idea is not to think "I'm giving a talk." Instead, think "I want to give this audience a powerful experience of my work." The single worst thing artists and architects can do is to retreat into abstract or conceptual language.

Video has obvious uses for many speakers. In a TED Talk about the intelligence of crows, for instance, the scientist showed a clip of a crow bending a hook to fish a piece of food out of a tube—essentially creating a tool. It illustrated his point far better than anything he could have said.

Used well, video can be very effective, but there are common mistakes that should be avoided. A clip needs to be short—if it's more than 60 seconds, you risk losing people. Don't use videos—particularly corporate ones—that sound self-promotional or like infomercials; people are conditioned to tune those out. Anything with a soundtrack can be dangerously off-putting. And whatever you do, don't show a clip of yourself being interviewed on, say, CNN. I've seen speakers do this, and it's a really bad idea—no one wants to go along with you on your ego trip. The people in your audience are already listening to you live; why would they want to simultaneously watch your talking-head clip on a screen?

Putting It Together

We start helping speakers prepare their talks six months (or more) in advance so that they'll have plenty of time to practice. We want people's talks to be in final form at least a month before the event. The more practice they can do in the final weeks, the better off they'll be. Ideally, they'll practice the talk on their own and in front of an audience.

The tricky part about rehearsing a presentation in front of other people is that they will feel obligated to offer feedback and constructive criticism. Often the feedback from different people will vary or directly conflict. This can be confusing or even paralyzing, which is why it's important to be choosy about the people you use as a test audience, and whom you invite to offer feedback. In general, the more experience a person has as a presenter, the better the criticism he or she can offer.

I learned many of these lessons myself in 2011. My colleague Bruno Giussani, who curates our TEDGlobal event, pointed out that although I'd worked at TED for nine years, served as the emcee at our conferences, and introduced many of the speakers, I'd never actually given a TED Talk myself. So he invited me to give one, and I accepted.

It was more stressful than I'd expected. Even though I spend time helping others frame their stories, framing my own in a way that felt compelling was difficult. I decided to memorize my presentation, which was about how web video powers global innovation, and that was really hard: Even though I was putting in a lot of hours, and getting sound advice from my colleagues, I definitely hit a point where I didn't quite have it down and began to doubt I ever would. I really thought I might bomb. I was nervous right up until the moment I took the stage. But it ended up going fine. It's definitely not one of the all-time great TED Talks, but it got a positive reaction—and I survived the stress of going through it.

Ultimately I learned firsthand what our speakers have been discovering for three decades: Presentations rise or fall on the quality of the idea, the narrative, and the passion of the speaker. It's about substance, not speaking style or multimedia pyrotechnics. It's fairly easy to "coach out" the problems in a talk, but there's no way to "coach in" the basic story—the presenter has to have the raw material. If you have something to say, you can build a great talk. But if the central theme isn't there, you're better off not speaking. Decline the invitation. Go back to work, and wait until you have a compelling idea that's really worth sharing.

The single most important thing to remember is that there is no one good way to do a talk. The most memorable talks offer something fresh, something no one has seen before. The worst ones are those that feel formulaic. So do not on any account try to emulate every piece of advice I've offered here. Take the bulk of it on board, sure. But make the talk your own. You know what's distinctive about you and your idea. Play to your strengths and give a talk that is truly authentic to you.

HBR Reprint R1306K

Chris Anderson is the curator of TED.

10 Ways to Ruin a Presentation

As hard as it may be to give a great talk, it's really easy to blow it. Here are some common mistakes that TED advises its speakers to avoid.

1. Take a really long time to explain what your talk is about.
2. Speak slowly and dramatically. Why talk when you can orate?
3. Make sure you subtly let everyone know how important you are.
4. Refer to your book repeatedly. Even better, quote yourself from it.
5. Cram your slides with numerous text bullet points and multiple fonts.
6. Use lots of unexplained technical jargon to make yourself sound smart.
7. Speak at great length about the history of your organization and its glorious achievements.
8. Don't bother rehearsing to check how long your talk is running.
9. Sound as if you're reciting your talk from memory.
10. Never, ever make eye contact with anyone in the audience.

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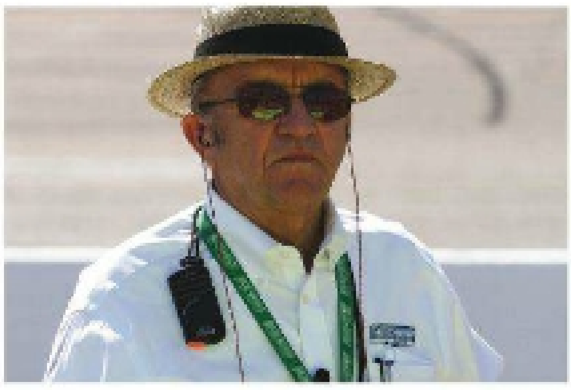

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Case Study

William C. Kirby is the T.M. Chang Professor of China Studies at Harvard University, the Spangler Family Professor of Business Administration at Harvard Business School, and a Harvard University Distinguished Service Professor.

When should a family business give up on an outside leader? *by William C. Kirby*

The Ex-CEO Contemplates a Coup

The Experts

Les Trachtman, CEO, Force 3

Lilli Friedland, founder and president, Executive Advisors

ILLUSTRATION: DANILO AGUTOLI

HBR's fictionalized case studies present dilemmas faced by leaders in real companies and offer solutions from experts. This one is based on research by William C. Kirby.

It's after midnight, and Myra Wanandi is writing in her journal in the Jakarta home she shares with her husband:

I'm tired, but I have to concentrate. My father is relying on me for one of the most important decisions of his life. What's scary is that I'm sure he'll take my words to heart. He always does. But this time I'm really stuck. I pray that an insight will come to me as I write. He's expecting an answer tomorrow.

The situation is simple. My father, Jaya Tan, retired three years ago as the CEO of our family's business, the Martapura Group, relinquishing control to a nonfamily CEO to ensure that the company would regain its strength and grow. But the business is having a harder time recovering from the recession than anyone expected, and some of my cousins have now asked my father to come back. He's tempted. Retirement turned out to be a bore, and when he talks about returning, his eyes gleam. But Ricky, my brother, is shocked that my father would even contemplate a "coup." He says the family is obliged to follow the governance rules it created. Otherwise the business will fail.

I wish I knew which side was right.

Nutmeg and Palm Oil

My grandfather and his brother started their company in Indonesia shortly after World War II. Times were hard, but as Sukarno rose, their little business selling vegetables began to grow. They were soon shipping food to Singapore and Australia. My grandfather ran the exports, while my great-uncle managed the palm plantation.

My father began working in 1961, at the age of 12. He says his childhood smelled of nutmeg—he carried it by the boxload onto the boats. He was at least as strong as his two brothers—one older and one younger—and soon proved to be the most capable businessman of his generation of Tans. In the 1970s he pushed the company to expand into palm oil and helped create a chain of food stores.

My bookish elder uncle was in line to succeed my grandfather as CEO, but he had enough self-awareness to know that he wasn't well suited for the role. He favored my father instead. My younger uncle, who took a casual approach to his job as vice president, was opposed to this plan—he worried that my father would shake things up. The question festered until 1979, when my grandfather summoned his sons, along with the other family members. Sitting in his living room, he brought out a "constitution" that he and his brother had written. It stated that family members must work to maintain love, forgive one another when differences arose, and put the company's interests above their own.

