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January–February 2021

When to Work with Rivals

Sometimes you need to join forces with your fiercest competitors. 48


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DEPARTMENTS

> ***"We're a 160-year-old company that aims to be around for another 160."***
> –DEANNA MULLIGAN

Photograph by **KHOLOOD EID**


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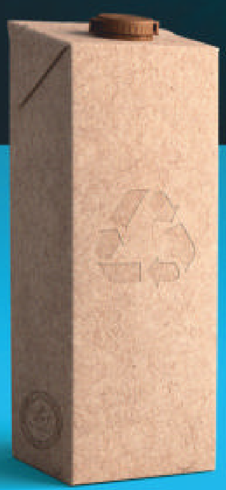
food packaging were carbon-neutral?



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Rivals and Friends

Clockwise from the top left: Adi Ignatius, guest Walter Isaacson, Octavia Goredema, and Josh Macht

WHEN THE WORLD went into lockdown last spring, my colleague Josh Macht and I decided to launch a series of live video interviews with experts who could offer perspective on these strange days. We called it *HBR Quarantined,* and to distribute it we made an unusual choice to partner with LinkedIn.

LinkedIn is best known as a professional networking site, but it also publishes articles on management topics—competing with us for readers. At the same time, HBR has 11 million followers on LinkedIn, which drives traffic to our site. Is LinkedIn our friend, our rival, or both?

We ask ourselves a similar question whenever we run articles by authors who write books for other business publishers, or partner with competing media organizations on events. We bet this question comes up in your business, too. Under what circumstances does it make sense to team up with a competitor?

More than 20 years ago, Adam Brandenburger and Barry Nalebuff coined a word to describe these sometimes awkward partnerships: *co-opetition.* In “The Rules of Co-opetition” (page 48), they offer principles for making deals with rivals.

Done right, co-opetition works out well for both parties. Our first season of *HBR Quarantined* attracted nearly 800,000 viewers; in October we renamed it *HBR Now;* added a cohost, Twenty Ten’s Octavia Goredema; and scheduled 11 more episodes. You can find them at hbr.org/video.

This issue also marks a milestone: Two colleagues, executive editor Sarah Cliffe and senior editor Gardiner Morse, are leaving HBR after a combined 40 years of service. If you’re a longtime reader, you’ve probably profited from some of the articles they’ve brought to life. Please join us in expressing gratitude to them.

ADI IGNATIUS
Editor in chief

Contributors

Working in the tropics to help brands source sustainably, **Tensie Whelan** (then president of the Rainforest Alliance) had an aha moment. An insurance broker told her that he'd decided to give coffee brands certified by her organization a "sustainability" discount, because the rigorous tracking the certification required often reduced theft during transport. Now the director of NYU's Center for Sustainable Business, she focuses on developing financial tools to help companies measure return on sustainability investments, the subject of her article in this issue.

86 How to Talk to Your CFO About Sustainability

Colin M. Fisher has been fascinated by how people make sense of real-time group interaction since his days as a professional jazz trumpet player (most notably with the Grammy-nominated Either/Orchestra). Inspired by a question about how team leaders can learn to act with good timing, he has been studying processes underlying leadership and group dynamics for more than a decade. As an associate professor at University College London School of Management, he studies how teams can foster creativity, improvisation, and effective decision-making.

123 How to Help (Without Micromanaging)

Early in her career, **Jessica Rodell,** a professor of management at the University of Georgia, worked in the nonprofit sector, where she often acted as a liaison between charitable organizations and local corporations. Some companies she worked with had high levels of staff enthusiasm and made a significant impact; others just seemed to be going through the motions. That disparity drove her to focus her research on the pitfalls of and best practices for corporate volunteering initiatives. She shares her findings in her article in this issue.

94 Volunteer Programs That Employees Can Get Excited About

Whenever his research led **Lucian A. Bebchuk** to conclude that shareholder rights and investor oversight should be strengthened, he encountered warnings: Any move in that direction would induce detrimental short-termism. So over the past several years, Bebchuk, a professor of law, economics, and finance at Harvard Law School and the founding director of its Program on Corporate Governance, set out to test the validity of such claims. In this issue, he explains why the policy prescriptions of short-termism worriers should be rejected.

42 Don't Let the Short-Termism Bogeyman Scare You

Los Angeles–based photographer **Tierney Gearon**'s photos of her children capture the complexity that can arise when rivals collaborate. The images accompanying Adam Brandenburger and Barry Nalebuff's article on co-opetition in this issue first appeared in *Alphabet Book,* published in 2013. "I wanted to create images that made children think when they looked at them," Gearon says. "I wanted to provide a thought, a feeling, a story, or a conversation." What's the secret to capturing imaginative images of your own children? "Time, effort, and patience," she says.

48 The Rules of Co-opetition

Harvard Business Review

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IdeaWatch

New Research and Emerging Insights

IN THEORY

WHY ROOKIE CEOs OUTPERFORM

Experienced executives rely too much on old playbooks.

WHEN SEEKING THE best CEO candidate, boards might begin with lofty goals. But directors recognize that a botched succession could hurt their reputations (not to mention their shareholders), so in many cases they end up focusing not only on the upside potential of a candidate but also on the downside risk, asking: Who is the safest choice? Who is least

Illustrations by TIM BOWER

likely to fail? And their answer is often the candidate with prior experience in the top job. In fact, the share of newly hired CEOs who previously held the role has quadrupled since 1997 and now stands at 16%.

In most endeavors, experience is a good thing. But new research from the executive recruiting and leadership advisory firm Spencer Stuart finds that for CEOs, it often carries surprising costs. In a study of 855 S&P 500 CEOs appointed over a 20-year period, the researchers found that those with experience in the role consistently underperformed their novice counterparts over the medium to long term. First-timers led their companies to higher market-adjusted total shareholder returns, with less volatility in the stock price. Among CEOs who headed two successive companies, 70% performed better the first time—and for more than 60%, their second companies failed to keep pace with the overall stock market.

Why do so many seasoned leaders lag? Having interviewed 50 directors and CEOs, the research team believes it happens because they fall back on the playbook from their last job, become overly concerned with cost-cutting, and are less adaptable than rookies, who tend to pay more attention to top-line growth. “First-time CEOs’ longer-term orientation and more balanced focus between profitability and revenue growth is reflected in their performance,” the researchers write. “Even in challenged companies, first-timers attempt to lead through a mix of growth and return on capital.” Rookies are also likely to stay in the role longer (nine years, on average) than experienced CEOs (six years), in part because they are generally younger.

Some of the difference in performance, the researchers explain, has to do with mindset. “In many ways, these results are not surprising,” says Cathy Anterasian, who coleads Spencer Stuart’s North American CEO Succession Services group. “We’ve been talking with boards over the past decade about the importance of curiosity, adaptability, flexibility, and the ability to confront problems with fresh eyes rather than with rules of thumb.” First-time CEOs, she says, are more likely to approach problems in this manner.

Experienced CEOs did display some advantages, including wider access to external resources and to talent and other critical relationships. “There’s also a speed component,” says Claudius Hildebrand, Spencer Stuart’s CEO data and analytics head. One two-time CEO reported that he accomplished as much in the first two years of his second stint as he did in the five years of his first stint. And although the research suggests that repeat CEOs focus too

much on cost-cutting, their recognition of the importance of short-term results can be a plus. "Experienced CEOs know how to deliver value to shareholders and the Street, how to free up resources to fund what they may want to do next, and how to get some quick wins," Anterasian says. In addition, she and Hildebrand point out, when a company is in trouble, the board may prefer an outside hire with a track record to an untested internal successor—so some of the performance differences may reflect the fact that experienced CEOs often face more-challenging circumstances.

Even leaving performance aside, there's a troubling downside to relying on existing CEOs. The overwhelming majority of people helming large companies are white men: Just 6% of the CEOs of S&P 500 companies are women, and only 10% are ethnic or racial minorities. So when recruiters looking to fill a CEO job focus on that pool, they are perpetuating the lack of diversity in the C-suite. The preference for experienced chief executives, the researchers write, "represents yet another barrier to underrepresented groups."

How can boards use these findings when planning succession? Before homing in on specific candidates, they should be clear about what challenges the incoming leader will confront and what his or her priorities should be. If the company would benefit most from a shorter-term leader who's skilled at cost-cutting and creating quick wins that will please financial markets, an experienced CEO may be the better pick. But if revenue growth and a longer-term orientation are key concerns, someone new to the role may be more appropriate—and if boards *are* considering an experienced candidate in this sort of situation, they should conduct "an explicit dialogue about the type of talent needed based on the desired outcomes and specific business context," the researchers say.

Boards should also assess how well candidates listen and whether they enjoy grappling with unfamiliar problems. When the research team interviewed CEOs who had succeeded in both their first and their second assignments, it learned that these executives were careful not to assume they knew all the answers the second time around. Rather than try to run the same plays again, they asked questions and explored what was different about circumstances in their new companies.

"With this research, we hope to shift the default," Hildebrand says. Instead of presuming that experienced CEOs inherently have better qualifications than first-timers, boards should view them as having *different* qualifications—ones that might or might not mean superior performance.

And counterintuitive though it may seem, the researchers say that experience might be even less valuable during the current period of high uncertainty. "It's the old adage: 'What got you here may not get you there,'" Anterasian says. "During times like these, the ability to understand problems you haven't seen before becomes much more important."

HBR Reprint F2101A

ABOUT THE RESEARCH *"Predicting CEO Success: When Potential Outperforms Experience," by Claudius A. Hildebrand, Cathy Anterasian, and Jordan Brugg (white paper)*

IN PRACTICE

"Hunger Is Worth More Than Experience"

Before becoming CEO of Honeywell, in 2002, ***David Cote*** *headed the automotive and aerospace firm TRW for seven months—too short a stint, he says, to be a big factor in how he led Honeywell. But as he began preparing for retirement, in 2017, he thought extensively about what characteristics and experiences would increase his replacement's odds of success. (He shares those reflections in his recent book,* Winning Now, Winning Later.*) Cote spoke with HBR about the pros and cons of hiring a CEO with previous experience in the role. Edited excerpts follow.*

How should boards think about previous CEO experience when choosing a new leader?
In general, experience is overrated. Someone can have a bunch of different experiences but still not be a change agent. Experience can make directors feel more comfortable with a candidate, but the question is: Does he or she have the hunger to make a difference? When people start to lose that hunger, they don't investigate things as deeply. Hunger is worth a lot more than experience.

Are inexperienced CEOs more likely than others to be hungry?
If somebody has no real reputation yet, they're going to be more driven to succeed. When I became CEO of Honeywell, some commentators said they didn't know if the company could be turned around—and that even if it could be, they weren't sure I was the person to do it. They pointed out that I wasn't Honeywell's first choice for the job. Those comments just increased my hunger.

Were you surprised by the finding that previous CEO experience can hurt performance?
I'd phrase it a little differently. Any leader needs to be open to all facts and opinions, recognizing that he or she will never know everything. Making an educated decision is like making a mosaic—you're putting all the pieces together to form a picture. An experienced CEO might say, "I've seen all this before, so I know what to do." That can get in the way of soliciting all the facts and really listening to what people have to say. As the leader, it's your job to be right at the end of a meeting, not at the beginning of it. Sometimes experience can be a detriment.

Do you agree that experienced CEOs tend to focus more on cutting costs and improving margins and less on growth?
I get frustrated by the implication that leaders have to focus either on growth or on productivity. Success is about doing both things at the same time. That's what we did at Honeywell: By boosting productivity, we created the income flexibility to allow us to perform well in the short term and also to invest in long-term growth.

Inexperienced CEOs tend to be younger. Is that an advantage?
None of us want to be sexist or racist or ageist. But when considering who should succeed me at Honeywell, I thought it important to find somebody who could stay in the job for at least 10 years. If you're in the CEO role for only three to five years, it can be hard to change the culture and get it focused the way you want to, especially in a large organization. So being young enough to have a long tenure was part of our criteria.

What other factors do boards weigh incorrectly?
It can be really seductive to try to determine what the future will be and then choose someone suited to that vision. That's usually spurious reasoning. Who could have predicted Covid, or 9/11, or the Iraq War? Nobody knows the future. It's more important to hire somebody who can figure things out.

Redux

Photograph by MATT FURMAN

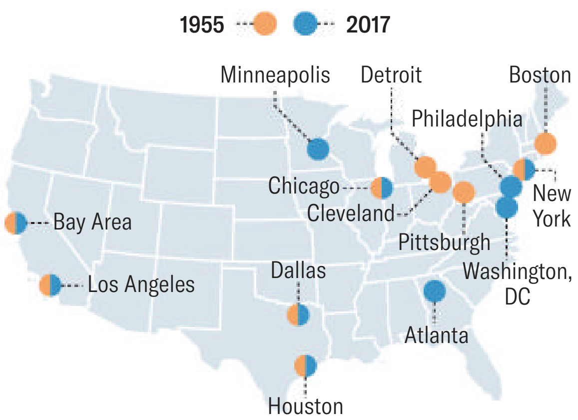
IdeaWatch

CORPORATIONS

HQ, Then and Now

Location is a key part of corporate strategy—and big shifts have taken place since the 1950s, when industrial firms tended to cluster in the Midwest for easy access to labor, raw materials, and factories. With the rise of knowledge-based companies, the need to attract highly skilled talent has skewed companies toward "superstar" cities and leading tech hubs instead.

Metro areas with the greatest number of *Fortune* 500 headquarters



Biggest increase in the number of *Fortune* 500 headquarters

Metro area	1955	2017	Change
Denver	2	10	+400%
Seattle	2	10	+400%
San Antonio	1	5	+400%
Washington, DC	4	17	+325%
Bay Area	13	52	+300%

Biggest decrease in the number of *Fortune* 500 headquarters

Metro area	1955	2017	Change
Milwaukee	11	7	–36%
Detroit	16	10	–38%
Charlotte	11	6	–45%
Pittsburgh	13	6	–54%
Cleveland	18	5	–72%

Source: "Geography as Strategy: The Changing Geography of Corporate Headquarters in Post-Industrial Capitalism," by Patrick Adler and Richard Florida

CUSTOMER RELATIONS

Honesty Really Is the Best Policy

Conventional wisdom and common practice alike suggest that it's usually wise to highlight the advantages of an offering and gloss over any downsides—but a new study casts doubt on that strategy.

The researchers conducted a field experiment involving 389,611 consumers considering a credit card with the Commonwealth Bank of Australia. Over a five-month period, the bank presented website visitors with one of two sales pitches: one that emphasized only a card's benefits, in accordance with usual marketing practices, and one that also prominently featured potential drawbacks (high annual fees or additional charges for overseas transactions, for instance—the sorts of things that must legally be disclosed but are normally buried in fine print). After customers signed up for and activated their cards, the researchers tracked their spending for nine months. Those for whom their card's downsides had been highlighted spent 10% more each month, on average, than others. Their cancellation rate was 21% lower, and they were 11% less likely to make late payments. Improvements were greatest among customers over the age of 28, who presumably had more experience with credit cards and could make better use of the highlighted information.

The researchers can't definitively explain their findings, but they hypothesize that having information about trade-offs prominently displayed enabled people to select a card that was well-suited to their needs, improving their experience and averting surprises. They note that the greater transparency did not diminish sign-up rates, although the two groups of customers chose different cards. "The costs of being fully open with prospective customers that many managers perceive...may be misplaced," the researchers write.

ABOUT THE RESEARCH *"Improving Customer Compatibility with Operational Transparency," by Ryan W. Buell and MoonSoo Choi (working paper)*

BANKRUPTCY

Which Companies Will Make It?

The value of U.S. public firms' assets under bankruptcy protection has surged in recent months and now stands at its highest level in a quarter century. Whether or not companies go under is of critical importance not just to the companies themselves but also to their suppliers, partners, and other stakeholders. A new study suggests a novel way to help those stakeholders assess the odds of survival.

Given that advertising and R&D increase a firm's expected future cash flow, it might seem that above-average investments in those activities would boost the chances of surviving a Chapter 11 filing. But they also increase the value of assets awarded to creditors should the firm be liquidated, presumably exerting

AFTER YOU!

Investors judging entrepreneurial competitions consistently gave the first two pitches lower ratings than they gave to subsequent pitches, even though the entrepreneurs were sequestered and could not benefit by observing judges' reactions to their predecessors.

"In Pitch Contests, Going First Is a Disadvantage," by Scott Shane, David Clingingsmith, and Mark A. Conley

pressure in that direction. The researcher decided to explore this tension from the perspective of the main creditors whose votes influence the bankruptcy court's determination: suppliers and banks. He reasoned that the two groups have competing interests. Above-average advertising and R&D expenditures should make suppliers more willing to accept a firm's reorganization plan and allow business to continue, because the survival of a customer helps protect their future revenue. But banks earn revenue from business customers primarily by issuing collateralized loans and collecting the interest, and they are given priority when a company is liquidated—so hefty advertising and R&D spending should incline them to vote for liquidation, because it means they are likely to be repaid in full.

The outcome, the researcher theorized, would ultimately be affected by how much influence suppliers have: If they hold enough of the firm's debt to make large concessions to creditor banks when negotiating the debt reorganization plan—perhaps allowing the bank loans to be paid off immediately—they can persuade the banks to approve the plan and let the firm carry on. If they don't, the bank is unlikely to agree to the plan, and the court will probably deny it.

An analysis of 1,672 bankruptcies filed from 1996 to 2019 confirmed this theory and allowed the researcher to identify some dividing lines. High levels of advertising increased bankruptcy survival when suppliers held at least 35% of the firm's debt; below that point, they decreased survival rates. Similarly, high levels of R&D spending increased survival when suppliers held at least 18% of the firm's debt; below that point, they decreased survival rates. Stakeholders "can improve their ability to predict whether their customer or partner will survive bankruptcy by considering the firm's advertising, R&D, and suppliers' influence, in addition to the usual financial predictors," the researcher writes.

ABOUT THE RESEARCH *"The Impact of Advertising and R&D on Bankruptcy Survival: A Double-Edged Sword," by Niket Jindal* (*Journal of Marketing*, *2020)*

TEAMS

The Downside of Creative Superstars

It stands to reason that a creative star would bolster team creativity. But new research suggests that the picture is more complicated than that.

The researchers surveyed 676 members of R&D teams in 23 Chinese firms and 457 members of sales teams in two Chinese customer-service companies and collected information from the teams' managers. From this they identified each team's creative star or stars; they also measured overall team creativity, coordination, and learning activities and examined the star's role on the team. The more central that stars were to their team's workflow, the greater the direct boost to overall creativity—but nonstars' learning took a hit. When teammates depend on a star for key information or material, they may feel less urgency about contributing themselves, making them less likely to pursue relevant knowledge or explore other perspectives, the researchers explain. There was a mitigating factor: A high level of team coordination lessened the inhibitory effect on nonstars' learning.

IdeaWatch

"Solely focusing on the most talented individuals...is likely an unwise practice when trying to promote creative processes," the researchers warn. "Managers should strive to promote efficient team coordination, thereby relieving some of the burden placed on centrally located stars."

ABOUT THE RESEARCH *"The Boon and Bane of Creative 'Stars': A Social Network Exploration of How and When Team Creativity Is (and Is Not) Driven by a Star Teammate," by Yuan Li et al.* (Academy of Management Journal, *2020)*

OPERATIONS

A Better Way to Manage Virtual Queues

Virtual lines are nothing new, but social-distancing requirements have accelerated their adoption in novel contexts, from retail stores to day care centers. Because people waiting can't see the line and how quickly it is—or isn't—moving, companies often provide information about the likely time remaining and issue periodic updates. Balancing the need for reasonably accurate estimates with the goal of keeping people from abandoning the line can be a challenge, but a new study offers some guidance.

The researchers conducted a field experiment with a global ride-sharing firm, focusing on its operations in one city over four weeks in 2018. During busy periods, the firm places customers in virtual queues before matching them with a driver, provides an estimate of their wait time, and notifies them whenever it drops by a minute. The customers in the experiment were randomly divided into three groups. One received a neutral estimate of the wait time, one received an optimistic estimate, and one received a pessimistic estimate. All estimates were within the range predicted by the platform's algorithm; actual wait times did not vary.

The researchers then studied what happened. Significantly pessimistic estimates (at least two minutes over neutral ones) caused large numbers of people to drop out—but slightly pessimistic estimates (a minute over) did not. By definition, customers receiving them got more-frequent updates for any given wait time than customers who received shorter initial estimates, creating a sense of progress that encouraged them to remain in line.

Slightly optimistic estimates made no difference to dropout rates, while more-optimistic ones kept more people in line. Still, managers should avoid overly optimistic estimates, the researchers write; although those may reduce abandonment, they may also "lead to bad customer experiences when customers get stuck on 'the last minute' for too long." Slightly pessimistic estimates can only be helpful, the researchers note; those don't cause people to give up and may provide a pleasant surprise. Indeed, the firm has since incorporated these insights—thus sharply reducing the share of customers who wait longer than initially estimated along with the share who experience delays near the end of their waits, without raising the overall abandonment rate.

ABOUT THE RESEARCH *"Delay Information in Virtual Queues: A Large-Scale Field Experiment on a Ride-Sharing Platform," by Qiuping Yu, Yiming Zhang, and Yong-Pin Zhou (working paper)*

IdeaWatch

FIRST IMPRESSIONS

“Just Be Yourself” Is Good Advice

People in high-stakes first encounters—interviewing for a job or seeking financial support, say—often try to cater to the interests and expectations of whomever they’re hoping to impress. A new study suggests that they’re hurting, not helping, their chances.

In a field experiment, the researchers studied the presentation styles and outcomes of 166 entrepreneurs competing for funding. After pitching, the founders indicated the extent to which they felt they had been authentic and the extent to which they had catered to what they thought the judges wanted to hear. Those who had catered were far less likely than others to win funding. A subsequent lab experiment involving a mock job interview found a similar pattern: Participants instructed to “be themselves” got higher ratings than those instructed to tailor their responses to what they perceived the interviewer’s expectations to be. Questioning the participants provided an explanation, which was bolstered by additional online experiments: “Catering harms performance because trying to anticipate and fulfill others’ preferences...increases anxiety,” the researchers write.

ABOUT THE RESEARCH *“To Be or Not to Be Your Authentic Self? Catering to Others’ Preferences Hinders Performance,” by Francesca Gino, Ovul Sezer, and Laura Huang* (Organizational Behavior and Human Decision Processes, *2020)*

MARKETING

A Boost for the Tried and True

In recent years U.S. consumers have migrated away from large national brands in favor of smaller, private-label foods. During the pandemic, that trend has been reversing. A new study suggests that deep-seated emotional responses to contagious disease are driving the shift.

Much research over the years has shown that people react to contagious disease with disgust and avoidance: They instinctively want to steer clear of the threat, and that impulse can cause them to shop less and consume less. But across two large empirical analyses and four experiments, the researchers showed that a second emotion—fear—is also activated, mediating the effects on consumption patterns. Analyzing data from 2009 through 2014 from the CDC, Google Flu Trends, and Nielsen consumer panels, they found that people bought more items when the incidence of influenza was high in their state, and they gravitated toward products that were familiar. If a household had historically favored a certain brand, that preference was more pronounced during spikes of flu. And on an aggregate level, sales of well-known national brands rose disproportionately during outbreaks, at the expense of less-familiar ones. Even less-familiar variations on well-known brands—tiramisu Oreos, say—took a hit.

The threat of contagion creates uncertainty and a sense of losing control, the researchers explain, and when trying to regain control, people seek out the trusted and familiar. The lab experiments showed that this response is specific to communicable diseases (subjects did not react this way when prompted to think about heart disease, for example) and that it also held for nonfood products, such as headphones. Marketing managers should take note not just during the pandemic but beyond. The researchers write: “If a product is novel, marketers might be better served promoting [it] in the summer months, when people are less likely to encounter contagious cues and are more receptive to novelty,” while for familiar products, the converse may be true.

ABOUT THE RESEARCH *“Disgusted and Afraid: Consumer Choices Under the Threat of Contagious Disease,” by Chelsea Galoni, Gregory S. Carpenter, and Hayagreeva Rao* (Journal of Consumer Research, *2020)*

A FEW HONEST WOMEN

Firms with a female CFO have, on average, a 2.6% lower Financial Statement Divergence score—a proxy for financial misreporting—than firms where a man fills that role.

"CFO Gender and Financial Statement Irregularities," by Vishal K. Gupta et al.

MOTIVATION

Why Underdogs Frequently Come Out on Top

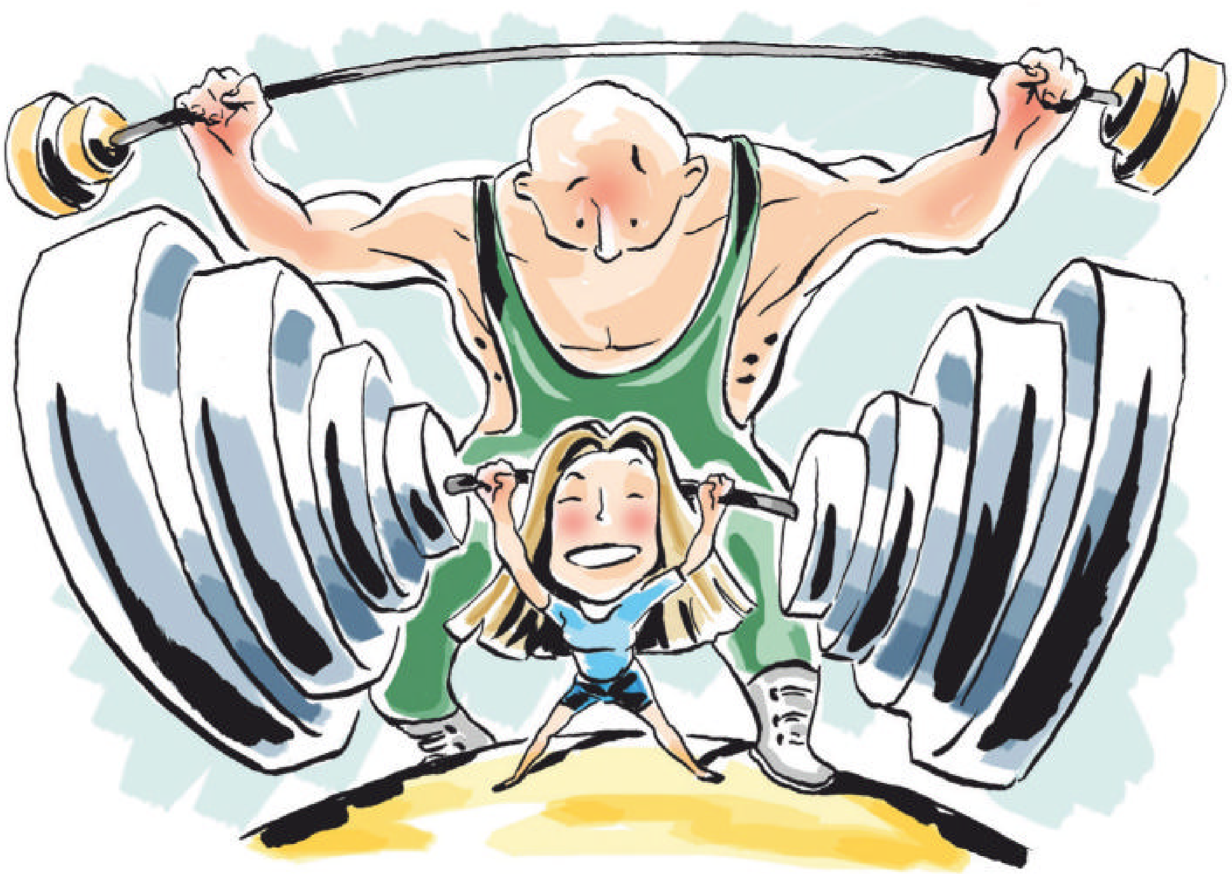
Sports and politics are replete with examples of people defying low expectations. A researcher wondered: What happens when ordinary employees believe they are not expected to succeed?

Across four studies, such employees generally outperformed others. In one study, employees of a consumer goods company who reported being seen as underdogs were more likely than others to get high marks from their supervisors several weeks later. In another, workers engaged in a computer task did best when told that observers had predicted poor results. A third study probed the reason for this pattern. In it, business school students told that observers expected them to flounder in a simulated negotiation did better than students led to think they would outperform others and students not primed with any expectations at all.

Questioning the participants afterward, the researcher learned that this happened because the underdogs wanted to prove the naysayers wrong. The fourth study—a variation on the computer-task experiment—found an important distinction: The desire to prove a critic wrong translated to better performance only when workers thought the critic was not credible (because they were told that he or she had done badly on the same task and had been inaccurate in predicting the performance of previous participants). Otherwise it backfired, causing anxiety that detracted from focus and attention.

"Framing low expectations as an opportunity to prove others wrong may have beneficial consequences for performance," the researcher writes, noting that it's important to undermine the validity of those expectations. "Managers [of underdog employees] may be able to show the ways in which observers lack credibility or point to prior instances in which their expectations have been incorrect."

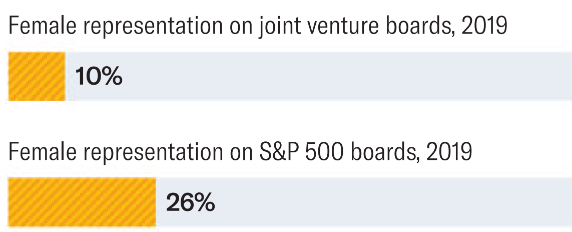
ABOUT THE RESEARCH *"The Underdog Effect: When Low Expectations Increase Performance," by Samir Nurmohamed* (Academy of Management Journal, *2020)*



DIVERSITY

A Yawning Gender Gap on Joint Venture Boards

Joint ventures are an increasingly important part of the economy—and a promising place for women to develop leadership and governance skills. But female representation on their boards remains scant, in part because they face far less public exposure than public company boards and are not subject to the same quotas and disclosure requirements.



Source: Water Street Partners, an Ankura Company (joint venture data) and Spencer Stuart Board Index (S&P 500 data); analysis by Molly Farber, James Bamford, and David Ernst

IdeaWatch

Andy Wu of Harvard Business School and his doctoral student Sourobh Ghosh embedded a field experiment in a Google hackathon to investigate the impact of stand-up meetings—a core component of agile management practices—on innovation. They found that the teams that engaged in them developed less-novel products. **The conclusion:**

Stand-up Meetings Inhibit Innovation

Professor Wu, DEFEND YOUR RESEARCH

WU: More and more companies are adopting agile practices in product development, but it isn't always clear why. There seems to be an assumption that agile is a cure-all for innovation. The study that Sourobh and I did, however, shows that one key element of the agile approach—regular stand-up meetings—is great for implementation but actually undermines idea generation.

HBR: So frequent stand-up meetings make people less innovative? The literature defines innovation as the combination of two factors: value—or usefulness for a specific customer—and novelty. We found that frequent stand-up meetings at the hackathon resulted in products that were rated by judges as more valuable but less novel. To be innovative, products must be both.

Why do you think that happened? Stand-up meetings encourage team members to coordinate their work at the cost of independently pursuing new ideas. Why? First, the meetings create a perception of deadlines—even if they aren't spelled out—which makes people focus on delivering something by a certain time rather than exploring less-well-defined and thus riskier and more-time-consuming opportunities. Second, in the stand-up format the team explicitly states its goals, which refocuses the energy on those targets and doesn't leave members feeling open to searching for other avenues. Third, novel ideas often bubble up when individuals think deeply about their particular areas of expertise, and stand-up meetings tend to keep people focused on work that is easier to integrate with the team's, so they don't leverage their specializations as much.

What about other agile practices? Is it just stand-ups we need to worry about? I'd say stand-ups are fairly representative of other practices and frameworks that derive from the agile approach, like scrum and kanban. They all focus on coordination around shared goals, so I suspect that they'd have a similarly detrimental effect on new-idea generation.

What should managers using agile do to encourage their teams to be more innovative? The short answer is: Have fewer meetings! Just let people work on their own and dig really deep into the problem at hand. Don't be afraid they'll fall down rabbit holes, because that's where real innovation often comes from.

Too many managers act as though company leadership is the main source of creativity. In my experience it's the engineers and designers at the middle and the bottom that come up with the best ideas. Bill Gates had to be told by his subordinates that the internet was worth his attention, for example.

But implementation is important too. How do you keep people on track without dampening their creativity? It's not either/or. You just need to be intentional about which you want to emphasize now. To shift the focus of stand-up meetings, managers can pull two levers: frequency and content. If you want more novelty, have fewer meetings and keep them short. If your priority is implementing existing ideas, greater coordination from more-regular meetings can be helpful. As for meeting content, a discussion of goals focuses people on implementing old ideas rather than on coming up with new ones. So if you don't talk about goals, you open the door to more creativity. Say you're a tech company trying to develop a completely new category of product. A lot of agile meetings could get in your way; it would be better to just have your engineers follow their individual inclinations and explore randomly.

On the other hand, you have companies like Microsoft or Facebook that frequently generate lots of new ideas at internal hackathons, but it's tough to turn them into products that make it to market. That's where agile can really help. Logitech CEO Bracken Darrell has told me that reorganizing his company around agile management really paid off. My view is that it worked because the firm had clear goals to achieve. For example, when it wanted to improve its presentation clicker to make it easier to see the laser pointer on large screens, it came up with the idea of adding motion tracking to the clicker and combining it with software to render a virtual "spotlight" on the screen. For that kind of bounded, straightforward problem, bringing in agile practices to get your engineers and designers to execute is effective.

You studied a software hackathon. How is that different from a real work environment? The hackathon setup is actually very similar to how a lot of real-world engineering work gets done. In fact, a number of successful start-ups have come out of hackathons just like the one we studied. The teams were similar in size to engineering or product design teams in real companies, and they built real software applications. The main difference was that the hackathon teams didn't have to worry about integrating their products with other functions like compliance, billing, marketing, and customer support.

Another advantage of doing the experiment at a hackathon was that we were able to observe the development process at an incredibly granular level. Instead of just rating the end products, we could see how teams coordinated and came up with new ideas in real time by tracking their activity in GitHub. We saw exactly when individuals leveraged specialized skills by adding advanced artificial intelligence or cloud-based tools. We also saw that after each stand-up, engineers would start merging their code, indicating a focus on integration rather than on new ideas.

How do your findings apply to other industries, like hardware, or to creative projects, like music or art? Agile practices have been less common with hardware because it tends to take a lot longer to develop, which makes the constant check-ins and adjustments associated with agile more costly. In hardware, "waterfall" practices—a hierarchical, linear approach—traditionally make sense. But a lot of recent advances in hardware have actually been software-based, as we saw with Logitech's clicker. So agile is worth thinking about even if your business has offered only hardware products.

As far as creative projects go, the research suggests that agile practices aren't your best bet. If you're working with a group to develop a screenplay or a song, it's better to let people go at it independently. Of course, it also depends on the nature of the project. If you're working on a complex production with lots of moving parts, stand-up meetings might be very effective for coordinating sound engineers, writers, artists, and so on.

Does culture matter? You studied a tech environment in the United States. Would your findings be different in other countries or in nontech workplaces? Local culture is absolutely an important factor. American culture can be more individualistic and put less emphasis on authority and following rules. In more-collectivist cultures, agile might inhibit innovation more, since people would probably feel greater pressure to adhere to the group goals discussed in stand-up meetings. Another dimension of national and organizational culture is the extent to which employees are trusted to work hard without supervision. The coordination provided by agile is one way to monitor employees, but that might not be necessary for all organizations.

That's especially relevant now, since so many people are working remotely in the pandemic. Definitely. The shift away from offices has led to less constant coordination and more independent work. The employees that gained time and autonomy from going remote can focus more on their own ideas (with the major caveat that many may have less time now because of child care and other needs). Twitter CEO Jack Dorsey noticed in 2018 that he was more focused and creative when working at home, and he just allowed Twitter employees to work from home indefinitely. In my recent research it appears that virtual meetings, adopted during the pandemic, generate less accountability toward shared goals than in-person meetings do, suggesting that they may not have as much of a negative impact on creativity.

Ultimately, what we're all seeing is that you can't plan out novelty. All these companies are looking at Google, Facebook, and hip tech start-ups and saying, "They're innovative, and they use agile, so we should too." But that's not what agile actually delivers.

Interview by **Dagny Dukach**

HBR Reprint F2101B

THE FORMER CEO OF GUARDIAN ON USING VALUES TO DRIVE STRATEGIC PLANNING

by Deanna Mulligan

WHEN HURRICANE SANDY hit the mid-Atlantic coast, in October 2012, I was at my home in Westchester County, New York. It's an old house, surrounded by old trees, so as the rain battered my windows and the wind shook the walls, I took shelter with my dog under a center-hall desk. But I was less worried about myself than about the thousands of Guardian employees who live across New Jersey and New York, within commuting distance of our Lower Manhattan headquarters. I had become CEO of the insurance company—which offers life, disability, and dental policies and administers family and medical leave—just over a year before. How would we help our people and our company get through this?

Photograph by KHOLOOD EID

Because the electricity had gone out, I listened for the news on a crank radio. The reports of damage and distress were deeply concerning. I prayed for everyone's safety. And then, after the storm had passed, we got to work.

Somehow we managed to pull together a small crisis-management team. We learned that our main office in Manhattan had been wrecked. We'd lost phone service; five feet of water flooded the lobby; and we were told that we wouldn't be able to get back in for several months. Fortunately, we had a satellite office in Stamford, Connecticut, that was miraculously still up and running. We printed out lists of employees and began calling their phone numbers. We were determined to make sure that everyone was OK.

Two days later all our team members had been accounted for. To find the last few, dedicated Guardian employees had driven to their homes. For those whose properties were now uninhabitable, we rented hotel rooms. For those without power, we delivered generators; when they sold out locally, the head of human resources drove to Maine to buy more. The leadership team also activated our corporate social responsibility function to create a fund to cover employees' hurricane-related costs—whatever people needed to get back on their feet. Some used the money for home repairs; others used it to replace damaged goods. One employee who lost a relative in the storm paid for other family members to fly in and help with the funeral planning.

Of course, we wanted to get Guardian up and running again. But we knew that people couldn't work unless they felt that they and their families were safe and secure.

Our next task was to find a temporary headquarters. Our head of real estate at the time located a space and suggested that we lease it until December. Many of us suspected that we'd need it longer than that. The infrastructure under the streets of Lower Manhattan is more than 100 years old and, we later learned, riddled with asbestos. It would be nine months before we could return to our headquarters. I'm thankful we ended up pushing for a yearlong rental.

Once we were settled in that temporary space, with our employees cared for and back on the job, the leadership team knew exactly what our priorities should be. A crisis like that crystallizes your thinking. I knew that Guardian's employee- and customer-focused culture is strong and something we all wanted to build on. It was clear that we needed to be better prepared for the next disaster—and our digital future—by migrating all our data and work processes to the cloud and becoming location-independent. And we committed ourselves—and our company—to staying ahead of the curve in other areas, from diversity, equity, and inclusion to globalization to the gig economy.

I've always been a planner by nature. But my experience leading Guardian through Hurricane Sandy taught me to start thinking even longer term: What were all the things that could go wrong, and how could we protect ourselves from them? Also, what could go *right* if we were poised to seize the opportunities presented?

This mindset served us well through my almost decade-long tenure as CEO. In that time we increased our end user base from 5 million to 29 million, doubled our workforce to 9,500, logged 10 consecutive years of growth in assets under management to hit nearly $80 billion, and more than doubled our pretax operating income. More important, our most recent engagement surveys, taken during the height of the Covid-19 crisis, show a customer satisfaction score of 89%, while 86% of our employees say they would recommend Guardian as a great place to work. Those figures are well above industry and national benchmarks. We're a 160-year-old company that aims to be around for another 160. We are preparing for that future in the present.

FINDING MY CALLING

I grew up in a small town in Nebraska that had been settled by some of my pioneering ancestors. My parents raised my sister and me to appreciate our family and community, but they also expected us to focus on our education and eventually move away and do big things. They ran a small business, with my mother handling the finances, and she constantly encouraged us to focus on math and science. She used to walk around in the house saying, "Math is easy. Math is fun." One time, when I complained about chemistry class, she shut me down by reciting the periodic table from memory.

My parents also talked to me about business. When the Nixon administration was instituting wage-price controls, my father gave a lecture on supply and demand at the dinner table. My mother explained the importance of being properly insured. Sometimes I think I learned more at home than at school; that's where many concepts were made real.

I attended the University of Nebraska as a National Merit Scholar and found that of all my classes, statistics most resonated with me. After graduation I put those skills to work at an insurance company and then, two years later, enrolled at Stanford's business school. It might sound odd, but I loved insurance—the stats, the modeling, the analytics, and, to top it all off, helping people feel protected and get through the worst moments of their lives. So, as a newly minted MBA, I joined New York Life Insurance for two years and then decamped to McKinsey's financial services group, with a focus on insurance, where I stayed for nine years. In 2000 I left for an internet start-up that, like many dot-coms of that era, didn't survive; but I landed, happily, at the French insurance company AXA.

The year 2001 was one of crises and family emergencies as well as the 9/11 attacks. Like so many other New Yorkers, I decided to take some time off to be with my family. After a while, however, I started my own consultancy. One of my clients was Guardian, a purpose-driven, policyholder-owned, employee-centric company that I greatly admired. Although going back into a corporate job was not part of my plan, the executive team eventually talked me into joining the organization. Within two years I was named chief operating officer, and in 2010 the board offered me the position of CEO. My initial reaction was reluctance, but my husband, Steve, asked me a pointed question that shifted my thinking. He said, "You love this company, its culture, and its people. Who is going to take better care of them than you?" A short time later I accepted the position. I was all in.

FUTURE-PROOFING OUR BUSINESS

Guardian has three central values: We do the right thing. People count. And we hold ourselves to very high standards. As the company's new leader in 2011, I wanted to see just how far the team could take that culture.

Technology was now a top priority for us. It was time to move into a new era and better serve modern-day customers. The damage wrought by Sandy was an impetus to accelerate our efforts and rebuild much better. In 2013 we hired a new chief information officer and head of operations, Dean Del Vecchio, and gave him the location-independence mandate. Together, with tremendous support from the board, we vowed that our operations would never be shut down by another crisis. A pandemic was already on our minds, because regulators require life insurers to address such scenarios in routine financial stress tests. But this wasn't just about the financial impact; it was about our employees and customers. We didn't want to be telling frontline workers to get back to the office when a virus was running rampant, nor did we want any policyholders to experience delays in our response to them.