There wasn't a lot of love between my father and his younger brother after my grandfather's next words: "My middle son, Jaya, will succeed me as CEO."

But after a long pause, everyone shook hands.

Family Friction

Growing the business was easy; my father vigorously expanded the company, acquiring firms that exported plywood and rubber. Following the guidance about family harmony proved more difficult.

My younger uncle seemed to think the Martapura Group existed solely to serve the family. My father wanted it to become the best in the world in each of its businesses, and as a result, he insisted that his son—Ricky—be treated like everyone else when it came to promotions. But my younger uncle worked behind the scenes to make sure that his sons, Fred, Roy, and Bill, were given executive positions in the operating units despite their obvious shortcomings.

Most of the time my father tolerated this behavior. But when the head of the grocery stores division died unexpectedly, leaving Fred in line to succeed him, the blatant nepotism could no longer be ignored. My father acted swiftly to replace the full leadership team, enraging my cousins and their father. He called a family meeting, explaining that his actions were for the common good and asking his relatives for understanding. My grandfather was there too, ill and pale but still formidable, and his presence had a powerful effect. My younger uncle caved and gave his approval.

Ricky is now the chief operating officer, but Fred, Roy, and Bill never rose as high. My elder uncle's sons have also been unable to break in to leadership positions. As for me, I'm happily uninvolved! When I was getting my MBA at Stanford, I met and married the wonderful Daniel Wanandi, and we now run a language school in Jakarta. I'm content to be on the sidelines, with my father relying on me for advice. Some of his friends tease him for listening to his daughter, but he just laughs back.

Bold Action

After my grandfather passed away, my uncles became closer, and there were rumors that my younger uncle had convinced his oldest brother that my father's value as CEO had run its course. I'm sure both uncles were thinking about their sons, who were looking for positions of greater authority. And Southeast Asia's financial crisis was crippling Indonesia's growth; perhaps they also sensed vulnerability.

One afternoon my father sat in my courtyard and poured out his worries about the rumors and the economic downturn. I pointed out that he had never gone wrong by taking bold action. He liked hearing that and became excited thinking about how to take advantage of the crisis. Over the next three hours I helped him formulate a plan to place the company on a more professional footing so that it would last "seven more generations."

The Martapura Group would be listed on the Jakarta Stock Exchange, which would require transparency and accountability. All the companies in the conglomerate would have to measure themselves against global industry benchmarks. My father would put more professional managers in key positions.

Anticipating opposition, he established a board of directors. He also promised to retire in eight years. I laughed at that one. I couldn't imagine him retiring that soon, nor did I think it was a good idea. But the provisions worked: The prospect of being on a board and seeing my father give up the CEO position was irresistible to my uncles, and they agreed to the whole package!

Dramatic growth followed. As the economy improved, the company expanded into machinery and chemical imports. Nonfamily managers were elevated to executive positions and invited to become shareholders, although family members still owned the majority of shares. My father won the Star of Mahaputera for service to Indonesia.

I truly think my father was so immersed in his work that he didn't realize when eight years—then nine, then 10—had passed. I also think his relatives and employees were secretly grateful that he stayed on, because he was doing an excellent job. It was only in 2008, when the worldwide recession started, that my uncles, and then their sons, began to complain.

Again my father came to me. Foreseeing a deeper downturn this time, he said he couldn't in good conscience leave the company just then. I felt strongly that he should adhere to the rules and step aside; if a nonfamily CEO couldn't manage the firm, he could always return. To counter any accusations of hypocrisy, he could argue that he had made a good-faith effort to abide by the new governance system. I reminded him that bold action was his trademark. He smiled.

The recession was in full force by the time he decided to leave. The export and import businesses were struggling, and the palm oil business was hit by negative publicity from NGOs.

After a long search for a new CEO, the firm hired Amin Tueni, a Canadian of Lebanese origin who had previously run a Toronto-based food company. Upon Mr. Tueni's arrival, my father reminded him (as I had urged him to) that all executives were subject to replacement if they

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didn't meet expectations. Mr. Tueni said he understood perfectly well.

Retiring from Retirement?

A month after my father retired, we took a glorious vacation—he and my mother, my husband, my children, and I. We visited places we had only read about or seen on television: Rome, Paris, Berlin. But back in Jakarta, my father found that he didn't have enough to do. He bought an expensive boat, but it didn't interest him.

Meanwhile he watched helplessly as the firm declined. Occasionally he would come over with a notepad and a red Sharpie to sketch out recovery plans. But now he was just another shareholder. "I'll never have an impact unless I can get my brothers and nephews to vote with me," he said. "And that won't happen."

He was wrong. My cousins were upset that Mr. Tueni hadn't achieved the expected turnaround. As speculators in Hong Kong real estate, they were feeling the pinch of lower dividends and were worried about defaulting. Whatever my father's shortcomings (in their view), their dividends had been reliably high during his tenure. And Mr. Tueni's opinion of my cousins was apparently even more negative than my father's, so they had been marginalized. "Professional" management hadn't worked out quite as the family had hoped.

Growing the business was easy. Maintaining family harmony proved more difficult.

Last night over dinner at my house Fred, Roy, and Bill made their case to my father. They realized, they said, that the company had grown so large and complex that only a person with his extraordinary strength of mind could manage it. My father beamed. He had waited a long time for such a compliment from them. They added that Mr. Tueni seemed cautious and indecisive. "He is no Jaya Tan," they said. Finally they put the question to my father: Would he consider coming back?

I was thrilled. My father needed to be back at work, and the company needed his talents. And hadn't I suggested that his retirement might be temporary?

He told my cousins he would consider their suggestion. But after they left, he turned to me in frustration. "They make it sound simple," he said. "I walk in, thank Mr. Tueni for his hard work, and take over, backed by enough family members for a majority of shares. But it's not so simple. I can't be objective about this, Myra."

He said we should meet again, on Thursday—which is tomorrow. "I want you to think about it—think hard—and tell me what you believe the right course of action is," he said. He looked at me warmly. "I trust you."

A Second Opinion

Today Ricky visited me at my school, accompanied by Amin Tueni, whom I had met just once before, at a dinner in his honor. Seated in my otherwise empty boardroom, Mr. Tueni seemed much less impressive than he had at the reception.

Ricky explained that my cousins' proposal was already common knowledge. They were trying to build support for it among other family members, and many seemed amenable. "But you must persuade him not to accept," he said.

"He makes his own decisions," I replied, hedging.

Mr. Tueni spoke. "Jaya Tan is revered in this company, and for good reason. But we face challenges on all sides, and we must move forward, not backward."

"My father has plenty of ideas for moving forward," I said, remembering the red Sharpie. "Sell the palm oil business. Divest a few other underperforming assets."

"I've heard all that," Mr. Tueni said. "And I appreciate his ideas. But a recession is no time to divest. The businesses would have to be sold at rock-bottom prices. Our markets have taken a beating. But once they recover, we will be well positioned."

He had a point about divestitures, of course. But I could almost hear my father saying that standing still is no strategy.