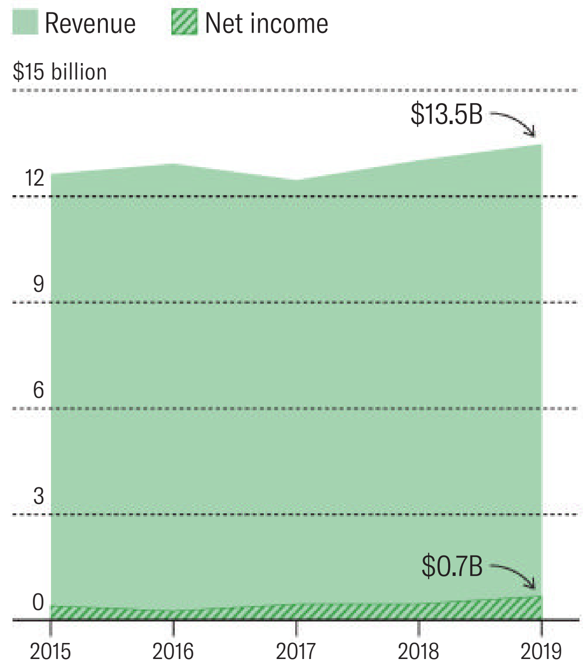
Our ambitions were big and expensive. We migrated many of our applications to the cloud and modernized our employee productivity tools. We hired new technology talent while also reskilling existing employees, a process I wrote about in my book, *Hire Purpose: How Smart Companies Can Close the Skills Gap.* We needed to move fast, but we didn't want to leave any willing and engaged employees behind. We built a data analytics operation from the ground up, retraining actuaries to be analysts through a yearlong course with General Assembly, and brought in a team of PhDs. Over several years we created a data lake from which to mine information to improve the business. Of course, we had a lot of internal discussion about whether those investments would pay off. But the board understood and fully supported the plan. And once we were operating in a more sophisticated fashion, with better technology and data and employees repurposed accordingly, the costs savings and revenue gains began to accumulate.

The shift also helped facilitate remote work for the roughly 3,000 employees who were then based at headquarters and the 2,000-some at offices around the United States. In 2014 we began building out our operations in India, and our workforce there now numbers 2,000. In 2016 we launched a program to train leaders in best practices for managing remote workers and teams. Today we

FACTS & FINANCIALS

Guardian

Founded: 1860
Headquarters: New York, NY
No. of employees: 9,500



Source: Guardian

Guardian has three central values: We do the right thing. People count. And we hold ourselves to very high standards.

still have a large, relatively new headquarters in the Hudson Yards area of Manhattan and campuses in Bethlehem, Pennsylvania, and Holmdel, New Jersey, but I'd estimate that on any given day before the pandemic, 30% to 40% of our employees were working from home. We were more prepared than many for Covid-19 office closures.

Our executive and actuary teams spent a good part of January closely monitoring World Health Organization reports and studying the 1918 flu pandemic; they then quickly moved to ban meetings of a certain size and institute travel restrictions. By mid-February we were mapping out a full work-from-home strategy, and in early March we did a test run with nearly every employee spending the whole day working remotely. Apart from a skeleton facilities-and-security crew, we are all still working that way as of this writing. And yet, thanks to our post-Sandy investment, we haven't missed a beat.

Not surprisingly, we've also seen increased interest in life insurance, and in this era of social distancing, our salespeople—who had already begun to embrace new digital tools—have successfully pivoted to an entirely digital sales process, from prospecting to meeting to handling policy applications. Where we can, we have also leveraged customers' electronic health records, rather than the traditional in-person exam, for underwriting. You can draw a direct line from our tech investments to this innovation and flexibility.

Five years ago we asked ourselves where the marketplace was going and how our policyholders could benefit from those shifts. From that set of questions was born Guardian Strategic Ventures: a $100 million venture fund designed to invest in companies and technologies at the cutting edge of artificial intelligence, data, and automation.

STAYING AHEAD ON TALENT AND SERVICES

Guardian has done well to anticipate two other important issues for organizations over the past decade: diversity, equity, and inclusion (DEI) and the gig economy. The company was founded by a civil rights attorney and thus has always prioritized DEI. In 1999 we became one of the first *Fortune* 500 companies to have a female lead director. We also led the way in offering domestic-partner benefits. Early in my tenure an employee observed that we weren't endorsed by the Human Rights Campaign's "Best Places to Work for LGBTQ Equality," so we made that a focus when we refreshed our HR policies, and the organization gave us a perfect score of 100 within two years.

When we began tracking pay across gender and race, in 2017, we happily learned that it was equitable. If anything, the women were being paid a little more, on average, than the men. Our latest data indicates that we're well balanced. At the entry level, 50% of our workforce consists of women or members of other underrepresented groups. At the executive level the figure is 30%, and our board has received national recognition for its diverse makeup. Recently we announced that we aspire to double the number of Black and brown managers at the company over the next two years. Many of these steps may be perceived as common sense, but it takes leadership, measurable goals, team alignment, a disciplined push forward, and accountability to accomplish them.

Our move to serve gig-economy customers was the brainchild of an innovative employee in our group insurance business who worried about the fact that people could access Guardian's extensive benefits and well-regarded customer service only through their employers. Why couldn't we take the same offerings direct to freelancers, part-timers, entrepreneurs, retirees, and others who wanted good insurance? She pitched the idea of a direct-to-consumer business; the executive team greenlit a pilot; and by year's end she had sold 5,000 policies. That business line continues to gain momentum, with sales growth of 50% in just the first half of 2020.

IN THE MIDST of a technology revolution, sustained low interest rates, globalization, and shifting customer expectations, the entire insurance industry is facing considerable headwinds. Still, I believe that Guardian is positioned not only to meet those challenges but also to seize on new opportunities under the entrepreneurial, data-focused, and values-driven leadership of my successor, Andrew McMahon. I stepped down as CEO in early October 2020 but stayed on as chair of Guardian's board, which I'd had a seat on since 2011. On December 31, just as this article is published, I will relinquish that position. It's not that I don't love my job or the company anymore. I do. But it's time for a new leader to be that forward thinker who holds fast to our principles and steers Guardian into the next decade.

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Spotlight

DOES BUSINESS NEED A NEW MODEL?

Photograph by ANDREA STONE

AUTHOR
Roger L. Martin
Former dean, Rotman School

It's Time to *Replace* the Public Corporation

We need a model that truly focuses on the long term.

THE PROFESSIONALLY MANAGED, widely held, publicly traded corporation has been the dominant structure in business for the past 100 years. It came to prominence in the wake of the Great Depression because it was effective at mobilizing capital from private investors—who by the 1960s held more than 80% of company stock—for productive ventures. The model enabled executives to focus on long-term growth and profitability, to the benefit of the many individuals who owned shares in their companies.

Over the past 40 years, however, the fitness of the public corporation has been called into question. Critics charge that in

PHOTOGRAPHER ANDREA STONE

Public corporations no longer serve the interests of their most important shareholders—retirement investors—or the most critical part of their workforce: knowledge workers.

today's far more heavily traded capital markets, the model increasingly incentivizes executives to manage in tiny, short-term windows, with an eager eye on their stock-based compensation and a fearful one on activist hedge funds. Whether or not they're right, something isn't working: The number of public companies in the United States halved from 1997 to 2015, while the number of controlled companies (those with a dominant shareholder or a dominant group of shareholders) in the S&P 1500 increased by 31% from 2002 to 2012. The number of companies with multiple voting shares among S&P 500 companies increased by 140% from 2007 to 2017.

In this article I'll track the decline of the public corporation, explain why that model no longer satisfies the primary needs of critical stakeholders, and present a new one that I believe could well displace the public corporation as the dominant structure in business.

The Turning of the Tide

The shift against public corporations can be traced back to the late 1970s. A key marker was a 1976 article published in the *Journal of Financial Economics* by Michael C. Jensen and William H. Meckling, titled "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure."

The paper argued that professional managers are imperfect agents who, if left to their own devices, are inclined to maximize their welfare rather than that of shareholders. The solution to that problem came to be seen as stock-based compensation. That idea and its underlying assumption that the shareholder was the company's primary stakeholder triggered an explosion in stock and stock-option grants over the following decades.

Unfortunately, there is little evidence (as I have argued elsewhere) that corporate performance has actually improved as a result. That's partly because the shareholder-value revolution that Jensen and Meckling helped trigger has had the unintended consequence of focusing top executives on short-term movements in their companies' stock prices rather than on long-term value creation. CEOs started meeting more and more often with investors and the analysts whose advice those investors followed. To demonstrate the superiority of their strategies, they would emphasize how much shareholder value they had created since last checking in. At the same time, falling transaction costs and new approaches to portfolio management encouraged the large, professionally managed investment institutions to trade more actively.

The corporate raiders who came to prominence in the early 1980s amplified the effects of these trends. Their activism gave executives an added incentive to pay close attention to the stock price. If they didn't, a raider could launch a hostile takeover bid, gain control of the company, fire them, and possibly tear the company apart to wring maximum immediate value from it—as Carl Icahn famously did with Trans World Airlines after his 1985 takeover. Where the raiders led, today's activist hedge funds have followed, but with far more capital at their disposal.

What constituted good or bad management performance became clearly defined from one perspective following the creation in 1980 of the First Call service, which aggregated analysts' forecasts to come up with a "consensus forecast" of each company's quarterly revenue and earnings. An executive team knows that if it doesn't hit the consensus forecast, its company's stock will be trounced by traders, increasing the danger of a hostile takeover. That

IDEA IN BRIEF

THE PROBLEM
The public corporation is no longer fit for purpose, and its popularity as an ownership model is declining.

WHY IT HAPPENS
In today's capital markets, the model incentivizes executives to manage in tiny, short-term windows, thus failing to satisfy the primary needs of its critical stakeholders: retirement investors and knowledge workers.

HOW TO FIX IT
Switch to a model in which the owners are an employee stock ownership plan (ESOP) and one or more pension funds—thus focusing governance on ensuring real long-term performance rather than on short-term stock price fluctuations.

ABOUT THE ART
Photographer Andrea Stone documents how reflections of cityscapes distorted by light, glass, steel, and stone invite the viewer beyond the rigidity and solitude of urban architectural forms.

provides executives with a powerful incentive to meet the quarterly consensus even if doing so means sacrificing longer-term goals. Research confirms that they do indeed make this trade-off. They may even engage in fraud: In the early 2000s executives seeking to boost their stock price were responsible for accounting scandals of a magnitude never seen before: those involving Enron in 2001 and Adelphia, Global Crossing, WorldCom, and Tyco in 2002.

The Failure of the Public Corporation

Attempts have been made to improve the governance of public corporations. The 2002 Sarbanes-Oxley Act, for example, introduced new rules concerning the independence of directors and set requirements for financial expertise on boards in an effort to avoid further accounting scandals. CEOs and CFOs were made personally liable for their financial statements. Stock analysts were obliged to disclose conflicts of interest and breakdowns in buy, hold, and sell recommendations. But such fixes don't address the root of the problem, which is that public corporations no longer serve the interests of their most important shareholders—retirement investors—or the most critical part of their workforce: knowledge workers.

Retirement investors. Peter Drucker was, as usual, right in 1976 when he forecast the rise to prominence of pension funds, arguing that America's workers would come to own the means of production through equity ownership by the pension funds that held their

The bottom line is that institutional investors have neither the ability nor the incentive to discipline executives or protect companies against rapacious hedge funds.

retirement assets, rather than through a violent revolution by the proletariat. People saving for retirement constitute the largest group of investors today.

These investors typically have a very long-term outlook—20, 30, or 40 years—and defined-benefit pension plans are strictly liable for established retirement benefits (as are life insurers, whose interests largely align with those of such plans). Although defined-contribution pension plans, such as 401(k)s, and IRAs carry no such liability, the managers of those investments share the goal of producing high long-term returns to maximize beneficiaries' retirement income. They can and do invest in long-term bonds, real estate, and infrastructure. But to earn at the levels required, they must also invest in equities, which have typically offered the highest rates of return.

As things stand, however, executives' incentives are clearly not aligned with retirement investors' need for long-term value creation. What's more, the investors are largely powerless to change this state of affairs. One might assume that large institutions such as BlackRock, Fidelity, State Street, and the big pension funds have so much capital that they can force executives to act in the interests of their clients. Although some are attempting this, their ability to do so is limited, because the large funds are so big that each of them has ownership in most of the market. That means two things: First, the big institutions can go only so far in punishing any one company, because if they sell out, depressing the share price, they will simply provide an opportunity for a leveraged buyout or an activist hedge fund. Second, big, diversified funds have no incentive to see any one company do particularly well, because they own all its competitors; any outstanding success on the part of one company will come at the expense of its rivals and their stock prices. One might think that an institutional shareholder of Kimberly-Clark would like to see the company come up with a fantastic innovation that enabled its Huggies disposable diapers to crush P&G's Pampers. But because it's likely to hold as big a position in P&G as it does in Kimberly-Clark, its gains on the latter's stock would probably be offset by its losses on P&G stock.

The bottom line is that institutional investors have neither the ability nor the incentive to discipline executives, protect companies against rapacious hedge funds, or even encourage companies to compete aggressively.

Knowledge workers. In 1959, almost two decades before his prediction about pensions, Drucker alerted the world to the arrival of a new breed of employee: knowledge workers. Instead of the muscles in their arms, legs, and backs, these workers would employ the muscle between their ears. He warned that they would be pickier about the nature of their work because it is done in and by their minds. They *are* their work.

That is at the core of the problem with the public corporation. Knowledge workers, the primary driver of a company's value, are being asked to work for the benefit of its shareholders. They are asked to make sacrifices to meet quarterly financial targets. When activist hedge funds circle, they are asked to acquiesce in the firing of friends and colleagues across the company to improve earnings.

Who are the company's shareholders? The share register will feature names such as BlackRock, Fidelity, State Street, and Vanguard. But those are just fiduciary institutions that invest on behalf of the real shareholders. The same holds for pension funds such as CalPERS, New York State Common Retirement Fund, and the Teacher Retirement System of Texas and for the activist investors Pershing Square, Third Point, and ValueAct Capital. Collectively, these institutions represent 80% of supposed shareholders. The actual shareholders have no conversation with the companies they own, and may not even know they own them.

So the dominant model asks workers to toil under executives whose financial welfare is determined by the stock price, in the interests of owners no one knows. That seems about right for a workplace in which, according to Gallup's 2020 results, only 31% of employees are engaged in their work, 54% are not engaged, and 14% are actively disengaged. Drucker would probably have predicted those numbers had he known the environment in which his knowledge workers would be toiling. The modern public corporation has become a terrible home for them.

What might emerge in its place?

A New Model

The obvious candidate to replace the publicly held corporation is private equity ownership. Since 2002 the net asset value of private equity has grown more than sevenfold—twice as much as the value of public equities. That growth has been fueled largely by the major pension funds, which have become the biggest investors in private equity. Michael Jensen himself predicted the growth of private equity in 1989 in his provocative *Harvard Business Review* article "Eclipse of the Public Corporation," and history has proved him right.

But private equity is not a substitute for public corporations, because it is predicated on their existence. Private equity investors expect to realize a return after five to seven years, so PE funds must sell the companies they've bought within that period. Traditionally that has meant returning them to the public markets, by way of either an IPO or sale to a public company. But those exit routes (especially IPOs) have become less easy to take of late, and a growing trend is PE funds' selling companies to other PE funds. Of course, that doesn't eliminate an eventual return to public markets—it merely kicks the can down the road.

The story of Dell provides a textbook example. In 2013 its founder, Michael Dell, and the PE firm Silver Lake Partners took the company private for nearly $25 billion, because they felt that as a public company, Dell could not transform itself from primarily a player in the commoditizing personal computer business to an enterprise services provider. As a private company, Dell was able to engineer the game-changing takeover of EMC, which owned a valuable stake in the cloud computing provider VMware. It took the transformed company back to the public market five years later at an approximate enterprise value of $70 billion. Pension fund investors who had sold out at $25 billion could buy back in at $70 billion, but in the meantime, $45 billion in value had gone to private investors—including, by some estimates, $28 billion to Michael Dell himself.

If public corporations and capital markets did not exist to enable PE funds to turn their investments into cash, a deal like that could not happen, and PE funds would not exist. That disqualifies private equity as the next new model.

To understand what might displace the public corporation, let's consider what's involved in meeting the needs of knowledge workers and retirement investors—the critical creators and beneficiaries of sustainable value. To satisfy their needs, any new model must overcome the fundamental governance problem of widely held corporations: that CEOs' incentives are at odds with the long-term interests of those stakeholders. In addition, the model must diminish the ability of activist hedge funds to extract gains at their expense.

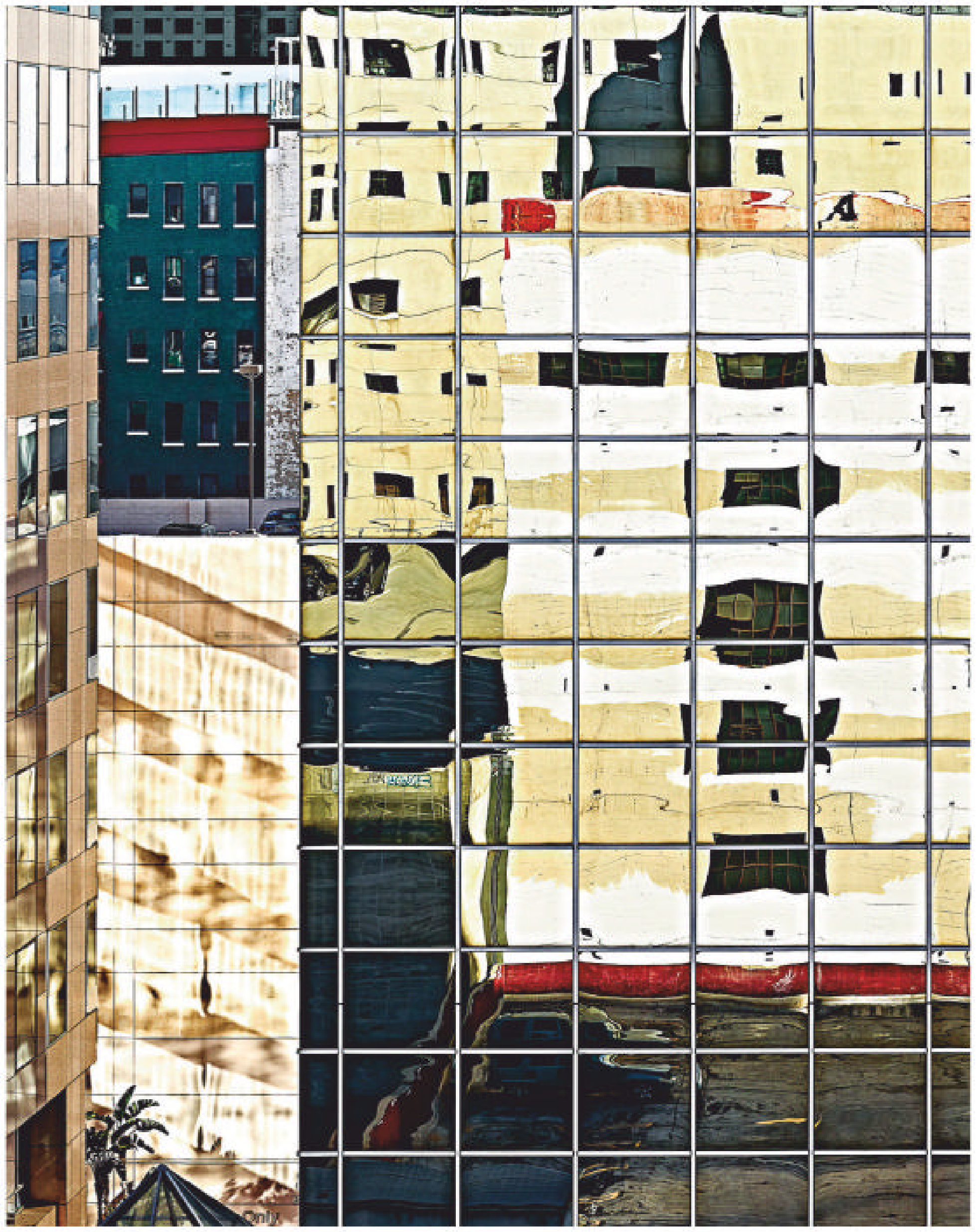
I believe that the most likely successor is what I call the *long-term enterprise* (LTE), a private company in which ownership is limited to the stakeholders with the greatest interest in long-term value: retirement investors and employees. It would work like this: An employee stock ownership plan (ESOP), whether existing or specifically created for this transaction, would partner with one or several pension funds to acquire the company and take it private. Governance would focus on real long-term performance rather than on short-term stock price fluctuations—because there would be no stock price. Other classes of long-term investors might also find the model attractive. The likes of BlackRock, Fidelity, and State Street, for example, could create vehicles whereby their IRA investors could invest alongside ESOPs.

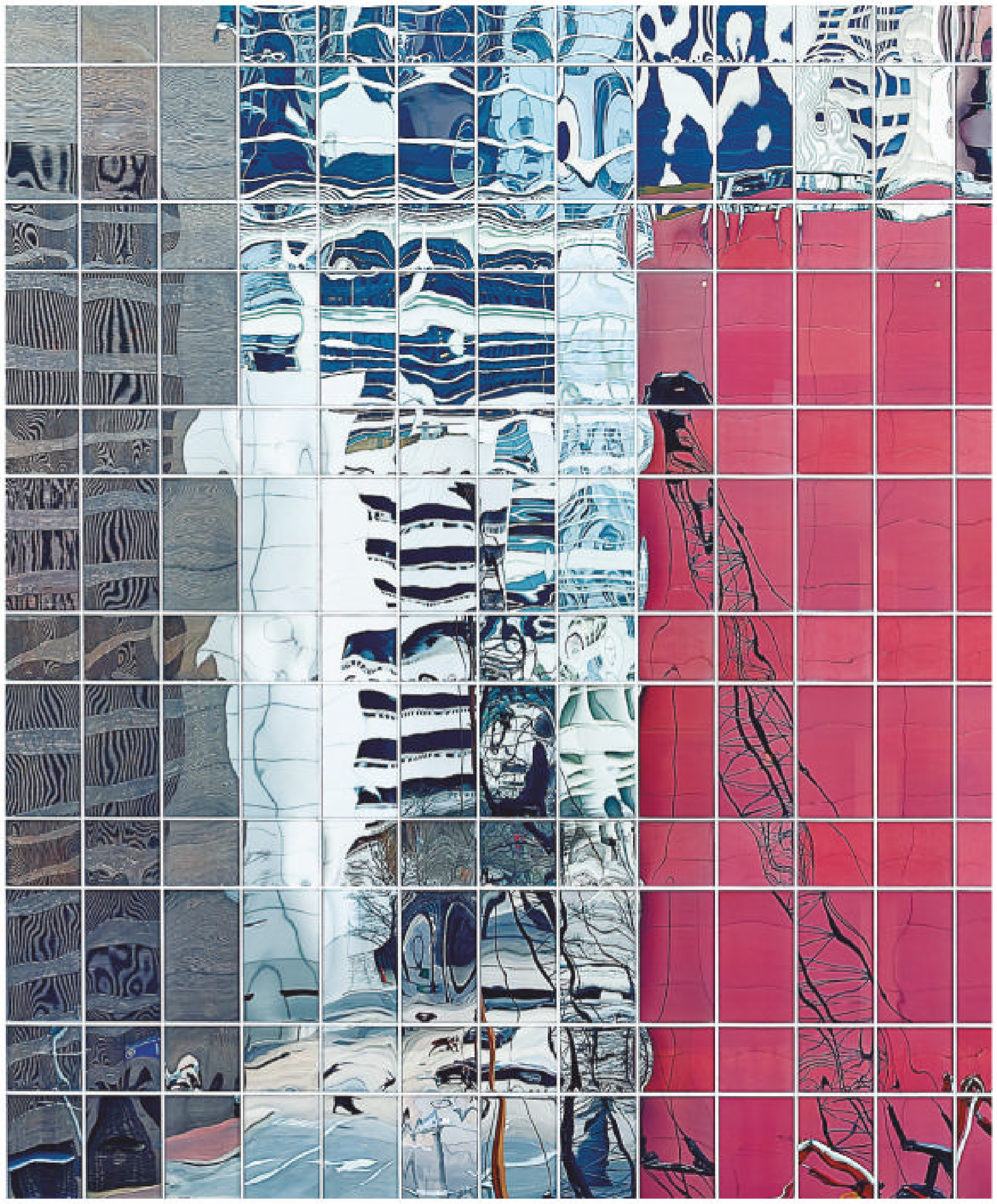
Let's look at what this model would do for its key stakeholders.

Retirement investors. The model is not completely unfamiliar to these investors. Two of Canada's three biggest pension funds (which are also among the top 20 worldwide) have taken private very large Canadian real estate development companies. The Quebec-based CDPQ took Ivanhoé private in 1990 and Cambridge Shopping Centres private in 2000, and merged them to create a wholly private real estate giant. The Ontario Teachers' Pension Plan (OTPP) took another large realty firm, Cadillac Fairview, private in 2000. Those were not typical PE deals. The investors were not seeking to turn the companies around and take them public again five years later. They were looking for steady returns over the long haul.

To be fair, those acquisitions were in a single business—real estate, not classic consumer or industrial enterprises—in which pension funds are major buyers of individual assets. For LTEs to become the dominant ownership model, pension funds and other retirement investors would have to become comfortable owning a wider variety of businesses. That does seem to be happening: In 2019 the biggest Canadian pension fund, CPPIB, took an alternative-energy company, Pattern Energy, private for US$6.1 billion.

This approach borrows from the playbook of the world's most famous investor, Warren Buffett, who is best known for taking huge ($15 billion-plus) stakes in public companies such as Apple, Bank of America, Coca-Cola, Amex, and Wells Fargo. But those investments make up less than half of Berkshire Hathaway's market capitalization of $313 billion (as of this writing). A larger proportion comes from its ownership of fully privatized companies such as GEICO, Burlington Northern Santa Fe, Dairy Queen, Fruit of the Loom, Lubrizol, and Duracell. The most valuable private stake is probably GEICO (worth about $50 billion),





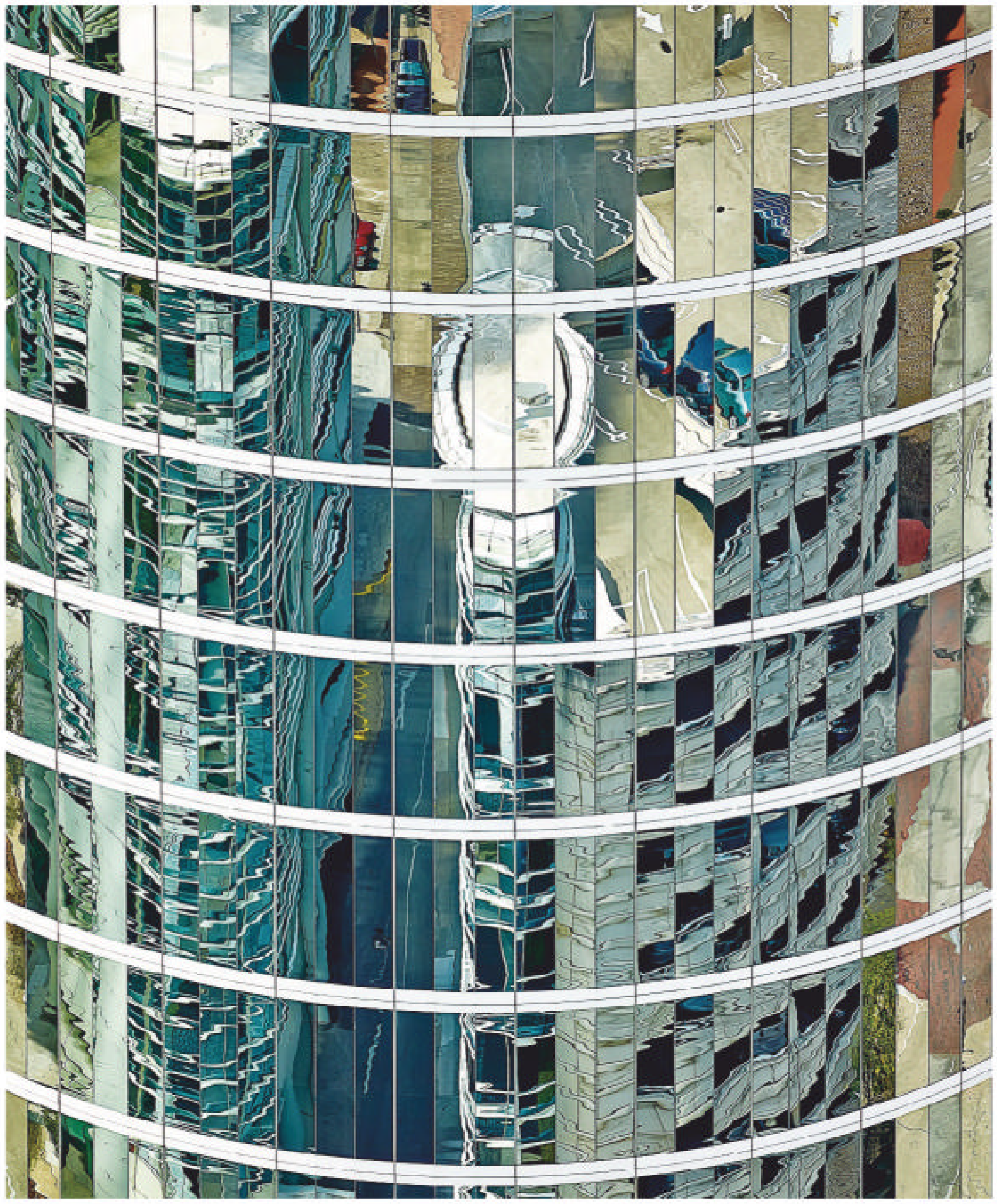
but perhaps the most intriguing is Burlington Northern Santa Fe, the parent of BNSF Railway, America's largest railroad. In 2009 Berkshire Hathaway acquired the 77.4% of BNSF it didn't yet own for $26 billion, which with the acquired debt made the holding worth $44 billion. The stated intention was to run the railroad privately—forever.

It makes sense that Buffett would figure out something good before everybody else did. He has made a career of doing so. He favors concentrated and focused ownership, works toward a long-term horizon, and positions chief executives to be incentivized by value enhancement, not stock price movements, protecting them from activist hedge funds, stock analysts, and traders: market actors pushing for short-term gains.

Knowledge workers. Working at a company solely owned by Berkshire Hathaway has many attractive features for employees. They know for whom they are working: shareholders who have legendarily long holding periods. But it's not enough to know your shareholders. In the modern economy, critical employees themselves need to have a long-term stake in the company. And as we have seen, stock options don't provide an incentive to engage for the long term. That's where employee stock ownership plans come in.

Large companies wholly owned by ESOP participants perform remarkably well. Take Publix Super Markets, which is 100% owned by an ESOP. With $36 billion in revenue, Publix ranks 87th in the *Fortune* 500 and is the 29th-largest private-sector employer by head count in America. Perhaps most impressive, shoppers rank it the number one supermarket chain in the United States. Other large supermarkets that have ESOPs include WinCo Foods, Brookshire Brothers, and Metcash, the parent of IGA. Outside retail, we have W.L. Gore & Associates, the famous creator of Gore-Tex; Graybar, one of the top distributors of electrical, communications, and data-networking products; and Gensler, the top-grossing architectural firm in the United States.

As that list suggests, many of the biggest companies with ESOPs are either retailers, for which the interaction between customers and frontline employees is critical to success, or enterprises dependent on a large number of professionals, such as architectural, engineering, and consulting firms. They



are typically innovative and highly competitive.

Little or no new regulation would be required to roll out ESOPs on a large scale. A robust infrastructure is already in place to protect the interests of individual employees enrolled in them. (An ESOP is not equivalent to an employee retirement plan, which should not be wholly or even largely invested in company stock. It is, rather, a way to reward and motivate employees for value creation.) All shares vest after six years, and ESOPs are required to have a third party establish the fair value of the shares once a year so that when employees leave, their shares will be bought by the plan at a fair price, enabling them to benefit from capital appreciation much as employees of public companies do. Retiring employees benefit in the same way and enjoy favorable tax provisions for rolling the proceeds into their retirement accounts.

It's surprising that employee stock ownership plans aren't more widely used, but dominant models are hard to displace. Publicly held corporations are the default—the safe choice. Bankers, lawyers, and accountants can facilitate that structure in their sleep, whereas few specialize in creating ESOPs. Additionally, no single person or small group has a huge incentive to drive toward an ESOP solution. When a private company goes public, a few people—the founding group and the initial angel or VC investors—tend to reap very large rewards. Under an ESOP, each of many employees stands to benefit by a meaningful but modest amount. If an employee group starts in that direction, it will have to explain why it's trying something different, and no bevy of advisers will be standing by to help. Nonetheless, employees, shareholders, and society would be better off if ESOPs were used more widely.

In sum, the model I propose would satisfy the primary needs of both retirement investors and knowledge workers without taking away any of the advantages offered by the public corporation's structure. Long-term enterprises can help channel retirement savings toward investments that will reliably deliver high returns 20 or 30 years later. They also motivate workers in dynamic, knowledge-intensive industries to create the value needed to generate those returns.

Supporters of the current model point out that public markets have

Spotlight

been highly effective mechanisms for aggregating and processing information about value and for taking cash in and out of investments—which is why the publicly traded corporation was such a successful model.

But it's no longer clear that this model is the best way to determine fair value. The dominance of short-term factors in corporate decision-making and the activities of short-term investors are making quoted market prices a less-reliable indicator of value than they used to be. At the same time, the widespread availability of information online and the increased sophistication of formal modeling are dramatically improving the quality of market-independent business valuations.

PUBLICLY TRADED CORPORATIONS and the capital markets won't become extinct. Not all investors take a long-term perspective, and in many industries it can be difficult, if not impossible, to do so. But the stock market increasingly sabotages rather than supports the creation of long-term value, reducing the investment options available to retirement savers and demotivating the people most likely to create the value those savers need. The model I propose here will better serve the interests of these critical stakeholders.

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COUNTERPOINT

Don't Let the Short-Termism *Bogeyman* Scare You

Active investor oversight is a plus, not a minus.

THIS ISSUE OF *Harvard Business Review* includes, as many prior issues did, an article decrying the perils of short-termism and supporting measures for insulating corporate leaders from the outside pressures that allegedly make them myopic. But such arguments are long on alarming rhetoric and short on empirical evidence or economic logic. Furthermore, their supporters overlook substantial benefits that outside-investor oversight produces and that such measures would sacrifice.

HBR readers have been warned about the dangers of short-termism for at least four decades. In their 1980 article "Managing Our Way to Economic Decline," Robert Hayes and

PHOTOGRAPHER PETER WEGNER

William Abernathy argued that the short-term focus of corporate managers was to blame for a "marked deterioration of competitive vigor." Similarly, in his 1992 article "Capital Disadvantage: America's Failing Capital Investment System," Michael Porter claimed that short-termism was causing underinvestment in long-term R&D projects and was the reason that "the competitive position of important U.S. industries has declined relative to other nations, notably Japan and Germany."

Although short-termism has not produced the predicted deterioration and decline during the decades since, calls to protect corporate leaders from pressures that could induce short-termism have persisted if not intensified. Indeed, such arguments have for long been a key reason provided for supporting measures—such as takeover defenses, staggered boards, dual-class share structures, and dual-class recapitalizations—that limit the power of shareholders and insulate corporate leaders.

Unfortunately, the superficial appeal of such arguments has won over many institutional investors and public officials. It's important that they and others learn to recognize the shortcomings of short-termism claims.

Does the Market Underestimate Long-Term Projects?

A major premise of short-termism worriers is that markets systematically undervalue long-term investments, which are consequently not fully reflected in stock prices. Although markets do sometimes err, people who express such concern have thus far not provided solid empirical evidence to justify their alarm.

Indeed, over the past two decades, as dire warnings regarding short-termism have proliferated, growth companies—whose value largely reflects expectations about their payoff in the long term—have enjoyed substantial appreciation in value. As of the end of the third quarter of 2020, the companies in the tech-heavy Nasdaq 100 made up more than one-quarter of the total capitalization of U.S. stock markets, and they were trading at high price/earnings ratios, reflecting the willingness of the markets to attach great value to companies on the basis of their future prospects rather than their current earnings.

If investors were systematically underestimating long-term prospects, growth companies would tend to trade at discounted levels, enabling their investors to obtain higher returns over the long term. But the empirical evidence indicates that growth stocks actually tend to offer *lower* returns over the long term—and thus, if anything, tend to trade at elevated levels—compared with stocks whose valuations are grounded in current profitability.

Amazon and Netflix vividly illustrate that when appropriate, investors will accept with considerable patience a corporate strategy of investing in the long term at the expense of no or little current profit. Over the past decade the stock prices of those companies appreciated steeply, rising more than 20-fold and 10-fold respectively, even though their growth-oriented strategies resulted in relatively small profits along the way.

Of course, some corporate leaders may take the view that the market doesn't adequately appreciate the long-term prospects of their companies and consequently underprices their stock. But such reactions may simply reflect the tendency of those individuals to overvalue or defend their own performance. Even if a stock market price disappoints a company's leaders, it may in fact accurately reflect the company's long-term prospects.

Is Hedge Fund Activism Detrimental?

Short-termism worriers view hedge fund activism as a menace. Consequently, they advocate for measures that would impede it and urge other investors to avoid supporting activists. But that view reflects a flawed assessment of the effects of activism.

Opponents of hedge fund activists argue that they profit by pushing companies to make short-term improvements that come at the expense of long-term prospects and bring about stock price declines down the road. In a 2012 debate I had at the Conference Board with Marty Lipton, the prominent corporate lawyer who invented the "poison pill" takeover defense, he challenged me to empirically investigate his concern about what happens to activism targets in the several years following the activists' intervention. In a subsequent empirical study, Alon Brav, Wei Jiang, and I met this challenge. We examined the five-year aftermath of such interventions and found no evidence providing a basis for Lipton's concern. Whereas the start of an activist intervention is commonly accompanied by a stock price spike, that spike isn't reversed in the following five years.

Supporters of insulation also argue that the shadow of hedge fund intervention has a major adverse effect on the operation of all companies, not

Previous spread: Peter Wegner, *Buildings Made of Sky III*, 2009. Courtesy of Peter Wegner and Galerie m, Bochum, Germany

If the prospect of an activist intervention discourages managerial slack and underperformance, all the company's investors are rewarded.

just those with which activists actually engage. The desire to reduce the odds of such engagement, it is argued, provides corporate leaders with an incentive to beef up short-term stock prices by significantly underinvesting in long-term projects. The validity of this view, however, depends on the questionable premise that market prices generally reward reducing investment in long-term projects.

Furthermore, this view overlooks a significant beneficial effect that the prospect of hedge fund activism should be expected to have on the performance of corporate leaders who seek to avoid it. The threat of such intervention should be expected to discourage managerial slack and underperformance, thus playing an important disciplinary role and incentivizing leaders to enhance shareholder value. This mechanism is especially important given the substantial impediments to hostile takeovers permitted by U.S. law. If hedge fund activists were also impeded, managerial slack and underperformance could be expected to increase, to the detriment of investors and the economy.

Long-Term and Short-Term Investors: Foes or Allies?

Those who want to protect corporate leaders from market pressures often distinguish between long-term ("good") investors and short-term ("bad") investors and view all hedge fund activists, even those who hold positions for a substantial time, as the latter. They urge long-term investors to see the influence of short-term investors as detrimental to them and to support insulating managers from it. According to this view, long-term investors should generally lend their support to management and avoid cooperating with hedge fund activists, to enable managers to focus on delivering long-term value without distractions.

As Doron Levit and I show in a recent analysis of the interests of short-term and long-term investors, however, this view suffers from significant flaws. For one, even investors who plan to hold their shares in a company for a very long time (in, say, index funds) should hardly be uninterested in short-term results. Looking for long-term value does not mean leaning back and counting on managers to ultimately deliver it. Even long-term investors should be keenly interested in interim results, which may signal needed changes in management or governance and incentivize management to focus on shareholders' interests.

Furthermore, long-term investors often benefit from the work of hedge fund activists, who usually cannot effect change unless other investors are willing to support their proposals. And other investors should be expected to provide such support only if they believe that they, too, will benefit from proposed changes. Moreover, if the prospect of an activist intervention discourages managerial slack and underperformance, all the company's investors are rewarded.

To be sure, opponents of hedge fund activism argue that the activists' interests diverge from those of long-term investors because the former bail out before the adverse effects of their interventions get reflected in stock prices. That claim, however, is not supported by the data. My study with Brav and Jiang found that in the years following an activist hedge fund's exit from a target's stock, there was no evidence of abnormal negative returns reflecting a price reversal.