"It's also a governance issue," Mr. Tueni continued. "In Canada, and in Indonesia, too, there are branches of government that keep one another in check. Your father established a system that keeps the family in check, balancing its wishes with the judgment of professional managers."

"It's not a system, really," I said. "It's just a family constitution that says we should live in peace and harmony."

Ricky jumped in. "Myra, for more than a decade the firm has been run according to one idea: that it's a professional company with professional managers. Father's return would be a repudiation of all that. A coup could be devastating to our reputation with analysts and outside investors, not to mention the morale of nonfamily executives, who might question whether they have a future at the company."

Mr. Tueni nodded. "The professional managers don't want him to take over," he said. He added, sounding apologetic: "I include myself in that."

I wanted to rattle off the names of highly regarded companies that are run by members of their founding families—companies like Purdue and SC Johnson. Although I suppose there are counterexamples, too. Isn't News Corp. trading at a discount because of the Murdoch fiefdom?

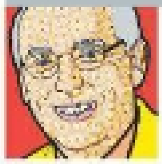
"Please, Myra," Ricky said. "Help him see that the best thing he can do for his beloved company right now is nothing at all."

This morning I was certain what my advice would be. I was looking forward to seeing my father get back to work. But tonight I'm completely confused. Why won't a clear answer come?

Should Myra's father retake the reins of the Martapura Group?

See commentaries on the next page.

The Experts Respond



Les Trachtman is the CEO of Force 3, a Maryland-based company that provides video, mobility, and teleworking solutions for industry and government. He has served as the CEO of several other technology companies.

JAYA TAN'S brothers and nephews are right in one respect: The professional CEO needs to go. That's hard for me to say, because several times in my career I've been the professional CEO running a family company.

But Amin Tueni has failed to meet the family's expectations. I'm not talking about his inability to turn the business around quickly; I don't fault him for that. Nor do I blame him for his supposed lack of vision. I'm talking about a failure to recognize his duty to carry on the family's legacy and culture. This aspect of the CEO's relationship to the family isn't explicitly stated in the story, but I've seen over and over how important it is—even if it's unarticulated.

After a family founds a business, members see the firm as embodying their identities and values, and they want to feel good about not just its performance but also its impact on its stakeholders. Tueni doesn't seem to understand that.

A third-generation family company I know well hired a nonfamily executive and is grooming him to take over as CEO. Although this executive had no prior experience in a family company, he has just the right temperament for the job. He's a strong decision maker with a very soft, human touch. He's sensitive to the culture that existed prior to his arrival and to how the company is viewed by the community. He has become a close confidant of the current CEO but also realizes that change is needed. He understands that he must support the family legacy. He's clear about balancing the stakeholders' short-term cash expectations against long-term value creation.

Amin Tueni needs to go. But the company must keep its commitment to professional management.

Notice that the company not only found the right guy but also gave him a long runway. He has already spent five years getting acclimated, and the family members and employees have had plenty of time to get used to him.

The Martapura Group, by contrast, seems to have thrown Amin Tueni into the CEO job without a proper transition and with little or no support. He's probably unable to see why the family is unhappy with him. No one explained the importance of the family's legacy and culture, so he thinks his job is just about financial performance. He might be salvageable as CEO, but my guess is that he just doesn't have the right temperament.

Even so, the Martapura Group needs to keep its commitment to professional management. It would be a mistake for Jaya to return to his job. Nonfamily executives have been led to believe that the company really is modernizing.

I'm also not sure Martapura needs Jaya's skill set right now. Jaya's brothers and nephews seem to think their business can somehow go back to the way it used to be, but a lot has changed.

I believe Jaya should become chairman of the CEO search committee. That will placate the relatives who want him to be more involved. After a successor is chosen, Jaya should create an environment that enables him or her to succeed. The company must find a way to ease in the new leader so that everyone becomes comfortable. And it's critical that the family back the new CEO wholeheartedly. That way no one will think again about staging a coup.

WHAT WOULD YOU DO?
SOME ADVICE FROM THE HBR.ORG COMMUNITY

JAYA TAN should return. But maybe it could be done diplomatically, by creating a co-CEO or similar position for Amin Tueni; that would probably minimize disruption and backlash.
Randall Arnold, *editor in chief, post404*

AMIN TUENI makes a valid point about the damage Jaya Tan's return might cause to nonfamily executives. Nepotism in Indonesia has already caused a talent drain: Many bright people who have left the country have no intention of coming back to a system that does not reward merit. If Tueni is deemed to be incompetent, the family can replace him with another nonfamily executive.
Petrus Bosa Layarda, *student, New York University Abu Dhabi*

MYRA SHOULD recommend that her father seek the counsel of her brother, Ricky. A demonstration of faith in him might give Ricky the inner strength to help Amin Tueni turn around the fortunes of the company—and maybe even to succeed him in due course.
David J Foster, *managing director, Rally Strategic*

Lilli Friedland, the founder and president of Executive Advisors, counsels leaders in family firms, other privately held businesses, and public companies.

JAYA TAN should retake the company's reins—*if*.

If he gains self-awareness. *If* he learns to pay attention to others' feelings. *If* he makes an effort to build family cohesion. And *if* he and the family agree that the business must be run professionally, with an independent board.

Jaya Tan could be the Martapura Group's next great CEO. But unless he meets all those ifs, his return could drive the company, and the family, into the ground.

Anyone who has worked with family businesses has known a Jaya Tan—the great brain for business, the huge ego. The Martapura Group would not be what it is without him. But no one ever helped him see his weaknesses as a leader:

- He created no structure to allow the company to prosper with someone else at the helm. Amin Tueni was given no criteria with which to define or measure success.
- He didn't establish a leadership-training program for younger relatives and nonfamily managers. Allowing incompetent nephews to be promoted didn't build their skills—and it didn't help create an effective succession plan.
- He never instituted a process for managing conflict and communication.
- He failed to establish a system for educating family members about the business. In families that have grown dependent on the income from a company, members not in the business need to be taught the value of long-term investing. Successful multigenerational business families such as the Fords, the Pritzkers, and the Rockefellers hold regular meetings to this end.
- He overlooked his brothers' and nephews' discomfort and failed to promote family values such as loyalty and commitment.
- He failed to create an environment in which family members felt safe speaking their minds to him. Every CEO needs a board that will provide an honest perspective.

If Jaya returns as CEO, he will need to put his ego aside, recognize his shortcomings, and focus on the family as well as on the business. He will undoubtedly need the active participation of his relatives and of an outside adviser who can help him discover his blind spots.

If Jaya returns as CEO, he will need to put his ego aside and focus on the family as well as on the business.

Because he's a man of action, it's possible that Jaya could jump in too quickly. He needs to gradually establish credibility with each family member, demonstrating a genuine interest in his or her career. And he and his brothers need to build bridges of understanding and trust.

With his brothers, he should institute a process to evaluate each family member's strengths, passions, and leadership style and to build needed competencies. A nephew with great people skills might be steered toward sales; one who's good with numbers might be a natural for finance.

Jaya also needs to bring the family together regularly and rally it around common purposes—philanthropic efforts, perhaps. He might create a video history of the family and its business to emphasize values such as determination in the face of adversity. This could inspire the current generation to increase its commitment and help ensure that future generations are part of a continuing legacy.