Internally Driven Short-Termism

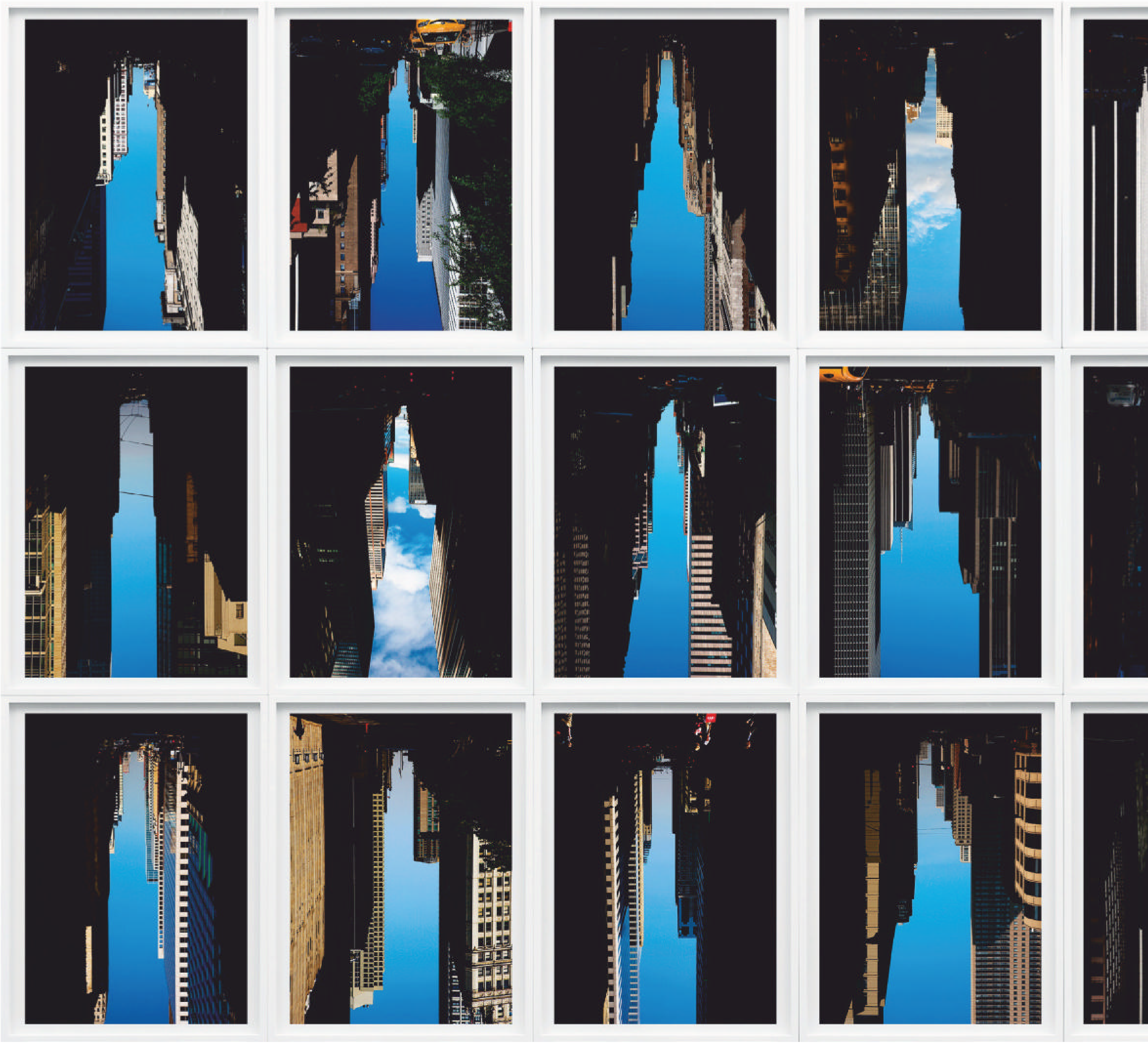
Although there is currently no basis for viewing short-termism problems as severe enough to justify insulating managers, there is still significant room for improvement in the governance of public companies in general and decision-making about long-term projects in particular. One beneficial measure would be to tighten the alignment between executive pay and long-term results.

The attention that corporate leaders give to quarterly earnings and meeting analyst expectations could well be excessive. But that attention is due more to internal choices made by leaders themselves than to outside pressures. In particular, compensation arrangements, which directors and executives themselves put in place, incentivize managers to attach weight to short-term results and their stock price effects.

Standard compensation arrangements have long included considerable bonuses that reward short-term improvements even if they are short-lived. These arrangements also commonly grant executives substantial freedom to unload equity incentives and thereby benefit from short-term spikes in stock prices.

Eliminating short-term incentives and placing substantial limits on corporate leaders' freedom to unload

Those who are concerned about short-termism should focus on reforming pay arrangements before considering the adoption of measures to insulate managers.



ABOUT THE ART
In this series, artist Peter Wegner inverts urban streetscapes to reveal his Buildings Made of Sky.

shares, as Jesse Fried and I advocated in our book, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation,* would significantly increase corporate leaders' attention to long-term value. As we demonstrate in the book and our subsequent work, arrangements that provide short-term incentives persist largely because they serve executives' private interests, not because of outside pressure from investors and markets.

Unlike measures that insulate corporate leaders from investor oversight and intervention, a redesign of executive pay arrangements would temper short-termism without imposing large costs arising from slack and underperformance. Therefore, those who are concerned about short-termism should focus on reforming pay arrangements before considering the adoption of measures that would insulate managers and bring about such costs.

The Folly of Going Back

Insulation advocates essentially seek to reverse the effects of capital markets developments over the past several decades that have been largely beneficial. As Adolf Berle and Gardiner Means documented in *The Modern Corporation and Private Property,* the ownership of large U.S. companies used to be dispersed, with owners lacking both the incentives and the ability to monitor performance and intervene. Managers were largely unaccountable and free from investor oversight. To be sure, they felt no pressure to produce short-term results; but they felt no pressure to produce long-term results either.

The rise of institutional investors has led to a concentration of ownership. As Alma Cohen, Scott Hirst, and I document in a 2017 study on institutional investors, the largest 50 of them commonly account for a substantial majority of the votes cast at shareholder meetings. This concentration of ownership has introduced the possibility of meaningful investor oversight. Although such oversight may have some adverse effects, overall it is a substantially beneficial mechanism that serves the interests of investors and the economy. Measures to weaken it would move us in the wrong direction.

WARNINGS OF THE perils of short-termism are repeatedly used to argue for shielding managers from outside pressures and oversight. But those warnings are not supported by evidence of the severity of alleged short-termism effects, and they overlook important benefits provided by market and investor oversight. Fears of the short-termism bogeyman should not scare us into supporting measures that insulate managers. Adopting or maintaining such measures would operate to the detriment of American investors and the U.S. economy.

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The Rules of

Co-opetition

STRATEGY

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PHOTOGRAPHER TIERNEY GEARON

Rivals are working together more than ever before. Here's how to think through the risks and rewards.

STRATEGY

the moon landing just over 50 years ago is remembered as the culmination of a fierce competition between the United States and the USSR. But in fact, space exploration almost started with cooperation. President Kennedy proposed a joint mission to the moon when he met with Khrushchev in 1961 and again when he addressed the United Nations in 1963. It never came to pass, but in 1975 the Cold War rivals began working together on Apollo-Soyuz, and by 1998 the jointly managed International Space Station had ushered in an era of collaboration. Today a number of countries are trying to achieve a presence on the moon, and again there are calls for them to team up. Even the hypercompetitive Jeff Bezos and Elon Musk once met to discuss combining their Blue Origin and SpaceX ventures.

There is a name for the mix of competition and cooperation: *co-opetition*. In 1996, when we wrote a book about this phenomenon in business, instances of it were relatively rare. Now the practice is common in a wide range of industries, having been adopted by rivals such as Apple and Samsung, DHL and UPS, Ford and GM, and Google and Yahoo.

There are many reasons for competitors to cooperate. At the simplest level, it can be a way to save costs and avoid duplication of effort. If a project is too big or too risky for one company to manage, collaboration may be the only option. In other cases one party is better at doing A while the other is better at B, and they can trade skills. And even if one party is better at A and the other has no better B to offer, it may still make sense to share A at the right price.

Co-opetition raises strategic questions, however. How will the competitive dynamics in your industry change if you cooperate—or if you don't? Will you be able to safeguard your most valuable assets? Careful analysis is required. In this article we'll provide a practical framework for thinking through the decision to cooperate with rivals.

What Is Likely to Happen If You Don't Cooperate?

If a cooperative opportunity is on the table, start by imagining what each party will do if it's *not* taken. What alternative agreements might the other side make, and what alternatives might you pursue? If you don't agree to the deal, will someone else take your place in it? In particular, will the status quo still be an option?

Let's start with a simple example. Honest Tea (which one of us cofounded) was approached by Safeway supermarkets to make a private-label line of organic teas. The new line would undoubtedly eat into Honest Tea's existing Safeway sales. So even though the supermarket was offering a fair price, the deal would ultimately be unprofitable for Honest Tea.

IDEA IN BRIEF

THE CONTEXT

The idea that competitors should sometimes cooperate with one another has continued to gain traction since it was initially explored in the 1990s.

THE ISSUE

Even so, executives who aren't comfortable with "co-opetition" bypass promising opportunities.

A FRAMEWORK FOR ACTION

Start by analyzing what each party will do if it doesn't cooperate and how that decision will affect industry dynamics. Sometimes cooperation is a clear win. Even if it isn't, it may still be preferable to not cooperating. But it's critical to try to figure out how to cooperate without losing your current advantages.

> There are many reasons for competitors to cooperate. At the simplest level, it can be a way to save costs and avoid duplication of effort.

However, if Honest Tea didn't cooperate, Safeway would surely find another supplier, such as rival tea maker Tazo. Honest figured that if it took the deal, it could design the new Safeway "O Organics" line to resemble the flavors and sweetness of Tazo's products and compete less against its own. If Honest had said no, Tazo would probably have said yes and targeted Honest's flavors, leading to the worst possible outcome. So Honest agreed to the deal.

Yet the company turned down a similar request from Whole Foods because the grocery chain insisted that the private line include a clone of Moroccan Mint, Honest's best-selling tea at the time. Honest didn't want to compete so directly against itself and believed that its rivals would have trouble copying the tea—which indeed turned out to be true.

UPS had to think through a similar opportunity when DHL, which had acquired Airborne Express some years earlier and was suffering large losses, asked UPS to fly DHL's packages within the United States. UPS had the scale to make the service efficient (potentially saving DHL $1 billion a year) and was already providing a similar service to the U.S. Postal Service, so the opportunity appeared to be a profitable one that would allow UPS to rent out space on planes it was already flying.

That said, *not* cooperating might have been even more profitable in the long run. If DHL's continuing losses led to its exit, UPS stood to gain much of DHL's U.S. market share.

But if UPS turned the deal down, DHL might have offered it to FedEx. And if FedEx accepted it, DHL would still be in the market and UPS would have lost out on potential profits. So UPS agreed to DHL's proposal, announcing a deal in May 2008. (It turned out to be not enough to save DHL, which decided during the recession later that year to leave the market.)

In the tech industry, thinking through alternatives to a deal is complicated because companies have multiple relationships with one another. Samsung's decision about whether to sell Apple its new Super Retina edge-to-edge OLED screen for the iPhone X is a good example.

Samsung could have temporarily hurt Apple in the high-end smartphone market—where the Samsung Galaxy and iPhone compete—by not supplying its industry-leading screen. But Apple isn't the only rival Samsung has to worry about. In addition to being one of the world's largest phone manufacturers, Samsung is also one of the largest suppliers to phone manufacturers (including Apple, across several generations). If it hadn't provided its Super Retina display to Apple, Apple could have turned to LG (which supplies OLED screens for Google's Pixel 3 phones) or BOE (which supplies AMOLED screens for Huawei's Mate 20 Pro phones), strengthening one of Samsung's screen-technology competitors. Plus, Apple is well-known for helping its suppliers improve their quality. Cooperating with Apple meant that Samsung would get this benefit and that its screen-technology rivals would not. The fact that the deal would increase Samsung's scale and came with a big check attached—an estimated $110 for each iPhone X sold—ultimately tilted the balance toward cooperating.

It takes two to cooperate. Now let's look at the deal from Apple's perspective. Would it make Samsung a more formidable rival? It probably would: In the year prior to the iPhone X launch, revenue from Apple accounted for almost 30% of the Samsung display business, a division that generated $5 billion in profits. (Apple was also buying DRAM and NAND flash memory chips, batteries, ceramics, and radio-frequency-printed circuit boards from Samsung.) But for Apple, getting the best screen was worth bankrolling an already well-resourced rival—at least for a while.

The underlying economic reason that working together was advantageous to *both* sides was that Samsung had the best screen and Apple had a loyal customer base. Without cooperating, neither company could get the extra value from putting the superior screen on the new iPhone.

Will Cooperation Give Away Your Competitive Advantage?

Suppose you've analyzed the alternatives to cooperation and tentatively decided to move ahead. Doing so may mean sharing your special sauce. Then it might not be so special, and that could be a real problem. To get a read on the potential risk, figure out which of these four categories the deal falls into:

Neither party has a special sauce at risk, but the parties' combined ingredients create value. In this scenario neither side is giving anything away. A recent example is Apple and Google's decision to cooperate in creating

STRATEGY

contact-tracing technology for Covid-19. By sharing user location data across platforms, the two companies enabled governments and others to create effective notification apps. The circumstances here are exceptional, but it's not unusual for rivals to team up to set standards and create interoperability protocols and thereby create a bigger pie they can later fight over.

Both parties have a special sauce, and sharing puts them both ahead of their common rivals. In 2013, Ford and GM agreed to share transmission technologies. This made sense because they had complementary capabilities: Ford led in 10-speed transmissions, GM in nine-speed. The arrangement saved both money, had no significant strategic impact, and freed their engineers to work on next-generation electric vehicles, giving each company a leg up on other automakers.

There's a caveat here: Cooperation is more challenging if the playing field isn't level at the start. GM turned down an opportunity to collaborate with Ford on a next-generation diesel engine for super-duty pickup trucks. Though the potential cost savings were compelling, Ford already had a competitive advantage in the F-150's lightweight all-aluminum body, and GM feared that without differentiation between engines, Ford would have an unbeatable edge.

Sometimes, getting ahead of (or not falling behind) other rivals outweighs considerations of relative advantage. Autonomous driving technology, for instance, will be a key capability in the near future. Most automakers recognize that they won't be able to develop self-driving vehicles quickly or cost-effectively alone. That's why Ford invited Volkswagen to join its investment in Argo AI, an autonomous vehicle start-up. VW's $2.6 billion investment (along with its $500 million purchase of Ford's shares of the start-up) greatly reduced the drain on Ford's resources.

The deal also plays to each party's respective strength in getting regulatory approvals—Ford is strong in the United States, VW in Europe—significantly increasing the chance that Argo AI will be one of the platforms that gets worldwide approval. Ford also believed that if it didn't work with VW, VW would find another partner, which would decrease the chance that Argo AI would become one of the approved standards.

Because Ford's market share is greater than VW's in the United States and VW is ahead of Ford in Europe, it was a

good bet that this partnership wouldn't change the balance of power between them. The focus was on elevating the pair relative to their many rivals.

One party has a strong competitive advantage, and sharing only heightens it; even so, less-powerful parties are willing to cooperate. Amazon gives rival sellers on Amazon Marketplace access to its customers and warehouses. Why? For starters, while it loses some direct business and the associated markup, it makes a commission on Marketplace sales. The net effect on profit depends on how the commission compares with the markup, and whether Amazon Marketplace (which accounts for $50 billion of the company's revenue) leads to an increase in the company's total volume.

Even if the net effect were negative, blocking rival sellers from its platform would push them to other sites that could compete with Amazon. More important, though, when Amazon shares its platform, it becomes a hub—the starting place for any search. It makes money when a person looking for a book or a computer cable comes to its site and purchases additional, higher-margin products like electronics or clothing. Amazon also learns about the customer's preferences and can use this data to offer better recommendations and more accurately identify which Amazon-branded products to offer. And finally, opening up Amazon Marketplace allows Amazon to operate more warehouses and increase shipping volume, thereby reducing shipping times and lowering overall costs.

But why do other merchants cooperate with Amazon? Each partner, acting individually, finds it more profitable, even necessary, to be part of the Amazon ecosystem. But it's a collective action problem: When the merchants all join its platform, they make Amazon a more formidable rival. Indeed, both the European Commission and the U.S. House Subcommittee on Antitrust, Commercial, and Administrative Law are investigating whether Amazon Marketplace is using its dominant position to undermine and compete unfairly with its merchant "partners."

One party shares its secret sauce to reach another's customer base, even though doing so carries risks for both parties. We saw this dynamic when Samsung shared its high-end screen with Apple. Google and Yahoo provide another example.

Google is better than any of its rivals at turning ads that appear alongside searches into clicks—that's its secret sauce. In 2008 it agreed to do ad placement for Yahoo. Google's technology would generate substantially more revenue per search for Yahoo, and sharing it was the quickest, surest way to extend its value to the market Google didn't already have. (In the short run, Google was unlikely to capture all of Yahoo's customers. By 2020, Yahoo's share of search was down to 1.6%, but that decline took a dozen years.)

The potential gains were enormous. Given Yahoo's then 17% share of the $9 billion market, a 50% to 60% revenue increase would create almost $1 billion in annual profits to be split between the two companies.

The deal did carry some risks for Google. It might have made Yahoo into a stronger competitor, but that possibility was less worrisome because Yahoo was already cash-rich owing to its stake in Alibaba. (More cash probably wasn't material to its competitive position.) Improved ad technology on Yahoo might have led some Google users to switch, but it seemed unlikely that better ads would cause a large number to do so. Perhaps the greatest risk was that Yahoo would learn the recipe for Google's special sauce—but Google never planned to hand over its algorithms.

The risks for Yahoo were bigger. Its capabilities might wither if it became dependent on Google's black box. Were the partnership to end, Yahoo would be further behind, perhaps dangerously so. Those risks were mitigated by Yahoo's plan to continue doing ad placement for its sites in Europe and thus maintain its own capabilities.

What About Antitrust Issues?

Regulators are naturally suspicious when rivals get together. Executives need to know which types of cooperation are permissible and which are not. Some antitrust violations are black-and-white: Businesses that coordinate to raise prices or divide up the market are engaged in collusion, pure and simple.

Regulators tend to take a more favorable view when businesses work together to reduce costs or expand demand. One good litmus test is to ask if customers will be better off as a result of the cooperation. For example, customers benefit if rivals partner to provide charging stations for electric cars. Similarly, supplying a rival tends to pass muster when it improves quality (as is the case when Samsung sells its Super Retina screens to Apple) and doesn't foreclose market entry to other players.

There is always the possibility that regulators will step in to nix a deal, as they did with Yahoo's 2008 agreement to have Google provide it with search ads. This is one of the challenges of co-opetition.

Cooperation is an overall win-win, but splitting the gains is a zero-sum game. The solution is relatively straightforward when there's an even trade but harder if the trade is uneven.

In the end the deal didn't materialize; the U.S. Department of Justice ruled against it on the grounds that it might leave Yahoo a weaker competitor in the future. (One of us helped defend the agreement.) But the economics were compelling. One year later, Yahoo made a deal with Microsoft to have Bing provide its search ads.

It isn't always possible to rent the sauce without giving away the recipe, however. Could the United States and China, for instance, cooperate on a mission to Mars? A seemingly insurmountable challenge is that it would involve sharing intellectual property that can't be recaptured. This is a particularly sensitive issue since space technology spills over to military applications.

How to Structure an Agreement

The parties have almost gotten to yes. They've identified a desirable opportunity and found a way to share their special sauce without giving away the recipe. The remaining task is to craft the agreement. Two issues are particularly challenging when a prospective partner is also a competitor: the scope of the deal and how the costs and benefits will be divided. (There may also be antitrust concerns; for more on those see the sidebar "What About Antitrust Issues?")

Establishing scope and control. First the parties have to figure out how far to extend their cooperation, who is in charge, and how they might unwind their arrangement should it no longer make sense.

The simplest types of cooperation are limited and don't raise control issues. In some cases one party becomes a nonessential supplier to the other—as Honest Tea did with Safeway or as CBS did when it supplied the show *Dead to Me* to Netflix. In other cases the parties share costs but not proprietary knowledge. Rival television stations sometimes share camera crews, for instance, and rival breweries coordinate on recycling. Several museums in a city may run an ad campaign or develop an all-access museum pass together. Generally these arrangements are easy to negotiate and can be unwound easily.

Agreements become challenging when one party has to cede control, however. Ford and GM's plan to share transmission technologies worked well at the R&D stage, but neither company was willing to give control of manufacturing to the other or even to a joint entity. Ford and GM could have written a contingent contract about who got what transmission production capacity when, but this would have been tricky since demand is variable and transmissions are mission-critical. Fortunately, the majority of the cost savings came from using common designs and common parts, so Ford and GM limited the agreement to those areas.

In other circumstances one party is in charge and the other party is protected by a contingent contract with performance guarantees and penalties for not hitting specific targets. This works well in situations where there are established performance benchmarks. The party in charge, the one providing the guarantees, doesn't have to be told what to prioritize; instead the right-sized penalties allow it to internalize decisions and make calls that optimize the combined outcome.

It's important to structure any agreement in such a way that one side doesn't become dependent on the other. Otherwise, the dependent party may be backed into a corner when it comes time to renegotiate the deal—or distressed when the deal ends. As noted earlier, this was one of the Justice Department's issues with the 2008 Google-Yahoo deal.

Dividing the pie. Cooperation is an overall win-win, but splitting the gains is a zero-sum game. The solution is relatively straightforward when there's an even trade, as when Ford and GM shared transmissions. It's harder if cooperation involves an uneven trade and payments are required.

Consider interairline agreements to help stranded passengers. For a long time it was customary for airlines to take care of one another's passengers in the event of a flight cancellation, or what the industry calls an IROP (irregular operation). Airlines paid a low IROP rate to secure a seat on another carrier.

Cooperation broke down in 2015 when Delta thought other airlines were getting the better end of the deal and proposed a steep increase in the IROP rate. Delta was taking five American Airlines passengers for each Delta passenger that American took. American declined to pay more, and the agreement ended.

The underlying problem was an uneven trade. With an even balance of trade, the IROP fare doesn't matter. When the trade is out of balance, the right price is what ensures a fair deal. An IROP fare that was Delta's cost of a seat (including forgone sales to displaced customers) plus half the value

of American's gains (the savings on a hotel and meals and avoidance of the customer's ire) should have done the trick.

There might have been a way to save at least part of the deal without agreeing on price. Delta and American could have set up an agreement that guaranteed parity, trading seats on a one-for-one basis. If one airline had more cancellations and took more seats, the number of seats it got could be rationed going forward until things evened out.

The problem was ultimately resolved when the balance of trade was restored. After a series of computer outages and systemwide shutdowns, Delta found that it, too, needed some help. It renewed an agreement with American in 2018.

The challenges are greater when there are three or more parties to the deal and offsetting trades aren't possible. Take Ionity, a joint venture involving BMW, Daimler, Ford, Hyundai, Kia, and VW, which is building ultrafast electric-charging stations across Europe. The speed and cost savings advantages from teaming up are enormous. Still, each partner has different geographical priorities, creating tensions over where to place the stations.

Splitting the massive price tag is even harder. It wouldn't work to divide the costs equally; the partners have significantly different shares of the market, and Kia, with its much smaller slice, would walk away. Costs could be split according to market share—but should market share be based on unit sales, dollar sales, profits, or even miles driven? Each party had its favorite answer.

In the end the six companies agreed that costs would be divided in proportion to current unit sales. A simple, albeit somewhat arbitrary, heuristic like that may be a practical way to get a cooperative venture off the ground.

Changing Minds

Cooperation with rivals also has an important emotional aspect. Some people are comfortable with the idea that

ABOUT THE ART
Tierney Gearon collaborated with her children and their friends to create her Alphabet Book series, setting up scenes of calculated kid-chaos playtime for each letter of the alphabet.

there can be multiple winners, and some are not. As a result, co-opetition may end up being a strategy of last resort even in cases where it should be a first resort.

Apple was on the verge of failure in August 1997 when Steve Jobs was finally forced to confront the fact that Microsoft was not the enemy. Jobs later admitted that “if the game was a zero-sum game where for Apple to win, Microsoft had to lose, then Apple was going to lose.” That change in perspective was hard for Apple loyalists to accept. When Jobs announced at the Macworld conference that Microsoft had invested $150 million in Apple, Bill Gates was booed.

Obvious opportunities for cooperation fall by the wayside when businesspeople don’t focus on ensuring that all parties come out ahead. The world of check payments illustrates the problem.

Ever since printed checks were invented, more than 300 years ago, banks have needed a way to exchange those deposited by their account holders but written on other banks’ accounts. The obvious solution was to establish a central clearinghouse. When the London banks failed to do this, the bank runners did it themselves. Instead of crisscrossing the city to exchange checks, they did an end run and all met at the Five Bells tavern. Some 50 years later the banks established the Bankers’ Clearing House to do the same job.

In the modern era the U.S. Federal Reserve operated a system in which each bank would forward the paper checks it received to the Fed, which would then distribute them to the banks on which they were written. In 2001 some 40 billion checks were being flown around the country.

A logical alternative was to scan the checks and send digital images, thereby saving time and money. The challenge was that some of the small banks weren’t set up to process digital images. Thus cooperation would further tilt the playing field. When the large banks didn’t ensure that the small banks would also come out ahead, the small banks used their political power to block digital check clearing.

Then 9/11 forced the issue. With all planes grounded for over a week, checks were stranded and could not be cleared. At that point, the large banks finally agreed to ease the transition for small banks by having the Fed print the digital images and send the substitute checks to the small banks. In 2003 digital check clearing became established in law when Congress enacted the Check Clearing for the 21st Century Act.

It’s also possible to work *around* mindsets. One solution is compartmentalization—both mental and actual. The Apple-Samsung deal, which happened during a billion-dollar legal battle between the two tech giants over patent infringements, was doubtless easier to arrange given that Samsung operates as three separate companies with three separate CEOs. Apple could cooperate with one autonomous part of Samsung while competing with and suing another.

For a similar reason, we think it was wise for Ford to keep Argo AI, the autonomous vehicle start-up, a separate company. It was psychologically and contractually easier to get VW to invest in an entity that was outside Ford. The external structure helps ensure that the two will be equals and also makes it easier to bring in future partners.

ULTIMATELY, GETTING THE right mindset requires choosing the right people. The executives we interviewed emphasized the need to staff the cooperating teams with people who are open to the dual mindset of co-opetition.

That isn’t always easy, because people tend to think in either/or terms, as in either compete or cooperate, rather than compete *and* cooperate. Doing both at once requires mental flexibility; it doesn’t come naturally. But if you develop that flexibility and give the risks and rewards careful consideration, you may well gain an edge over those stuck thinking only about competition.

We began this article with the missed opportunity for cooperation between the United States and the Soviet Union on a mission to the moon. Today the opportunities for countries to cooperate are even larger—from tackling Covid-19 and climate change to resolving trade wars. We hope that a better understanding of co-opetition will help businesses, managers, and countries find a better way to work and succeed together.

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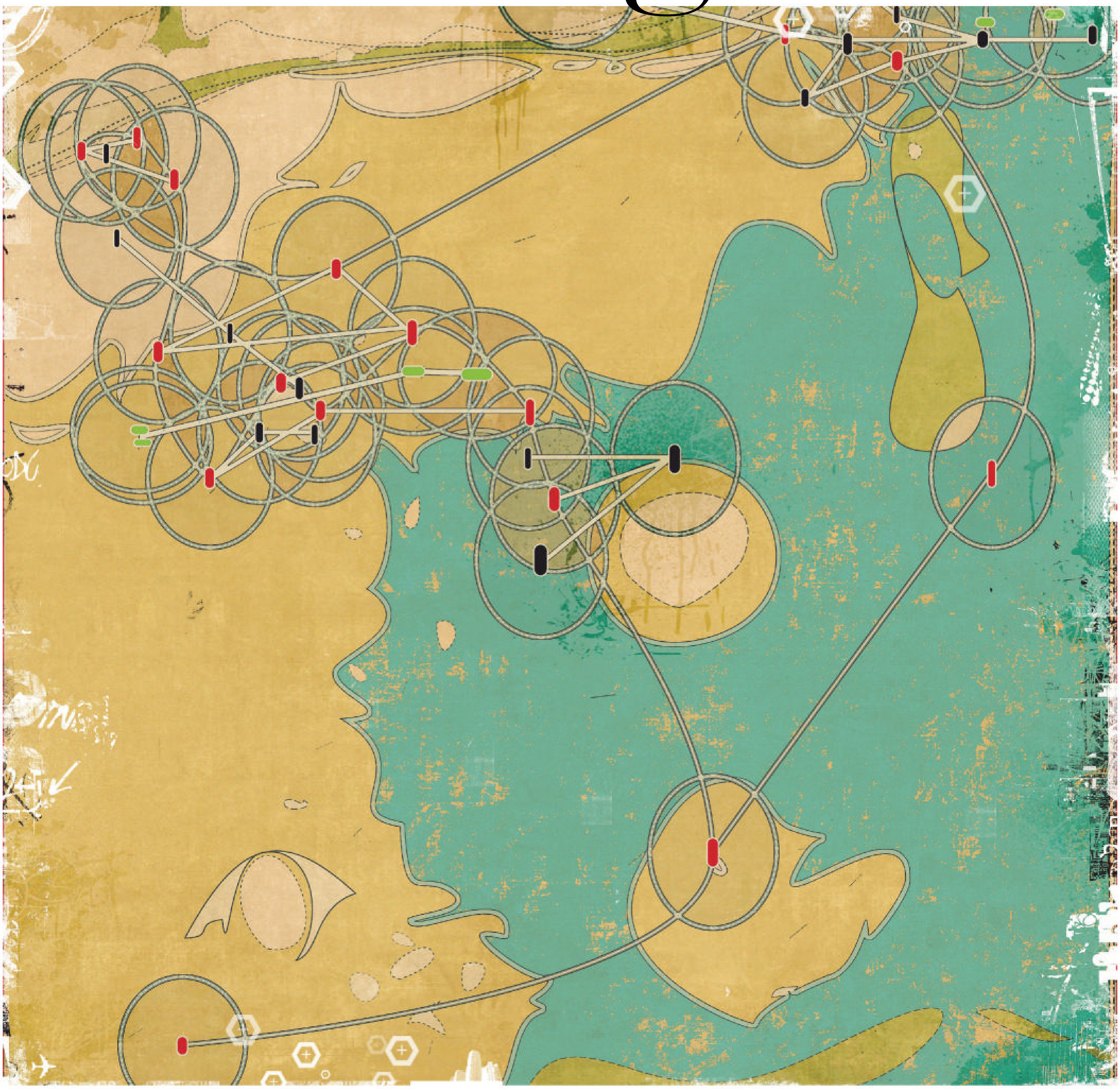
The Forgotten



Social class is as important as race or gender.

Dimension *of Diversity*

DIVERSITY

AUTHOR

Paul Ingram
Professor, Columbia Business School

ILLUSTRATOR **OLALEKAN JEYIFOUS**

DIVERSITY

I ONCE HAD A STUDENT in my executive education class, a managing director at a global bank, who told a heartrending story of her first steps toward professional success. As a teenager she had become a mother, and to make ends meet she'd worked cleaning offices. Even though she was dealing with substantial hardship at home—caring for a young child while defending against an abusive partner—she always brought a spark to her work, and soon she caught the attention of a manager at the bank. Sensing her potential, the manager encouraged her to apply for an entry-level white-collar job at the bank and to pursue training in finance—developmental steps that won her admission into the bank's professional ranks and then allowed her to start rising up the managerial ladder. By the time she and I met, she held a top job negotiating massive debt deals and was working alongside colleagues who had started in positions right out of elite universities. The work she was doing required grit, courage, and a deep human understanding—qualities that I venture are more common among the stars of custodial crews than among the middling members of junior-analyst groups hired each year out of universities.

Unfortunately, her story is the exception, not the rule, as I've learned through years of teaching managers, working with companies, and researching the role of lower social-class origins on behaviors and outcomes at work.

When I refer to people of lower social-class origins, I mean those who through the conditions of birth and upbringing have had relatively less access to money, to contacts who promote their upward mobility, and to the cultural know-how necessary to get ahead in schools and companies. Those of us who study social class origins often measure them along several dimensions: family income during early years, parents' level of education, and parents' occupations.

A person's social class origins leave a cultural imprint that has a lasting effect, even if the individual gains money or status later in life. Class origins certainly have an effect in the workplace. In recent research, my colleague Jean Oh and I found that U.S. workers from lower social-class origins are 32% less likely to become managers than are people from higher origins. This disadvantage is even greater than that experienced by women compared with men (27%) or Blacks compared with whites (25%). And it prevails in every major economy in the world.

The disadvantage matters—for individuals, organizations, and society.

It matters for individuals because it materially reduces their career potential and general well-being. We would consider a disadvantage of 32% among equally qualified candidates to be problematic when it comes to pay; we should also find it problematic when it comes to promotions. Researchers have found that promotion to a managerial role creates substantial job satisfaction—as much as a 60% raise in pay would, according to my own analysis. Managerial roles are also associated with better health: Managers experience less stress and live longer than nonmanagers do. Top managers, for example, are one-third less likely to die from coronary heart disease than are those on the bottom rung of an organization. One study found that simply labeling a participant as a "leader" rather than a "support person" before a task produced a better physiological response and better performance under pressure. Overall, the well-being benefits of hierarchical advantage are even greater than those of the accompanying boost in income.

The class disadvantage matters for organizations because it excludes from the management ranks a group that may produce better-than-average leaders. A study using data from the U.S. military, for example, suggests that individuals with lower social-class origins are less self-centered, which sets them up to be more effective as leaders. Similarly, a UK study found that lawyers from less-elite backgrounds are

> Any hopes we might have of addressing racial inequity in the workplace require a clear-eyed analysis of its root causes—and these are increasingly connected to social class.

more motivated and capable than their privileged peers. Not surprisingly, too, research shows that when a disadvantaged group is well represented among company managers, it receives more-effective advocacy. This suggests a trickle-down effect: If firms had more managers from lower social-class origins, employees and customers with similar origins could expect more-equitable treatment. Managers have an outsize influence on their companies, so inherited privilege in the promotion process can be a source of durable inequality.

The class disadvantage matters for society because it means that many workers do not have the opportunity to contribute to economic growth to their full potential. This is true of any disadvantaged group, but it's notably so in the case of social class, given that the majority of people in the workforce have lower social-class origins. In representative samples, more Americans identify as "lower or working" class than "middle or upper" class. Only a quarter of American adults today were raised by a parent with a degree, and by that measure three-quarters of adults fall into the lower social-class origins category. That's a startling figure. In discriminating against people who come from a lower social class, we're discriminating against a majority of the eligible workforce—a grossly harmful indulgence, especially when you consider what happens if you *don't* discriminate. According to my research with Jean Oh, GDP is higher per capita in countries where more managers come from lower social-class origins.

We've learned a good deal in recent years about how social class inequities affect access to jobs and promotions, but what we've learned is still mostly ignored by U.S. companies—even those celebrated for their diversity and inclusion efforts. In 2020, for example, not one of the companies on DiversityInc's "Top 50 Companies for Diversity" mentioned social class in their diversity, inclusion, and equity (DIE) goals and programs.

Those companies paid a lot of attention to gender and race, however, and for very good reason: Researchers have definitively established that being a woman or Black adversely affects the likelihood of being promoted. Consequently, companies such as Google and Bank of America publish extensive statistics every year to document the representation of women and racial minorities in their workforces, including in the ranks of managers. But as a rule, they do not report on social class disadvantage. Twitter, Facebook, Netflix, Google, and Amazon have all established employee resource groups (ERGs) to support employees from racial minorities or other underrepresented groups (Google alone has 16), but again, none of them addresses social class. In my own extensive search, I've found only one U.S. company that has an ERG based on social class: Uber.

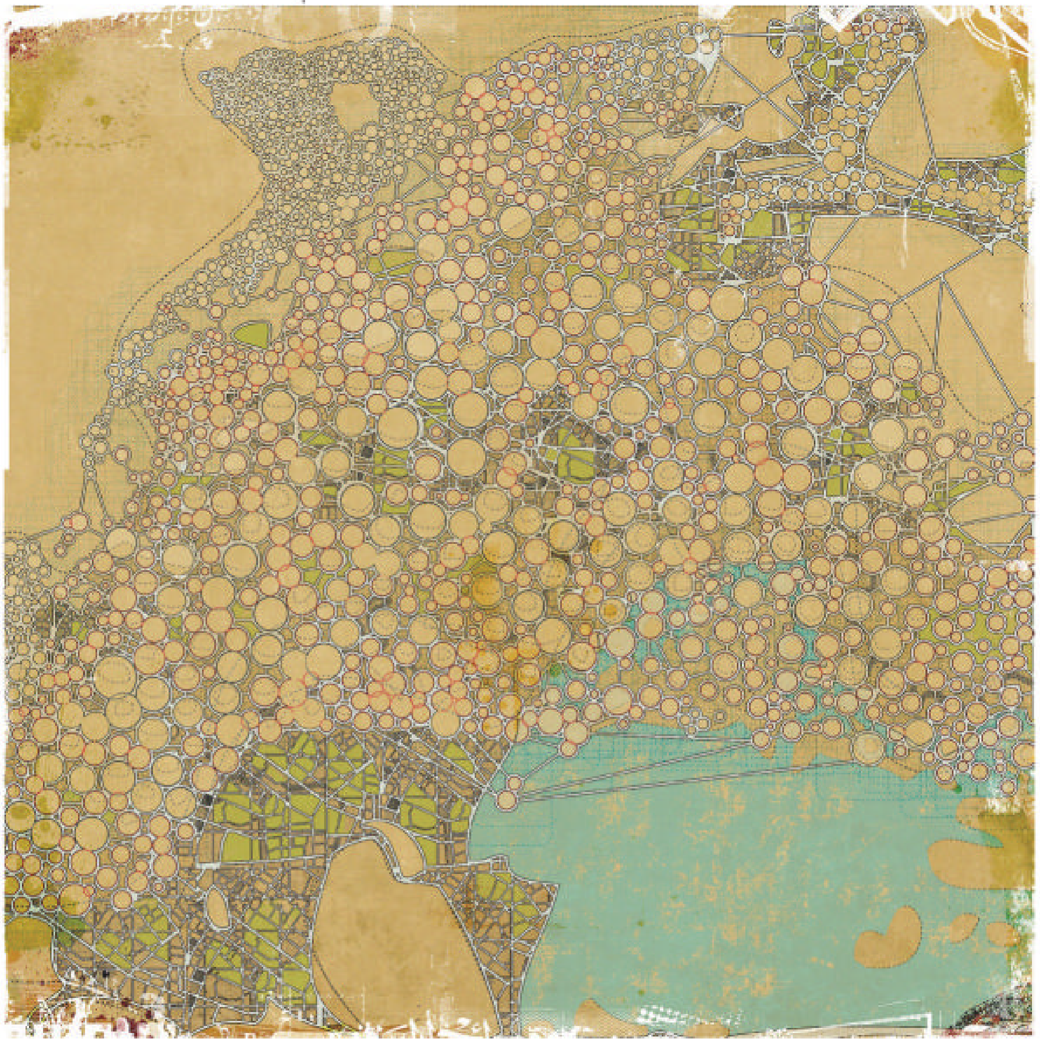
Companies may feel daunted by the prospect of another battle to fight, but they need not. By attending to social class disadvantage, they reinforce their efforts to combat other forms of disadvantage. As the Harvard sociologist William Julius Wilson points out, racial disadvantages in particular are intertwined with social class disadvantage in such a way that remediation of the former is impossible without attention to the latter. Any hopes we might have of understanding and addressing racial inequity in the workplace require a clear-eyed analysis of its root causes—and these, recent studies suggest, are increasingly connected to social class.

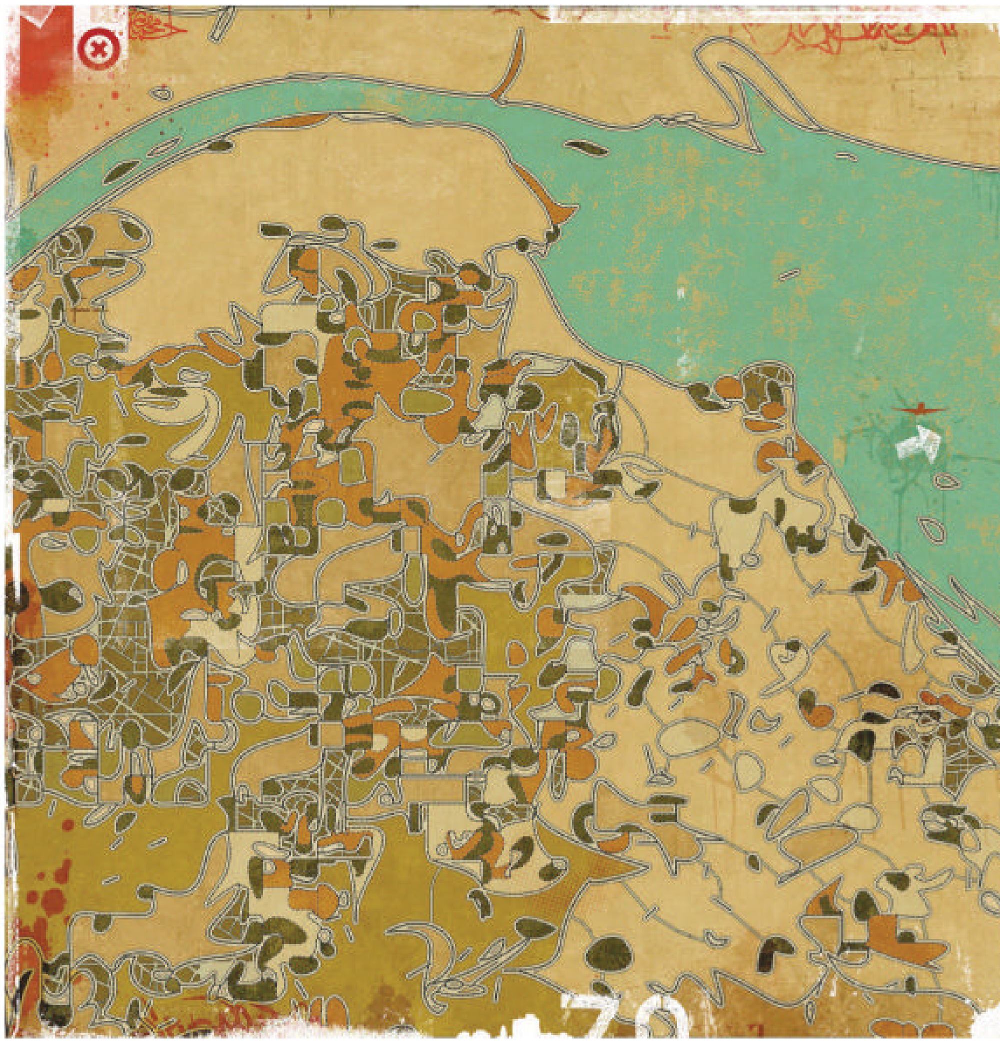
IDEA IN BRIEF

THE PROBLEM
A person's social class origins leave a cultural imprint that has a lasting effect. U.S. workers from lower social-class origins are 32% less likely to become managers than people from higher social-class origins.

THE PREVALENCE
This disadvantage is even greater than that experienced by women compared with men (27%) or Blacks compared with whites (25%). And it prevails in every major economy in the world.

THE SOLUTION
To combat social class disadvantage, companies should add social class to diversity goals, avoid degree inflation, promote candidates from all departments, and build a cohesive organizational culture.





In this article, I'll detail the most promising interventions that are emerging from research and practice to help remediate social class disadvantage. But first we need to explore the causes of the problem.

Cause and Effect

Workers with lower social-class origins tend to be less educated, a factor that, according to my research with Jean Oh, explains about 60% of the disadvantage they experience in the workplace. But that disparity in education levels has nothing to do with intelligence. As is the case for women and racial minorities, it has much more to do with context, expectations, and what's known as "stereotype threat"—the well-documented phenomenon whereby people perform worse because of negative stereotypes attached to their identity. When people from lower social-class origins are inoculated against negative stereotypes, they perform just as well as others on tests of intelligence.

The real deficit that workers from lower social-class origins suffer in school is not intellectual but cultural: They know less than those from higher class origins about what the pathways to education are and how to make the most of them. Evidence from elite colleges indicates that cultural capital matters more than financial capital in predicting which students will succeed. For example, the sociologist Anthony Abraham Jack identifies a group he calls the "privileged poor," by which he means people with few economic resources who nevertheless understand how to take advantage of the opportunities at college, often because they have been supported in their teen years by nonprofit leadership-development organizations. The privileged poor, he has shown, achieve educational outcomes comparable to those of their economically advantaged peers. Similarly, experiments show that when sufficient effort is made to help first-generation students adjust culturally to college, they achieve the same academic outcomes that other students do.

Fascinating recent research has shown that cultural capital matters in the workplace, too. In one study, Lauren Rivera and András Tilcsik found that interviewers for elite jobs in banking and law use markers of culture associated with social class, such as an interest in sailing or classical music, to screen candidates. A senior leader at my own organization, Columbia University, once informed me that he favored certain candidates for management roles on the basis of the high-status occupations their fathers had held.

Even when workers with a lack of cultural capital manage to get hired, they are hindered in their ability to move into

management roles. One study has shown, for example, that workers from lower social-class origins are unwilling to engage in office politics to get promoted, in large part because they tend to be more focused on others than on themselves and thus shy away from what they see as a self-serving pursuit. Even though they understand that playing politics is necessary for getting ahead, they are reluctant to seek advancement in that way—and over time, they become less enthusiastic about working for their organizations. Bias also seeps into everyday workplace interactions: Workers from higher social-class origins tend to distance themselves from those from lower ones, cutting them off from the connections that are essential for job performance and advancement and well-being at work. Although culture creates disadvantages for workers from lower social-class origins, it can be a source of strength if they're able to overcome barriers and attain managerial roles. Many become "social class transitioners"—workers who have managed to move up in the world despite their origins. A 2019 study, for instance, shows that such workers, like the bank managing director whose story I used to open this article, are more creative, more empathetic, and uniquely capable of bridging cultural divides, which makes them a precious managerial resource. As such they might be expected to be the focus of intense recruitment, inclusion, and development efforts. But so far, that has not been the case.

Why not?

Confronting Inaction

Social stigma is one reason. As Joan Williams and her coauthors put it in a recent HBR.org article, "It's awkward, talking about social class." CEOs and diversity VPs I have interviewed have suggested that some employees are ashamed to put themselves forward for programs designed to include or develop employees from lower social-class origins.

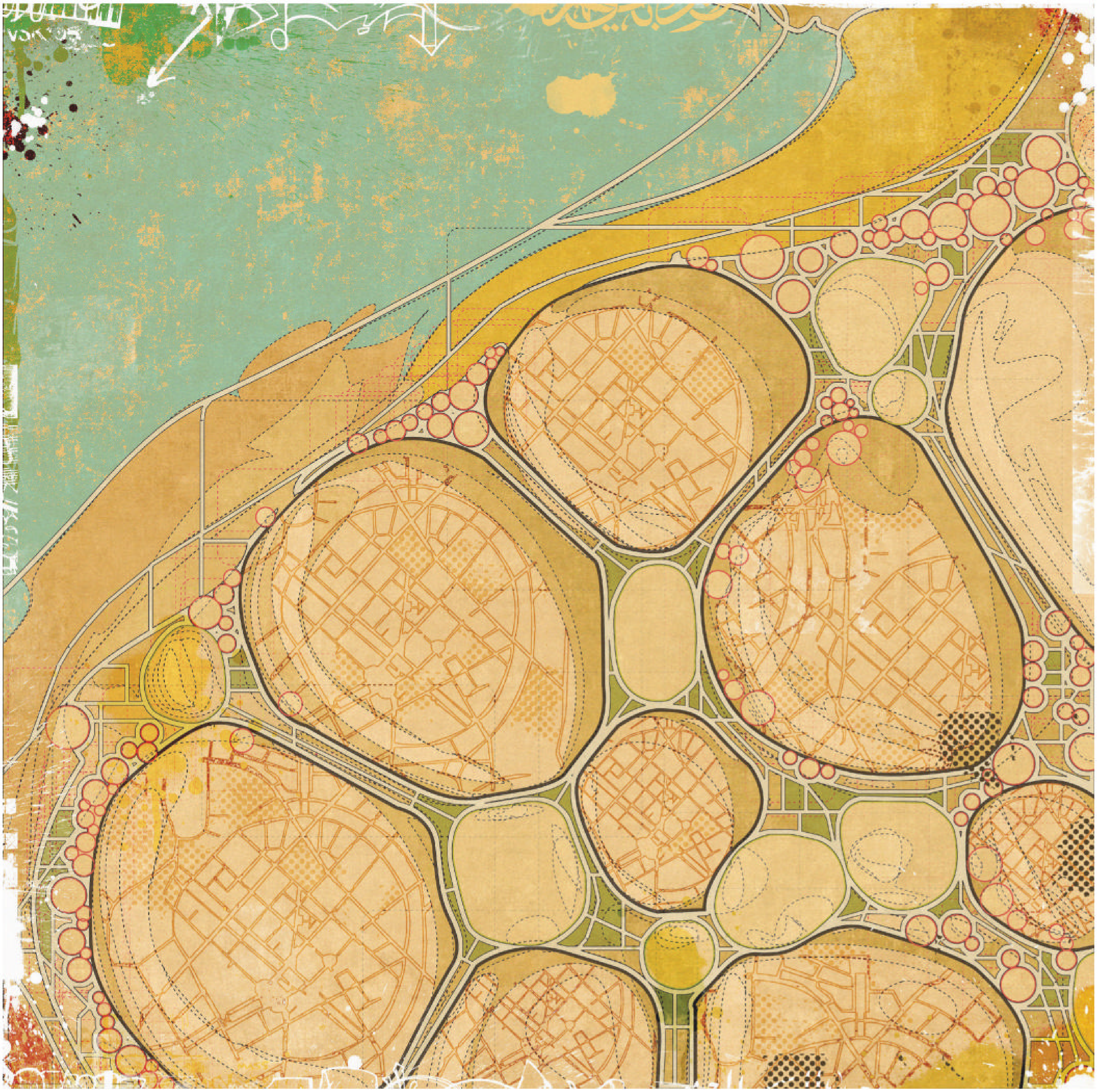
But stigma can—and should—be overcome. One VP of diversity and inclusion, a Black woman, told me that early in her career as a manager she was hesitant to join women's support groups and consciously avoided frequent hallway conversations with Black colleagues, out of concern that such associations might cause her to be negatively stereotyped. Today, the companies where she worked all have corporate programs designed to include and develop women and minority leaders. There's no reason the same can't be done for social class.

The corporate leaders I work with sometimes raise the question of how to measure social class representation in the workplace. For answers, we can again look at what's been done with other disadvantaged groups. The challenges involved in measuring race, ethnicity, and, increasingly, gender are not trivial—but many companies have nonetheless managed to overcome them. In the UK, the government has provided some very practical guidance on how to study social class origins in the workplace, using measures similar to the ones listed above: parents' education level, parents' occupational status, whether workers attended private or public high school, and whether they qualified for free meals in their school years. These measures are easy to implement and can translate across contexts. On its employee engagement survey, for example, Spotify has recently added this question: "Did any of your parents or guardians have a college degree?"

One top leader of a global company told me that social class is probably overlooked in corporate DIE efforts because it's not a protected category in employment law. That

ABOUT THE ART

Olalekan Jeyifous's series of planimetric drawings, "Settlements and City Strategies," explores the idea of a degenerate futurism through an abstract representation of the changing contours of urban settlements.



represents a flagrant hypocrisy: To genuinely embrace diversity, inclusion, and equity, organizations have to embrace it for everybody. Attending only to groups in protected categories would discredit the whole enterprise.

The Way Forward

There are some good examples of well-designed policies and practices that counteract class disadvantage and pursue equity and organizational performance by recruiting, including, developing, and promoting individuals from lower social-class origins. Here are a few ways to get started.

Add social class to your DIE goals. Many companies have successfully increased the representation of women and racial minorities in their managerial ranks by setting specific DIE goals, backing them up with smart programs, and holding themselves accountable for results. The same approach works for social class.

Consider PwC, the number-one-ranked firm in the UK's 2019 Social Mobility Employer Index. In 2017, PwC created a team dedicated to improving social mobility in its workforce; its goal was to apply the same level of attention to the disadvantages of social class that it was already applying to those of gender, ethnicity, and race. The company now has a 1,000-member social-mobility support group that serves as a bridge to the community—notably to schools, where it facilitates outreach to students from lower social-class origins. Leveraging a broader effort that's under way in the UK to collect and disseminate data on social class in the workplace, PwC will also soon begin publishing statistics on the social class origins of its employees in its diversity reports. Such reporting helps promote accountability and has been shown to be one of the most effective practices for improving the representation of disadvantaged groups in management. To encourage access and fairness, PwC has also reviewed its recruitment processes and now strives for social class diversity on its interview panels.

Push back against degree inflation. A recent study found that 67% of job postings for "production-worker supervisor" in the United States required a bachelor's degree or higher, even though only 16% of the people who already held the title had that qualification. By demanding an educational credential that was not necessary for performing the job, recruiters were exacerbating social class disadvantage. In the UK, Ernst & Young has taken the bold step of eliminating the requirement of a degree as a qualification for joining the firm, after finding that success at a university has no relationship to achieving professional certifications. A better approach, the firm concluded, would be to measure capabilities directly in the recruiting process through formal tests and assessments. IBM has a kindred initiative that it calls the "new collar" program, which aims to hire for jobs, including software engineering, on the basis of skills rather than degrees. Google's recently announced Career Certificates program provides a noncollege training program to prepare people for jobs in IT throughout the United States.

Promote the best candidates from every department. Departments in organizations tend to be stratified according to social class: People with higher origins cluster in high-status departments; those with lower origins work in less-visible groups. Because companies often seek candidates for managerial roles from only a handful of departments, the odds are stacked against some of the best candidates simply because they work in the wrong place.

Walmart, where 75% of today's salaried store managers began as hourly associates, seeks out leadership talent in overlooked places. The company has recently established more than 100 Walmart Academies at its supercenters around the country. These academies provide developmental training in leadership and management to hourly employees who have moved into supervisory roles. And sometimes the path continues all the way up to senior leadership, as it did for the current COO of Walmart U.S., Dacona Smith, who began as an hourly employee at an Oklahoma Walmart at the age of 17, after his dream of playing college football was ended by a broken hip. That first job was arranged for him by his mother, who was herself a Walmart associate.

Face up to the interdependence of race and social class. As William Julius Wilson noted, it's impossible to understand racial disadvantage in the U.S. workforce without also considering social class. Working with data from the General Social Survey, a comprehensive, representative survey that has been conducted in the United States since

1972, I've found that for workers from higher social-class origins, race is not a factor in determining who becomes a manager. For people with lower social-class origins, however, race does matter: Blacks from lower-class origins are substantially less likely than whites with similar backgrounds to become managers. These people, Wilson points out, are the "truly disadvantaged." Understanding this interdependence is fundamental to improving economic outcomes for Blacks and remedying social class disadvantage.

Few companies in the United States set a goal of establishing equality across social class origins, but those that do often conflate social class origin with race and then make interventions solely on the basis of race. It's possible to justify that approach, given that Black workers are more likely than whites to come from lower social classes and suffer more disadvantage because of those origins. But to the extent that race-based interventions favor Black workers from higher social-class origins, they do little or nothing to resolve the class disadvantage in management. For example, although historically Black colleges and universities (HBCUs) are unusually diverse in terms of their students' social class origins, half of their students come from the middle class or higher. A company recruiting on those campuses might make no hires from among students with lower social-class origins unless they deliberately attend to social class bias in their recruiting interviews.

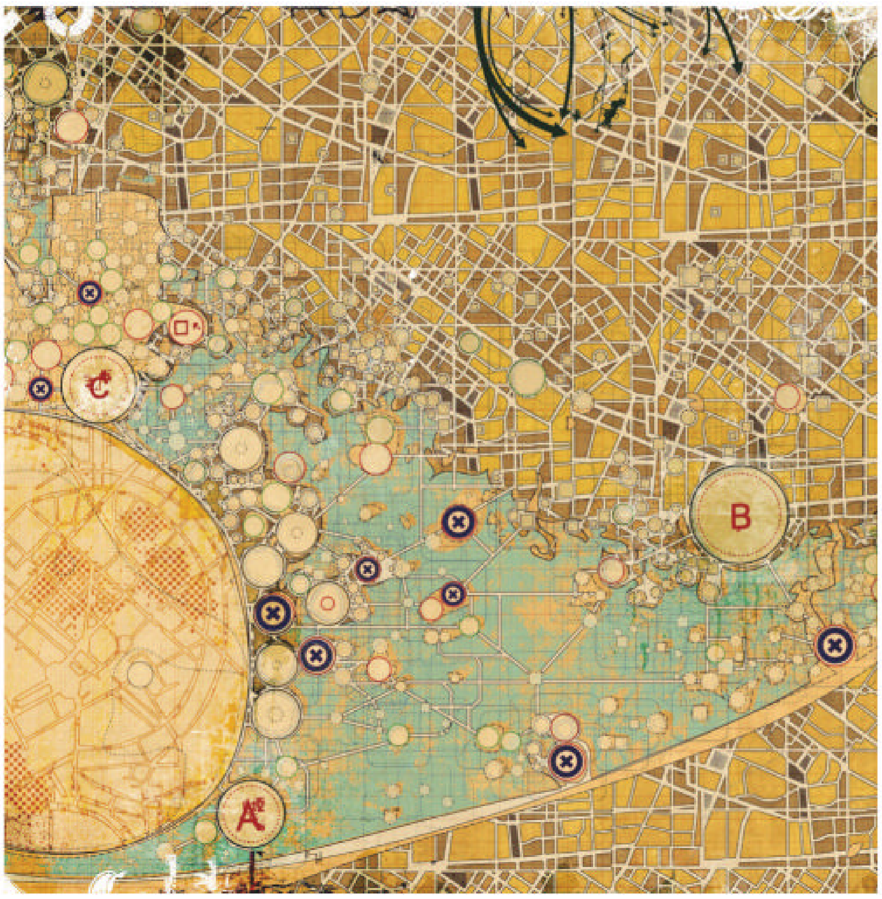
The most effective recruitment programs focus on race and social class simultaneously. That's what JPMorgan Chase does in its Advancing Black Pathways (ABP) program, which gives special attention to first-generation and low-income students in the recruiting it does at HBCUs—an approach it calls recruiting for "diversity within diversity." ABP also supports a financial-hardship fund for students at HBCUs, providing money for transportation, technology, and food, the goal being to enable students under financial duress to stay in school and earn their degrees. After participants in the program graduate, ABP maintains contact with them and invites them to apply for internships and jobs.

Build a cohesive organizational culture. Companies that hire with cultural fit in mind can significantly improve employee commitment, satisfaction, and motivation, and in doing so can reduce turnover and boost overall performance. Building a cohesive culture is also a means of social class inclusion, because workers from lower social classes are more likely than those from higher ones to understand that their outcomes and responsibilities in the organization are interdependent with those of the people around them. Hiring for cultural fit, however, too often consists of hiring employees who share managers' hobbies, personal interests, or backgrounds—a practice that HR directors increasingly denounce because it can be used to exclude disadvantaged groups, especially those from lower social-class origins.

Airbnb has shown that a rigorous evaluation of fit can produce a strong organizational culture without allowing discriminatory biases to hold sway. It has established guardrails against personal bias in its hiring process, for example, by clearly and explicitly identifying the competencies and attributes required for each position. Organizations can also use machine-learning techniques to avoid the superficial noise that sometimes distracts interviewers. For example, my colleagues and I have used machine learning in reviewing MBA applications. It has helped us identify students who are diverse on many dimensions but hold similar values and are therefore likely to perform better together.

Organizational culture can be strengthened among current employees by implementing strategies of active social inclusion. Consider the case of Televerde, an Arizona-based marketing company at which incarcerated women make up half the workforce. The company introduces new employees to the organization through an intense socialization process it calls boot camp. The process promotes such values as "caring for people," "trust," and "courage to change"; this resonates with people of lower social-class origins, who understand that their outcomes are dependent on those around them. The approach pays dividends for Televerde's incarcerated employees, who after release are employed at rates double the average for formerly incarcerated women—and whose recidivism rates are 90% lower. It works also for Televerde's clients, who, thanks to the dedication and professionalism of the company's employees, benefit in the form of increased sales. Televerde today has 600 employees, and in 2019 it grew at a rate greater than 10%, a testament to the economic viability of its social inclusion strategy.

By demanding an educational credential that was not necessary for performing the job, recruiters were exacerbating social class disadvantage.



Role modeling presents another opportunity to build organizational cultures that support and integrate workers from lower social-class origins. It's been shown to work, for example, in programs aimed at assisting first-generation college students, who typically don't perform as well academically as students from higher social classes. That performance gap can be closed, it turns out, if those students participate in workshops on navigating social class disadvantage in higher education—especially workshops run by older students with similar origins.

Role modeling helps in the workplace, too. When social transitioners offer guidance to new employees from lower social classes, they can effectively make up the know-how deficit. That's the case at PwC UK, where Laura Hinton, the company's chief people officer, speaks regularly to employees and potential recruits about her upbringing in public housing and how she avoided the path expected for her by high school counselors.

IN RECENT DECADES, companies have focused on building programs that improve the representation of women and racial minorities in management. That work is far from over, but it demonstrates that the barriers to inclusion and equity are surmountable. As research reveals the powerful negative effects of the social class disadvantage, we must expand our DIE efforts to improve the representation in management of workers from lower social-class origins. A few organizations are showing the way forward—by explicitly recognizing social class as an important and measurable target of DIE efforts, by addressing the causes of social class disadvantage, and by confronting the relationship between social class and race. But we have much more work to do. Given the significant number of people from lower social classes in the American workforce, I estimate that if we were to resolve the problem, we might increase the supply of capable managers by a third.

Imagine that. The potential rewards—for individuals, organizations, and society—are enormous.

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Focus on your role, responsibilities,

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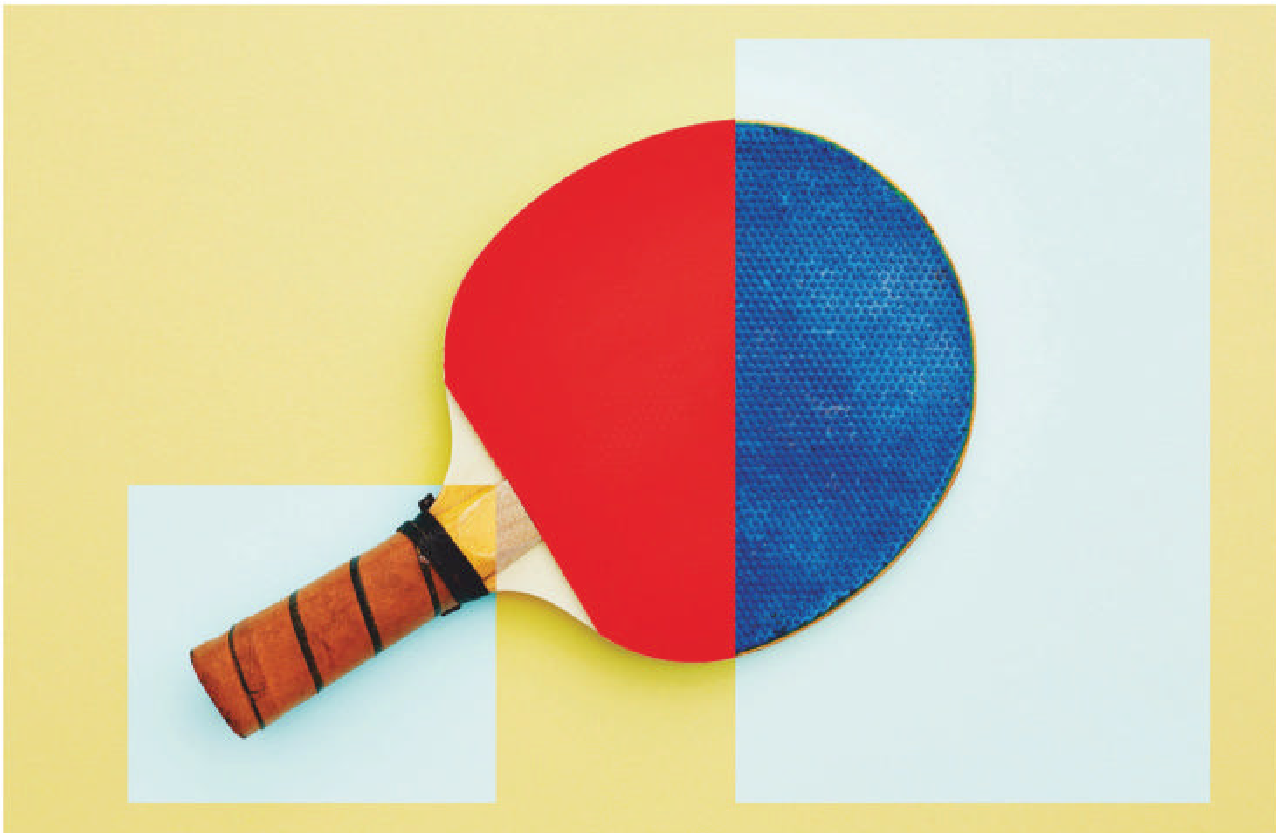
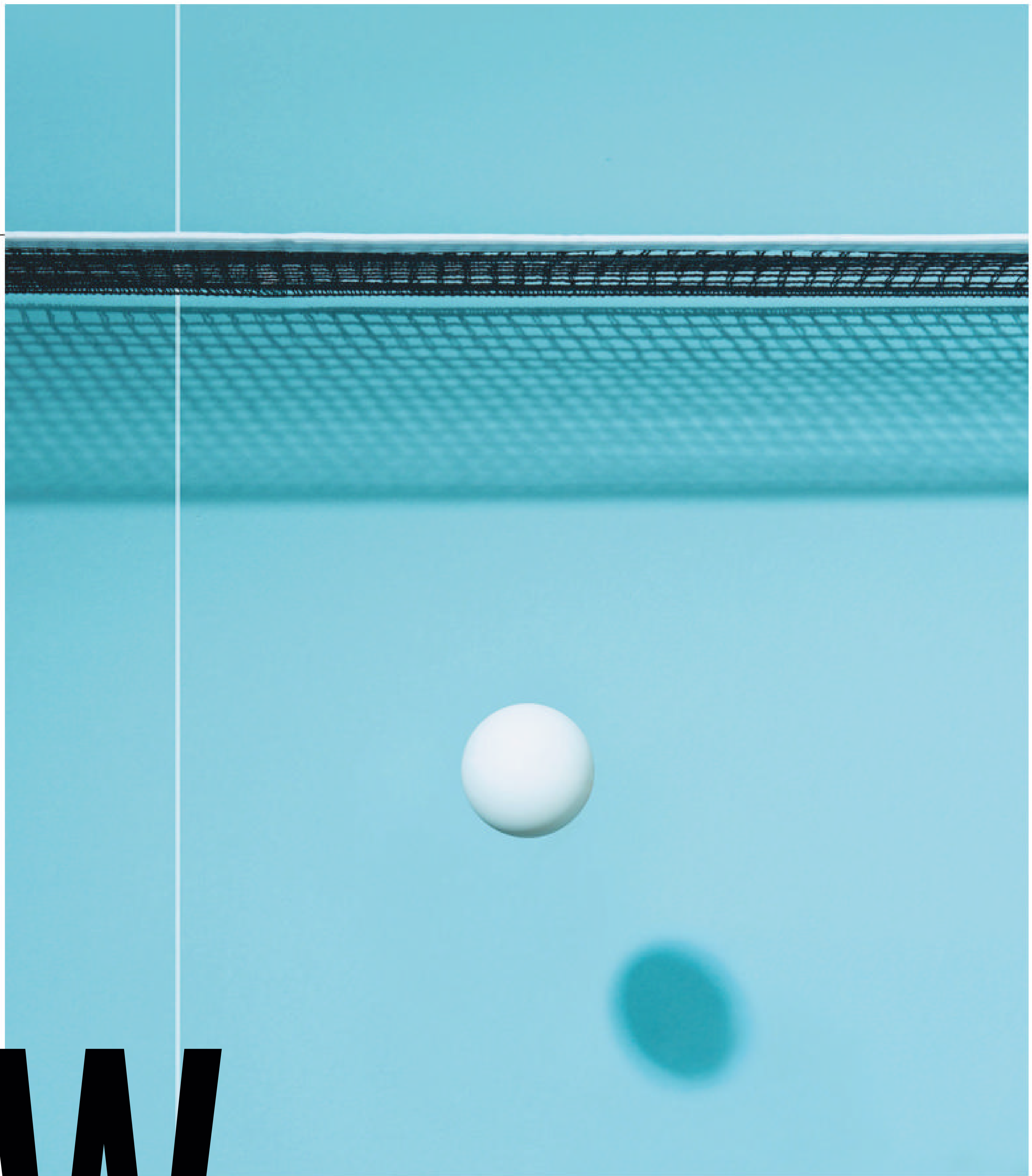
NEGOTIATION

Negotiating Your Next Job



and career trajectory, not your salary.

NEGOTIATION



IDEA IN BRIEF

THE PROBLEM
In job negotiations, professionals too often focus on pay and benefits and fail to think more broadly about how the opportunity will fit into their long-term career goals.

THE WAY TO START
Work backward from your career objectives to define the next steps you want to take. Be mindful of whether you're proposing something standard, an unusual arrangement for yourself, or an idea that will change the organization.

THE NEGOTIATION
Make sure you have all the necessary information and aren't operating under false assumptions. Explain why your request is also in the other party's interest. Seek input and feedback from people who could be helpful, and enlist allies to support your proposal.

WHEN WE ASK PROFESSIONALS to describe a career negotiation, the first thing many people think of is bargaining with a hiring manager over an offer package. That scenario may spring to mind because compensation negotiations can be especially stressful and awkward and therefore become seared into our memories.

Although reaching agreement on pay and benefits is important, failure to think more broadly about your career could mean losing valuable opportunities for advancement. For instance, women are increasingly urged to negotiate for higher pay as a way to close the gender wage gap. However, studies have shown that women's "80 cents on the dollar" is explained more by differences in men's and women's career trajectories than by differential pay for doing the exact same job. Our research and our work coaching executives suggest that negotiating your role (the scope of your authority and your developmental opportunities) is likely to benefit your career more than negotiating your pay and benefits does. And at times of work-life conflict, negotiating your workload and the conditions that affect it (including your

Negotiators too often start their preparation focused on the opportunity right in front of them rather than on their ultimate work and life aspirations.

responsibilities, your location, and travel requirements) may be critical to remaining gainfully employed and moving forward professionally.

As with other dealmaking, career negotiations should not be solely about getting as much as you can. The best negotiators generate mutually beneficial solutions through joint problem-solving and creative trade-offs, along with compromise. Furthermore, negotiating the direction of your career typically involves multiple stakeholders—including those in your personal life as well as those at work.

We advise professionals to think strategically about not just *what* they might negotiate but *how.* That means going beyond planning what to say at the bargaining table; it requires keeping your eye on larger objectives, ensuring that you are negotiating with the right parties over the right issues, and preventing misunderstandings from derailing your requests or proposals because they are unconventional or potentially pathbreaking.

In the age of Covid-19, the time is ripe to improve your career negotiation skills. Many people are changing how they work (shifting to remote or flexible arrangements, for example), what they are working on (being redeployed or responding to new priorities), and with whom they're working (collaborating in new ways across functions and geographies). And transformations in our work lives are increasingly interlinked with transformations in our personal lives—whether that involves relocation decisions, periods of intense dedication to our jobs, or adapting to spikes in caregiving demands.

Drawing from a research project in which we collected thousands of stories from recent professional-school graduates, mid-level managers, and senior executives from seven global regions about how they advanced at pivotal points in their careers, we propose four steps for preparing for your career negotiations. They progress in a logical order, but you are likely to return to earlier steps as your analysis proceeds. For instance, you might start out intending to negotiate for one type of opportunity but discover that you're better off negotiating for a different type. Or you might initially conceive of a proposal to present to your boss but then come to understand that your boss is actually not the key stakeholder who needs to be persuaded. Particularly for a complex and protracted negotiation, you should continually refine your analysis as you gain information.

1

Start with Your Career Goals

In our experience, negotiators too often start their preparation focused on the opportunity right in front of them, such as a job offer, rather than on their ultimate work and life aspirations. As you enter a period of change in your career, you should think about your short- and long-term aims and then map backward from those objectives to define the next steps you want to take. Don't forget to include quality-of-life considerations as well as professional ones. And be prepared to defer gratification if that's the right thing to do for the endgame.

Anya's story offers a cautionary tale. ("Anya" and all other individuals discussed in this piece are composites of case examples we studied.) When finishing her MBA program, she was evaluating two offers: one in consulting—the field she had previously worked in for several years—and one that would launch a new career in tech, which was what her heart truly desired. (Feeling torn between two industries is common in job searches.) The consulting firm was offering her more money and status than the tech company was—unsurprising, given her track record in consulting and her limited experience in tech (one summer internship). Focused on the terms of the offers, Anya started her negotiation preparation wondering if she should walk away from the tech company unless it matched the salary offered by the consulting firm.

Making compensation the deciding factor can be a mistake. If we'd been coaching Anya, we would have encouraged her to start with her career goal: transitioning out of consulting into tech. We would have encouraged her to compare the competing offers not only with each other but also against her vision of what she wanted to achieve in her first five years out of graduate school. Next we might have asked, "To improve the tech offer, what might you negotiate to fulfill your dream of a career in tech?" After all, her lifetime earning potential could be higher in that booming sector than in consulting. Perhaps she could accept the lower compensation but negotiate for an accelerated promotion track—a solution that might appeal to the tech company because it would not need to deviate from its compensation standards for MBA recruits.

Previous spread: Richard Drury/Getty Images; this spread: Yagi Studio/Getty Images

NEGOTIATION

> Depending on whether you are in an “asking,” a “bending,” or a “shaping” negotiation, you will need to vary your arguments.

Such longer-term thinking often pays off. In *Chasing Stars: The Myth of Talent and the Portability of Performance,* Boris Groysberg reports that the financial analysts who were most likely to retain their star status after moving to a new firm were those who had looked beyond pay and carefully researched whether the new firm would provide them with the organizational resources to excel. They understood that being successful in one setting doesn’t guarantee success in another, so the compensation package was just one aspect of the job offer to consider. Our advice is to define from the start what you most want to achieve—whether that’s being a top professional, making money, or living up to some other ideal—and then keep that goal in mind as your negotiation progresses.

2

Understand What You’re Negotiating For

Career negotiations fall into three buckets. In *asking* negotiations, you propose something that’s standard for someone in your role or at your level. In *bending* negotiations, you request a personal exception or an unusual arrangement that runs counter to typical organizational practice or norms (for example, a remote work setup or a promotion to a position for which you lack the conventional qualifications). And in *shaping* negotiations, you propose ways to play a role in changing your organizational environment or creating a new initiative (such as revamping the way a project is run or launching a new business unit). Depending on whether you are in an asking, a bending, or a shaping negotiation, you will need to vary your arguments to win your counterparts’ support.

In asking situations, you must demonstrate that your request or proposal is reasonable because it fits with existing practices or norms—for example, a pay raise is warranted in light of an outside offer, or you deserve a promotion or a developmental opportunity because other employees with your track record or experience have received such rewards. Asking negotiations often arise in the context of routine conversations about role assignments. If you are asked to do work that would move you away from your career goals, see if there is room for negotiation. For instance, you might be able to explain why the proposed change in your role is not in the employer’s interest: Perhaps it would hurt the performance of your team or damage the relationship with a high-value client. Another option is to agree to do the job for the sake of organizational needs in exchange for some other career-advancing opportunity. For example, you might say, “I will take on this role to help us out of the current crisis, but I would like to rotate into a job with more P&L responsibility after two years.”

If you are in a bending negotiation—seeking some special exception or privilege—you need to keep your counterparts from doing what’s easiest and simply saying, “No, that’s not the way things are done around here.” Justifying your request is particularly important if you are asking people to take a chance on you, such as putting you in a position for which you are not traditionally qualified.

Consider the case of Bela, who wanted to move from finance into a leadership role in IT as her company launched a digital transformation. The CIO considered her unqualified and seemed likely to dissuade the CEO from giving her the job. Bela came to realize that the CIO wanted someone more experienced to oversee the IT transition, in part because failure would reflect poorly on the CIO’s own leadership. So she asked for a six-month trial while the CIO searched for a potential replacement. Bela explained why her deep knowledge of the company’s financial systems and her track record managing cross-functional teams prepared her to succeed in this IT role or, at a minimum, keep the company on solid footing until she was replaced by a new hire.

Although any negotiation can backfire, bending negotiations are particularly risky because they may give the impression that you’re a prima donna seeking special treatment or unwilling to pay your dues. Deborah Kolb, an expert in career negotiations, suggests a role-play exercise to mitigate this risk: List the reasons why your counterparts would support your proposal; then come up with a list of reasons why they might say no anyway—and your possible responses. Beyond strategizing to get past “no,” we advise weighing the downstream career risks and benefits of entering into an exceptional or unconventional work arrangement.

Whereas asking and bending negotiations are focused solely on your personal career path, shaping negotiations

Richard Drury/Getty Images

center on proposals to change the path of your organization or working group. Because that commonly means seizing leadership opportunities, shaping negotiations typically involve more parties and the backing of allies.

Consider Samir's desire to lead a restructuring of his firm, which was run by an elite old guard that he saw as out of step with globally competitive business practices. Samir recognized that he needed to build a cross-generational coalition to support this change. As he made his case to key colleagues, he found allies among the veteran leaders who recognized that the firm's legacy would depend on retaining bold thinkers like him. He also found peers who appreciated his vision for growth. Finally, with his spouse's support, Samir worked out a plan to relocate internationally for another position if the firm rejected his proposal. He then began the negotiation process with confidence that he had enough buy-in within the firm to lead a transformational change, but also a satisfying alternative for himself and his family if that was not possible.

Organizations may be especially receptive to bending and shaping negotiations during challenging or fast-changing times, when people are looking for ways to adapt and innovate. For instance, in light of the Covid-19 pandemic and social distancing restrictions, many employees need to change the way they work. Their collective bending negotiations are a useful source of information and experimentation for organizations and individuals trying to figure out how to maintain high morale and productivity during the crisis. Organizations are also welcoming shaping proposals from employees who have ideas about how to redeploy resources and open new markets in response to economic disruptions at home and abroad.

3

Reduce Ambiguity About What, How, and with Whom to Negotiate

No one would ever advise walking blind into a potential negotiation, but people do it all the time. One risk is that you'll "get Wahlberged," as the journalist Kate MacArthur put it, writing about how Mark Wahlberg negotiated a payment of $1.5 million to reshoot some scenes in a Hollywood

Stretch your inquiry beyond your closest networks to ensure that you have the broadest information possible.

film while his costar Michelle Williams accepted less than $1,000 for the same work. That case has been highlighted as an example of women's failure to negotiate, but the underlying problem was a lack of information on what was negotiable. Williams had been led to believe that all the actors on the reshoot were effectively donating their time to save the film after another costar was pulled from the cast.

Reducing ambiguity is particularly important for ensuring that people from underrepresented groups—oftentimes women and people of color—get a fair shake. Many organizations are moving to make their recruitment and promotion practices more transparent so that all candidates have access to the same information and opportunities. Increasing transparency is obviously the responsibility of organizations, but individuals can take action too.

As you prepare to negotiate, write down all the questions you have: *What is potentially negotiable? How should I negotiate? Who will be my counterparts, and what do they care about?* There are many sources for this type of information. Talent professionals, for example, will explain in general terms what is typically negotiable and how (although they usually won't reveal the specifics of any individual case). Some information is available online. A media or YouTube search can give you perspective on counterparts' points of view on strategic issues. A LinkedIn search can help you find professional contacts who may tell you more about a hiring manager or a department.

Although your personal and professional networks can be a valuable source of information, you should not rely on them alone to get an unbiased understanding of the situation. Think of a field in which men tend to be better paid than women. If women confer only with other women about customary salaries, and if men confer only with other men, women are likely to enter pay negotiations with lower expectations than men have—and to exit with worse outcomes.

Stretch your inquiry beyond your closest networks to ensure that you have the broadest information possible. Recently many people have been learning from how organizations in other industries or geographies are responding to the challenges presented by the Covid-19 pandemic. Better information helps generate innovative solutions; it can also help you make a persuasive case for managing your career the way you want to during these turbulent times.

4

Enhance Your Negotiations Through Relationships—and Vice Versa

As you aim to reduce ambiguity, you will undoubtedly think of people you might go to for information or advice. You might also think of others who could provide social support—those who would encourage and stand by you and give honest feedback if you are off track. Don't forget to identify potential advocates for your proposal. Who might be willing to speak up in favor of it? Who are your allies? Connecting with people who can be helpful is what we mean by enhancing your negotiations through relationships.

Consider the example of Brandon, an engineer who landed a job as a private equity associate after finishing business school. Lacking finance experience, he had been advised that his prospects of making partner were dim if he did not make a distinctive contribution. Brandon hoped to do that by arguing for the creation of a small fund to invest in marketable robotics projects—an underdeveloped growth area for the firm. Before negotiating to spearhead this initiative, he sought advice from his former robotics professor, who could spot weaknesses in his proposal and help him fix them. He also found a partner at the firm who agreed to let Brandon shadow him on tech company boards.

To build a coalition of support for what you hope to do, you might start off by trying something akin to the shuttle diplomacy used by negotiators of international affairs: Make the rounds of key stakeholders, talking with them individually to solicit their feedback and input. Shuttling is more time-consuming than calling a summit of all interested parties (a meeting to pitch your proposal). But it enables you to privately explore people's interests and concerns and to incorporate their ideas into your game plan. It also helps you predict how people will respond when it comes time for you to present a formal proposal.

If you're concerned that shuttling around might make you appear conniving or manipulative, then be transparent about it. Explain that you're seeking input on an idea you have, and meet early with people who might block

Yagi Studio/Getty Images

NEGOTIATION

your proposal if they felt you weren't consulting them. To broaden buy-in, you might also enlist others to help you get feedback, keeping in mind Harry Truman's words: "It is amazing what you can accomplish if you do not care who gets the credit."

Many of the negotiation cases we studied were rife with tales of conflict and resistance, but you needn't settle for compromises that leave both sides unhappy. The give-and-take that occurs when you're seeking a mutually beneficial deal can open your eyes to other perspectives, help you better understand your colleagues, and find ways of working together to create lasting solutions. In other words, career negotiations can enhance your working relationships—and we encourage you to strive for that outcome.

To generate goodwill and motivate agreement, we recommend that you explain to counterparts both why it is legitimate for you to be negotiating and how your proposal takes their interests into account. That's not always easy. For instance, we met one female executive who found out for the second time that a male subordinate was being paid more than she was. She probably wanted to say many things to senior leaders at her firm, but she chose the approach she knew would be most persuasive: "I know you are going to want to fix this, because it is inconsistent with company practices and values."

Or take the example of Sandra, who ran the U.S. division of a major business unit and wanted to globalize it. To achieve her aim, she had to make a strategic case for why globalization was in the company's best interest and why she was the right person to lead the initiative. Addressing the hopes and concerns of managers both at headquarters and in the non-U.S. business units required numerous rounds of conversation in which she seeded and got feedback on her ideas. Sandra told us: "Over time, the logic [for globalization and my leadership] became compelling."

THE FOUR STEPS outlined above take time to implement—and there will be false starts and reversals. Most of the career negotiations recounted to us by senior executives, managers, and other professionals lasted weeks or months. They started with preliminary conversations that gradually evolved, particularly as new information or the entrance of new players influenced the way various parties perceived their interests and the alternatives to agreement.

To maximize your odds of success, set targets for yourself that are specific and realistic—and that help hold you accountable to follow through with your plan amid pressing distractions and demands. Too often, negotiations fizzle or never get off the ground because larger goals become buried by everyday work.

One senior executive we interviewed told us, "You have a book to write of your life. Don't let anyone else write your chapters." We second that, but we also urge you to remember that great careers are not authored alone. Your narrative will be cowritten with work and life partners, and negotiation is at the heart of finding mutually gratifying ways for that story to unfold.

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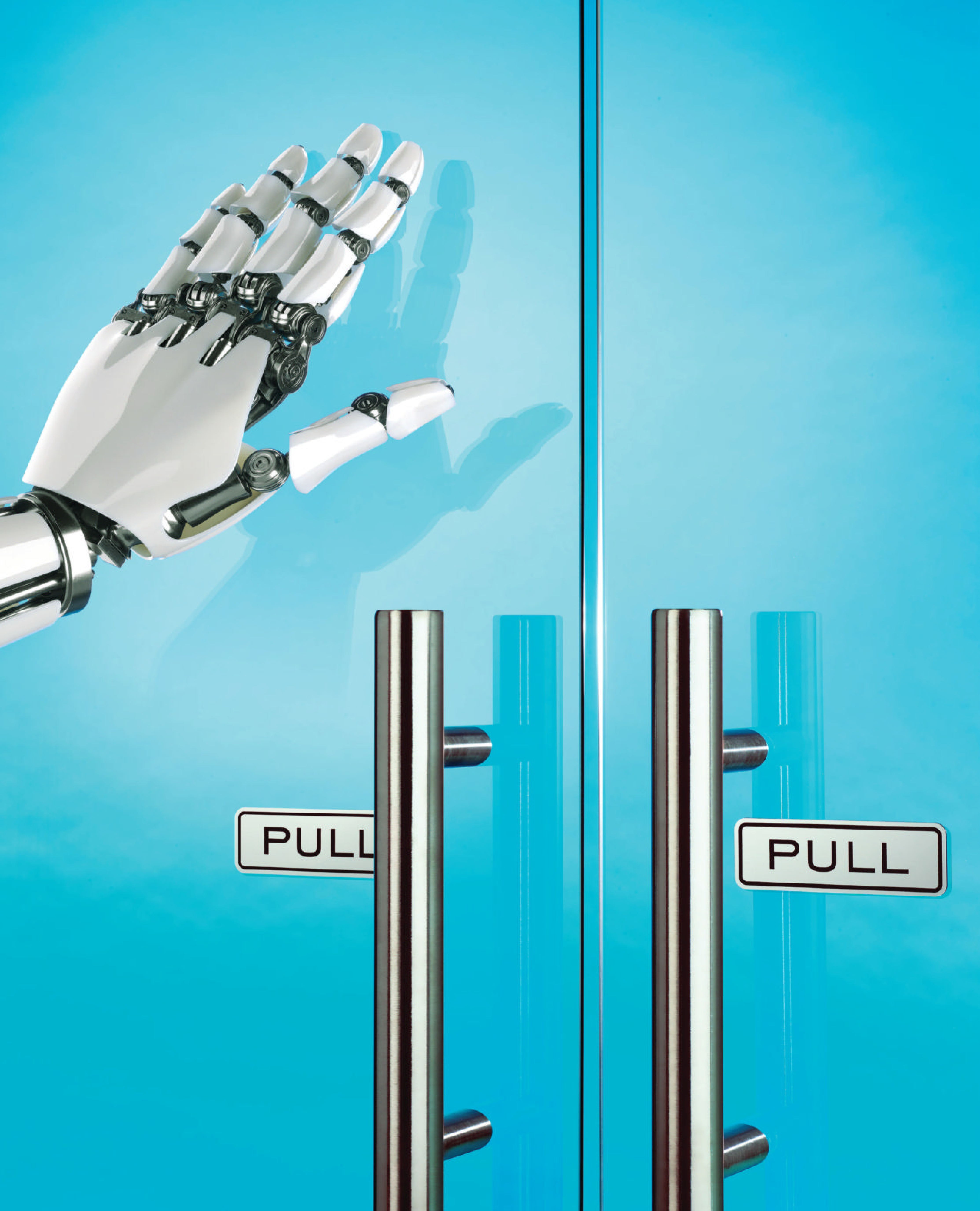
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When Machine Learning Goes Off the Rails

TECHNOLOGY

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A guide to managing the risks

PHOTOGRAPHER GREGORY REID

IDEA IN BRIEF

THE PROBLEM
Offerings that rely on machine learning are proliferating, raising all sorts of new risks for companies that develop and use them or supply data to train them. That's because such systems don't always make ethical or accurate choices.