There's a reason why some version of the saying "Shirtsleeves to shirtsleeves in three generations" can be found all over the world: It's because the family part of a family business tends to receive insufficient effort. Jaya can succeed as his company's next leader only if he pays closer attention to the people at the heart of the business. ⛉

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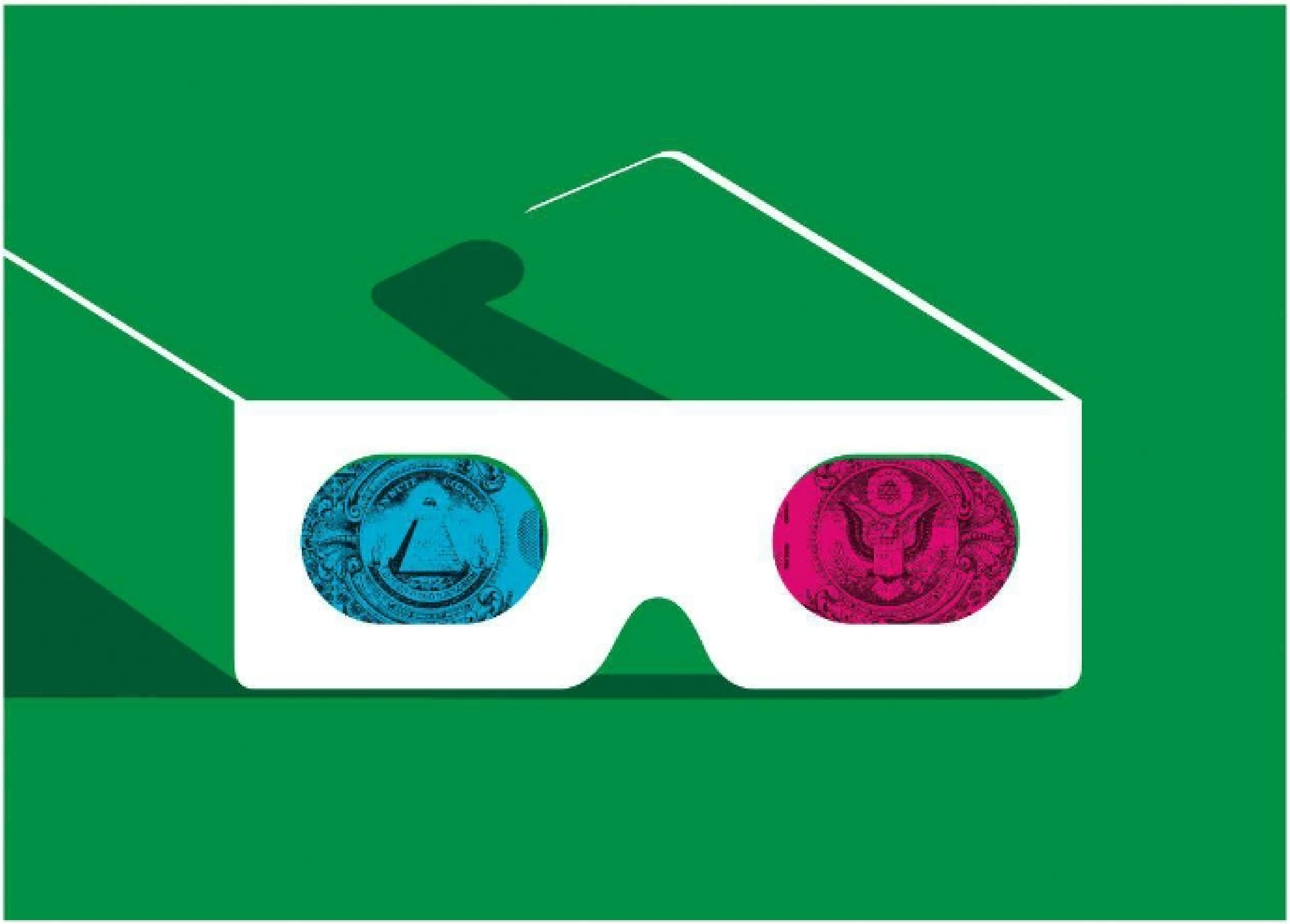
Synthesis

A review of emerging ideas in the media



Hollywood's Obsession with Blockbusters

by Kevin Evers

Summer, in my opinion, is the worst season for movies. Sequels, reboots, franchises, superhero sagas, action flicks—big-budget blockbusters just aren't my thing. Take a look at the 2013 May through August lineup: *Man of Steel, Iron Man 3, Star Trek into Darkness, The Wolverine, 300: Rise of an Empire*... The list goes on and on. In Hollywood today, bigger is better and repeatability is king.

But these movies are the industry's lifeblood, and audiences seem to love them. According to Box Office Mojo, a website that tracks ticket sales, the 10 top-grossing movies worldwide in 2012 were animated films, action sequels, or franchises, and they propelled the major studios to record profits.

So, to use superhero parlance, are blockbusters a force for good or evil? After reading books from several experts on the topic—a lover of big-budget movies, a producer, and a film critic—I'm torn.

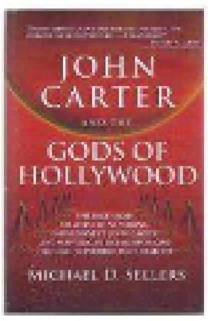
First let's take a close look at an ultra-expensive blockbuster that crashed and burned. Michael D. Sellers's *John Carter and the Gods of Hollywood* chronicles Disney's 2012 release of a movie that cost more than $250 million to make and $100 million to market and then bombed at the box office, forcing the company to take a $200 million write-off. This came as a big surprise, because the movie seemed destined for success. As Sellers notes, the source material, from a story by Edgar Rice Burroughs, was incredibly rich—in fact, Burroughs's writing had been a big influence on both the *Star Wars* franchise and *Avatar*. The director, Andrew Stanton, was

ILLUSTRATION: BEN WISEMAN

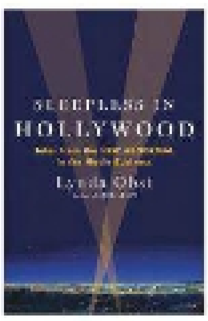
HBR.ORG We don't review our own books, but check out our "New Books from the Press" blog post each month at blogs.hbr.org/synthesis.

a Pixar whiz, perfectly capable of delivering the goods. And the lead actor, Taylor Kitsch, was a respected up-and-coming talent. The movie even played well at test screenings. But Disney failed to create buzz and galvanize a fan base.

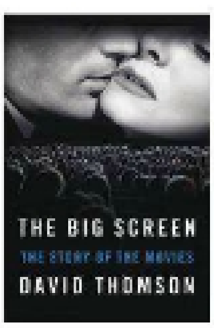
Of course, the studio was fine. Another of its 2012 blockbusters, *The Avengers*, raked in $1.5 billion worldwide, generating 43% of Disney's gross revenue. By now we all know that this is how Hollywood hedges its bets: Throw money at enough of these movies, and one will surely hit it big, making you a crazy amount of profit, which helps you forget the failures. The Harvard Business School professor Anita Elberse has spent years researching uber-competitive, winner-take-all markets in which companies earn the vast majority of their profits with only a couple of successful products. (Her book *Blockbusters: Hit-Making, Risk-Taking, and the Big Business of Entertainment*, forthcoming from Henry Holt, is likely to shed more light on the issue.)