THE CAUSES
First, the systems often make decisions based on probabilities. Second, their environments may evolve in an unanticipated way. Third, their complexity makes it difficult to determine whether or why they made a mistake.

THE SOLUTIONS
Executives must decide whether to let a system continuously evolve or introduce locked versions at intervals. In addition, they should test the offering appropriately before and after it is rolled out and monitor it constantly once it's on the market.

What happens when

machine learning—computer programs that absorb new information and then change how they make decisions—leads to investment losses, biased hiring or lending, or car accidents? Should businesses allow their smart products and services to autonomously evolve, or should they “lock” their algorithms and periodically update them? If firms choose to do the latter, when and how often should those updates happen? And how should companies evaluate and mitigate the risks posed by those and other choices?

Across the business world, as machine-learning-based artificial intelligence permeates more and more offerings and processes, executives and boards must be prepared to answer such questions. In this article, which draws on our work in health care law, ethics, regulation, and machine learning, we introduce key concepts for understanding and managing the potential downside of this advanced technology.

WHAT MAKES MACHINE LEARNING RISKY

The big difference between machine learning and the digital technologies that preceded it is the ability to independently make increasingly complex decisions—such as which financial products to trade, how vehicles react to obstacles, and whether a patient has a disease—and continuously adapt in response to new data. But these algorithms don’t always work smoothly. They don’t always make ethical or accurate choices. There are three fundamental reasons for this.

One is simply that the algorithms typically rely on the *probability* that someone will, say, default on a loan or have a disease. Because they make so many predictions, it’s likely that *some* will be wrong, just because there’s always a chance that they’ll be off. The likelihood of errors depends on a lot of factors, including the amount and quality of the data used to train the algorithms, the specific type of machine-learning method chosen (for example, deep learning, which uses complex mathematical models, versus classification trees that rely on decision rules), and whether the system uses only *explainable algorithms* (meaning humans can describe how they arrived at their decisions), which may not allow it to maximize accuracy.

Second, the environment in which machine learning operates may itself evolve or differ from what the algorithms were developed to face. While this can happen in many ways, two of the most frequent are *concept drift* and *covariate shift*.

With the former the relationship between the inputs the system uses and its outputs isn’t stable over time or may be misspecified. Consider a machine-learning algorithm for stock trading. If it has been trained using data only from a period of low market volatility and high economic growth, it may not perform well when the economy enters a recession or experiences turmoil—say, during a crisis like the Covid-19 pandemic. As the market changes, the relationship between the inputs and outputs—for example, between how leveraged a company is and its stock returns—also may change. Similar misalignment may happen with credit-scoring models at different points in the business cycle.

In medicine, an example of concept drift is when a machine-learning-based diagnostic system that uses skin images as inputs in detecting skin cancers fails to make correct diagnoses because the relationship between, say, the color of someone’s skin (which may vary with race or sun exposure) and the diagnosis decision hasn’t been adequately captured. Such information often is not even available in electronic health records used to train the machine-learning model.

Covariate shifts occur when the data fed into an algorithm during its use differs from the data that trained it. This can happen even if the patterns the algorithm learned are stable and there's no concept drift. For example, a medical device company may develop its machine-learning-based system using data from large urban hospitals. But once the device is out in the market, the medical data fed into the system by care providers in rural areas may not look like the development data. The urban hospitals might have a higher concentration of patients from certain sociodemographic groups who have underlying medical conditions not commonly seen in rural hospitals. Such disparities may be discovered only when the device makes more errors while out in the market than it did during testing. Given the diversity of markets and the pace at which they're changing, it's becoming increasingly challenging to foresee what will happen in the environment that systems operate in, and no amount of data can capture all the nuances that occur in the real world.

The third reason machine learning can make inaccurate decisions has to do with the complexity of the overall systems it's embedded in. Consider a device used to diagnose a disease on the basis of images that doctors input—such as IDx-DR, which identifies eye disorders like diabetic retinopathy and macular edema and was the first autonomous machine-learning-based medical device authorized for use by the U.S. Food and Drug Administration. The quality of any diagnosis depends on how clear the images provided are, the specific algorithm used by the device, the data that algorithm was trained with, whether the doctor inputting the images received appropriate instruction, and so on. With so many parameters, it's difficult to assess whether and why such a device may have made a mistake, let alone be certain about its behavior.

But inaccurate decisions are not the only risks with machine learning. Let's look now at two other categories: agency risk and moral risk.

AGENCY RISK

The imperfections of machine learning raise another important challenge: risks stemming from things that aren't under the control of a specific business or user.

Ordinarily, it's possible to draw on reliable evidence to reconstruct the circumstances that led to an accident. As a result, when one occurs, executives can at least get helpful estimates of the extent of their company's potential liability. But because machine learning is typically embedded within a complex system, it will often be unclear what led to a breakdown—which party, or "agent" (for example, the algorithm developer, the system deployer, or a partner), was responsible for an error and whether there was an issue with the algorithm, with some data fed to it by the user, or with the data used to train it, which may have come from multiple third-party vendors. Environmental change and the probabilistic nature of machine learning make it even harder to attribute responsibility to a particular agent. In fact, accidents or unlawful decisions can occur even without negligence on anyone's part—as there is simply always the possibility of an inaccurate decision.

Executives need to know when their companies are likely to face liability under current law, which may itself also evolve. Consider the medical context. Courts have historically viewed doctors as the final decision-makers and have therefore been hesitant to apply product liability to medical software makers. However, this may change as more black-box or autonomous systems make diagnoses and recommendations without the involvement of (or with much weaker involvement by) physicians in clinics. What will happen, for example, if a machine-learning system recommends a nonstandard treatment for a patient (like a much higher drug dosage than usual) and regulation evolves in such a way that the doctor would most likely be held liable for any harm only if he or she did not follow the system's recommendation? Such regulatory changes may shift liability risks from doctors to the developers of the machine-learning-enabled medical devices, the data providers involved in developing the algorithms, or the companies involved in installing and deploying the algorithms.

MORAL RISK

Products and services that make decisions autonomously will also need to resolve ethical dilemmas—a requirement that raises additional risks and regulatory and product development challenges. Scholars have now begun to frame these challenges as problems of *responsible algorithm design*. They include the puzzle of how to automate moral reasoning.

> How should we program an autonomous car to value the lives of three elderly people against, say, the life of one middle-aged person?

Should Tesla, for example, program its cars to think in utilitarian cost-benefit terms or Kantian ones, where certain values cannot be traded off regardless of benefits? Even if the answer is utilitarian, quantification is extremely difficult: How should we program a car to value the lives of three elderly people against, say, the life of one middle-aged person? How should businesses balance trade-offs among, say, privacy, fairness, accuracy, and security? Can all those kinds of risks be avoided?

Moral risks also include biases related to demographic groups. For example, facial-recognition algorithms have a difficult time identifying people of color; skin-lesion-classification systems appear to have unequal accuracy across race; recidivism-prediction instruments give Blacks and Hispanics falsely high ratings, and credit-scoring systems give them unjustly low ones. With many widespread commercial uses, machine-learning systems may be deemed unfair to a certain group on some dimensions.

The problem is compounded by the multiple and possibly mutually incompatible ways to define fairness and encode it in algorithms. A lending algorithm can be calibrated—meaning that its decisions are independent of group identity after controlling for risk level—while still disproportionately denying loans to creditworthy minorities. As a result, a company can find itself in a "damned if you do, damned if you don't" situation. If it uses algorithms to decide who receives a loan, it may have difficulty avoiding charges that it's discriminating against some groups according to one of the definitions of fairness. Different cultures may also accept different definitions and ethical trade-offs—a problem for products with global markets. A February 2020 European Commission white paper on AI points to these challenges: It calls for the development of AI with "European values," but will such AI be easily exported to regions with different values?

Finally, all these problems can also be caused by model instability. This is a situation where inputs that are close to one another lead to decisions that are far apart. Unstable algorithms are likely to treat very similar people very differently—and possibly unfairly.

All these considerations, of course, don't mean that we should avoid machine learning altogether. Instead, executives need to embrace the opportunities it creates while making sure they properly address the risks.

TO LOCK OR NOT TO LOCK?

If leaders decide to employ machine learning, a key next question is: Should the company allow it to continuously evolve or instead introduce only tested and locked versions at intervals? Would the latter choice mitigate the risks just described?

This problem is familiar to the medical world. The FDA has so far typically approved only "software as a medical device" (software that can perform its medical functions without hardware) whose algorithms are locked. The reasoning: The agency has not wanted to permit the use of devices whose diagnostic procedures or treatment pathways keep changing in ways it doesn't understand. But as the FDA and other regulators are now realizing, locking the algorithms may be just as risky, because it doesn't necessarily remove the following dangers:

Inaccurate decisions. Locking doesn't alter the fact that machine-learning algorithms typically base decisions on estimated probabilities. Moreover, while the input of more data usually leads to better performance, it doesn't always, and the amount of improvement can vary; improvements in unlocked algorithms may be greater or smaller for different systems and with different volumes of data. Though it's difficult to understand how the accuracy (or inaccuracy) of decisions may change when an algorithm is unlocked, it's important to try.

Environmental changes. It also matters whether and how the environment in which the system makes decisions is evolving. For example, car autopilots operate in environments that are constantly altered by the behavior of other drivers. Pricing, credit scoring, and trading systems may face a shifting market regime whenever the business cycle enters a new phase. The challenge is ensuring that the machine-learning system and the environment coevolve in a way that lets the system make appropriate decisions.

Agency risks. Locking an algorithm doesn't eliminate the complexity of the system in which it's embedded. For example, errors caused by using inferior data from third-party vendors to train the algorithm or by differences in skills across users can still occur. Liability can still be challenging to assign across data providers, algorithm developers, deployers, and users.

TECHNOLOGY

Executives need to think of machine learning as a living entity, not an inanimate technology.

Moral risks. A locked system may preserve imperfections or biases unknown to its creators. When analyzing mammograms for signs of breast cancer, a locked algorithm would be unable to learn from new subpopulations to which it is applied. Since average breast density can differ by race, this could lead to misdiagnoses if the system screens people from a demographic group that was underrepresented in the training data. Similarly, a credit-scoring algorithm trained on a socioeconomically segregated subset of the population can discriminate against certain borrowers in much the same way that the illegal practice of redlining does. We want algorithms to correct for such problems as soon as possible by updating themselves as they "observe" more data from subpopulations that may not have been well represented or even identified before. Conversely, devices whose machine-learning systems are not locked could harm one or more groups over time if they're evolving by using mostly data from a different group. What's more, identifying the point at which the device gets comparatively worse at treating one group can be hard.

A TOOL KIT FOR EXECUTIVES

So how should executives manage the existing and emerging risks of machine learning? Developing appropriate processes, increasing the savviness of management and the board, asking the right questions, and adopting the correct mental frame are important steps.

Treat machine learning as if it's human. Executives need to think of machine learning as a living entity, not an inanimate technology. Just as cognitive testing of employees won't reveal how they'll do when added to a preexisting team in a business, laboratory testing cannot predict the performance of machine-learning systems in the real world. Executives should demand a full analysis of how employees, customers, or other users will apply these systems and react to their decisions. Even when not required to do so by regulators, companies may want to subject their new machine-learning-based products to randomized controlled trials to ensure their safety, efficacy, and fairness prior to rollout. But they may also want to analyze products' decisions in the actual market, where there are various types of users, to see whether the quality of decisions differs across them. In addition, companies should compare the quality of decisions made by the algorithms with those made in the same situations *without* employing them. Before deploying products at scale, especially but not only those that haven't undergone randomized controlled trials, companies should consider testing them in limited markets to get a better idea of their accuracy and behavior when various factors are at play—for instance, when users don't have equal expertise, the data from sources varies, or the environment changes. Failures in real-world settings signal the need to improve or retire algorithms.

Think like a regulator and certify first. Businesses should develop plans for certifying machine-learning offerings before they go to market. The practices of regulators offer a good road map. In 2019, for example, the FDA published a discussion paper that proposed a new regulatory framework for modifications to machine-learning-based software as a medical device. It laid out an approach that would allow such software to continuously improve while maintaining the safety of patients, which included a complete assessment of the company—or team—developing the software to ensure it had a culture of organizational excellence and high quality that would lead it to regularly test its machine-learning devices. If companies don't adopt such certification processes, they may expose themselves to liability—for example, for performing insufficient due diligence.

Many start-ups provide services to certify that products and processes don't suffer from bias, prejudice, stereotypes, unfairness, and other pitfalls. Professional organizations, such as the Institute of Electrical and Electronics Engineers and the International Organization for Standardization, are also developing standards for such certification, while companies like Google offer AI ethics services that examine multiple dimensions, ranging from the data used to train systems, to their behavior, to their impact on well-being. Companies might need to develop similar frameworks of their own.

Monitor continuously. As machine-learning-based products and services and the environments they operate in evolve, companies may find that their technologies don't perform as initially intended. It is therefore important that they set up ways to check that these technologies behave within appropriate limits. Other sectors can serve as models. The FDA's Sentinel Initiative draws from disparate data sources, such as electronic health records, to monitor the safety of medical products and can force them to be withdrawn if they

Gregory Reid/Gallery Stock

Are there conditions under which machine learning should not be allowed to make decisions, and if so, what are they?

don't pass muster. In many ways companies' monitoring programs may be similar to the preventive maintenance tools and processes currently used by manufacturing or energy companies or in cybersecurity. For example, firms might conduct so-called adversarial attacks on AI like those used to routinely test the strength of IT systems' defenses.

Ask the right questions. Executives and regulators need to delve into the following:

→ **Accuracy and competitiveness.** How much is the performance of the machine-learning-based system likely to improve with the volume of new data from its use if we don't lock the algorithm? What will such improvements mean for the business? To what extent will consumers understand the benefits and drawbacks of locked versus unlocked systems?

→ **Biases.** What data was used to train the algorithm? How representative is it of the population on which the algorithm will ultimately operate? Can we predict whether an unlocked algorithm will produce less-biased results than a locked one if we allow it to learn over time? Do the algorithm's errors affect minorities or other groups in particular? Can a continuous monitoring approach establish "guardrails" that stop the algorithm from becoming discriminatory?

→ **The environment.** How will the environment in which the offering is used change over time? Are there conditions under which machine learning should not be allowed to make decisions, and if so, what are they? How can we ensure that the offering's behavior evolves appropriately given how the environment itself is changing? When should we withdraw our offering because the gap between the environment and our offering's behavior has become too big? What are the boundaries of the environment within which our offering can adapt and operate? How robust and safe are our machine-learning systems throughout their life cycles?

→ **Agency.** On which third-party components, including data sources, does the behavior of our machine-learning algorithms depend? How much does it vary when they're used by different types of people—for example, less-skilled ones? What products or services of other organizations use our data or machine-learning algorithms, possibly exposing us to liability? Should we allow other organizations to use machine-learning algorithms that we develop?

Develop principles that address your business risks. Businesses will need to establish their own guidelines, including ethical ones, to manage these new risks—as some companies, like Google and Microsoft, have already done. Such guidelines often need to be quite specific (for example, about what definitions of fairness are adopted) to be useful and must be tailored to the risks in question. If you're using machine learning to make hiring decisions, it would be good to have a model that is simple, fair, and transparent. If you're using machine learning to forecast the prices of commodity futures contracts, you may care less about those values and more about the maximum potential financial loss allowed for any decision that machine learning makes.

Luckily, the journey to develop and implement principles doesn't need to be a lonely one. Executives have a lot to learn from the multiyear efforts of institutions such as the OECD, which developed the first intergovernmental AI principles (adopted in 2019 by many countries). The OECD principles promote innovative, trustworthy, and responsibly transparent AI that respects human rights, the rule of law, diversity, and democratic values, and that drives inclusive growth, sustainable development, and well-being. They also emphasize the robustness, safety, security, and continuous risk management of AI systems throughout their life cycles.

The OECD's recently launched AI Policy Observatory provides further useful resources, such as a comprehensive compilation of AI policies around the world.

MACHINE LEARNING HAS tremendous potential. But as this technology, along with other forms of AI, is woven into our economic and social fabric, the risks it poses will increase. For businesses, mitigating them may prove as important as—and possibly more critical than—managing the adoption of machine learning itself. If companies don't establish appropriate practices to address these new risks, they're likely to have trouble gaining traction in the marketplace.

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SUSTAINABILITY

How to Talk to Your CFO About Sustainability

Use this tool for measuring the financial return on ESG activities.

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IDEA IN BRIEF

THE PROBLEM
Corporate sustainability strategies can reduce costs and generate revenue, but many CFOs still don't believe they can create value. That makes it hard to unlock the internal financing needed to scale them up.

THE FACTS
Sustainability strategies can improve financial performance by boosting any of nine "mediating factors": innovation, operational efficiency, sales and marketing, customer loyalty, risk management, employee relations, supplier relations, media coverage, and stakeholder engagement.

THE SOLUTION
Companies can use an analytic approach called the Return on Sustainability Investment (ROSI) method to precisely measure the value created by sustainability strategies through those nine factors. ROSI analyses in the automotive, pharmaceutical, and agricultural industries have revealed hundreds of millions of dollars of sustainability-related savings.

By now most companies have committed to improving their environmental, social, and governance performance. Such sustainability efforts have increasingly become table stakes. And yet many CFOs still see them as a cost rather than a source of value. That makes it hard to unlock the internal financing needed to scale them up.

Nonfinancial metrics such as carbon emissions can reveal hundreds of millions of dollars in sustainability-related savings and growth.

Most recent studies show a correlation between sustainability and financial performance. Our own research finds that for many companies, nonfinancial metrics such as carbon emissions can reveal hundreds of millions of dollars in sustainability-related savings and growth. In large companies it can be billions.

Why don't more CFOs see the connection?

First, they are thrown off by the language and metrics used by their sustainability colleagues. CFOs talk about EBIT and ROI; sustainability people focus on measures such as reductions in wastewater or emissions. The separate reporting of sustainability and financial metrics both internally and externally exacerbates the problem. There is little clear connection between the two worlds under current management, reporting, and accounting structures.

Second, few companies adequately track the returns on their existing sustainability investments or carefully assess those on future ones. Among the reasons for this omission are poor communication between the people in charge of sustainability initiatives in various units; the difficulty of measuring intangible benefits; the limited availability of accounting systems designed to capture sustainability performance data; the use, when returns are measured, of different metrics by different units; and the finance function's belief that the monetary benefits of sustainability activities aren't sufficient to warrant tracking them. But as the links between sustainability and economic performance become clearer, pressure will mount from investors, boards, and executive leadership to track and report the payoffs.

Our work at the NYU Stern Center for Sustainable Business focuses on making those links explicit and providing the tools companies need to monitor and improve the returns on their sustainability investments. To that end we have identified nine drivers of corporate financial performance that can be bolstered by sustainability strategies: innovation, operational efficiency, sales and marketing, customer loyalty, risk management, employee relations, supplier relations, media coverage, and stakeholder engagement. We call the drivers *mediating factors.* (For details, see the sidebar "Mediating Factors: How Sustainability Improves Performance.") Good management of any type can improve financial performance through the mediating factors; however, good management of sustainability risks and opportunities is one of the most powerful ways to do so.

In studying the automotive sector, for example, we found 16 sustainability strategies and related changes in practices (such as reducing carbon emissions) that, by boosting one or more of the mediating factors, contribute to astonishing returns by generating new revenue or reducing costs or both. In one company they yielded more than $5 billion in net benefits in a single year.

The ROSI Methodology

Working with firms across sectors, we developed the Return on Sustainability Investment analytic method, which companies can use to measure the financial returns on their sustainability activities (you can find ROSI resources and tools on the NYU Stern Center for Sustainable Business's website). It can be deployed to look retroactively at the value created by sustainability strategies, to track sustainability-related financial performance in real time, and to assess the potential ROI of future sustainability initiatives at both the firm and the division level.

Let's look at how to implement ROSI—a five-step process. Particularly when this is a cross-divisional effort, you will need the C-suite's support. Point to increasing investor and consumer demand for better sustainability performance, opportunities to build on the company's existing sustainability efforts, and the need to monetize returns on those investments.

In our work with companies, we start by conducting one-on-one interviews with executives, either in person or—especially during the pandemic—online. We use a standard set of questions to learn what benefits the company is seeing from its sustainability activities and, if those activities are not generating measurable financial returns, how they could do so. The overall ROSI process should be led by a senior executive; the chief sustainability officer would be a good choice, for obvious reasons and also because he or she generally has relationships across the organization. Ideally the CSO is joined by a leader from finance. (If a company doesn't have a CSO, a senior executive from finance, strategy, or operations can fill that role.) It's critical to engage participants from finance, investor relations, marketing, human resources, operations, and, if appropriate, procurement and manufacturing, along with representatives from any other division that's especially

SUSTAINABILITY

important to your business. Each C-suite office should choose a lead to assist the CSO in the process.

1 **Identify your current sustainability strategies.** Surprisingly, in our experience many firms have not clearly articulated their material sustainability strategies: those that address sustainability issues on which the company has a significant impact or that have a significant impact on it. These might include activities with sustainability components that haven't been identified as such—for example, a logistics program ensuring that trucks are fully loaded, which may be aimed at efficiency but also reduces the fleet's greenhouse gas emissions.

If your firm has a materiality matrix—a map of sustainability issues laid out according to their importance to the business and its stakeholders—you will find it helpful. If you don't have a matrix, this is a good time to create one, working as needed with your cross-divisional team, outside consultants, and external stakeholders. With a matrix for reference, you can more easily identify existing activities that address relevant but not immediately obvious sustainability issues. The Sustainability Accounting Standards Board and the Global Reporting Initiative, which have identified material sustainability metrics by industry, can help you get started.

As mentioned earlier, applying ROSI in the automotive sector case, we identified 16 strategies that address material sustainability issues; they include waste management, a focus on innovative products (such as electric vehicles), and water conservation. Broad strategies like these tend to encompass many activities that have not been formally identified as components of them but should be included in the ROSI accounting that will follow. In the auto industry many activities contribute to the waste management strategy, such as hazardous materials disposal, wastewater management, and product end-of-life management.

2 **Identify the related changes in operational or management practices.** In many companies the practices associated with a given strategy were implemented organically over time—and nobody has a full view of what has changed. If your company has emissions-reduction targets, for example, what specific practices has management changed in order to meet them? Is it shifting the energy mix

Stephen Lenthall/Gallery Stock

to include more renewables? Installing energy conservation technologies? Changing manufacturing processes?

You may not be able to immediately identify which changed practices will generate financial returns. In that case, identify as many changed practices as you can for each strategy without regard to their financial impact. In our study of the automotive sector, we identified 240 changed practices. One, under the waste management strategy, reduces volatile organic compound (VOC) emissions by recycling paint and solvents. That may seem like a small change, but as we'll see shortly, it can generate tens of millions of dollars in savings. In a study of sustainable ranching practices, we identified dozens of changes, including increasing the number of cattle per hectare, rotating pastures, and stopping deforestation. We similarly identified dozens of new practices in the apparel sector, including the use of more-sustainable materials, the certification of fair labor practices in supply chains, reduced packaging, and "circular" solutions such as the return and repurposing of garments.

Your cross-divisional team will be essential to the tallying. Small groups in each division should review actions taken in their areas to implement sustainability strategies. To facilitate their brainstorming, illustrate what's needed by providing a few examples of changed practices at the start.

3 Determine the resulting benefits. Next, explore the nonmonetary benefits of your sustainability strategies and changed practices by looking at how the changes contribute to the mediating factors; we'll get to the financial impacts later. For example, better waste, energy, and water management generally improves operational efficiency. One pharmaceutical company redesigned a drug production process using "green" chemistry principles, which reduced the energy, chemicals, and water required by about 80% and cut waste generation and greenhouse gas emissions by about 75%.

Some of the benefits you find may not be obvious. For instance, mining companies are notoriously bad neighbors—often polluting the environment, exploiting local labor, and placing demands on water supplies and other community infrastructure. But by creating goodwill, a robust community-engagement effort (which falls under the stakeholder relations mediating factor) can speed regulatory approval and reduce the time needed to move projects forward.

4 Quantify the benefits. Having identified your nonmonetary benefits, next determine how to assess their financial worth. You can often do so by comparing a new practice with an established benchmark. To measure the value of recycling solvents in the auto industry, a team collected data on kilograms of solvent reclaimed and recycled, the unit cost of virgin solvent, the unit cost of reclaiming and recycling solvents, and the cost of water-based substitute solvents—information that was readily available but had never previously been collected for analysis. To measure the value of sustainable ranching practices, another team gathered data on factors including the reduced acreage needed, the change in the cost of renting land, the amount of beef sold before and after the introduction of sustainable practices, and the difference in price between conventional and sustainable beef.

5 Calculate the overall monetary value. As we've mentioned, each broad strategy is made up of many separate practices. By totaling the financial value created (or lost) by each of the practices in a strategy, you can identify which strategies generate the most value and where you might want to focus resources. We collected data at one auto company on the impact of reducing VOC emissions, including by improving filtration systems and implementing the solvent reuse and substitution described above. To value the benefits resulting from production efficiencies, we multiplied the year-over-year reduction in the volume of solvents used by the average cost of virgin solvent;

As the links between sustainability and economic performance become clearer, pressure will mount from investors, boards, and executive leaders to track and report the payoffs.

Mediating Factors: How Sustainability Improves Performance

Sustainability strategies can contribute to nine mediating factors that drive financial results.

Innovation

A focus on sustainability can spark innovation in design, process, products, and services. In 2012 Nike used sustainable design principles to develop Flyknit, a recycled polymer woven into the shoe upper, resulting in a lighter, higher-performance athletic shoe. Flyknit produces 60% less manufacturing waste than traditional methods do, and it helped create a robust business: Shoes sold under the Flyknit brand have become a $1 billion business.

Operational efficiency

A sustainability strategy can improve operational efficiency, and thus cut costs, by reducing waste and the use of natural resources. Consider Nestlé's sustainability strategy, which centers on water conservation. In the company's manufacturing operations in drought-prone South Africa, improvements in wastewater reduction and water recovery increased plant production by 32% from 1997 to 2001 while reducing water and water management costs by 12%.

Sales and marketing

Sustainable products and services can help a brand stand out from the crowd and increase market share and sales. An NYU Stern Center for Sustainable Business and IRI study of 36 consumer packaged goods categories from 2013 to 2018 found that 50% of their growth in sales came from products marketed as sustainable. And those brands enjoyed an average premium of 39%.

Customer loyalty

People are more devoted to purpose-led brands that make a positive contribution to society. The CGS 2019 U.S. Consumer Sustainability Survey found that purchasing loyalty is determined first by brand quality, second by brand sustainability and ethical business practices, and last by brand name and mission. It also found that brand sustainability is particularly important to Gen Z consumers.

Risk management

Investors and corporate leaders alike are increasingly focused on sustainability-related risks in markets, regulation, reputation, and operations. Ignoring those risks can have significant negative financial impacts. The Malaysian palm oil producer and refiner IOI illegally cleared forests and peatland and was suspended for several months from the standards-setting Roundtable on Sustainable Palm Oil. Several multinational firms canceled their contracts with IOI, and the company suffered a $42 million earnings hit, a 20% drop in stock price, and a 2% decline in bond prices.

Employee relations

Workers identify more strongly with a company if they believe it is socially and environmentally responsible—increasing commitment and improving morale. In a Society for Human Resource Management survey conducted with the consultancies Aurosoorya and Business for Social Responsibility, 55% of respondents said that strong sustainability programs improve morale, and 38% said they increase loyalty.

Supplier relations

Relationships with suppliers are often solely transactional, but a sustainability focus can foster a broader and more fruitful partnership. An EcoVadis and NYU Stern Center for Sustainable Business survey of procurement professionals and suppliers found several benefits of sustainable supply chains, including cost reductions (reported by 30% of respondents), innovations and access to new categories and price premiums owing to differentiation (25%), and improved procurement metrics, such as on-time delivery and more-reliable supplier relationships (24%).

Media coverage

News coverage of a firm's environmental and social performance is significant in consumers' evaluation of a firm and their intent to buy its products, according to a study published in *Corporate Reputation Review*. The researchers argue that the public relies on the media for information about companies' sustainability performance, which—unlike data on product quality—it cannot directly ascertain.

Stakeholder engagement

A firm's sustainability activities can improve relations with local communities and society more broadly, with positive financial impacts. A study of mining companies that worked with local communities to ensure good relations improved the discount placed by financial markets on the net present value of their physical assets from 72% to a range of 13% to 37%.

this translated to annual savings of $72 million. Applying the same cost of virgin solvent to the amount of solvent reused revealed additional savings of $8 million. And to gauge the value of using more-sustainable water-based solvents, we compared the unit cost of the substitutes to the unit cost of traditional virgin solvents and multiplied the difference by the quantity of substitutes used. The result was an additional $10 million in savings, bringing the total to $90 million.

Reducing VOC emissions also creates intangible benefits that have a financial impact. Consider regulations addressing pollution and employee safety, which can increase costs. The potential value of abiding by them can be estimated by tallying the annual average number of incidents over five years that resulted in VOC-related fines and multiplying that by the average size of fines. It's also possible to calculate year-over-year reductions in health and safety costs, such as VOC-related health and workers' compensation claims. These intangible benefits add another $2 million in annual savings for our auto company, for a total of $92 million.

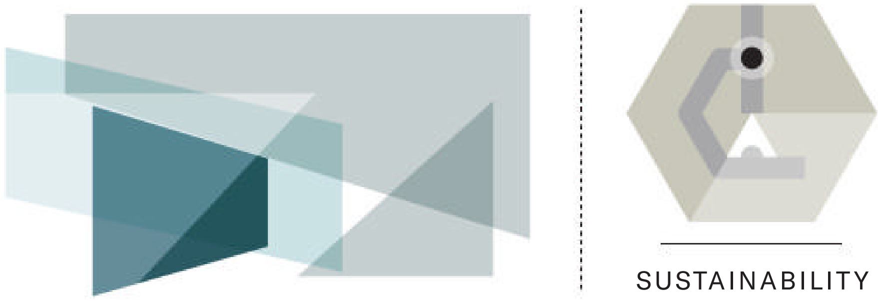
Finally, we estimated the total return on investment in these new VOC practices. For simplicity, we assumed a five-year time horizon, similar benefits achievable in each year, and the same recycling costs and level of capital investment required each year (totaling $3.8 million annually). This gave us a net yearly benefit of $88 million, or $440 million over five years. Discounting that at a rate of 10% results in a five-year ROI of $334 million.

Now let's return to our pharmaceutical company. For every 100 tons of product manufactured with the new green chemistry principles, we estimated savings of about $1.5 million in production costs ($943,000 in reduced energy and water consumption, $364,000 in reduced waste generation and disposal, and $240,000 in avoided carbon-emissions charges). And the company retained a larger-than-usual share of revenue in markets where it had lost exclusivity. In the year after loss of exclusivity, revenue from sales of the product in question typically decreases by 60%. In this case, in part because of the more-efficient and less-expensive production process (and in part because of a price reduction), the company retained 65% of its revenue from the previous year.

Engaging the CFO

We've shown the power of ROSI in evaluating the returns on existing sustainability initiatives. But bringing the CFO fully onboard requires showing that *proposed* sustainability activities will meet the company's required ROI on a project.

A Canadian utility was considering whether to cut coal power generation from its portfolio before the government's deadline of 2030. The CSO asked us to work with her and the CFO on a ROSI analysis of making the shift sooner. We began



by holding a two-day workshop with a cross-functional team to determine where to focus and to develop the relationships needed to flesh out the analysis. Through this we identified potential benefits (such as improved employee relations and a lower cost of debt and equity) and calculated their value using a mix of company data and assumptions built on the academic and industry literature.

The CFO found the analysis compelling enough to engage his team in tightening up the starting assumptions and the resulting performance projections. The expected reduction in the cost of debt and equity soon emerged as a major benefit, amounting to 3 million Canadian dollars annually. Along with the value of the expected 20% to 33% decline in greenhouse gas emissions and associated regulatory risks (particularly those related to forecasted carbon prices), this persuaded the CFO and the executive team to accelerate the transition away from coal. A key equity analyst cited their decision as the reason for increasing his estimate of the target stock price by 10%. Indeed, the company's stock rose immediately after the change was announced, in June of 2019, and for the remainder of the year it increased more than 50% faster than the rate of growth of the Dow Jones utility index. Impressed by ROSI's predictive power in evaluating its coal strategy, the company has since applied the tool to an analysis of future solar projects, concluding that the predicted returns warrant substantially lowering the hurdle rate.

THERE ARE FEW limits to how your organization can use ROSI to better understand the returns on its sustainability investments and drive smarter decision-making. Particularly now, as companies scrutinize budgets threatened by the Covid-19 pandemic, ROSI analysis can help CFOs improve organizational finances through sustainability investments that create value for investors, employees, customers, and the world at large.

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Volunteer Programs That Employees Can Get Excited About

HUMAN RESOURCES

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To boost engagement, avoid these common traps.

ILLUSTRATOR **OLLIE HIRST**

Across society, volunteerism has been stagnant or trending slightly down in recent years. In the corporate world, however, it has been on the rise. In fact, paid time off for volunteering is one of the few employee benefits that has increased significantly in recent years.

According to the Society for Human Resource Management, 47% of U.S. companies offered community volunteer programs in 2018, up from 40% in 2014. That percentage is even higher for large companies. The Chief Executives for Corporate Purpose—a global coalition of multibillion-dollar companies—reports that 66% of its member firms offered paid-time-off volunteer programs in 2019, compared with 56% in 2016.

It is unclear whether these trends will continue as the Covid-19 pandemic and global recession continue to unfold. Some crises seem to sensitize people to societal needs: In the aftermath of the 9/11 terrorist attacks in the United States, for instance, volunteering reached its highest level in two decades, a bump that lasted for several years. Yet in the wake of the Great Recession, volunteer participation and charitable giving both declined. The current economic

IDEA IN BRIEF

THE PROBLEM
The benefits of well-designed corporate volunteer programs have been clearly established: They boost productivity, increase employee engagement, and improve hiring and retention, to name just a few. But too often, firms' programs fall short.

THE REASON
In designing their volunteer programs, companies fall prey to common pitfalls: They blindly copy what other firms are doing, they prioritize leaders' pet projects, or they pressure employees to participate, essentially making volunteering mandatory.

BEST PRACTICES
Such errors diminish the value of the programs to the company, employees, and society. Instead, firms should prioritize meaning, balance top-down structure with bottom-up passion, and seek to involve a variety of stakeholders in their initiatives.

Corporate volunteer programs tend to reflect the personal priorities of top management. But what matters to executives doesn't necessarily matter to employees.

downturn is likely to cause corporate belt-tightening, and managers may be pressured to cut volunteer programs. But even in trying times there are good reasons to preserve well-run initiatives.

Many studies have shown that volunteer programs boost productivity, increase employee engagement, and improve hiring and retention. For example, a study I conducted in 2013 showed that the more people volunteered (even if it was on their own time instead of on company time), the better they performed on work tasks. It also showed that volunteers tended to be better citizens at work (helping others, voicing ideas, and so on). Another study, by David Jones of the University of Vermont and colleagues, showed that potential applicants found companies with employee volunteering programs especially attractive, for three key reasons: job seekers' anticipated pride in being affiliated with the company, their perception of how their values fit with the firm, and their expectations about how the firm treats its employees. Research has also firmly established the benefits of volunteering to people's well-being and sense of purpose, not to mention their physical and mental health.

In my research and consulting work, I've seen corporate volunteer programs of all shapes and sizes. Some firms allow employees to volunteer for whatever cause or activity they choose; others arrange highly structured outings that teams can participate in together—a charity run, for example, or a house-building effort. Although the constraints associated with Covid-19 have halted many common volunteer activities, they have also given rise to a host of creative programs that allow people to make a difference even during a lockdown—by, for instance, remotely staffing vital hotline services, serving as "phone buddies" to check on seniors, or participating in 5K races at home on treadmills. Companies also differ in how they encourage, recognize, and reward employees' volunteering efforts. And that variation makes sense: Companies should tailor their programs according to factors such as firm size, the expectations of customers and investors, and cultural norms and characteristics. As varied as the programs are, however, the mistakes companies make are often painfully similar. In this article, I talk about the pitfalls companies commonly encounter and some best practices for designing and implementing programs that work.

THE PITFALLS

There are many ways in which companies can go wrong when they structure and implement volunteer programs. Three problems are most common:

Copying others. When designing programs, executives are often tempted to take the easy way out and simply copy what they see successful companies in their industry doing. The thinking is "everyone else around me is doing it this way, so it must be effective." However, this rationale rests on an assumption that may be faulty; the programs of those other firms may *not* be effective or beneficial. The cut-and-paste approach can also cause a disconnect between a company's mission and goals and its program, limiting its strategic value and its intrinsic appeal to employees.

Prioritizing pet projects. Too often, executives focus their corporation's volunteer programs around their own personal charitable-giving preferences. (They often do the same when making corporate donations or in-kind gifts to charitable organizations.) Or they allow inertia to dictate a continuation of their predecessors' philanthropy choices. The result is that corporate volunteer programs tend to reflect the personal priorities and values of top management. But what matters to senior executives doesn't necessarily matter to employees—who are the linchpin of corporate volunteering efforts.

In conjunction with United Way Worldwide, my colleagues and I surveyed nearly 500 employees in 2014 and 2015—some who volunteered and some who did not—in 50 companies that offered volunteer programs. Among employees who chose not to participate, some said it was because of logistical concerns and lack of flexibility in the program, explaining, for example, that the timing of the opportunity "just wasn't right" or that the location was "too far away." But many others reported that they were demotivated by what they saw as programs that prioritized executives' pet projects, sharing sentiments such as: "I would rather choose volunteer opportunities that I'm interested in and that I feel really need the extra help, not the ones that [my employer] has some association with." These findings suggest that volunteer programs structured around senior management's preferences are unlikely to be well received by rank-and-file employees.

Among companies that offered programs, employee loyalty increased not only among those who volunteered but also among those who did not.

HUMAN RESOURCES

Making volunteering mandatory. Once corporate volunteer programs are formed, companies often feel compelled to engage as many people as possible and then continually expand their initiatives. Unfortunately, this can put pressure on employees to volunteer—creating de facto "mandatory volunteering." Research by pyschologists Edward Deci and Richard Ryan shows that a problematic contradiction then ensues: If people perceive that they'll be rewarded for participating in a task or punished for choosing not to, their intrinsic motivation and satisfaction with the activity are often diminished.

Corporate pressure may also lead to what researchers call "virtue signaling" in employees, as they participate just to make a good impression on coworkers and supervisors. In theory, this could result in a virtuous cycle of employees' cheering each other on, but that's not what happens in practice. When employees respond to pressure from management to volunteer, their efforts are often perceived by coworkers as insincere attempts to ingratiate themselves with higher-ups. In a longitudinal field study of U.S. employees, my colleague John Lynch and I found that employees who volunteered in order to make a good impression were often stigmatized rather than applauded. Far from being viewed as moral paragons, they were characterized by their coworkers as distracted from their work, self-righteous, and narcissistic. Employees in our study noted how they commonly avoided or shunned colleagues who drew attention to their volunteering in this way, resenting what they felt was a subtle attempt to push the activity on others. Even supervisors were more likely to overlook those individuals when making important decisions, such as recommendations for promotions.

Companies often measure volunteer-program success in terms of the percentage of the workforce that participates, but my research suggests that the mere existence of volunteer opportunities can help employees feel more engaged. In our study with the United Way Worldwide, we discovered that among companies that offered programs, employee loyalty increased not only among those who volunteered but also among those who did not. People who chose not to volunteer made comments such as "It is great that [my company] offers volunteer programs" and "I am happy that volunteering is available."

BEST PRACTICES

Although companies should avoid pressuring employees to volunteer, they can still take steps to encourage engagement. My research provides some guidance on what to think about when designing or refining corporate volunteering programs.

Prioritize meaning. A study I conducted with the United Way and the Junior League found that volunteer experiences must be seen as meaningful in order to create a natural draw for employees. We heard time and again that people sought to make a difference. "It was more meaningful that we were able to do things that were literally helping," one participant noted. "Not monetarily—you can put two dollars in a jar and be blind to what you're doing. But when you're thinking it's going to be cold soon and there are homeless people who need blankets—or those children need blankets—that's really meaningful." In a study for the American Cancer Society, sociologists Jean Grube and Jane Piliavin found that people devoted more time and effort to volunteering when they believed that their efforts "contributed in important ways."

How can companies ensure that volunteer opportunities are viewed as meaningful by employees? According to Roy Baumeister at Florida State University, people derive meaning from situations in three ways: when they see purpose and value in what they are doing, when they have a sense of personal efficacy and control, and when they feel a sense of self-worth. The best volunteer programs offer some combination of the three. For example, when building homes with Habitat for Humanity, volunteers have the satisfaction of seeing a house going up as they work, they interact with Habitat representatives who come to the building site to explain how volunteers drive the organization, and they often get to hear directly from the recipient of the home, who is often also on-site to talk about his or her personal situation and experience. This raises a critical question: Is the goal of corporate volunteering to make an impact on society or to make an impact on workers? For example, it would likely be more impactful for the community if an employee spent a day organizing supplies at the food pantry and ordering necessary items, but the employee might find it more rewarding to hand out meals to people in need or deliver them to people's homes. The truth is that corporate volunteerism must strike a balance between impact and meaning.

Well-designed programs find ways to infuse even quotidian activities with meaning. Suppose a company organizes a volunteering initiative to prepare mailers for a charity's major fundraising campaign. The task is critical to the charity's survival but may be mind-numbing for employees. The company could, for example, invite a beneficiary of the charity to come and speak about his or her personal experience while volunteers are working. This transforms a boring task into something more. Indeed, a 2008 study led by Adam Grant, an organizational psychologist at Wharton, found that when call center agents soliciting donations for college scholarships actually met some of the students their work supported, their productivity and persistence skyrocketed.

Balance bottom-up employee passion and top-down corporate structure. When deciding whether to structure a volunteering program or take a more laissez-faire approach, executives face a trade-off. Employees' interest and sense of meaningfulness are maximized when they get to make choices for themselves and focus on projects that appeal to them personally. Yet structured, coordinated programs are more likely to encourage employee interaction and shared experiences, increasing morale and improving teamwork. In our study with the United Way Worldwide, we found that the strongest volunteering programs include both upper-management and employee input.

There are several ways to make this work in practice. One is to create a corporate volunteer initiative from the bottom up, by giving employees an active role in shaping its focus and features and then bolstering their efforts with corporate support and structure. Suppose a company sees that a growing number of employees are showing a passion for charities focused on sustainable food sources for those in need. The company could encourage this grassroots interest and increase impact by working with the group to articulate their goals, for example, or offering resources such as funds to purchase materials or space to store supplies. Allowing corporate volunteering programs to grow in this fashion may ultimately lead to a better-organized program that brings in more volunteers.

Alternatively, companies may provide the basic scaffolding for corporate volunteering, allowing employees to create and build specific opportunities that both fit the broader corporate vision and appeal to their personal passions. Take, for example, Timberland's Path of Service program. Consistent with the company's mission—"founded on the outdoor lifestyle"—the program emphasizes opportunities where employees can pull on their boots to help address environmental issues. The medical-technology company Stryker has similarly introduced a program that allows employees freedom to pursue volunteer activities of their choice within five mission-oriented focus areas—for instance, involvement in Operation Smile, a charity that performs cleft lip and palate surgery.

Providing loose direction in this way has the additional benefit of resolving the "paradox of choice" for employees seeking to make a difference. There are more than one million public charities in the United States, according to 2016 IRS registration reports. And as psychologist Barry Schwartz has argued, having too many options can be debilitating and harmful to people's decision-making. The scaffolding of a volunteering program simplifies the process, potentially encouraging more employees to participate.

A word of caution, however: When management selects programs that align with the company's purpose and mission, the distinction between normal work and volunteering can become blurry. Consider a coffee company that asks its employees to train independent farmers to use more-sustainable agricultural practices. The initiative offers benefits to the farmers—but it also helps the coffee company improve its own supply chain. If the volunteer work

We found that engagement by customers in corporate volunteer programs improved their connection with and opinion of the company.

A Different Way to Find Purpose at Work

Although managers should do everything they can to give all their employees a sense of purpose and autonomy in their work, some jobs are more routine than others, or so narrow or specialized that it can be hard to see the bigger picture. Corporate volunteerism can have especially powerful benefits for those employees who do not find their regular jobs personally fulfilling.

In a 2013 study, I surveyed 172 employees in the southeastern United States who volunteered for a variety of charitable organizations—including the Humane Society, Boys & Girls Clubs, Habitat for Humanity, March of Dimes, and the United Way—to examine whether the meaningfulness of their jobs influenced their volunteering levels. I found that employees who felt a lack of variety or impact in their paid work were more likely to sign up for what they viewed as meaningful volunteering activities. By offering such programs, my research suggests, companies can help less-engaged employees fill a void—an unmet desire for meaning—in their day-to-day work.

is wrongly classified by management as purely charitable, employees may rebel against what they perceive as a cynical corporate ploy. In my experience working with companies in such situations, I've found that transparency and communication are key: Senior leaders should address any ambiguity up front, acknowledging that the volunteering is part of a business strategy that will benefit the company's bottom line.

Involve other stakeholders. Another way to increase the effectiveness of volunteering programs is to extend their boundaries beyond traditional employee involvement. I have seen companies include customers, suppliers, retired workers, and even board members in their volunteer activities. For example, in one community I studied, some residents needed to make their homes handicap accessible but were unable to get government assistance because of their homes' modular structure. A group of retired engineers from a local construction firm worked through its volunteering program to design and build custom wheelchair ramps that worked for the homes. This program took advantage of the the company's area of expertise, engaging an unexpected but useful group of stakeholders.

My research team and I also worked with a microbrewery, Creative Comforts, to examine its involvement of customers in its corporate volunteering initiative. Employees and customers worked side by side one evening a week for five months on a variety of projects including making blankets for a local homeless shelter, assembling hygiene kits for homeless adults and children, and painting and maintaining signs for community gardens.

We interviewed and surveyed customers throughout the process and again more than a year later. We found that their engagement in those activities improved their connection with and opinion of the company. One customer reflected: "As I found out that they were giving back in the community, I thought that was great, and I will go there over other places." The program not only made customers more loyal to the company—as evidenced by their purchasing decisions more than a year later—but also motivated them to spread the word to others.

BY FOSTERING EMPLOYEE productivity, improving employee engagement, and deepening a company's ties to the communities that they serve, corporate volunteering can unlock substantial intangible value for companies. Like anything else in business, however, reaping such powerful rewards requires thoughtful planning and consideration. Companies should avoid taking the easy route to creating their volunteering initiative—such as mimicking others, focusing on pet projects, and forcing employees to engage. Instead, they should consider their company's specific situation and strengths, capitalize on employees' interests and engagement, and build the most meaningful volunteering opportunities possible.

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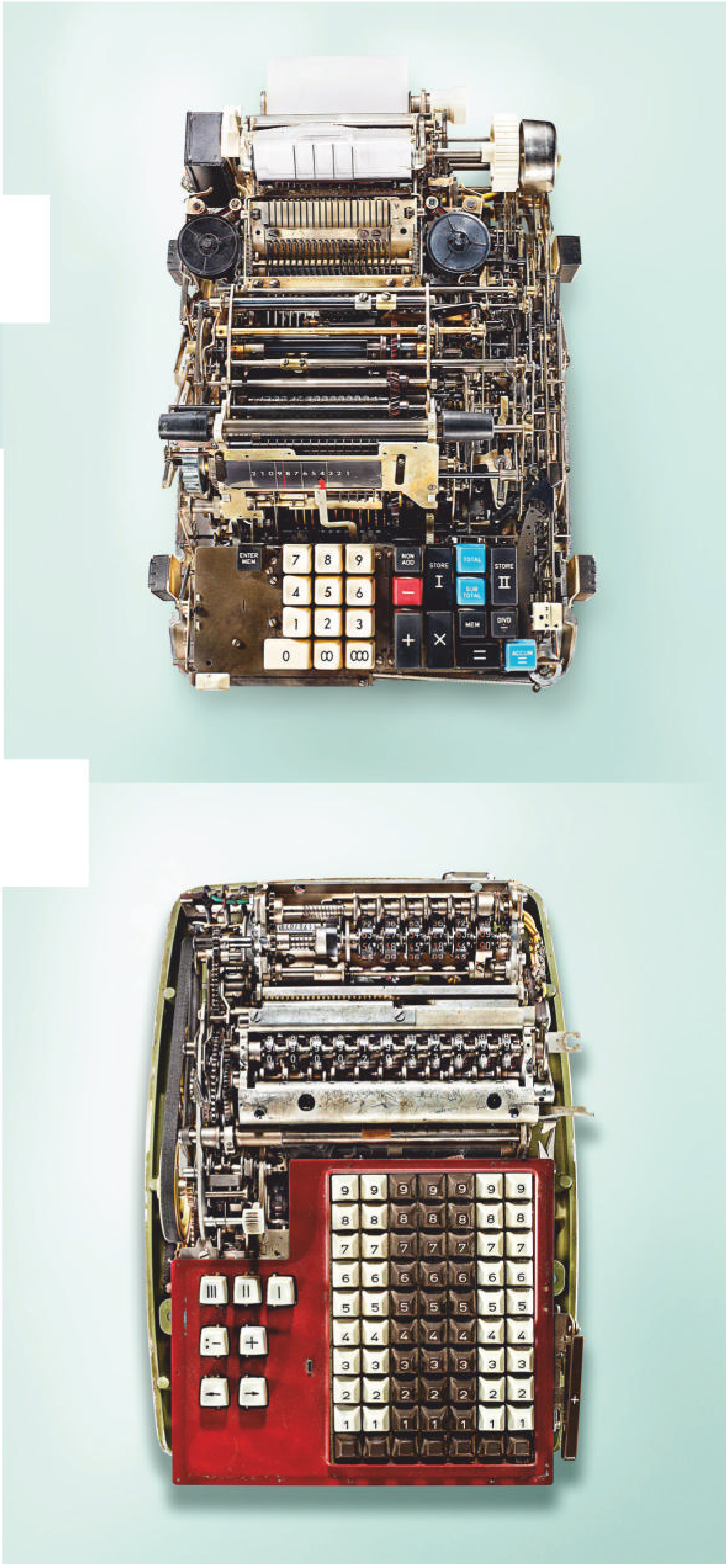
COMPENSATION

PHOTOGRAPHER
KEVIN TWOMEY

Compensation Packages That Actually Drive Performance

Principles for designing executive pay



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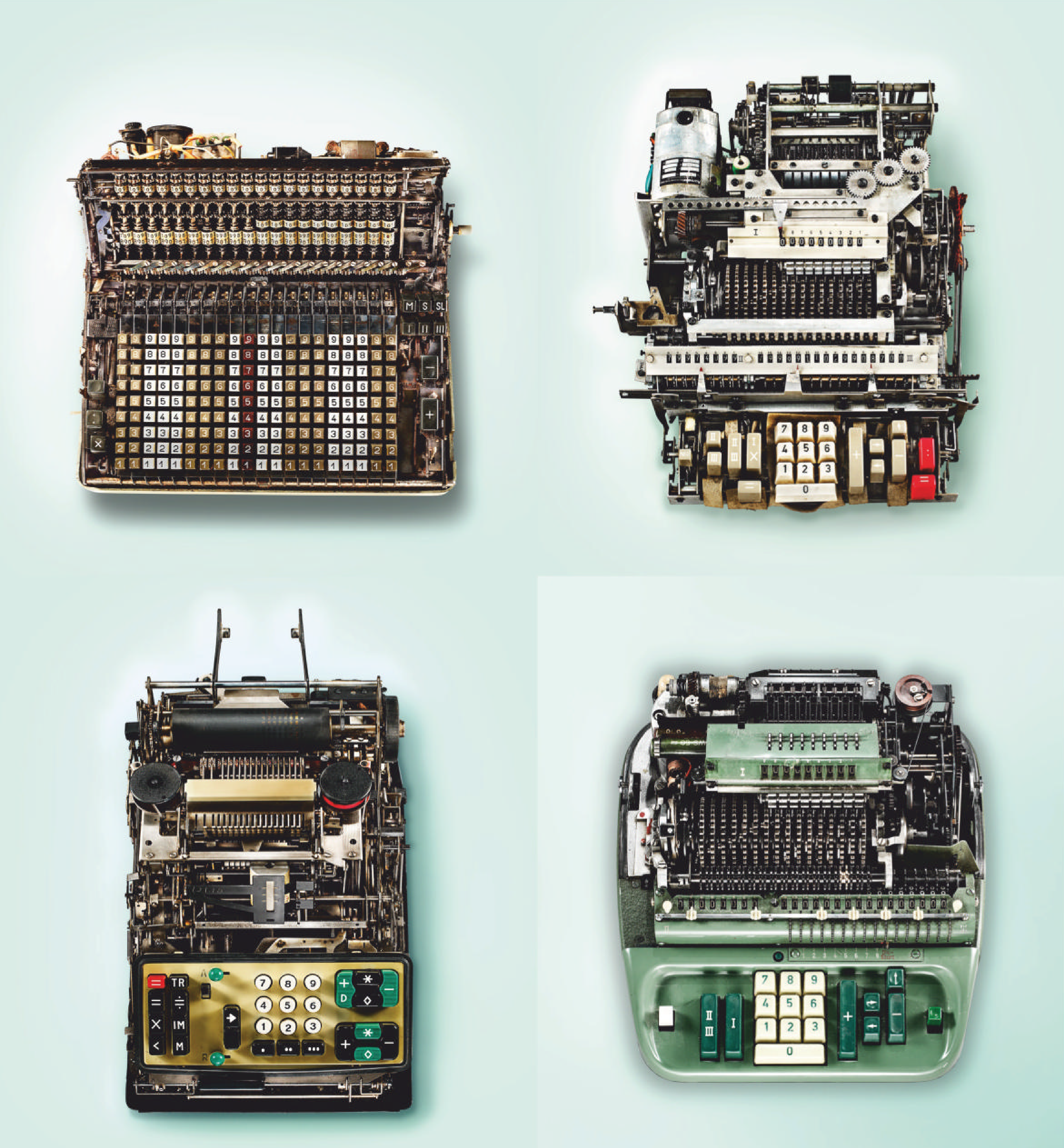


COMPENSATION

Decisions about executive pay can have an indelible impact on a company. When compensation is managed carefully, it aligns people's behavior with the company's strategy and generates better performance.

When it's managed poorly, the effects can be devastating: the loss of key talent, demotivation, misaligned objectives, and poor shareholder returns. Given the high stakes, it's critical for boards and management teams to get compensation right.

Many struggle with this challenge. One problem is that only a few best practices work in all situations. So it's imperative for companies to start with clear strategies and for their leaders to understand the basic elements of compensation and ways to link it to desired outcomes.

In this article we'll describe how firms approach executive compensation and how some have used it to improve performance, sharing insights from our research and experiences. Two of us (Boris and Sarah) have studied compensation for over a decade. The other two (Mike and Metin) have more than 30 years of combined experience advising a broad range of companies on executive compensation.

We'll draw on FW Cook's analysis of executive comp at companies in the Russell 3000, an index of the top 3,000 U.S. stocks by market capitalization, from its *2019 Annual Incentive Plan Report,* and from its *2018 Global Top 250 Compensation Survey.* We'll also draw on Harvard Business School's extensive research on boards of directors, including quantitative data from a survey of 5,000-plus global board members. We'll share some perspectives we gained from in-depth interviews with more than 100 directors of public and private companies from over a dozen countries. Last, we'll discuss how the recent pandemic and economic crisis will inevitably change the thinking on compensation.

How Boards Approach Executive Compensation

When making decisions about compensation, many directors look at the large amount of data available on executive pay. U.S. regulations require every publicly traded company to disclose the amount and type of compensation given to its CEO and CFO and other highly paid executives, as well as the criteria used in setting it.

IDEA IN BRIEF

THE FINDING
When executive pay is structured to align with corporate strategy, it can drive better performance.

THE CHALLENGE
Many firms struggle to achieve this alignment, and only a few best practices work in all situations.

THE RECOMMENDATION
The company must start with a clear strategic objective and then consider several trade-offs as it designs compensation packages.

> Most companies try to keep up with what their peers are offering, but some directors felt that benchmarking had created a "race to the top."

Most companies try to keep up with what their peers are offering, but as one director told us, "Obviously, there is some balancing. If you want your CEO to stay, you'll probably err on the side of paying more. But in a public company, we can't go wildly off the rails because there's enough data out there." Another director commented, "You need to look at what other firms are doing with their incentive programs because that will set the expectations of your people. And if your people are being poached, you need to know what they're being approached with." Many others echoed the belief that the market determines executive compensation levels.

However, directors also argued that there are complex nuances to setting compensation. They pointed to challenges in finding suitable companies to use as benchmarks and in ensuring that that selection isn't manipulated to achieve a certain outcome. The obstacles are even greater for smaller private companies, for which data is less available. Some directors also felt that benchmarking had created a "race to the top." One commented, "The problem is that everyone always says, 'We want to be just above the midpoint in this.' And when everyone does that, then the midpoint keeps moving, right?" Other board members explained that deviations from benchmarks are often necessary to align executives with unique corporate strategies and organizational cultures.

According to FW Cook, 83% of the 250 largest S&P 500 firms use a formulaic annual incentive plan, or one that includes predefined metrics and weightings. These plans tend to incorporate multiple metrics; 76% have at least two. The most common are profits (used by 91%) and revenues (used by 49%). Seventy percent of the companies also use nonfinancial (both strategic and individual) metrics, though they're usually weighted less heavily than financial goals.

Twenty-six percent of the companies with formulaic plans include at least one environmental, social, or governance (ESG) goal. In some cases targets are attached to those goals, and in others the goals are part of an assessment of strategic performance. Among the companies using ESG measures, 43% set human capital goals (such as diversity, employee engagement, and a positive company culture); 25% set health, safety, or environmental goals; and 32% use both types. Utilities and energy companies have the highest prevalence of ESG goals (81% and 77%, respectively), typically related to health, safety, and the environment.

CEO Compensation Across the Globe

Because the Russell 3000 is made up of U.S. companies, it's worth examining compensation practices in other countries. Recently U.S.-based FW Cook, UK-based FIT Remuneration Consultants, and Pretium Partners Asia Limited published the *2018 Global Top 250 Compensation Survey*, which looks at trends in CEO and CFO pay at the 250 largest public companies worldwide. It highlights a number of key regional differences:

→ Long-term incentives account for 75% of median CEO compensation in the Americas.

→ In Europe and Australia, long-term incentives make up 36% of median CEO compensation.

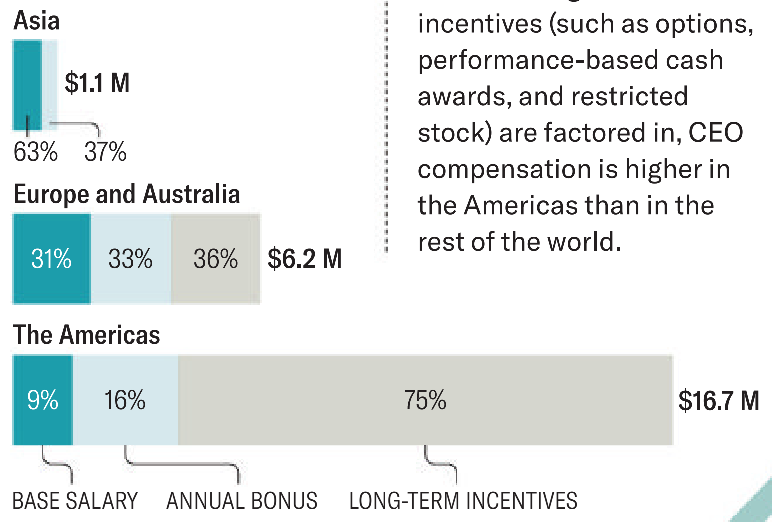
→ Long-term incentives aren't meaningful for CEOs at Asian companies. This is partly because some of the largest companies in China and Hong Kong are state-owned. At them compensation is regulated, base salaries and bonuses are not market-driven, and long-term incentives generally aren't offered.

→ The median CEO base salary is 20% lower in the Americas than in Europe and Australia and meaningfully lower in Asia than in other regions.

→ The median total cash compensation (base salary plus annual bonus) of CEOs is 4% lower in Europe and Australia than in the Americas and is lowest in Asia.

→ When long-term incentives (such as options, performance-based cash awards, and restricted stock) are factored in, CEO compensation is higher in the Americas than in the rest of the world.

Median CEO total compensation, by region



COMPENSATION

Because of the Covid-related economic crisis, many performance targets won't be achievable and will no longer be effective incentives.

Thirty-three percent of companies with formulaic annual incentives incorporate a performance modifier, which provides a check on the primary metrics by adjusting payouts up or down. Some modifiers only tweak results (increasing or decreasing payouts by 5% or less) while others have a meaningful impact (altering payouts by 20% to 25%). They're commonly based on nonfinancial metrics—like safety, customer service, and employee engagement—and often incorporate elements of individual performance.

As organizations work their way through the Covid-related economic crisis, we fully expect to see changes in approach. Many companies, for instance, have cut pay for senior executives—though these cuts are largely temporary and apply just to base salary. More pressing will be how to think about the goals embedded within incentive plans. Many targets won't be achievable given the new financial realities and thus will no longer serve as effective incentives.

In light of this, companies have begun considering a range of moves: adjusting performance metrics but capping payouts, revising goals for the year, and committing to monitor the situation but not take action yet. For multiyear plans, the options being discussed include deemphasizing 2020 results in award calculations, adjusting the payout curve, shortening the performance period, instituting new awards with relative performance metrics, adding relative total shareholder returns as a modifier, and paying out awards in cash rather than shares. Discussions about whether or not to reprice options, a controversial practice, have also taken place.

The silver lining here is that the crisis offers companies an important opportunity to revisit incentive programs and incorporate metrics that serve stakeholder interests in a broader and more meaningful way.

The Four Dimensions of Compensation Design

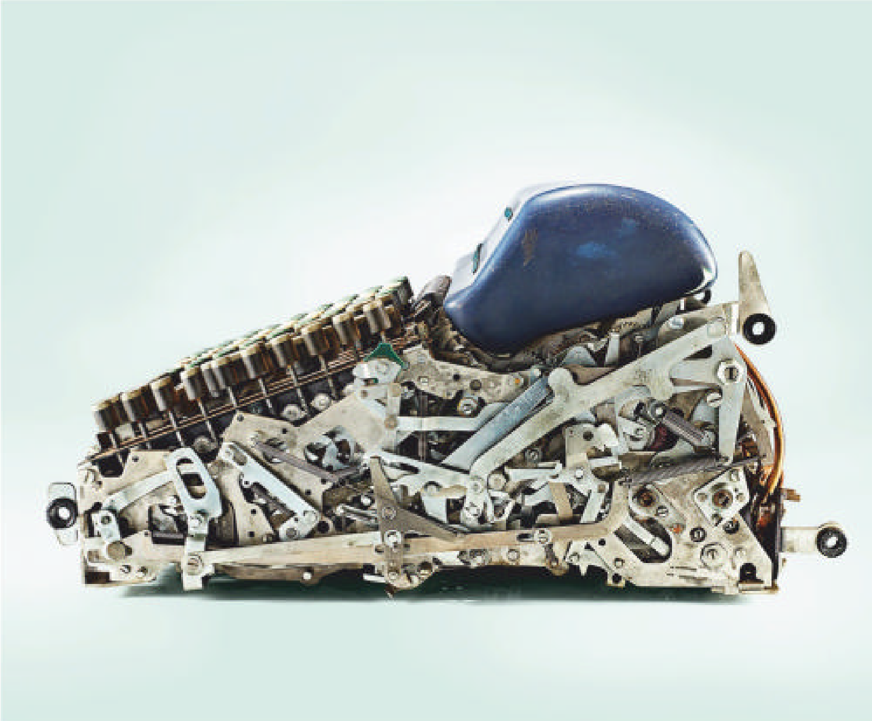
Modern compensation systems can generally be analyzed along four dimensions: fixed versus variable, short-term versus long-term, cash versus equity, and individual versus group. The factors that drive choices include the firm's strategic objectives, ability to attract and retain talent, ownership structure, culture, corporate governance, and cash flow. Within the Russell 3000 Index, companies focus on aligning pay and company performance—something stakeholders expect. But particularly outside the United States, companies may have to take into account other factors, such as seniority.

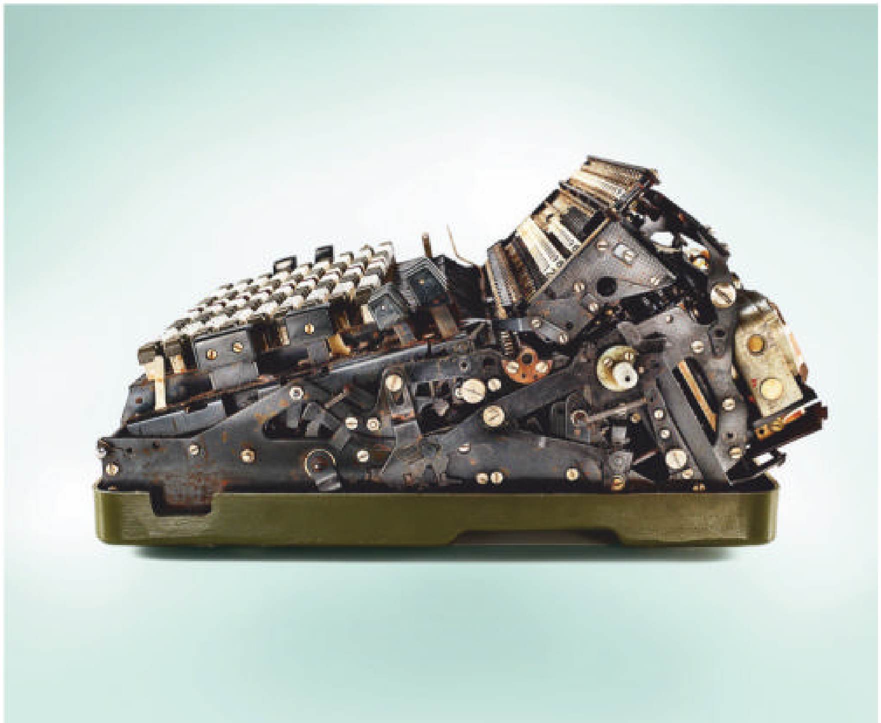
Fixed versus variable. Total direct compensation is made up of a base salary (set in advance and paid in cash) and short-term and long-term incentives. Both kinds of incentives are variable or at-risk elements and may be contingent on the achievement of certain organizational or individual goals. Awards can be based on an established formula or at the discretion of management or the board's compensation committee. Our analysis of the compensation of the five highest-paid executives at Russell 3000 companies shows that on average 82% of their compensation is variable; the rest is base salary. The mix of fixed and variable components is driven primarily by company size and industry, and to some extent, company-specific factors like culture and risk appetite.

The breakdown between fixed and variable comp is relatively consistent across industries, although telecom, technology, and energy companies pay a slightly higher percentage of variable compensation. Financial services, materials, and utility companies pay a slightly higher percentage of fixed. The balance is also relatively consistent across U.S. and non-U.S. companies. But there are notable differences across market caps: Small-cap companies put 69% of compensation in the form of variable payments, and large-cap companies 87%.

The directors we interviewed insisted that variable pay was an important component of executive compensation. As one commented, "I'm a strong believer that CEO compensation needs to be in large part at risk. I would like to see at least 70% to 80% of the CEO's pay at risk, with less emphasis on building too high a base salary that insulates the CEO from the effect of poor performance."

Short- versus long-term. A second dimension is the extent to which variable compensation is paid out in the year it is awarded or deferred and paid over some future period. This applies to awards where the amount (a specified cash payment or a fixed number of shares) is established up front and where it's based on meeting specified future hurdles. Short-term variable compensation generally takes the form of cash; long-term generally is delivered in equity, through instruments such as stock options, restricted stock, and performance shares. (See the sidebar "The Elements of Long-Term Compensation.")





ABOUT THE ART

Kevin Twomey photographs the complex inner workings of antique calculators, using his training in theatrical lighting to discover the objects' emotive appeal.

On average, 28% of senior executives' variable compensation is paid the year it's awarded (or immediately thereafter), and 72% is paid in future years. At the high end of the spectrum, technology companies pay 83% of variable comp in long-term awards, health care companies 81%, and telecom companies 80%. At the other end, financial firms pay only 60% of variable compensation in long-term awards.

Long-term compensation generally involves multiple overlapping cycles. Awards earned in 2018 may be payable in 2018, 2019, and 2020, but the executive receiving them may also get payments in 2018 from plans put in place in 2016 and 2017. Some companies, however, choose to make all grants up front (for example, giving three to five years of awards upon hiring or after another significant event without subsequent annual grants).

Companies undergoing a transformation usually emphasize short-term rather than long-term compensation to encourage fast change. The mix may also reflect other business practicalities. Companies with less cash, for example, may focus on long-term compensation.

Business cycles are another factor. A director we talked to described his experience with designing executive compensation at his company this way: "It's a long-cycle capital business, and most of the management team's compensation is three to five years out." He added that while executive compensation is to some extent set by market practice, the makeup of it should be determined by the company's strategy. "Is the compensation incenting sustainable long-term behavior that gets the organization where it wants to go, or is it really short-term-oriented?" he said.

Cash versus equity. Our analysis showed that on average 41% of senior executive compensation is paid in cash, and 59% in equity. The mix is often determined by business maturity. Young companies tend to rely a lot on equity to attract and retain key employees if cash is scarce. The percentage of equity compensation is notably higher for large-cap companies (63%) than for small-cap companies (48%), however. Technology, telecom, health care, and energy companies put the largest percentage of pay in the form of equity.

One director we interviewed noted that equity compensation encourages executives to think like owners. He detailed two experiences he had—one with a CEO who had a significant equity stake in the company, and one with a CEO who

How Industries Compare on the Four Dimensions of Compensation Design

When setting executive pay, companies must decide how much will be variable or fixed, awarded in the short term versus the long term, delivered in the form of equity versus cash, and tied to group versus individual performance. Compensation committees often use the pay practices of their firms' peers as benchmarks. Here are the norms in selected industries.

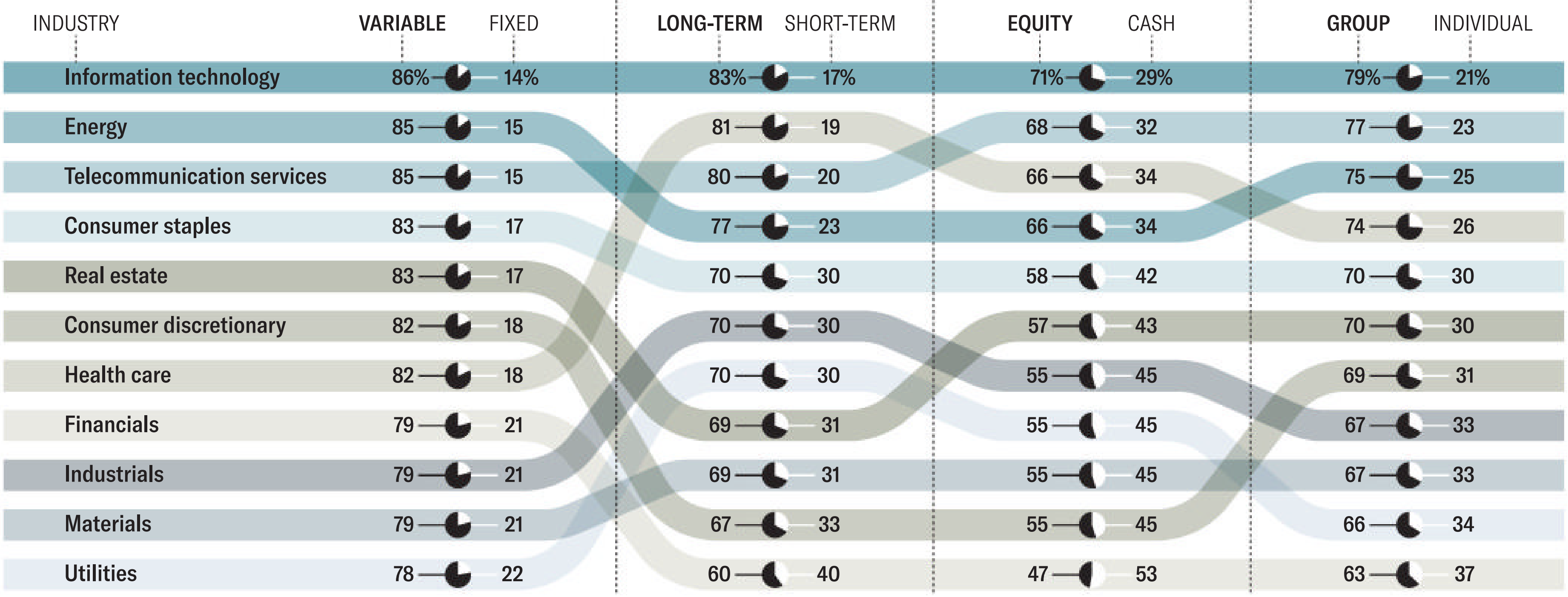
Composition of compensation, by industry

Variable vs. Fixed
Direct compensation is made up of a fixed base salary (paid in cash) and incentives contingent upon achieving certain goals.

Long-term vs. Short-term
Incentives may be paid the year goals are achieved or deferred and paid over several years. Companies that want to promote fast change tend to emphasize short-term rewards.

Equity vs. Cash
Stock and options usually represent a larger share of compensation than cash does. The business's maturity and geography often affect the mix.

Group vs. Individual
Organizational culture and values will have an impact on how much pay a company ties to achieving group goals and individual ones.



Note: Data reflects the compensation of the five highest-paid executives at each of the companies in the Russell 3000.

Source: FW Cook proprietary research

didn't. He recalled, "The person who owned a much more substantial stake in the company generally took the view 'We should do the right thing. We've got to grow the value of the business and the value of the equity, and that will be my compensation.'" The CEO with a smaller stake tended to have "much more of a professional-manager orientation, with an eye to cash compensation. And there was always a little bit of a tussle around whether the objectives were truly achieved or not."

Other directors argued that while stock rewards have benefits, they're not perfect incentives. One commented, "If you gave somebody stock options in 2008, 10 years later those stock options were hugely valuable no matter what the company did, because the market came up. A rising market floats all boats. But if you gave somebody stock options in, say, 2006, no matter what the company did, no matter how well it grew or how profitable it was, by 2008, those options were significantly underwater. And it probably took almost the next seven or eight years for them to get back to where they were. So stock options are a very flawed instrument, because you really want something that gives value if your company does better than its peers." For that reason several directors we spoke with argued that stock awards should be linked, in part, to outperforming comparable firms.

Individual versus group. On average 29% of comp is based on individual performance and 71% on the performance of the organization (such as a division) or company. A firm's culture and values will have an impact on the amounts tied to the two kinds of performance. "I" companies—in which there's a high degree of personal accountability and individuals have the ability to influence results—tend to link more compensation to individual accomplishments. Such companies tend to be human-capital-centric and highly competitive—think of consulting, law, investment banking, and asset management firms, where partners are often valued for bringing in business. "We" companies tend to focus more on organizational results—typically financial goals or shareholder returns. In those companies—often manufacturing, technology, or other product-driven businesses—firm performance is more stable and predictable.

When discussing performance benchmarks in their plans, the directors we interviewed focused largely on organizational metrics, including total shareholder return, revenue growth, and profit margins. However, some also brought up individual objectives, which they believed worked well. “These personal goals include things like maintaining a detailed succession plan for yourself and the top 10 managers,” one director told us, “and like attempting to choose two new specific acquisitions over the next 12 months or improving the company’s public image.” Directors also wrestled with the drawbacks of holding individuals responsible for metrics they can’t always control—which, they argued, is frequently the case with organizational and company metrics.

Linking Compensation Design and Outcomes

A good compensation system always begins with an organization’s strategic goals. When compensation is misaligned with them, trouble ensues. Consider what happened when one company based the bonuses of its CEO and CFO entirely on growing earnings per share—because it assumed that was what investors wanted. As a director explained to us, this incentive encouraged management to make acquisitions with debt, boosting EPS growth but also the company’s risk. Eventually the debt grew too expensive to service, and the company had to put itself up for sale.

Now we’ll explore five common strategic objectives and how companies can put the four dimensions to use in achieving them. Note that this is not meant to be an exhaustive list of strategic goals; nor are we presenting the only or even the best ways to reach them. The examples are simply meant to suggest potential approaches. When contemplating them or other pay programs, you should answer the following questions:

- How is the business strategy reflected in the reward program?
- Are the right metrics being used given the current circumstances?
- When is it time to make adjustments to the existing program design?
- When does it make sense to deviate from the norm and tailor the solution?

PRIMARY OBJECTIVE

Promote Profitable Growth

To achieve this goal, a large consumer-goods company adopted a plan with both short-term and long-term incentives. It rewarded increases in annual sales and gross margin equally and tied equity awards to the achievement of economic profit (profit after a capital charge) and long-term stock appreciation. Given that the firm wanted to generate growth over a period of several years, the long-term incentives were the largest component of compensation, and economic profit was the most significant metric in determining it.

At the beginning of each year the company set numerical targets for all the metrics. The targets didn’t function as triggers (hit them and achieve 100%; miss them and receive nothing); instead a payout curve was established for each, providing for a full range of outcomes. Executives could receive from 50% to 150% of their target bonuses.

One key aspect of this plan was that it was based on the achievement of companywide objectives. A modifier allowed the payout to be slightly adjusted according to each executive’s performance for the period, but the overall size of the bonus pool was based on organizational targets.

PRIMARY OBJECTIVE

Drive a Successful Turnaround

In a turnaround situation a company’s strategic focus can shift from growth to survival. The two are often in opposition, because growth typically involves investment, which can result in cash burn, while survival requires solvency, which requires cash generation until the business’s environment or operations improve.

An oil-and-gas company facing cash flow challenges after oil prices tumbled used a redesign of its compensation system to address them. Its annual incentive plan shifted its emphasis from revenue and net income growth to free cash flow generation and expense management. Similarly, its long-term incentive plan replaced annual awards of restricted stock, which were linked to three-year total shareholder return, with a front-loaded grant of options vesting over five years. The grant minimized accounting expenses and shareholder dilution while giving executives an opportunity to significantly benefit if the turnaround succeeded and the stock price hit certain targets. Thanks to the cost reductions and cash generation rewarded by the annual incentives, the company was able to hang on until oil prices rebounded. Meanwhile, the stock option plan helped it retain and engage employees in a difficult and demotivating business environment.

Note that in certain turnaround scenarios, when conditions are highly volatile or a company is in distress, it may make sense to move to semiannual and quarterly goals, to align incentives with critical short-term objectives.

PRIMARY OBJECTIVE

Transform the Business

A public company was pursuing an aggressive new growth strategy after a recent business reorganization. But it was risky, and the firm wanted executives' incentives to reflect that. So it made a large amount of management's pay contingent on successfully executing the strategy, which included entering new product markets, changing sales channels, and expanding geographic reach. The compensation committee defined success as a significant increase in shareholder value over three years. In other words, the market would determine whether the executives had implemented the strategy well.

When setting long-term incentives, the committee decided to deviate from the norm in three key ways. First it chose to front-load three years of awards and forgo future annual awards. Second the awards were delivered only if the firm hit certain share-price targets. Third the awards were based on a scale, and the targets and vesting schedules were set so that average performance resulted in minimal awards. However, under this plan executives would be rewarded for the risks they took because they could get more compensation sooner than they would have under a traditional approach.

PRIMARY OBJECTIVE

Compete Effectively with Public Companies as a Private Organization

Private companies are often in a war for talent with public rivals that have a powerful tool at their disposal: equity. To address this challenge, one private firm explored two potential solutions. First it considered paying above-market cash compensation (base and bonus). But that would have increased annual cash costs significantly without fostering a sense of ownership, linking compensation to better performance, or creating multiyear accountability.

Next the company considered three long-term incentives that could compete with public competitors' packages: real equity (which the company ruled out because it intended to remain private and therefore had no simple liquidity mechanism), phantom equity (ruled out because of complexities in design, administration, and communication, particularly around valuation methodology), and multiyear cash incentives, which it ultimately adopted.

The chosen plan used three-year cumulative EBITDA as a performance metric, and awards weren't vested and paid out until the end of year three. To maximize retention, the payout was back-end-weighted: 20% in year three, 30% in year four, and 50% in year five.

While a multiyear cash-incentive plan doesn't create an ownership mentality, it is a highly effective, easy-to-

The Elements of Long-Term Compensation

Because long-term incentives make up the majority of executive compensation and have the most variations, they deserve special attention. Key vehicles include:

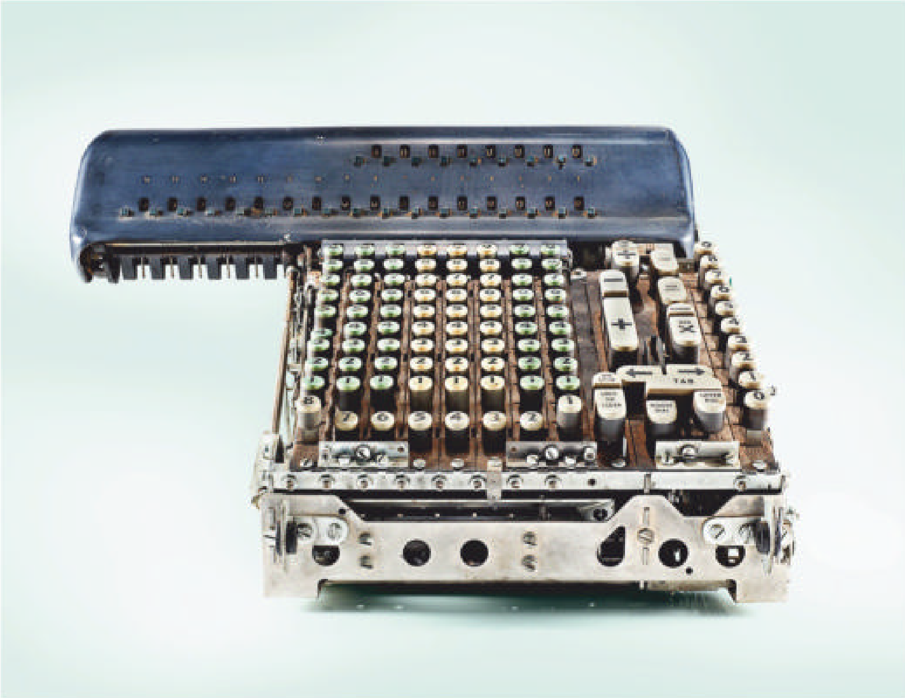
Restricted stock. Restricted shares are essentially common shares that cannot be sold immediately. They become sellable according to a vesting schedule, which encourages retention. However, the benefits of stock ownership (such as dividends) often accrue from the time of the award.