John Carter and the Gods of Hollywood
Michael D. Sellers
Universal Media, 2012



Sleepless in Hollywood: Tales from the New Abnormal in the Movie Business
Lynda Obst
Simon & Schuster, 2013



The Big Screen: The Story of the Movies
David Thomson
Farrar, Straus & Giroux, 2012

For now, we can turn to the producer Lynda Obst's *Sleepless in Hollywood: Tales from the New Abnormal in the Movie Business*, an inside account of the industry at work today. Obst explains the importance of foreign markets to its current strategy. The fact is that up to 70% of a movie's revenue can come from overseas. And which U.S. offerings play well in other countries? Blockbusters. Why? No other country can create movies on the same scale. Dramas, romantic comedies, genre pictures—studios around the world can make those. But only Hollywood has the technology and the talent (including world-famous celebrities) to churn out nine-figure spectacles. So although *Ice Age: Continental Drift* may seem like a lame rehash, the franchise's foreign box-office numbers are impressive: The first installment grossed $207 million, the second $460 million, the third $690 million, and the fourth $716 million. Even *John Carter* made close to $210 million outside the United States.

> "With all these tentpoles, franchises, reboots, and sequels, is there still room for movies in the movie business?"
> Lynda Obst, *Sleepless in Hollywood*

Obst, the producer of *Sleepless in Seattle* and a host of other "movie movies," as she calls them, is naturally worried about all this profit chasing. As studios become obsessed with building multimovie franchises with the basic plots, unsophisticated dialogue, and familiar characters that appeal mainly to teenage boys and foreigners, they're funding fewer dramas and comedies than they once did. The executives Obst interviewed confirmed her fears: They feel that the financials are forcing their hands.

The film critic David Thomson is equally concerned about this trend. If you look back through movie history, as he does in *The Big Screen: The Story of the Movies*, you'll see that the industry's most fertile and creative periods weren't driven by blockbusters; they were fueled by filmmakers who had the budgets and freedom to contribute new styles and techniques to the movie mainstream. Think of iconic directors like Charlie Chaplin, Orson Welles, and Alfred Hitchcock—or, more recently, Stanley Kubrick, Martin Scorsese, and Francis Ford Coppola—who made artistically daring movies (even sequels, in the case of *The Godfather*) while also racking up ticket sales. For decades this was the Hollywood way, and Thomson laments and rages against its passing.

My first inclination was to do the same. But looking at the current movie landscape—across all seasons, not just the summer—I don't think the situation is as dire as Thomson and Obst depict. After all, Hollywood is still innovating—even in some action films. Look no further than the special effects and sound wizardry in *Avatar* and *Hugo*. And even if the big studios are financing more *John Carter*s than they are commercial art films with creative storytelling, others are filling the void. Harvey and Bob Weinstein have made a career of it, and newcomers such as Megan Ellison (the daughter of Oracle CEO Larry Ellison), who personally financed *Zero Dark Thirty* and *The Master*, are stepping in.

I would like the big studios to do more, of course; we can't depend on two hard-charging brothers and a generous tech heiress forever. But I think the movies are going to be OK. We cinephiles will still be able to get our fix in the autumn run-up to awards season; you blockbuster lovers can spend the summer eating popcorn and watching stuff blow up.

Kevin Evers is an editorial coordinator at *Harvard Business Review*.

singapore sessions

THE ASIA INNOVATION SERIES

THE CHALLENGE

How can big data and analytics spur innovation in new markets?

Big data and analytics could be the twin forces driving innovation in Asia—one provides information while the other sifts through it for precious insight. In Asia, the applications are endless: forecasting the revenues of a new business unit; pinpointing bottlenecks in the regional supply chain; even searching for niches in unwieldy consumer markets.

But in a world of uber-statistics and change, how can companies develop the capabilities to truly distinguish between signal and noise? Can you confidently say your data and insights are better than your competitors' are? And when is too much information, well, too much?

THOMAS H. DAVENPORT

President's Distinguished Professor of Management and Information Technology, Babson College; Visiting Professor, Harvard Business School

///// **ORGANIZATIONS THAT WANT** a competitive edge are pursuing big data initiatives, using analytics to gain insights and spur innovation in every market. Global companies can use data and analysis to tailor products, services and offers to customer segments in each market in which they do business. Local companies in emerging markets can ensure that their offerings fit local customers and market conditions.

One key benefit is that organizations can make the same decisions faster and more frequently. If you're a bank detecting fraud or a retailer making price optimization decisions, you can do it in minutes instead of many hours, and you can make the decisions more frequently and timely, corresponding with the pace of the market. HSBC in Asia is one of the leaders in fraud management in the banking sector. With big data, HSBC can combine information from all customers' accounts and transactions with the bank, and make decisions about approving transactions in one second or less—while the purchase is still under way.

Another benefit of big data technology is that you can make decisions less expensively—an important factor as companies experiment in new markets. Many people are very excited about massively parallel server clusters running software like Hadoop and other open source tools. Some companies are exploring them aggressively as the tools can be much cheaper than the more traditional data warehouse environments of the past.

You can also make better decisions with new types of big data. For example, with social media data, a retailer would be able to understand a customer better and target a promotion more effectively. I've worked with a number of banks that are looking at social interaction across an omni-channel environment and adding that data to what they already know about the products and services that the bank has sold to these customers. That gives them a much better indication of their likelihood of leaving the bank as a customer, or of responding to an offer. You

> I think it's fair to say we're really entering a new phase of the data economy, not just for online firms but for all types of firms.

can also use new data for intelligence and risk assessment purposes. For example, the national security agency in Singapore is doing scanning and sentiment analysis of social media data for risk assessment and horizon scanning.

Finally, the fourth benefit of big data—one of the most relevant to new markets—is developing new products and services for customers based on data. Even in the industrial products sector, GE is spending billions to try to create new service offerings based on the data resulting from gas turbines, jet engines and locomotives.

In telecom, SingTel in Singapore has an offering for voice analytics that can analyze voice data of students as they practice pronouncing different languages. SingTel then gives them an immediate grade on how they're doing, all over a mobile phone.

Bharti Airtel in India has a service called SmartDrive, a new offering that not only gives you turn-by-turn directions, but also tells you where traffic is concentrated, based on signals sent from your mobile device, and redirects you or tells you the approximate arrival time based on how much traffic there is. I think it's fair to say we're really entering a new phase of the data economy, not just for online firms but for all types of firms.

Of course, the limiting factor for all of these benefits is not the data or the technology, but the people who can put it to work. Data scientists and "quants" can be found in every major city around the world, but it's still difficult to hire them. In Singapore, for example, the "meet up" is called BigData.SG: The Data Nerds of Singapore. If you want to hire people like this, you might want to connect with people at such gatherings. Companies can also "build" data scientists themselves through training programs; EMC, IBM and Deloitte all have training programs to try to nurture more employees with big data skills.

If you have a long-term view of your talent needs in big data, you may want to consider partnering with a university such as the Singapore Management University. SAS endowed an advanced analytics master's degree at North Carolina State, and now, a number of other universities have created similar programs. There is no doubt that people are the scarcest resource in big data.

NATHAN FALKENBORG

Head of Analytics, Visa Worldwide, Asia Pacific, Central Europe, Middle East & Africa

THE PROLIFERATION OF technology is spurring companies to explore the explosion of data availability and the opportunities and responsibilities that come with it.

At Visa, we use our network in combination with new technologies to help make commerce more secure. That means making meaning out of disparate pieces of information in ways that no other payment system can—insights that help merchants, financial institutions and governments reduce fraud and overall risk to the payment system.

The backbone of our network, VisaNet, is capable of processing more than 80 billion transactions totaling nearly $4 trillion in payments per year. And it's unique in that it does something few other payment networks can: offer a single, global view of its transaction data in real time to monitor fraudulent activity.

My work here at Visa in Singapore involves managing aspects of our business in about 120 different countries from South Africa to South Korea and Australia to Zimbabwe. Being at the center of so many diverse markets—both developed and emerging—allows us to apply our global analytical expertise to help secure the payments system in every country in which we do business.

One example of how we're able to derive insights from this data is in fraud detection. This means that we are able to distinguish legitimate transactions from suspicious transactions being submitted on our network in real time, using behind-the-scenes analytics. In less than one second of processing time, transactions are analyzed and risk scores provided. Visa's instant risk score engine is one of the most powerful fraud monitoring systems in the world, and the ability to analyze every Visa transaction is made possible by our centralized data processing system. Advances in our risk-scoring engine have resulted in $1.5 billion in potential fraudulent activity identified in 2010 alone.

> As we look to the future, we're focused on visualizing trends across geographies, which is critical to realizing the potential of innovation in both emerging and developed markets.

When a bank is considering serving a new market or launching a new product, the ability to identify and prevent fraud is a common concern. Because Visa has undertaken considerable work in this area, financial institutions and governments can benefit from our experience and focus their efforts on innovation and customer service. Among the most notable innovations is the advanced use of data, including mobile transaction alerts and purchase offers, for targeting and delivering communications in near real time to participating consumers.

As we look to the future, we're focused on visualizing trends across geographies, which is critical to realizing the potential of innovation in both emerging and developed markets. By monitoring and analyzing fraud trends, we can learn how fraud in one country might be replicated in another, protecting consumers and economies. And we do this with security and privacy in mind. It's about breaking new ground without breaking our promises.

JIM DAVIS

Senior Vice President and Chief Marketing Officer, SAS

///// **INNOVATION IS AT** the core of the high-performing organization, whether you're reinvigorating existing markets or conceiving new ones. Big data is one of the hottest topics in business and certainly can spur innovation, but you don't need big data to innovate. The wheel was invented long before the abacus. The iPhone was not the result of analyzing elaborate surveys of the multitudes. But analytical thinking is certainly a requirement.

Some things don't take many observations to see a pattern that will inspire an invention or a new way of doing things. The human mind can process all the data that's necessary to understand that round things roll better than flat things. But sometimes it takes millions or billions of records to be able to detect a pattern of something incredibly rare, like certain disease indicators or drug side effects that occur among a minute group of people. The whole pharmaceutical industry could be transformed by personalized drugs as a result of insights from big data.

> With so many new sources of massive amounts of data pouring into organizations today, more possibilities can be revealed than were ever possible before.

Making sense of big data has been the catalyst for an enormous amount of innovation. Advancements in new technologies and new techniques have allowed organizations to overcome the barriers of big data and turn the focus on the power of analytics. Analytics can extract impactful insights and hidden details within big data to support fact-based decision making in real time and at incredible speed.

With so many new sources of massive amounts of data pouring into organizations today—streaming data, text, Internet usage data and multimedia data amounting to exabytes being created every day—more possibilities can be revealed than were ever possible before. Recent technological developments have made it possible not only to store these vast amounts of data, but also to analyze it quickly enough to be useful. Even a year ago, analyzing the data required to optimize a marketing campaign for hundreds of thousands of customers would have taken half a day. Now that kind of analysis can be done in a couple of minutes.

What are the possibilities? Big data may not have been the source of inspiration for the iPhone, but it could predict the need for new types of financial services, new products that will address the needs of aging baby boomers, and new materials or policies to reduce failures in infrastructure. The possibilities are unlimited.

For instance, new markets like renewable energy that are struggling to gain a foothold because they're not yet cost-competitive can use big data and analytics to reduce costs. Maintenance on deep-water wind farms is a huge problem because of accessibility related to weather. Analyzing big data streaming from sensors can predict breakdowns before they happen, making it possible to schedule preventive maintenance when weather is favorable. This same technology can be implemented in consumer products. Embedded sensors can detect when a product like a car or a refrigerator needs service—before you're stranded on the highway or the ice cream melts.

Banks and governments are using big data and analytics to innovate new ways to fight some of the most innovative people on earth—fraudsters. Government agencies like the Hong Kong Efficiency Unit, which collects 300,000 citizen complaints annually, improve and create new services that address common issues.

While the use of big data and analytics has the potential to improve competitiveness through innovation, finding and retaining analytical talent will be a challenge. At SAS, we are not just committed to providing analytics that help to inspire innovation, we are also working with a number of universities to create programs that teach students how to use analytics to make new discoveries. Innovation is the engine of economic growth. We want to be sure that the next generation is prepared to take on that challenge.

STEVEN MILLER

Vice Provost (Research) and Dean, School of Information Systems, Singapore Management University

///// **SINGAPORE MANAGEMENT UNIVERSITY** (SMU) and Carnegie Mellon University are working together and with industry partners on a new paradigm called Living Analytics.

We analyze the digital traces of consumer and social behavior created by people living in everyday settings. Our goal is to generate useful information—personalized recommendations, guidance and incentives—that can flow back to people and help them with their consumer choices and social interactions. Analytics methods and models themselves need to be living in the sense that they need to evolve over time as we test, monitor responses and learn how people really respond—especially important as companies explore new markets and interact with new customers.

We all live in an increasingly interconnected and networked world where the digital traces of our social and consumer behavior can influence what others networked to us directly or indirectly choose to do, just as we are influenced by their choices. We are all "living in the network," where these influences interact in complex ways.

Our projects target a wide range of consumer and business activities. For instance, one LARC project analyzes e-channels and digital content to identify what leads customers to switch to new service offerings and identifies how promotions should be timed to increase revenue. Another project uses social media and mobile information to recommend when and where mobile platform operators should place ads to maximize click-through rates, as well as what kind of service bundles should be offered to customers. In travel and leisure locations, we're using analytics to explore bundling and pricing of tickets, as well as how to incentivize customers to alter their itineraries in response to changing conditions, such as queue lengths or weather conditions.

Through our joint SMU-Carnegie Mellon Living Analytics Research Centre (LARC) funded by the Singapore government's Interactive Digital Media R&D Program, we are working with companies in Singapore to develop, apply and test this approach.

Mobile devices—in particular smartphones and tablets—open up whole new vistas for this Living Analytics approach. With additional support from Singapore's Interactive Digital Media R&D Program, SMU has launched a companion effort, the LiveLabs Urban Lifestyle Innovation Platform. LiveLabs focuses on creating real-world test beds that combine mobile applications and supporting software and network infrastructure to enable an understanding of the mobile user's context, and then to interact with that mobile user in "context appropriate" ways.