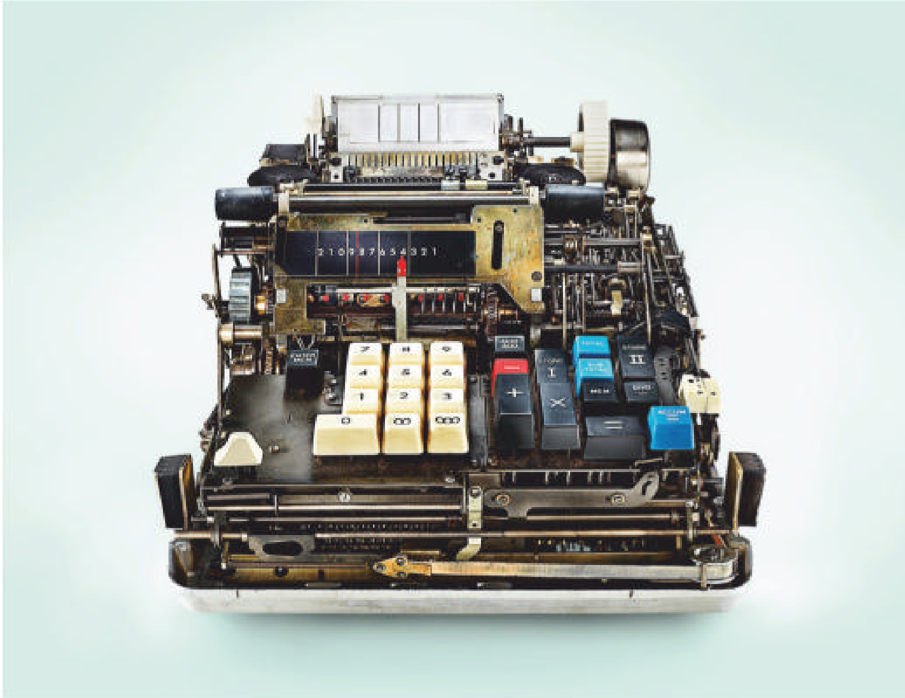
Stock options. These give employees the right to purchase stock at a predetermined price (the exercise price) during a set period (the term). The stock price must improve for the award to have value.

Stock-appreciation rights. Like options, these increase in value if the stock price rises, and may expire. Unlike options, they don't have to be exercised. Instead employees receive the value of the appreciation in shares or in cash.

Performance shares. These are stock allocations that are distributed only when preestablished goals, such as operating or financial results or stock or shareholder returns, are achieved. The goals may be absolute targets or based on performance relative to peers'.

Phantom equity. This cash-based award is structured to mimic an equity award. The value of a company's equity is tracked over time and determines the amount executives receive.





understand way to tie compensation to achieving agreed-upon objectives or performance superior to peers' for several years. This approach encouraged executives to remain at the company and served it well.

PRIMARY OBJECTIVE

Foster Alignment with Owners and a Long-Term Orientation When Traditional Equity Is Unavailable

At a private family business that wanted to strengthen the alignment between employees and the owners, the existing compensation program provided base salaries and annual incentives only and no long-term incentives. That reinforced short-term thinking, which conflicted with the risk-seeking entrepreneurial focus of the company's founders. To remedy this, the compensation committee worked with management and family members to redesign the firm's approach to pay.

After considering phantom equity (which offers employees the benefits of stock ownership without giving them company stock) and long-term-performance cash bonuses, the company settled on an economic-profit-sharing program. Each year the compensation committee looked at profits, subtracted the cost of capital, and put 20% of the resulting amount into a profit-sharing pool for employees. To lengthen the time horizon, the pool was not paid out in the year it was earned but instead was put into a "banking" system. Each participating employee had his or her own bank, and the annual contribution to it was based on a formula that allowed adjustments for performance. If the economic profit in a given year was negative, the bank's balance would fall. If it was positive, the balance increased. Employees received a third of their banks every year, and two-thirds were rolled forward. The plan helped employees adopt a long view but didn't require management to set specific long-term goals.

Challenges and Opportunity

Norms for key aspects of executive compensation clearly exist, but as the data shows, they vary to some degree by industry, geography, and company size. In addition, underlying any norms are individual decisions and solutions tailored to company needs and strategies.

In the immediate future, we expect business conditions to remain uncertain and changeable, complicating the design of executive incentives. How this will all play out is anyone's guess, but we know that employee health and safety have taken on new significance to virtually all companies. Enterprisewide liquidity also has new importance. In the past liquidity concerns arose primarily when external capital became scarce. Now they spring more from internal cash-flow issues. Liquidity and employee health are just two of the areas we expect incentive plans to start tying metrics to. Indeed, the current environment offers an opportunity to revisit plans with an eye toward incorporating measures that serve stakeholder interests in a broader and more meaningful way.

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MANAGING ORGANIZATIONS

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Build a Family Business That Lasts

Companies that endure do these five things right.

ARTIST **JORGE MAYET**

IDEA IN BRIEF

THE PARADOX
Family businesses are famous for power plays, backstabbing, and dramatic implosions. Yet some are among the most enduring companies in existence.

WHY IT MATTERS
Family-controlled firms represent some 85% of the world's businesses. In the United States they employ 62% of the workforce.

THE KEYS TO LONGEVITY
The owners of a family business have the right to: decide on an ownership type, structure governance, define success, determine what to communicate, and plan the transfer of power to the next generation. Misunderstanding or misapplying these rights can destroy the work of generations—and exercising them wisely can lead to long-term success.

Courtesy of Jorge Mayet and Richard Taittinger Gallery, New York

ABOUT THE ART

Jorge Mayet's sculptures draw from his experiences living as a Cuban exile in Spain. Suspended in midair, his photorealistic floating landscapes and uprooted trees offer ethereal, dreamlike visions of his homeland.

MANAGING ORGANIZATIONS

Given their portrayals in the media, it might be easy to dismiss family businesses as hotbeds of power playing, favor currying, and back-stabbing—preoccupations that can hurt the company, the family, or both. Think of the Murdochs and News Corp, or the Redstones and National Amusements, to name just two.

But despite the headline-grabbing tales, many family businesses have enjoyed success for decades, even centuries. For instance, the Italian winemaker Marchesi Antinori, established in 1385, has thrived as a family business for more than 600 years. Similar examples can be found across the globe just within the alcohol business; they include Gekkeikan in Japan (founded in 1637), Berry Bros & Rudd in the United Kingdom (1698), and Jose Cuervo in Mexico (1795).

So which is it? Are family businesses prone to dramatic implosions, or are they some of the most enduring companies in existence? The answer is both. They can be much more fragile or much more resilient than their peers. Given that family businesses—companies in which two or more family members exercise control, concurrently or sequentially—represent an estimated 85% of the world's companies, ensuring their longevity is essential. The United States alone has 5.5 million of these businesses, which employ 62% of the workforce, according to the research and advocacy group Family Enterprise USA.

To explain the difference between those two fates, we'll delve into an area rarely explored in business schools or the media: the impact of ownership on a company's long-term success. Ownership of any asset confers the power to fundamentally shape it. Think of a professional sports team. Within the rules of the league, the owner has the right to make essentially every important decision, including whether to fire the coach, which players are on the roster, where the team plays, whether the franchise seeks to maximize wins or profits, and whether and when to sell it. The teams with the best track records have great owners at the helm. If your favorite team has an ineffective owner, you are probably doomed to disappointment.

In a widely held public company, the owners are mostly investors. Their influence is limited. They typically let the board and management run the business; when dissatisfied, they "vote with their feet" by selling their shares. Ownership of a family business could not be more different. It rests with a relatively small number of people, who are related. Their ability to shape the company is profound and is itself shaped by their relationships with one another. That's a potent mix, creating the extraordinary highs and lows we see daily in our work advising the owners of family businesses.

Five core rights accompany family ownership—the right to:

- *Design:* What type of ownership do you want?
- *Decide:* How will you structure governance?
- *Value:* How will you define success?
- *Inform:* What will—and won't—you communicate?
- *Transfer:* How will you handle the transition to the next generation?

Understanding and effectively exercising these rights can lead to long-term success. Misunderstanding or misapplying them can destroy what a family has spent generations building. In this article we explore the five rights and offer battle-tested approaches for exercising them well.

WHAT TYPE OF OWNERSHIP DO YOU WANT?

Family businesses are often lumped together as if they were all the same. But four fundamentally different types exist, distinguished by who can be an owner and how owners share control. If you want your family business to last for generations, you need to understand the characteristics of your type and the strengths and challenges associated with it. The choice of ownership type isn't a mere legal formality; it can define or restrict various members' involvement and may loom as an unrecognized source of conflict.

Sole owner. One family member owns the company and is responsible for all decisions. This works best when the business requires decisive leadership and creates enough liquidity to satisfy nonowners (or when nonbusiness assets can do so).

The French cognac maker House of Camus has had a sole owner since its founding, in 1863. In each generation, one member leads the company, buying out siblings' shares. The current owner, Cyril Camus, says this model has been essential to the firm's longevity. With no siblings or cousins involved, family conflict around the business is rare. Sole ownership has downsides: Succession becomes a central issue, which may be decided according to merit (as assessed by the current owner) or assigned by primogeniture or a similar rule, and the owner must wrestle with what benefits to extend to other family members. This model can be risky, because much of the family's capital and talent exit in each generation.

Partnership. Ownership is restricted to family members actively working in the business. This allows for multiple perspectives and requires clear rules governing how people can join or leave the ownership group and what benefits accrue to nonowners. The German-Dutch Brenninkmeijer family, sixth-generation owners of the clothing chain C&A, have chosen this type. Children of current owners are admitted to the partnership on a competitive basis, after a rigorous evaluation and an apprenticeship. Like sole ownerships, partnerships keep family owners highly engaged but can be vulnerable to the loss of capital and talent. They are typically more resilient because they don't rely on just one leader, but they may face conflict over who is admitted to ownership.

Distributed ownership. Any family member may be an owner and participate in decision-making. This works well when most of the family wealth resides in the company, when it is mandated by law, or when it is expected by family culture. The Brazil-based conglomerate Votorantim has this type of ownership: In each generation, family members pass down their shares, usually evenly. With no need to buy out nonowner members, distributed ownership can keep family capital tied to the business. But owners may vary in engagement; aligning their interests and defining decision-making norms can be challenging, and resentment about "free riders" may arise if some are operating the business while others are "only" investors. Big problems may crop up if some members of the family want to cash out; having a clearly defined exit ramp reduces that risk.

Concentrated ownership. Any family member may be an owner, but a subset controls decision-making. This works well when decisive action is required despite a multiplicity of owners, and it mitigates some of the challenges of distributed ownership. But the question of who will exercise control becomes more complicated with each new generation. Vitamix, the 100-year-old manufacturer of high-performance blenders, operates this way. Shares are passed down to descendants, but in each generation the CEO must own or control a majority of voting shares. Although the owners aim for consensus on big decisions, the CEO makes the final call. One of the chief risks is conflict over who will lead. Another is the possibility that those not in power will lose interest and sell their shares.

Although hybrids exist, most family businesses fall into one of those four categories. (If a family business has some shares that are publicly traded, it may fit into any of them, depending on how the family has decided to handle its piece.) In a survey we conducted of family businesses of various sizes and across numerous industries and geographies, we found that 13% had a sole owner, 24% were partnerships, 36% had distributed ownership, and 27% had concentrated ownership.

The type of ownership needn't be a static choice. Be on the lookout for the need to make a change, which may arise when the next generation is joining, when the size or complexity of the business alters significantly, or when you're bringing in outside leaders. The Antinori winemaking family had a sole owner for 25 generations: Control passed to a male descendant, keeping the business and associated land united. But Piero Antinori, who took the reins in 1966, has three daughters and no sons. He opted for a three-way partnership to succeed him.

The owners of family businesses wield profound decision-making power. We know of sizable companies in which not a dollar can be spent without their approval.

HOW WILL YOU STRUCTURE GOVERNANCE?

The owners of family businesses wield profound decision-making power. We know of sizable companies in which not a dollar can be spent without their approval. When this power is channeled appropriately, it confers a major competitive advantage, facilitating the nimbleness needed to capitalize on opportunities as they arise. Many family business leaders we know can make big bets at a moment's notice, without having to run decisions through multiple layers of management and bureaucracy. "Speed of response is becoming more crucial, and we can put large projects to work quickly," says Alexandre Leviant, the president of the specialty chemical conglomerate ICD, which his father founded in 1952.

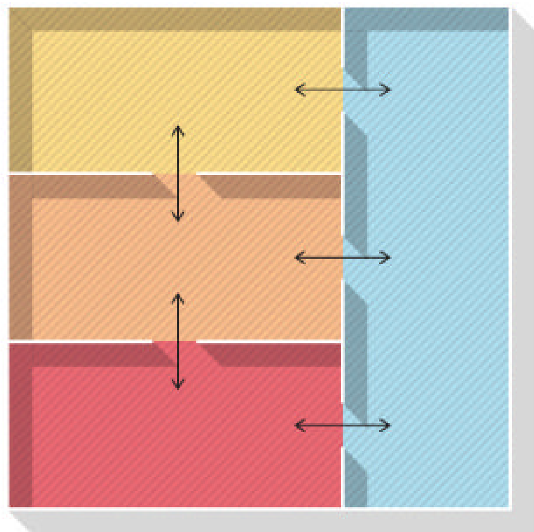
But if that power is wielded ineffectively, the business will suffer. Some owners exercise too much control, stifling innovation and making it hard to attract and retain great talent. Others step back from major decisions, leaving a vacuum that may be filled by executives looking to their own interests. We saw a number of family businesses nearly destroyed when decisions were left to nonfamily managers who wanted to run the company down and buy it at a fire-sale price.

Governance in a family business is all about finding a middle ground between micromanaging and abdicating responsibility, and it becomes more challenging as the family and the business grow. We suggest a simple framework to guide decision-making: the *four-room model*. Imagine your business as a home with one room each for the owners, the board, management, and the larger family. The owners set high-level goals and elect the board; the board oversees the business and hires (and if necessary fires) the CEO; and management recommends business strategy and directs operations. Because the board and management report to the owners, the first three rooms are in a row, with the owners' room on top. The family's room, which is critical for maintaining members' emotional connection to the business, sits alongside the other three, underlining the importance of family influence and unity throughout.

In a well-run family business, each room has explicit rules about who belongs there, what decisions are made there, and how. People's roles vary from room to room. For example, a nonfamily CEO can run the management room but shouldn't decide how the owners will use their dividends. Nonowner family members, for their part, can't walk into other rooms and make decisions. Governance based on the four-room model makes the hierarchy and boundaries clear.

The Four-Room Model

Thinking of your business as having a separate room for every group of stakeholders—along with rules about what may be decided in each—clarifies roles and minimizes conflict.



Owners define what success means for the business and hire the board.

Board of directors oversees the business and hires (and if need be fires) the CEO.

Management recommends strategy and directs operations.

Family members build family unity and develop the next generation.

Time and again, we've seen businesses slide into chaos for lack of a good decision-making process. Too often the problem becomes apparent only after disagreements have begun to destroy what years of collaboration built. At a regional retail chain headed by a family member we'll call Steve, the lack of governance let his self-described "cowboy" instincts run unchecked, sparking resentment in his sister and his cousin, who were equal owners. Once they all recognized the problem, they turned to the four-room model and created an owners' council, which Steve was required to consult for decisions of a certain magnitude. That allayed his co-owners' concerns while forcing him to plan big moves more carefully, and the business—along with the family—got back on track.

The four-room model helps owners maintain control over the most important issues and delegate other decisions. It establishes a process for revisiting decisions as goals evolve for the family or the business or both.

HOW WILL YOU DEFINE SUCCESS?

The owners of a business have a right to the residual value it creates. With that right comes the ability to define success. For widely held public companies, that's straightforward: They aim to maximize shareholder returns. But few family businesses we know would describe their primary objective in those terms. That's one of the best things about family ownership: *You* get to determine what matters most. No outsider can force you to value earnings growth more highly than, say, providing family members with employment, or can insist that you pursue opportunities that clash with your beliefs.

Effectively exercising this right can be an incredible advantage in making a business last. It enables a long-term, generational approach that contrasts sharply with public companies' obsession with quarterly results. But not all families are clear about what they value most. That lack of clarity can trigger battles over priorities, missed opportunities, or a failure to retain talented employees. More fundamentally, if you are unclear about your objectives, you risk losing your raison d'être for being in business together, especially as the company grows and transitions to new generations. Your path may become a dead end.

To avoid that fate, you need an owner strategy that identifies concrete goals and sets up guardrails.

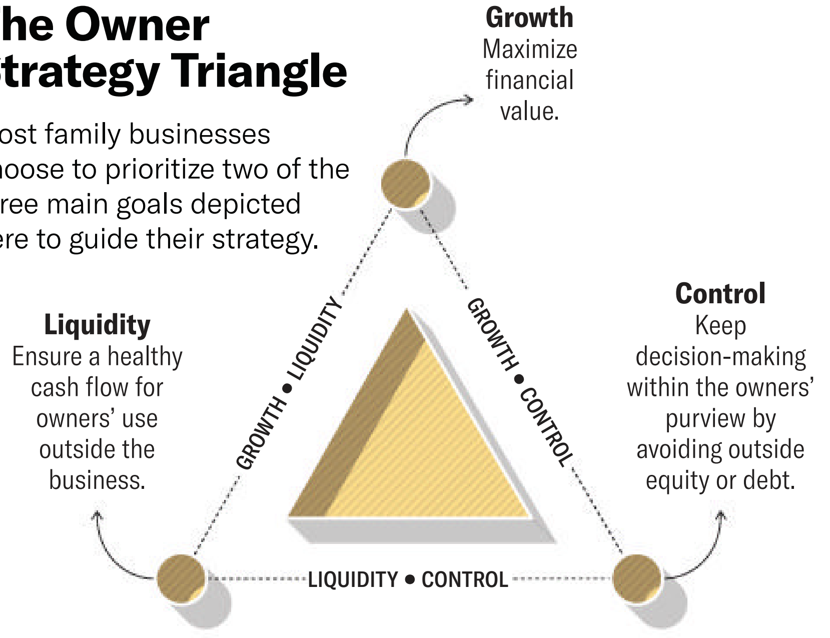
Goals. These fall into three main categories. You can aim for *growth:* maximizing financial value. You can seek *liquidity:* prioritizing a healthy cash flow for the owners' use outside the business. You can look to maintain *control:* keeping decision-making authority firmly within the ownership group by avoiding outside equity or debt.

There will be trade-offs among these options. You might pursue only one goal, or you might decide on a combination. We have found that for most family-owned companies, this is a "pick two" situation, meaning they prioritize two goals at the expense of the third. That suggests three basic owner strategies—one for each possible pairing of goals, each forming a side of what we call the *owner strategy triangle.*

Growth-control companies—the most common type we have encountered—focus on becoming bigger while keeping decision-making within the owners' purview.

The Owner Strategy Triangle

Most family businesses choose to prioritize two of the three main goals depicted here to guide their strategy.



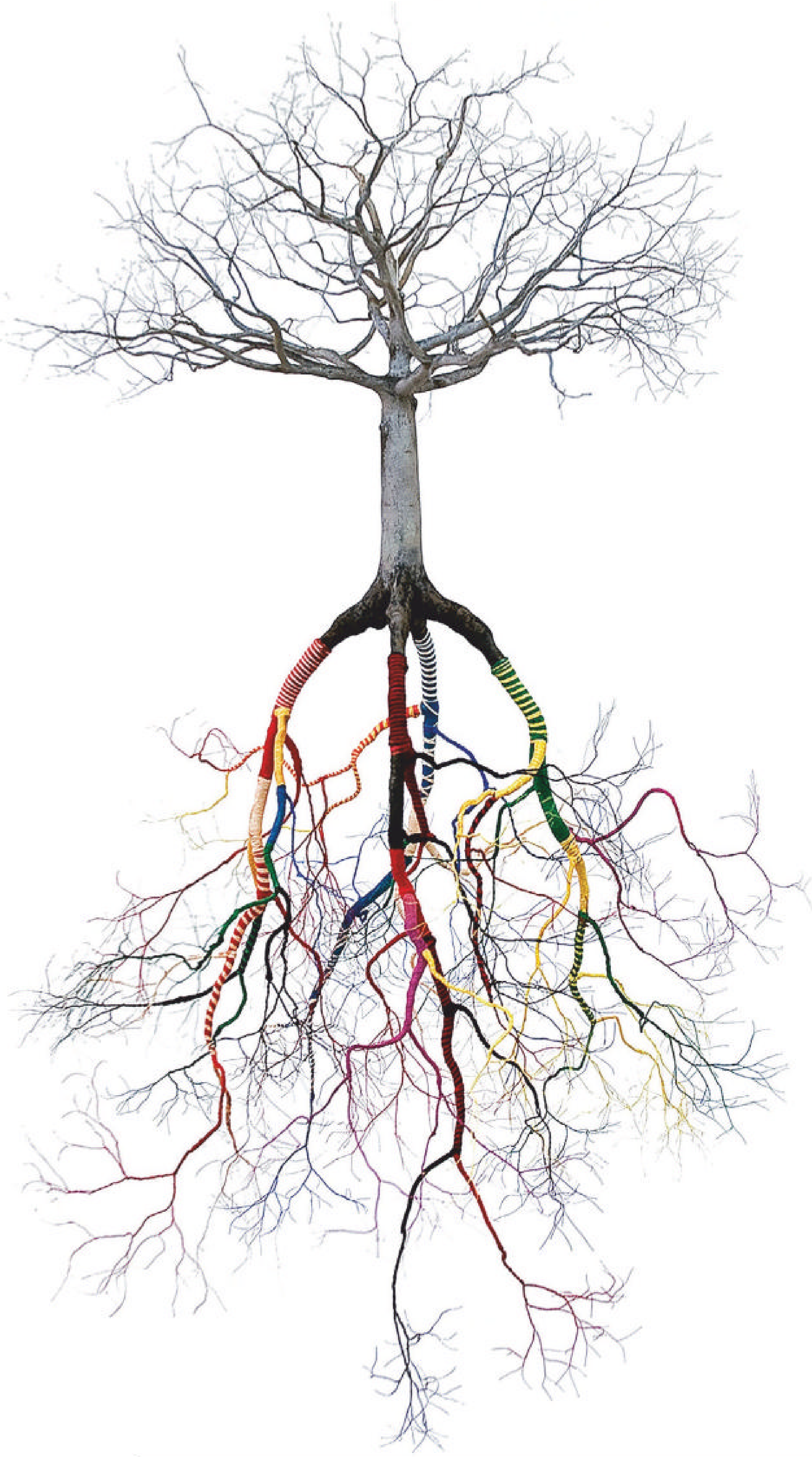
Growth-liquidity companies also seek to become bigger, but they pay out considerable money to the owners and use outside equity or debt or both to keep the engine going—consequently relinquishing some control.

Liquidity-control companies are not concerned with rapid growth; instead they hope to produce a significant cash flow for the owners while retaining decision-making authority.

We know highly successful family businesses that have chosen each strategy combination. And these are broad strategies; companies can find spaces between them. What's most important is understanding the explicit and implicit choices you are making about what to prioritize; those should flow from your fundamental values. You should revisit your choices as circumstances evolve, whether because of external factors such as economic developments, industry consolidation, and regulatory shifts or because of internal factors such as generational transitions, family conflict, and changes to senior management.

Guardrails. Aligning on priorities is essential. But without concrete ways of measuring performance, it's just lip service. Guardrails can help ensure that those running the business day to day are directing their energy and resources toward what you as owners care about most. They allow you to delegate decisions more confidently.

One of the best things about family ownership is that no outsider can insist that you pursue opportunities that clash with your beliefs.



Guardrails can be financial or nonfinancial. Owners should home in on a small number of financial ones—for example, minimum levels of return on invested capital or maximum levels of debt—and ensure that the company stays within them. Nonfinancial guardrails define outcomes for which owners are willing to sacrifice financial performance. The values informing them are often part of the glue holding the family together and a means of making the world a better place. For example, we work with a U.S.-based family business whose members lost relatives in the Holocaust. It invests only in countries with a high score in the nonprofit NGO Freedom House's annual ratings.

Having a clear owner strategy fosters longevity by ensuring that the business accomplishes the owners' financial and nonfinancial goals. Over the long term, families need an emotional connection to their company; they must be able to say, "We own this because we want to make a difference" or "This represents what our grandfather sacrificed to give us a better life." Without an emotional connection, owners may be tempted to cash out.

WHAT WILL—AND WON'T—YOU COMMUNICATE?

Owners are legally entitled to know a great deal about their business, such as what's in financial statements, certain organizational records, and ownership documents. And except when they bring in outside investors, lenders, or board members, they are not obligated to share that information with anyone (other than the government). That means they control communication; nothing of consequence can be shared without their permission.

How owners exercise this right significantly affects the business's longevity. That's because effective communication is critical to building one of a family business's most valuable assets: trusted relationships. These are often underappreciated, but they help generate three important things:

• *Financial capital:* committed owners who have an emotional connection to the business and value long-term performance

• *Human capital:* engaged employees and family members, including spouses, who bring their full talents to their work and the family

• *Social capital:* a positive reputation with customers, suppliers, the public, and other stakeholders, which can help differentiate you in a crowded marketplace and build partnerships across generations

The impulse to keep things private is understandable. Privacy can protect the business and the family from outsiders. But if owners hold their cards *too* close to the vest, they risk starving the business of its ability to cultivate valuable relationships.

A business school professor we'll call Sophie married into a family with a fourth-generation media business in Asia. Concerned about what she saw as a casual attitude toward innovation, she began asking about the company's long-term strategy. The more questions she asked, the more information the executive team withheld, until it requested that her husband stop sharing financial reports with her for fear she would "rock the boat." Sophie became increasingly anxious about whether her children would inherit a business with any value. In the face of the stonewalling, she withdrew, even scheduling vacations elsewhere during the family's annual reunions. That deprived her children of opportunities to forge relationships with their cousins (and future co-owners), which could have a devastating impact on the business in the years to come.

Early on in the life of your business, communication is likely to be informal, perhaps taking place over meals. As things progress, consider what meetings, policies, functions, or technological platforms could improve your dialogues. Start by aligning on what you will and won't disclose to each audience. In our experience, owners are often so worried about protecting details regarding their wealth that they fail to think through what they *can* share to help stakeholders feel connected to the business's long-term success. Such information might include your owner values and strategy, how decisions will be made, how you think about succession, and your passion for the business. If you decide to keep such information private, tell your stakeholders why.

We have seen cases in which the failure to communicate effectively was the single biggest reason for a family business's demise. We've also seen some in which skillful communication pulled the company through tough times. Wield the right to inform wisely.

Delaying or poorly planning a transition to the next generation can wreak havoc on the family and the business alike. You need a continuity plan.

HOW WILL YOU HANDLE THE TRANSITION TO THE NEXT GENERATION?

The final right of owners is deciding how to exit. You can choose who will own the business next, what form that ownership will take (whether shares or a trust), and when the transition will occur. With this right come complex and difficult decisions. What will you do with the assets you worked so hard to build? How will you let go? What roles should members of the next generation play? How should you prepare them? Are the relationships among them strong enough that they can work through decisions together?

Delaying or poorly planning your transition can wreak havoc on the business and the family alike. A Boston Consulting Group study of more than 200 Indian family businesses found a 28-percentage-point difference in market capitalization growth between companies that had planned their transitions and those that had not. Family empires may be consolidated or squandered in the transfer of power across generations.

To execute a successful transition, you'll need a *continuity plan* that maps a path from the current generation of owners to the next. It should address three main challenges:

• *Passing down your assets.* Will you keep the same type of ownership (sole owner, partnership, and so on) or change it? Will you transfer ownership all at once or gradually (for example, by giving economic interests to the next generation while retaining voting control)? What tools, such as trusts and gifting, will you use to minimize taxes?

• *Handing off roles.* How will you create the glide path necessary for the current leaders to let go? How will you select successors across the four rooms in a way that feels fair and identifies the most-talented candidates? How will you ensure a smooth passing of the baton?

• *Developing next-generation capabilities.* What skills will each of the new owners need, whether they actively work in the business or not? How will you help them identify the roles for which they are best suited? How will you create opportunities for them to learn how to collaborate with one another?

Transition is a process, not an event—and the more the continuity plan resembles a discussion rather than an ultimatum, the greater the chances of success. The plan can't simply be dictated from one generation to the next; incoming leaders need to be prepared and aligned. To see what can happen when they're not, consider the Pritzker family, which built the business empire that includes Hyatt hotels. Jay Pritzker, the leader of the third generation, and his brother Robert gathered the family in 1995 and handed out a two-page document describing their succession plans. It detailed a complex web of trusts created to hold the family's assets, spelled out when members would receive distributions, and assigned leadership to a triumvirate. It was undoubtedly well-intentioned, but it didn't work. Just months after Jay's passing, in 1999, a series of lawsuits began. The family eventually decided to divide its holdings.

Oftentimes the biggest hurdle to continuity planning is getting started. When facing pressing concerns in the present, it can be tempting to put off cross-generational conversations that may be fraught with issues of mortality and identity. So put those conversations on your agenda (in your owners' room, with a designated continuity-planning task force, or through your board) and set some deadlines for them.

WE WON'T SUGARCOAT the bottom line: Without hard and smart work by the owners, other family members, and employees, family businesses often implode. Much energy is needed to keep the many competing interests from turning destructive.

There is no single way to survive, and there are few universal best practices. But by applying the five-rights framework, you can organize yourself for the work that family ownership requires. Ask the members of your business to individually assess your performance against each right. Then share the results and develop a plan that builds on your strengths and shores up your vulnerabilities. Only through such collaboration can you use the power of ownership to sustain your family business for generations to come.

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Experience

Advice and Inspiration

MANAGING YOURSELF

HOW TO HELP (WITHOUT MICROMANAGING)

New research points to three strategies.

by Colin M. Fisher, Teresa M. Amabile, and Julianna Pillemer

"MICROMANAGEMENT" IS A dirty word in today's workplaces. Bosses who intervene too often or too extensively in their subordinates' activities get a bad reputation, and most forward-thinking organizations have come to value employee autonomy more than oversight. Research shows that people have strong negative emotional and physiological reactions to unnecessary or unwanted help and that it can erode interpersonal relationships. Even the U.S. Army general George S. Patton, a leader in one of the

Illustrations by NATHALIE LEES

> People are more willing to welcome assistance when they're already engaged in a task or a project and have experienced its challenges firsthand.

most traditional command-and-control groups in the world, understood the danger of micromanaging: He famously said, "Never tell people how to do things. Tell them what to do, and they will surprise you with their ingenuity."

Managers shouldn't be completely laissez-faire, however, especially when subordinates aren't colocated, as is the case for many during the global Covid-19 pandemic. People doing complex work often need more than just superficial advice or encouragement; they need assistance that is both well-timed and appropriate to their issues—and providing it can be challenging without opportunities for serendipitous encounters in a physical office. Extensive research indicates that pervasive helping in an organization correlates with better performance than letting employees go it alone does. So how can you give subordinates the assistance they need without undermining their sense of efficacy and independence?

Over the past 10 years we've been studying how leaders effectively offer help without being perceived as micromanagers. We have observed and talked to people inside various companies, including a prominent strategy consulting firm (we'll call it ConsultCo) where we interviewed partners who were named by top management as exceptional hands-on leaders. At a design consultancy that's well-known for its helping culture (pseudonym: GlowDesign), we conducted a large-scale qualitative study using daily diaries and in-depth weekly interviews with help givers and receivers. And we've run two behavioral experiments in the laboratory, exploring how 124 groups responded to differently timed interventions when asked to make decisions about opening a fictitious restaurant.

Together those projects have yielded important insights into how managers can better assist their employees. As a starting point, your employees need to know that you're willing to offer help—and they must feel comfortable asking for it. Additionally, you need to have a baseline understanding of their work and its challenges, as well as time and energy to give. But just how and when should you roll up your sleeves to get involved in employees' work? We've uncovered three key strategies for being a hands-on boss without micromanaging: (1) Time your help so it comes when people are ready for it, (2) clarify that your role is to be a helper, and (3) align the rhythm of your involvement—its intensity and frequency—with people's specific needs.

TIME YOUR HELP WISELY

When involving yourself in your employees' work, timing matters, but not in the way you might expect. Conventional wisdom suggests that heading off potential issues is the best strategy (recall Benjamin Franklin's famous adage "An ounce of prevention is worth a pound of cure"). We've found, however, that the leaders who are viewed as the most helpful don't try to preempt every problem or dive in as soon as they recognize one. Instead they watch and listen until they believe their subordinates see the need for help and are ready to listen receptively. They understand that people are more willing to welcome assistance when they're already engaged in a task or a project and have experienced its challenges firsthand.

GlowDesign, where we spent two years studying leaders' helping behavior, offers some illustrative examples. In one case, a manager checked in on a shorthanded team and discovered what he felt were fundamental issues with the project's scope. But rather than jump in right away with assistance or advice, he simply told the project lead, Violet, that he was available. (All names in this article are pseudonyms.) "I offered help," he told us, but "it took a while for Violet to figure out how she could use me." She ultimately asked him to weigh in on several key matters.

Those known as great helpers at ConsultCo were similarly careful about the timing of their help. One of the firm's partners, Adriana, described her approach when some of her people were struggling with their work. She told us that even before she met with them, "I thought the team was on the wrong track. [But] when I got in the room, I listened. I limited my questions to clarifying questions to make sure I understood what they were saying. There are two reasons I did this. One is that these are smart people, and I have enough respect for them—even the most junior-tenured people in the firm—to know that the work they do is very valuable.…Second, I thought they would be more willing to rethink [their ideas] if they had a chance to first explain what they were doing." By the end of the meeting, the team seemed ready for Adriana to offer suggestions, so she did.

Our experimental research—studying those 124 groups making entrepreneurial

decisions—confirmed the importance of lending a hand at the right time. We found that when advice was given in the course of teams' work, *after* problems had emerged rather than beforehand, members understood and valued it more. This led them to actually use the help, improve their processes, share more information, and make objectively better decisions than did groups that received more instruction at the start of their discussions.

What prompts employees to welcome assistance may vary from situation to situation. But we'd counsel managers not to provide input without first allowing those they supervise to gain knowledge of the task and express their views on it. In many cases, a well-timed cure may be better than that ounce of prevention.

CLARIFY THAT YOUR ROLE IS TO HELP

Even if the timing is right, intervening can go wrong when it isn't clear why you are getting involved. Managers play a lot of different roles, and their responsibilities include evaluating employees and doling out rewards and punishments. This power dynamic can get in the way of effective help. When bosses step in, their involvement can imply that people are messing up in a big way. That's why employees often hide or downplay issues and fail to solicit guidance. They can become unreceptive to the assistance, defensive, or demoralized, which hinders creativity and performance. Therefore, as a leader at GlowDesign told us, managers must be careful "not to go in there and create so much anxiety that you're in a worse spot....It can be like 'Here's the boss, and gosh, he's really unhappy with what we're doing.'"

Because seeking and receiving help can make people feel so vulnerable, managers need to clarify their roles when intervening in employees' work. They should explain that they are there to help, not to judge or take over. They need to foster what Amy Edmondson, a professor at Harvard Business School, calls psychological safety—an environment in which interpersonal risks are encouraged.

The importance of this framing was evident at GlowDesign. We found that leaders rated as particularly helpful took pains to persuade subordinates that they were stepping in for only one reason: to support their employees' work. Consider what happened when a team tasked with one of the firm's biggest projects was hobbled by several members' personal issues. The project leader, Aaron, emailed one of Glow's senior partners, Gary, for advice. Gary was the client's main contact at the firm, but Aaron knew him only slightly and was surprised when he volunteered to fly from Chicago to New York to help. Many people would balk at accepting such an offer, worrying that top managers lacked confidence in them. But Gary was careful to emphasize that he would not supplant Aaron as the person in charge. "I'm not here to change the project," he said. "I'm just here to help you...to be your crutch."

Across our research, we found that when managers clarified their intentions, as Gary did, employees were more candid about the problems they faced and more willing to accept help and work collaboratively to solve them.

Don't assume that employees concerned about performance reviews and pay can accurately discern your intentions. No matter how supportive you are as a boss, they won't forget that part of your job is to monitor and assess them. So when you start taking a stronger hand in their work, assure them that you're there as an adviser, not an evaluator. Be explicit about what you are trying to accomplish with your intervention.

ALIGN THE RHYTHM OF YOUR INVOLVEMENT TO PEOPLE'S NEEDS

To give people useful help, leaders must take the time to fully understand employees' problems, especially when the issues are thorny. If the work is complex, creative, and cognitively demanding, you'll need to engage deeply. But that means more than delivering help with the right content. It also means allocating time and attention in a pattern that works for receivers. We call this the rhythm of involvement, and it will vary depending on whether employees need intensive *guidance* in the short term or intermittent *path clearing* over a prolonged period.

Concentrated guidance is required when employees encounter hurdles that can't be overcome with quick feedback or a few hours of input. In such scenarios, leaders collaborate closely with subordinates in long sessions tightly clustered over a few days. That might sound like the definition of micromanaging. Indeed, bosses who assisted in this way without ensuring that their people were ready for it and without clarifying their helper roles were perceived as taking over. Employees felt undermined, with morale and performance suffering as a result. But when managers instead began with the other strategies we've described, this kind of time-intensive deep help was heartily welcomed.

For example, Hazel, a senior manager at GlowDesign, successfully guided a team as it moved from the research phase of a project to the design phase. Though she had attended a brainstorming session early on, she had been hands-off until the team leader asked for help. She obliged but spent the first day listening and asking questions to better understand the project and ensure that the team was ready for her input. On the second and third days, she suggested a framework to help everyone identify and communicate their key insights, articulate ideas, and move forward. Her intense involvement over a short period wasn't viewed as a threat or a commentary on the team's performance; instead it eased the pressure enormously. Moreover, it marked a turning point for the project: The work done during those three days became the foundation of the client presentation, which led to contracts for several additional projects.

In the second form of help, path clearing, leaders offer assistance in briefer, intermittent intervals when employees face ongoing problems. For instance, if your team is short-staffed, you might stop by every few days for a half hour or so, to help with whatever needs doing—whether it's participating in an important client call or simply ordering lunch during a long work session.

Path clearers maintain enough general knowledge about the project to understand emerging needs but seldom dig into the core work. Rather, they look for smaller ways to give relief to their subordinates. That's how Kaya, a partner at ConsultCo, helped the members of one team who were so busy struggling to meet client demands that they barely had time to update her on what was happening. She found ways to take pressure off them in short, scattered bursts: by talking to individuals about their concerns, cleaning up the team's shared calendar, and handling meeting logistics with the client.

Leaders trying this approach shouldn't underestimate the importance of staying informed about the work. Those who fail to do so can provide only shallow criticism or vague advice when they drop in—interactions that Glow designers derisively referred to as "swoop and poops." So keep abreast of the issues your employees are facing, and step in when you see roadblocks you can remove.

OUR RESEARCH SUGGESTS that leaders can help their employees in hands-on and meaningful ways—without being accused of micromanaging—if they pay careful attention to timing, articulate their helping role up front, and match the rhythm of their assistance to receivers' needs. These guidelines are especially important when teams are physically separated, as so many have been during the ongoing pandemic. When workers aren't colocated, managers are more likely to either check in too frequently and interrupt their colleagues' flow or fall out of touch and leave employees adrift. People working from home or from any separate location can easily feel isolated, confused, or even abandoned. Thus being a hands-on manager in such situations is critical; it not only improves employees' performance but also lets people feel supported and connected.

However, intervening in your team's work while ignoring any one of our guidelines can render your help ineffective or even harmful—potentially worse than doing nothing. Offering preemptive advice can keep people from seeing its value. Failing to frame your role can allow subordinates to feel threatened and undermined. And using the wrong rhythm—especially not allocating enough time to be an effective guide or path clearer—can lead to superficial or off-target feedback or be perceived as an invasion, engendering cynicism rather than gratitude. You can easily avoid these micromanagement traps, however. Follow the three strategies we've outlined and become a boss who truly comes through for employees when they need it most.

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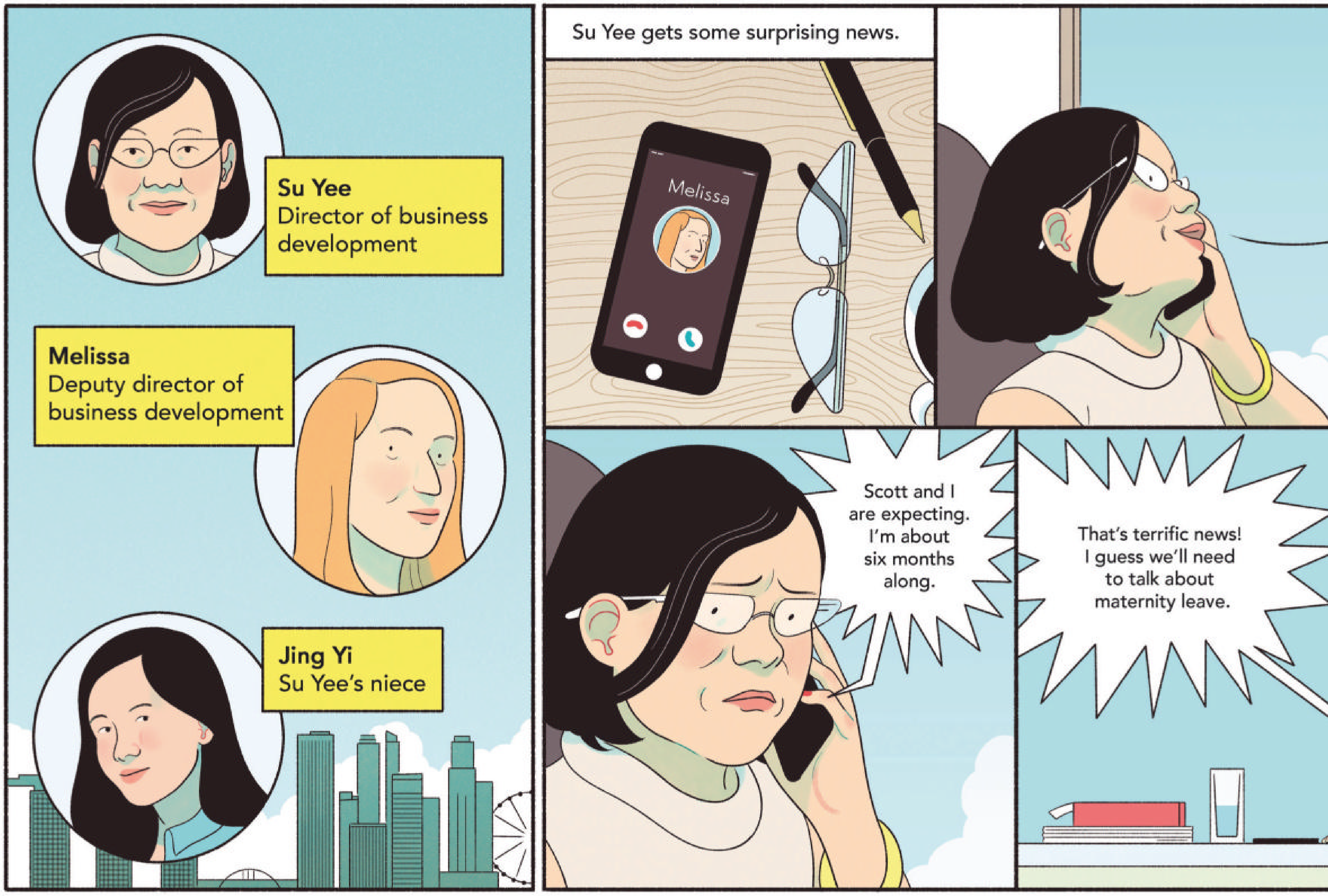


CASE STUDY
When Your Star Player Asks to Go Part-Time

by Thomas J. DeLong

*HBR's fictionalized case studies present problems faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "Shapiro Global" (case no. 407003-PDF-ENG), by Thomas J. DeLong, Michael Brookshire, Monica Haugen, Michelle Kravetz, and Sarah Sommer, which is available at **HBR.org**.*

"MELISSA, HI!" Su Yee Goh was surprised to see her deputy's name pop up on her phone, but she answered immediately. She'd been meaning to check in with Melissa for a few days.