Through LiveLabs, users with mobile devices in densely populated settings such as a Singapore mall, airport, dedicated tourist and leisure location, or urban university campus (SMU) can voluntarily choose to "opt in." By utilizing the location and sensor information available from the mobile devices in state-of-the-art ways, participants can receive personalized recommendations, guidance, promotions and other types of incentives.

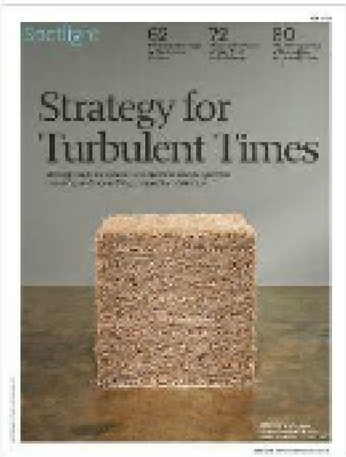
> Analytics methods and models themselves need to be living in the sense that they need to evolve over time as we test, monitor responses and learn how people really respond.

In a mall or airport, LiveLabs provides both a software platform and real-world ecosystem for running consumer and social trials that bring together all of the stakeholders who need to interact: the mobile user, the mall or facility operator, the store owners, and the brands whose goods and services are sold in the stores.

LARC and LiveLabs are not just advanced analytics efforts. At their core, these efforts involve deep levels of culture and mindset change, which need to happen inside companies and within the universities, where the computer science-trained data mining mobile technology researchers are learning to work with researchers trained in social science and management science. Together these teams are creating a new way to understand our world.

Executive Summaries June 2013

SPOTLIGHT ON STRATEGY FOR TURBULENT TIMES



Three new approaches to corporate strategy: Learn to uncover and exploit transient (not sustainable) advantages; develop a "theory of the firm"; and analyze your value networks rather than your value chain.

STRATEGY & INNOVATION

Transient Advantage

Rita Gunther McGrath | page 62

For decades, the business world has been fixated on achieving sustainable competitive advantage, a position within an industry that allows a company to best its rivals over the long term. Though we can all point to organizations that have succeeded with this approach—think GE and Unilever—in today's world, the edge of most companies doesn't last long. The forces at work here are familiar: the digital revolution, disappearing barriers to entry, globalization. In a turbulent environment, businesses can't afford to spend months crafting a single long-term strategy. They need a portfolio of multiple *transient advantages* that can be built quickly and abandoned just as rapidly.

Transient advantages call for a whole new playbook, says Columbia Business School's McGrath. It involves a view of strategy that is less industry-bound and more customer-centric. Executives who grasp this shift don't rely solely on analysis to develop strategy; they use tools like advanced pattern recognition and observation to set broad strategic themes and then let people experiment within them. They also adopt decision metrics that support entrepreneurship, replacing the net present value rule, for instance, with the logic of real options. And, knowing that product features can be copied instantly, they focus on providing experiences and solutions to problems to customers, and turn relationships into competitive barriers.

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GENERAL MANAGEMENT

What Is the Theory of Your Firm?

Todd Zenger | page 72

Asked to define "strategy," most executives would probably come up with something like this: Strategy involves discovering and targeting attractive markets and then crafting positions that deliver sustained competitive advantage there. This view of strategy as position remains central in business school curricula around the globe.

Unfortunately, writes the author, investors don't reward senior managers for simply occupying and defending market positions. Equity markets are full of companies with powerful positions and sluggish stock prices. Merely sustaining prior financial returns, even if they are outstanding, does not significantly increase a share price; tomorrow's positive surprises must be worth more than yesterday's.

Zenger argues that managers' most vexing strategic challenge is not how to win or sustain competitive advantage but, rather, how to keep creating value. He offers what he calls the "corporate theory," which reveals how a given company can do just that. Drawing on the history of Disney and Apple, he describes what makes a corporate theory strong, shows how it informs strategic choices, and warns what can happen when a company loses sight of its theory.

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STRATEGY & COMPETITION

The New Dynamics of Competition

Michael D. Ryall | page 80

In 1979 Michael Porter's five forces model transformed the field of strategy. But the 1996 article "Value-Based Business Strategy," by Adam Brandenburger and Harborne Stuart Jr., may prove to be even more significant, as it applied mathematics to the evaluation of strategic decisions. Ryall, of the University of Toronto's Rotman School of Management, now introduces a model of competitive strategy that is built on Brandenburger and Stuart's mathematical work.

The value capture model (VCM) has an explanatory, predictive power that no other theory of competitive strategy can claim. It defines competition in an industry as a tension between the value generated from transactions that a firm undertakes with a given set of agents and the forgone value it could have generated from transactions with other agents. An important implication is that strategists must shift from looking at how a firm competes with other players to examining how players compete for a firm.

Work on the VCM is already revealing important insights to leaders who chart the strategic direction of their firms. A streamlined version with a reasonably full complement of input variables, bolstered by empirical research and further refinements, could illuminate the way to better business practices.

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Features

THE BIG IDEA

HUMAN RESOURCES

Tours of Duty: The New Employer-Employee Compact

Reid Hoffman, Ben Casnocha, and Chris Yeh | page 48

For most of the 20th century, the relationship between employers and employees in the developed world was all about stability and lifetime loyalty. That has recently changed, giving way to a transactional, laissez-faire approach that serves neither party well.

A new arrangement is needed, the authors argue—one built on alliance (usually temporary) and reciprocity. The high-tech start-up community of Silicon Valley is pointing the way—and companies that wish to be similarly agile and entrepreneurial can learn valuable lessons from its example.

Under the new compact, both employer and employee seek to add value to each other. Employees invest in the company's adaptability; the company invests in employees' employability. Hoffman (a cofounder of LinkedIn), Casnocha (a technology entrepreneur), and Yeh (an entrepreneur and angel investor) outline three simple, straightforward ways in which companies can make the new compact tangible and workable. These are (1) hiring employees for explicit "tours of duty," (2) encouraging, even subsidizing, employees' efforts to build networks outside the organization, and (3) establishing active alumni networks that will enable career-long relationships with employees after they've moved on.

In the war for talent, such a compact can be a secret weapon that helps you fill your ranks with the creative, adaptive superstars who fuel entrepreneurial success.

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DIVERSITY

Dysfunction in the Boardroom

Boris Groysberg and Deborah Bell
page 88

Eighty-seven percent of female directors say they face gender-related hurdles on boards.

Though boards claim they strive for diversity, the number of female directors remains low; women held only 16.6% of *Fortune* 500 board seats in 2012. To find out why—and learn about the women appointed to boards and their experiences—Harvard Business School's Groysberg and organizational researcher Bell teamed up with Heidrick & Struggles and WomenCorporateDirectors to conduct annual surveys of board members. In this article they reveal the findings of their 2010 survey of 294 women and 104 men, presenting a profile of the typical female director, what directors thought about the benefits of diversity and the dynamics between men and women on boards, and best practices for recruiting and managing directors.

Three themes emerged from the data: (1) Women had to be more qualified than men to be considered for boards. Contrary to popular belief, female directors had more operational and leadership experience than male directors. (2) Boards don't know how to leverage diversity. The women said they were not treated as full members of the group, though the men were largely oblivious to this problem. (3) Great talent is not enough to create a great board. Boards need processes and cultures that encourage inclusiveness as well as diversity.

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ORGANIZATION & CULTURE

It's All About Day One

Suzanne de Janasz, Kees van der Graaf, and Michael Watkins
page 98

Leaders find transitions into new roles the most challenging times in their professional lives, when they either build credibility and create momentum or stumble and sow doubts about their effectiveness. Much attention has therefore been given to how they should take charge in their early days—but far too little to how the organization should set them up for success from the start. Failure to announce appointments in the right way can undo all the work that went into the selection and hobble even the strongest leader from the start.

When someone unexpected is chosen, the transition can set off an emotional storm. To avoid a bad start, the leader who made the selection, his or her HR partner, and the communications, investor relations, and legal professionals who advise them must provide good answers to four fundamental questions: (1) What message is this appointment meant to convey? (2) Why is this person the right one for the job? (3) Which members of the organization need to be informed? (4) What should they be told and when?

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MARKETING

Creativity in Advertising: When It Works and When It Doesn't

Werner Reinartz and Peter Saffert
page 106

Do highly creative ads really inspire people to buy products? Studies have found that creative messages get more attention and lead to positive attitudes about the products, but there's little evidence linking those messages to purchase behavior. To address this gap, Reinartz and Saffert developed a consumer survey approach that measures perceived creativity along five dimensions—originality, flexibility, elaboration, synthesis, and artistic value—and applied the approach in a study of 437 TV ad campaigns for 90 fast-moving consumer goods brands in Germany. The study then linked the assessments to sales figures for the products.

The findings confirm that creative campaigns are, in general, more effective than other types of ads. The research also shows that the various creativity dimensions deliver different results. Elaboration, for instance, had a far more powerful effect on sales than did originality, a more commonly used dimension. Indeed, many companies focus on the wrong dimensions in their campaigns. This article reveals which product categories are best suited to creative advertising and which dimensions of creativity have the most influence on sales.

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How I Did It

LEADERSHIP

Honeywell's CEO on How He Avoided Layoffs

David Cote | page 43

When Cote arrived at Honeywell, in 2002, the company had gone through three CEOs in four years. It had repeatedly missed earnings, and it had environmental liabilities that had never been dealt with. Virtually no pipeline of new products existed, because managers had been disinvesting to boost profits. Over the next five years he worked to fix many of those problems, and by the end of 2007 the company's credibility had been reestablished with investors and its share price had more than doubled. Then the recession hit.

Cote's view was that any restructuring Honeywell did in response should be what was best for business efficiency and profitability over the long term—not solely a reaction to the recession—and should have no impact on the company's ability to outperform in recovery. The leadership team settled on furloughs, and this is the story of how they worked.

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Managing Yourself

How to Give a Killer Presentation

Chris Anderson | page 121

For more than 30 years, the TED conference series has presented enlightening talks that people enjoy watching. In this article, Anderson, TED's curator, shares five keys to great presentations:

- Frame your story (figure out where to start and where to end).
- Plan your delivery (decide whether to memorize your speech word for word or develop bullet points and then rehearse it—over and over).
- Work on stage presence (but remember that your story matters more than how you stand or whether you're visibly nervous).
- Plan the multimedia (whatever you do, don't read from PowerPoint slides).
- Put it together (play to your strengths and be authentic).

According to Anderson, presentations rise or fall on the quality of the idea, the narrative, and the passion of the speaker. It's about substance—not style. In fact, it's fairly easy to "coach out" the problems in a talk, but there's no way to "coach in" the basic story—the presenter has to have the raw material. So if your thinking is not there yet, he advises, decline that invitation to speak. Instead, keep working until you have an idea that's worth sharing.

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THE GLOBE

L'Oréal Masters Multiculturalism

Hae-Jung Hong and Yves Doz | page 114

As the cosmetics company L'Oréal has transformed itself from a very French business into a global leader, it has grappled with the tension that's at the heart of every global enterprise: Achieving economies of scale and scope requires some uniformity and integration of activities across markets. However, serving regional and national markets requires the adaptation of products, services, and business models to local conditions.

Since the late 1990s, the L'Oréal Paris brand—which accounts for half the sales of the consumer products division—has dealt with that tension by nurturing a pool of managers with mixed cultural backgrounds, placing them at the center of knowledge-based interactions in the company's most critical activity: new-product development.

L'Oréal Paris builds product development teams around these managers, who, by virtue of their upbringing and experiences, have gained familiarity with the norms and behaviors of multiple cultures and can switch easily among them. They are uniquely qualified to play several crucial roles: spotting new-product opportunities, facilitating communication across cultural boundaries, assimilating newcomers, and serving as a cultural buffer between executives and their direct reports and between subsidiaries and headquarters.

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Harvard Business Review

Life's Work

PHOTOGRAPHY: TRACY WILCOX/GOLFWEEK

Arnold Palmer

Arnold Palmer won more than 100 amateur and professional golf tournaments by relying on the skills that his father, a greenkeeper, had taught him. Charismatic yet humble, and a risk taker on the course, he leveraged his popularity with fans into business success, paving the way for future generations of celebrity athletes. *Interviewed by Alison Beard*

HBR: You've described golf as precise yet unpredictable. How does one develop a strategy for winning in a game like that?

Palmer: The most important thing is to establish a system you have confidence in and rely on it when you get into tough situations. I'm talking about techniques, the fundamentals of the game that you've practiced all your life. When you run into a tight spot, a situation so complicated that you're not sure of the way out, that's when you fall back on your system to take you where you want to go. I used my system in each and every game of golf I played. I didn't believe in changing. I stuck to what I knew and had practiced, and I depended on it.

Most players today use coaches. Were you ever tempted to hire one?

I'm probably the least in favor of all the instructional gurus out there helping the young players. Everybody's got a system they think is the best, and there are so many you can't count 'em. But I always found that depending on my own system, my own ability to manufacture what I needed, was what carried me through. My father, who taught me to drive a tractor and cut fairways at Latrobe Country Club, told me that I could start talking to coaches and listening to all the advice they'd give me about my game—or I could play my own way. Regardless, I could always come back home and drive that tractor.

You've had many big wins but also some painful losses. How did you cope with the latter?

When I lost, I always learned something to help me in the next situation. I used that to take away the insult. One time at Augusta, I was going into the last hole with a one-shot lead to win the Masters, and a friend from the gallery hollered at me, so I walked over and accepted congratulations. And then I proceeded to make six on the hole and lose. My father had warned me about that. I was told all my life not to accept congratulations until it's over.

You've said that a lack of confidence can turn a good putter into a poor one. How does one regain confidence?

Number one, tell yourself you can do it. But it also helps to have someone who's an expert tell you not what to do but that you're good at what you do.

You were one of the first athlete-entrepreneurs to endorse brands and invest in real estate developments. How did you manage that transition?

When I started, I was trying to do anything I could to be successful. But most of the brands I endorsed were ones I used myself. I take some pride in my common sense, and I try to conduct my business dealings with that. I've always surrounded myself with people who are more intelligent or more familiar with a particular situation than I am. And I accept their advice.

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