Both worked in business development for the Singapore office of international energy-foods firm Shapiro Global (SG), Su Yee as director and Melissa as her number two. Their team had been working tirelessly since the Covid-19 outbreak to ensure that SG's expansion plans in Southeast Asia were not derailed. Melissa had been leading the charge, but in recent video calls the normally focused American had seemed distracted. Su Yee knew her work-from-home situation during the pandemic was not ideal. While many offices in Singapore had remained open, SG was one of several multinationals that had sent its entire staff home. Melissa and her husband, who also had a busy job, lived in a two-bedroom condo with their six-year-old son, whose school had gone remote three months before.

"I'm glad you called! I was just about to book some time on your calendar," Su Yee said. "Maybe we could both pop out for some fresh air and do a walk and talk?"

Illustrations by BIANCA BAGNARELLI

Su Yee was happiest when on the move—not just exercising but also working hard to advance her career. In 1997, she'd been among the first seven employees in SG's Singapore office. As an assistant to the office manager, she had run errands, answered the telephone, and kept the office operating smoothly. When it expanded, she was promoted to business analyst, and over the next 14 years she had grown with the company, acquiring skills and experience and winning promotions. Now she oversaw business development for all of Southeast Asia, with 28 employees reporting to her. The only female SG executive in the region and the only vice president who'd worked her way up from the ground floor, she made a point of mentoring the young employees, and particularly the women, on her team.

"Sure, that would be great," Melissa replied.

"Anything special you wanted to talk about?" Su Yee asked.

There was a pause. "I have some news. Scott and I are expecting," Melissa finally said.

Su Yee didn't process this right away. "Expecting?"

"I'm pregnant," Melissa said. "About six months along."

Only just walking out the door, Su Yee stopped in her tracks. The weather was balmy, but she felt as if she'd walked into an ice-cold wind. Quickly, though, she snapped back into manager mode.

"Congratulations," she said. "That's terrific news! I guess we'll need to talk about maternity leave. In Singapore, it's 12 weeks of paid leave, much better than in the U.S. !"[1]

"Well, that's the thing," Melissa said. "I may be asking for a bit more than that." Su Yee's jaw clenched. Melissa was a rising star at SG, one Su Yee had planned to lean on—and continue to groom—in the coming months and years. Even a three-month absence would be a struggle.

"What were you thinking?" Su Yee said, still trying to hide her surprise.

"Honestly, I'm not sure I want to come back full-time."

A RISING STAR

Su Yee struggled to process her emotions. First came shock. Since Melissa had arrived in Singapore as a three-year transfer from the San Francisco office a year earlier,[2] she had always come across as a go-getter with leadership capabilities, if not C-suite-level ambitions. More important, she was an extremely hard worker—easily keeping pace with long workdays and always willing to put in weekend hours if required. A quantitatively minded analyst, she pushed data-driven decisions that had reenergized the group's outreach and boosted revenues. While Su Yee had initially been frustrated because Melissa's rotation into her office was forced through without her consultation or buy-in, she eventually came to see in Melissa many of the qualities that had fueled her own rise. She quickly promoted her to deputy, gave her three direct reports, and nominated her for key committees to give her exposure to senior SG leaders. The pair had developed a very close working relationship.[3]

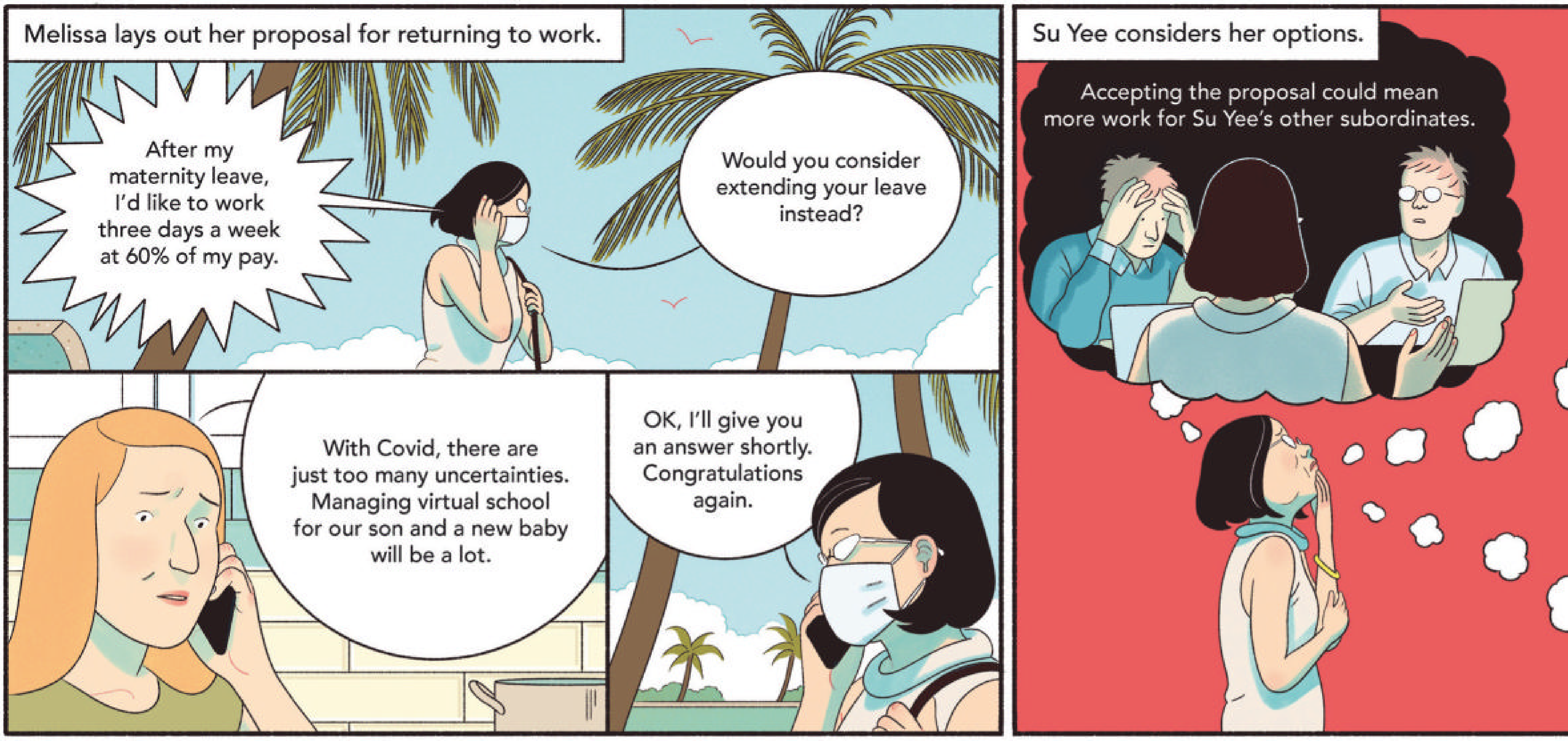
Su Yee thought back to one of their late nights in the office before the Covid-19 outbreak. Melissa had confessed that, even though she knew the move to Singapore would accelerate her rise at SG, doing so with a small child had been a difficult decision. She'd said yes only when Scott, her husband, also managed to get a three-year transfer, and they'd found a terrific nanny and school for their son. Doing the math in her head, Su Yee realized that Melissa was probably pregnant

Case Study Classroom Notes

1. *On average, OECD countries pay 16 weeks of parental leave at a rate of 55% to 100% of wages. The U.S. is the only OECD country that lacks government-mandated paid parental leave.*

2. *Job rotations have long been a popular way to build the skills and experience of promising employees. Should the fact that Melissa's time in Singapore is relatively short influence Su Yee's thinking?*

3. *Resilience, defined as the capacity to adapt to stressful circumstances, has been a hallmark of Su Yee's success. But has it led to her having unrealistic expectations of her workers?*



4. *In a recent poll by Ginger, an on-demand mental health company, nearly seven in 10 U.S. workers reported that navigating the Covid-19 pandemic has been the most stressful experience of their careers.*

5. *Should HR departments of global companies standardize benefits or leave decisions to regional and local managers?*

when they'd talked then but hadn't mentioned it! She couldn't help feeling a little betrayed.

But then Su Yee felt a wave of empathy. She knew how difficult the past few months had been for Melissa as she'd tried to juggle her work and family obligations during office and school closures.[4] To be pregnant in a pandemic, far from friends and family, would only have added to her stress. And Su Yee had the power to help. She had the final say in what allowances were made for Melissa beyond SG's official maternity leave. Recent efforts by headquarters to set global HR standards had fallen apart when regional managers (Su Yee included) had complained that they needed to be able to handle requests on a case-by-case basis.[5]

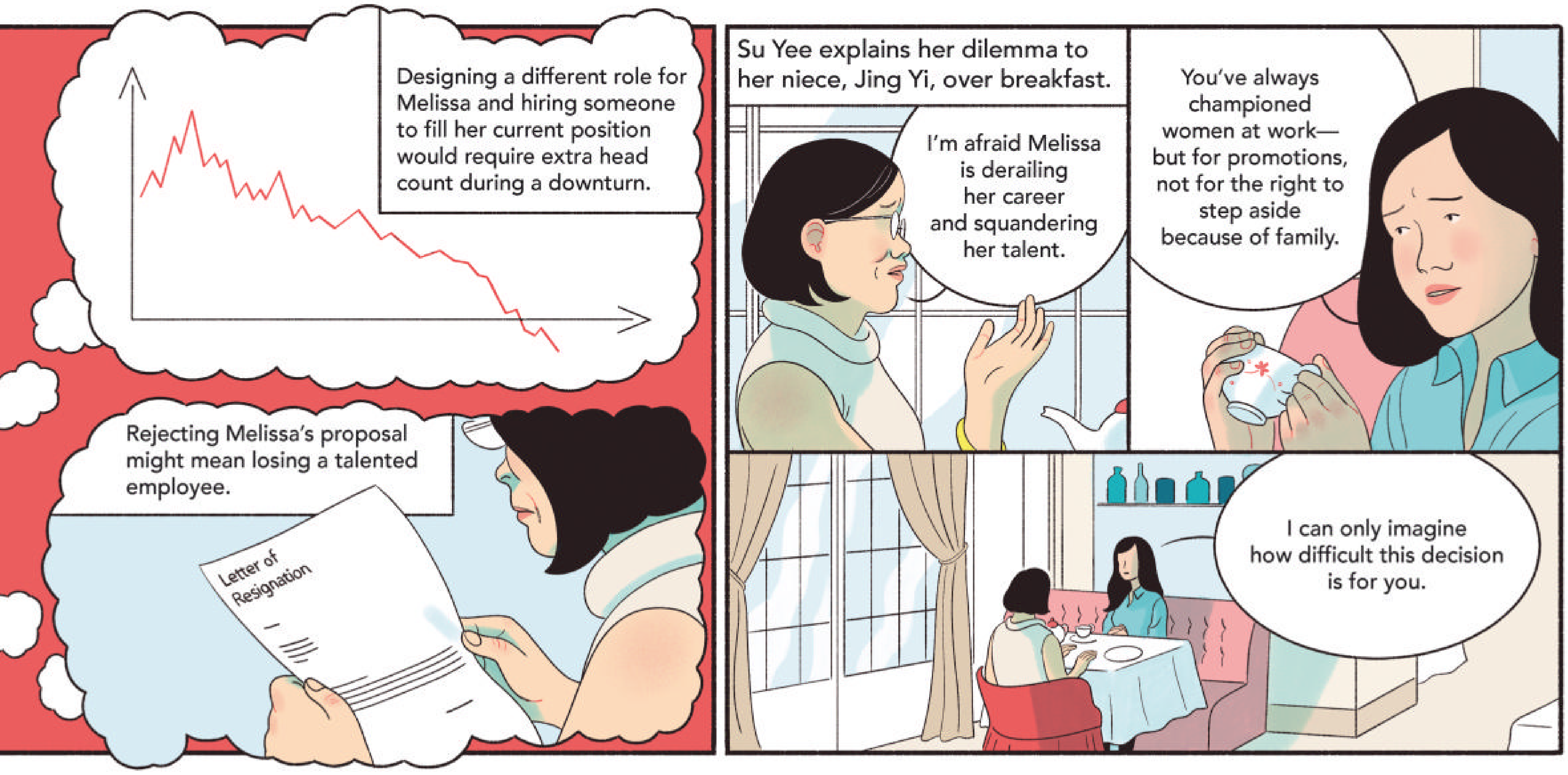
Su Yee listened quietly as Melissa laid out her proposal: After her 12-week leave, she wanted to work a three-day week at 60% of her full-time pay. Su Yee cringed inwardly. She was surprised that Melissa was asking for a part-time schedule. When she suggested an extension to her leave instead, Melissa replied that both she and Scott worried about continuing to manage virtual school for their son and bringing their live-out nanny back into the house given the uncertainties surrounding Covid-19.

Su Yee knew better than to push back any further. She congratulated Melissa again and promised to give her an answer on her proposal without delay. She then walked back to her desk and sent an email to the HR staff to fill them in on the situation—really just a formality, since she knew the decision rested with her.

OTHER OPTIONS?

That night, after a string of meetings with corporate lasting late into the Singapore evening, Su Yee finally had time to think about Melissa's request. The most obvious solution was to accept Melissa's proposal and restructure her job as a three-day position. Su Yee's own managerial duties would not be affected much, and Melissa would be able to accomplish a lot in the compressed workweek—conducting business via videoconference, which was now the norm anyway, even if she wouldn't travel. But Su Yee worried the arrangement would have an adverse effect on her other subordinates: The cutback in hours would most likely mean additional work for them.

And it might set a precedent that she—and SG as an organization—would regret. Melissa would be leaving in two years, once her transfer period was complete. That meant her manager in her next assignment would have to continue the accommodation



or deny it, which could cause problems in the new role. And Su Yee wouldn't ever see the payback on being a flexible boss.

Another alternative was to create a new, part-time special-projects position for Melissa after her leave and hire a replacement for her current role. But that would be a tough sell in an economic downturn.

The simplest approach would be to persuade Melissa that a part-time arrangement was neither advisable nor feasible. Su Yee had invested a great deal of time, energy, and social capital in developing and promoting her, and Melissa had an amazing future at SG ahead of her. The research was clear that switching to part-time work hurts employees—often women; they end up toiling away for more hours than they should for much lower pay and less credit. Meanwhile, many male professionals simply take the time they need without formally reducing their hours and pay.[6]

Would Melissa leave SG if she didn't get her way? Pre-pandemic, she had seemed totally enamored with her career at SG. Her salary would easily cover the cost of a larger apartment and a live-in nanny. Perhaps an offer to shorten her workday to eight hours would suffice, giving her time to experiment with work-family balance and renewing her enthusiasm for her job.

Glancing at the clock, Su Yee closed her laptop and decided to sleep on it.

ROLE MODELS

"Auntie, what is the matter with you today? You seem so distracted."

Su Yee put down her kaya toast and looked at her niece, Jing Yi, sitting across from her. Breakfast on Saturday mornings at the Raffles Hotel was their tradition and Su Yee's favorite part of the week. Jing Yi, a bright 22-year-old, loved hearing her aunt's office gossip and usually found a way to make Su Yee laugh—but not today.

Su Yee leaned forward and laid out the situation with Melissa for Jing Yi. She explained to her niece that she had misjudged her protégé's ambitions. No doubt Melissa could continue to contribute to SG as a part-time worker, but she wanted to get off the fast track. She would essentially be sidelining herself, moving from superstar to solid employee.[7] Su Yee couldn't shake the feeling that this was a mistake. She wanted to tell Melissa to snap out of it. Why, after years of being a successful working mom, did she now want to derail her career and squander her talent? Yes, the pandemic had made life much more difficult, but eventually life would return to normal. Su Yee knew,

6. *A study by Erin Reid of Boston University found that even though few male employees ask for reduced hours, many are able to limit their workweeks to attend to personal issues without calling attention to their absences.*

7. *Many firms invest significant resources in attracting and retaining star performers. Do they underestimate the importance of supporting players?*

however, that giving that kind of advice from a position of power was ethically—not to mention legally—questionable.

"I don't know," Jing Yi said. "My mom took a different path than you so that she could be at home with me. She's not well-off or powerful, but I appreciate what she did and know she feels she made the right decision. She's just as happy as we are."

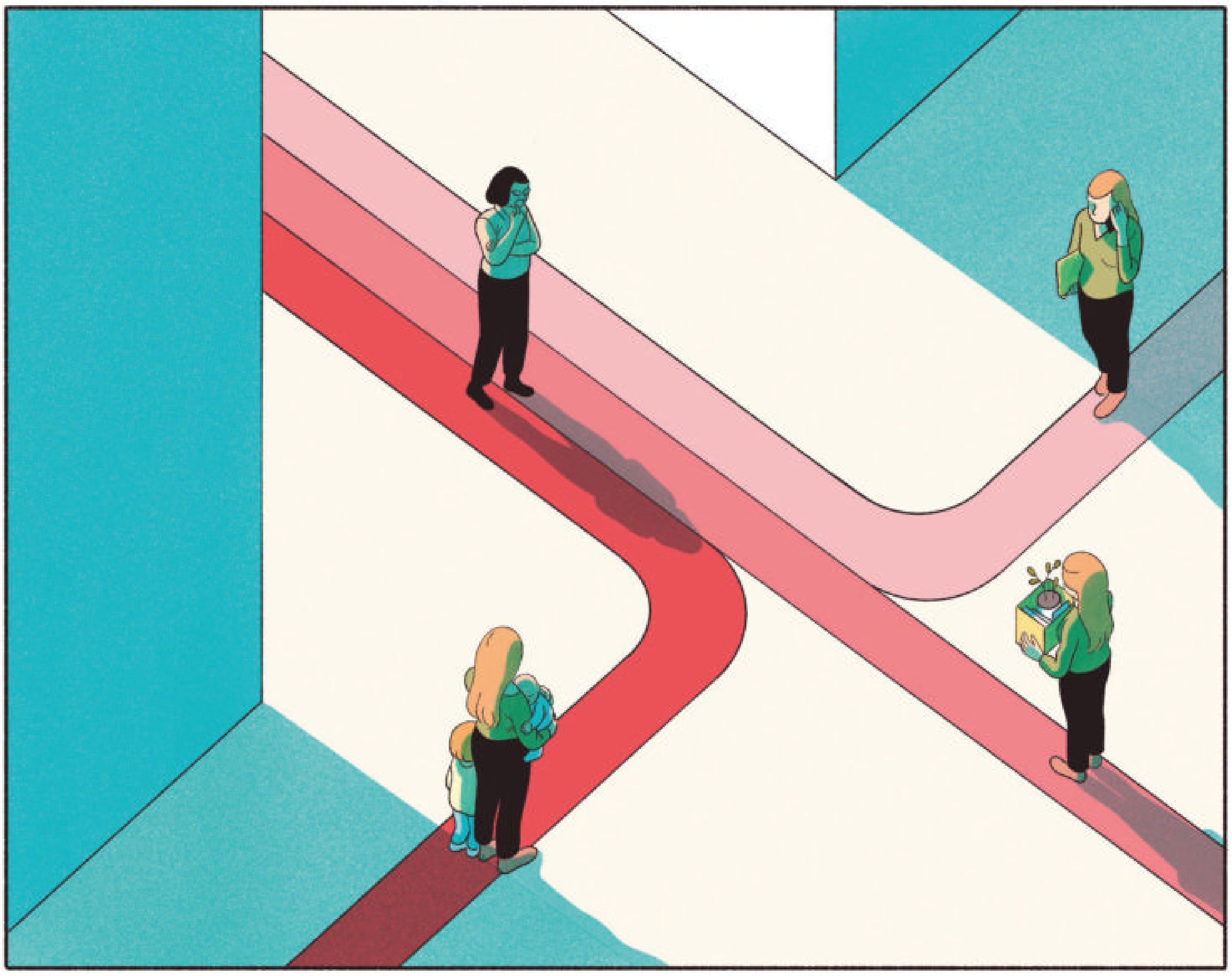
Su Yee was surprised. Her niece had gotten top marks at university, worked at a prestigious consulting firm, and would begin her MBA the following year. Su Yee had always felt slightly sorry for her sister, who had led such a conventional life, and thought Jing Yi felt similarly. "At the same time," her niece continued, "I had the best of both worlds because I had you as a different sort of role model."

Su Yee nodded, slightly reassured. "I suspect that Melissa doesn't yet know what will make her happy, but I need to think of how this affects my team."

Jing Yi took a sip from her cup of hot kopi and tilted her head. "Auntie, you've always supported women at work—but for promotions, not for the right to step to the side," she said. "This must be a difficult decision for you."

"Yes," Su Yee reflected, "it certainly is."

THOMAS J. DELONG *is a Baker Foundation Professor of Management Practice at Harvard Business School.*



Should Su Yee grant Melissa's request to go part-time?

THE EXPERTS RESPOND

ELIZABETH MCKINNON *is a co-CEO of Environmental Justice Australia.*

The best thing Su Yee can do is become a trailblazer for flexible and part-time work schedules.

Going part-time doesn't have to be an off-ramp for a career. Su Yee is worried that her protégé is making a mistake and feels slightly betrayed. But Melissa is obviously bright, ambitious, and hard-working. She could very well be back up and running on a full-time, five-day-a-week schedule within a year or two and go on to do great things at SG. Su Yee should not make assumptions about Melissa's intentions or her future.

Communication is key. Su Yee needs to put aside her dismay and have a frank conversation with Melissa about what she wants and how to make it work in a way that benefits both Melissa and SG. Su Yee should ensure that Melissa retains her client contacts, direct reports, and all the other parts of her job that will keep her career on track.

The worst thing Su Yee could do is move Melissa over to a special-projects role and hire someone else for her position (unless that's what she prefers). Once you get off the fast track, it's very hard to get back on.

Because neither woman has experience with flexible schedules, the two should agree to a trial period so that they and the team can adjust and learn as they go. The danger, as Su Yee knows, is that Melissa would end up squeezing a full-time job into a part-time schedule, which is a recipe for burnout.

Granting this flexibility to Melissa—and other team members should they request it—will most likely lead to short-term inconveniences and costs for Su Yee. For instance, she might need to hire a contractor to pick up some of the workload. But it's also possible that junior employees will want to take on more as Melissa cuts back. This is an opportunity for Su Yee's team members to transform how they collaborate and allocate resources. At my organization, for example, I share the CEO role with another female executive, and we both work three days a week.

The good news is that flexible work policies get easier over time. Fast-forward 10 years and Su Yee might have a much more dynamic and diverse team of employees who are not only hardworking but also extremely engaged and loyal to the organization because they feel that their professional and personal needs are being met. The benefits for SG—increased productivity, better recruitment and retention, and improved culture—could be significant.

Su Yee sees herself as an advocate for women, but that's not authentic if she provides support and encouragement only to certain categories of women—those who have made the same life choices that she has. Rather than feeling that Melissa is betraying her, Su Yee should consider the bigger picture and see this as her own moment to shine as a leader.

RACHEL THOMAS
is the CEO of Lean In.

Su Yee should reconceive the role so that Melissa doesn't have to step back unless she wants to.

Su Yee first needs to understand what's really going on in her protégé's life. Is Melissa asking to reduce her hours because she wants to spend more time at home with her family? If so, Su Yee should respect that and find a way to make it work. You don't retain talented employees by refusing to adjust as their lives and goals change. Or does Melissa feel as if she doesn't have a choice—that there's no way to balance her job and two kids during the Covid-19 crisis?

If Melissa would prefer to come back full-time but can't envision a way forward, the two should start thinking about creative options. There's no such thing as business as usual right now, so companies need to move beyond business-as-usual solutions. For example, Su Yee could temporarily eliminate some of her department's less-essential work to take the burden off Melissa (and others) during the pandemic. She could reframe Melissa's goals and performance criteria so that they're more attainable. She could commit to keeping meetings off Melissa's calendar during designated periods each day to make it easier for Melissa to accommodate her kids' needs during the crisis. Su Yee should also consider extending more flexibility not just to parents but to everyone.

These suggestions might sound over-the-top, particularly during an economic downturn, but leaders everywhere need to recognize that we are on the verge of losing millions of Melissas. Lean In and McKinsey recently released the 2020 Women in the Workplace report, which shows that as many as 2 million women in the U.S. are considering downshifting their careers or leaving the workforce as a result of the crisis. That means far fewer women on track to become leaders, erasing all the progress we've seen in recent years. If Lean In had a panic button, we'd be hitting it.

So while Su Yee is understandably focused on her young protégé, she shouldn't miss the bigger picture. I guarantee that there are dozens, maybe hundreds, of talented women at SG in the same boat. Before the pandemic, mothers employed outside the home were already working a "double shift"—a full day at the office, followed by hours of domestic duties. With schools and day care centers closed, that double shift has doubled again. Studies show that mothers spend 20 hours a week more than fathers, on average, on housework and childcare due to the pandemic.

Melissa's case provides Su Yee with an opportunity to sound the alarm within her firm. If she truly wants to be a champion of women, now is her chance. She should engage SG's executives, encouraging them to focus on the struggles of working parents—especially mothers—during Covid-19. She should suggest that SG work creatively with all employees so that no one has to step back—unless that's really the preference. Reimagining Melissa's role so that she can continue full-time is a big ask, but the long-term payoff is real. It's good for SG because having more women in leadership roles means a stronger culture and better financial performance. It's good for managers because they don't have to replace talented employees. And it's good for employees. Balancing work and family is still far too difficult in too many workplaces. We can and must do better.

HBR Reprint R2101M
Reprint Case only R2101X
Reprint Commentary only R2101Z

SYNTHESIS

SPORTS AND SOCIAL JUSTICE

From Kaepernick's kneel to the NBA Bubble

by Ramsey Khabbaz

ON AUGUST 14, 2016, the San Francisco 49ers quarterback Colin Kaepernick knelt during the national anthem before a preseason game. Few people noticed at first. But after he had knelt again and again and again, someone finally asked why. On August 26 he explained: "I am not going to stand up to show pride in a flag for a country that oppresses Black people and people of color." Reactions were mixed: support and vitriol.

Four and a half years later, it's impossible to overstate the prescience and consequence of Kaepernick's peaceful protest. It started a movement and raised fundamental questions about the role of professional athletes in public life—and of pro sports leagues in amplifying or muting the sociopolitical messages of their "employees."

These leagues are multibillion-dollar businesses, of course, run by people who are keenly aware of how their decisions affect the bottom line. Not surprisingly, their responses to Kaepernick and his followers diverged. The NFL sought to undermine the quarterback, and after pressure mounted from fans, President Trump, and other Republicans, it instituted a ban on kneeling during the anthem. The men's and women's basketball leagues—the NBA and the WNBA—emphasized an existing rule mandating standing for the anthem but encouraged more-business-friendly forms of dissent. Major League Soccer reinforced the rights of its players to peacefully protest in any way they saw fit, while Major League Baseball and the National Hockey League set no clear guidelines.

By the fall of 2017 Kaepernick had effectively been blackballed from the NFL. But he remained an icon of social activism. As the Black Lives Matter (BLM) movement gained momentum following the murders of Ahmaud Arbery, Breonna Taylor, and George Floyd in 2020, athletes across leagues were speaking out in unprecedented numbers, echoing Kaepernick's language and posture (and even wearing his jersey).

Throughout this reckoning, some leagues—namely, the NBA

Illustration by BETH GOODY

and the WNBA—have emerged as beacons of corporate social justice. Others—namely, the NFL—have flickered at best. Two recent books, ***The Game Is Not a Game*** and ***Football's Fearless Activists,*** both written by veteran sports journalists, offer some useful context for how we got to this moment in athletics and activism.

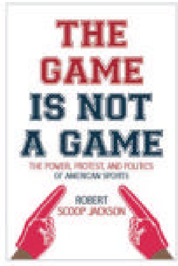
In the former, Robert Scoop Jackson presents incisive profiles of some of the leading voices on these issues (including the NBA coaches Gregg Popovich and Steve Kerr, the "God" LeBron James, and, yes, Kaepernick) along with deeply felt and reported pieces on subjects such as the "UnRespected" female athlete, the bias of data analytics, and "the business of football's ethic and ethnic morality." It's an artfully curated collection of close-ups that, when set side by side, tell the story of an industry that is inextricably tethered to—but still hoping to be insulated from—real-world politics. "For years," Jackson writes, "I've noticed how most of the people making decisions at the highest money-generating level are those furthest removed from the cultural center of the games."

The second book, by Mike Freeman, provides a detailed account of Kaepernick's story, delving into his decision to kneel, conservative media's attacks on him, and the mechanics of his exile from football. When describing the NFL commissioner Roger Goodell's (mis)management of the anthem protests, Freeman lobs a blunt observation: "Goodell couldn't take Kaepernick's side the way, perhaps, the NBA commissioner Adam Silver would, because Goodell was a representative of the [team] owners, and the majority of owners disliked what Kaepernick was doing, were afraid of the financial impact, or had some combination of the two."

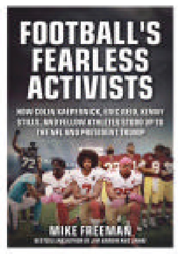
That brings us back to 2020. As the United States was roiled by racial justice protests amid a pandemic, the contrast between the NBA's and the NFL's reactions was stark. The NBA immediately issued a statement supporting BLM, and many players joined—even led—marches without rebuke. Meanwhile, the NFL was silent until 18 of its stars released a video demanding that their employer speak out. Goodell responded with his own video, saying he should have listened to players earlier.

Reporting from ESPN indicates that when the NBA began playing in "the Bubble," its Covid-safe way to finish the season, it was with a great deal of input from the league's talent; management did not call all the shots. Courts were decked with BLM decals, jerseys were printed with "Say Their Names" and similar messages, and postgame interviews often addressed social justice. After Jacob Blake, another Black man, was shot by the police, players boycotted games until the NBA agreed to open arenas as Election Day polling places. Compare all that to the NFL's comeback: masks for coaches but not for players on the field, and no bubble (thus many Covid-19 cases); games but no practice season (followed by several high-profile player injuries); and outspoken stars but a belated move to coordinated messaging from the league on BLM issues.

Why have the two most prominent male and majority-Black leagues handled this past year of crisis so differently? As Freeman and Jackson note, and readers of HBR will appreciate, it's all about organizational dynamics: structure, culture, power, and profit.



The Game Is Not a Game: The Power, Protest, and Politics of American Sports
Robert Scoop Jackson
Haymarket Books, 2020



Football's Fearless Activists: How Colin Kaepernick, Eric Reid, Kenny Stills, and Fellow Athletes Stood Up to the NFL and President Trump
Mike Freeman
Sports Publishing, 2020

The NBA is a smaller league than the NFL (30 teams with about 15 players each, versus 32 teams with about 55 players each). About 75% of the NBA's players are Black, compared with 70% of the NFL's. The NBA also relies more heavily on highly paid stars who have longer careers and outsize influence off the court. (Think LeBron James and Steph Curry.) It has a stronger players union and a collective bargaining agreement that's more favorable to players. For their part, league executives and team owners, managers, and coaches seem to understand that their role is to collaborate with, rather than oversee, the talent. Also (and this, sadly, may be key), because NBA fans are more racially diverse than those of other leagues, an unabashedly pro-BLM stance doesn't threaten ratings or revenues the way it might for the NFL.

If a book chronicling the Bubble is ever written, it will tell the story of brave players following Kaepernick's lead—not brave billionaires throwing spreadsheets to the wind. Like all for-profits, the NBA has a limited budget for altruism. In 2019, for example, it was reluctant to back a manager who tweeted support for Hong Kong protesters for fear of alienating its Chinese business partners. Still, over the past year of protests, the NBA (along with the WNBA) has run circles around the NFL in demonstrating good management and corporate social responsibility. It has moved us closer to a world in which professional sports leagues put purpose over profits. For that, for now, it should be applauded.

HBR Reprint R2101N

RAMSEY KHABBAZ *is an assistant editor at HBR.*

Executive Summaries January–February 2021

SPOTLIGHT

Does Business Need a New Model?

For the past century, the publicly traded corporation has been the dominant structure in business. But that model may no longer satisfy the needs of critical stakeholders.

page 33

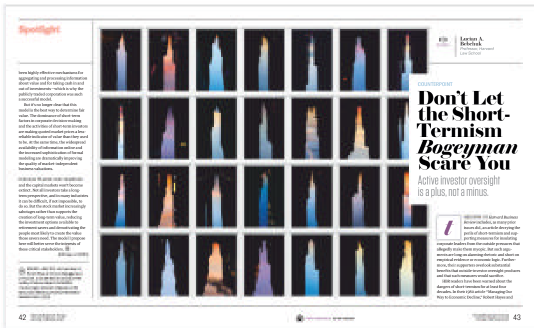
THE COMPLETE SPOTLIGHT PACKAGE IS AVAILABLE IN A SINGLE REPRINT.
HBR Reprint R2101B

It's Time to Replace the Public Corporation

Roger L. Martin | page 34

Critics charge that in today's heavily traded capital markets, executives are increasingly incentivized to manage in tiny, short-term windows, with an eager eye on their stock-based compensation and a fearful one on activist hedge funds. In any case, something isn't working: The number of public companies in the United States declined by half from 1997 to 2015, while the number of companies with a dominant shareholder or a dominant group of shareholders in the S&P 1500 increased by 31% from 2002 to 2012.

In this article the author tracks the decline of the public corporation and explains why its most important shareholders—retirement investors—and the most critical part of its workforce, namely knowledge workers, are ill-served by this model. He proposes a new structure, which he calls the *long-term enterprise* (LTE): a private company in which ownership is limited to those two groups of stakeholders, who have the greatest interest in long-term value. The LTE, Martin argues, would also diminish the ability of activist hedge funds to extract gains at their expense.



Don't Let the Short-Termism Bogeyman Scare You

Lucian A. Bebchuk | page 42

The author, a professor at Harvard Law School, argues that concerns about the perils of short-termism—and support for measures that would insulate corporate leaders from the outside pressures that allegedly make them myopic—are long on alarming rhetoric and short on empirical evidence or economic logic. Furthermore, he writes, the threat of hedge fund activism should be expected to discourage managerial slack and underperformance, thus playing an important disciplinary role and incentivizing leaders to enhance shareholder value.

HOW I DID IT

MANAGING YOURSELF

The Former CEO of Guardian on Using Values to Drive Strategic Planning

Deanna Mulligan | page 28

When Hurricane Sandy struck the mid-Atlantic coast, in October 2012, thousands of Guardian employees in New York and New Jersey were affected, and company headquarters was flooded by five feet of water. Two days later all the team members had been accounted for; some had been put up in hotel rooms, others had been supplied with generators, and Guardian had created a fund to cover employees' hurricane-related costs.

That experience taught Mulligan to think even longer-term than she always had: What were all the things that could go wrong, and how could the company protect itself from them? What could go *right* if Guardian were poised to seize the opportunities presented?

Technology became a top priority: The company migrated many applications to the cloud and modernized employee productivity tools. It built a data analytics operation from the ground up and retrained actuaries to be analysts. Working remotely became common at Guardian. And its leaders anticipated two other important issues for organizations: diversity, equity, and inclusion, and the gig economy.

HBR Reprint R2101A

How to Help (Without Micromanaging)

Colin M. Fisher, Teresa M. Amabile, and Julianna Pillemer | page 123

Extensive research shows that when employees get hands-on managerial support, they perform better than when they're left to their own devices, but unnecessary or unwanted help can be demoralizing and counterproductive. So how do you intervene constructively?

The authors share three key lessons learned during 10 years of study: (1) Step in only when people are engaged in a challenging task and ready to accept help; (2) clarify that your role is to offer assistance, not take over the project or judge anyone; and (3) align the rhythm of your involvement to employees' needs, determining whether the situation calls for intensive guidance in the short term or intermittent path clearing over a prolonged period. These strategies are especially valuable for helping teams that are physically separated, as so many are during the current pandemic.

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Features

STRATEGY

The Rules of Co-opetition

Adam Brandenburger and Barry Nalebuff | page 48

"Co-opetition"—cooperating with a competitor to achieve a common goal or get ahead—has been gaining traction for three decades. Yet many companies are uncomfortable with the concept and bypass the promising opportunities it presents.

In this article two professors who helped introduce the approach offer a framework for deciding whether to team up with a rival, drawing on examples from Apple and Samsung, DHL and UPS, Ford and GM, and Google and Yahoo. Their advice: Start by analyzing what each party will do if it chooses *not* to cooperate and how that will affect industry dynamics. Sometimes working together is a clear win, but even if it isn't, it may still be better than allowing someone else to take your place in the deal—which could leave you at a disadvantage. Next, it's critical to figure out how to cooperate without giving away your "secret sauce"—your current advantages. Once you've done that, you'll need to craft an agreement that clearly outlines the deal's scope, who is in charge, how the arrangement could be unwound if needed, and how gains will be divided. You'll also have to manage resistance within your own firm and alter internal mindsets. Co-opetition requires mental flexibility, but firms that develop it can gain an important edge.

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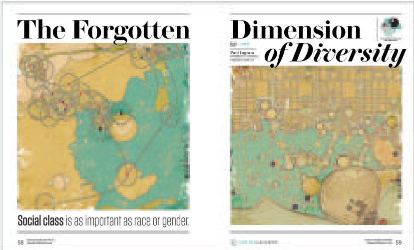
DIVERSITY



The Forgotten Dimension of Diversity

Paul Ingram | page 58

Workers who come from lower social-class origins in the United States are 32% less likely to become managers than those who come from higher social-class origins. That represents a disadvantage even greater than the one experienced by women compared with men (27%) or Blacks compared with whites (25%). Social class disadvantage in the workplace prevails in every major economy around the world.

In discriminating against people who come from a lower social class, we're discriminating against a majority of the workforce—a grossly harmful indulgence, especially when you consider what happens if you *don't* discriminate. According to the author's research, GDP is higher per capita in countries where more managers come from lower social-class origins.

Companies pay a lot of attention to issues of gender and race, and for very good reason. In this article, the author argues that it's time to focus equally on social class disadvantage. In doing so, he notes, firms reinforce their efforts to combat other forms of disadvantage. He explores the root causes of the problem and lays out the most promising interventions that are emerging from research and practice to help remediate it.

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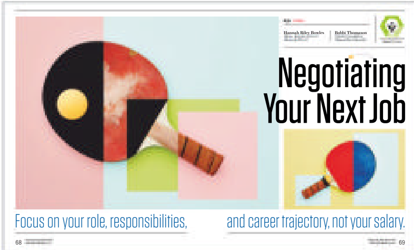
NEGOTIATION



Negotiating Your Next Job

Hannah Riley Bowles and Bobbi Thomason | page 68

When you're seeking to advance your career—by joining a different company or moving into a new role with your current employer—it's important to think strategically about not just what you want but how to get it. In this article the authors draw on their work coaching executives and their cross-cultural research to propose four steps that can help you prepare to negotiate.

First, think broadly about your long-term career goals instead of focusing narrowly on the offer at hand or the question of pay and benefits. Second, be mindful of what type of opportunity you're asking for—something standard, an unusual arrangement for yourself, or a chance to take your organization in a new direction—and tailor your arguments accordingly. Third, arm yourself with the necessary information to reduce ambiguity about what's possible and with whom to negotiate. Fourth, connect with people who can be helpful in making your case, and approach negotiations as an opportunity to enhance your working relationships.

If you follow these steps and set career targets that are specific and realistic, you're more likely to chart a path to success.

HBR Reprint R2101E

TECHNOLOGY

When Machine Learning Goes Off the Rails

Boris Babic et al. | page 76

Products and services that rely on machine learning—computer programs that constantly absorb new data and adapt their decisions in response—don't always make ethical or accurate choices. Sometimes they cause investment losses, for instance, or biased hiring or car accidents. And as such offerings proliferate across markets, the companies creating them face major new risks. Executives need to understand and mitigate the technology's potential downside.

Machine learning can go wrong in a number of ways. Because the systems make decisions based on probabilities, *some* errors are always possible. Their environments may evolve in unanticipated ways, creating disconnects between the data they were trained with and the data they're currently fed. And their complexity can make it hard to determine whether or why they made a mistake.

A key question executives must answer is whether it's better to allow smart offerings to continuously evolve or to "lock" their algorithms and periodically update them. In addition, every offering will need to be appropriately tested before and after rollout and regularly monitored to make sure it's performing as intended.

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SUSTAINABILITY

How to Talk to Your CFO About Sustainability

Tensie Whelan and Elyse Douglas | page 86

By now most companies have committed to sustainability efforts—and yet many CFOs still see those efforts as a cost rather than a source of value. That makes it hard to unlock the internal financing needed to scale them up.

The authors—the director and a senior scholar at the NYU Stern Center for Sustainable Business—have developed the Return on Sustainability Investment (ROSI) analytic tool, which companies can use to measure the financial returns on their sustainability activities. Implementing ROSI is a five-step process. Companies should (1) identify their current sustainability strategies, (2) identify related changes in operational or management practices, (3) determine the resulting benefits, (4) quantify the benefits, and (5) calculate the monetary value. The savings and growth thus revealed can reach hundreds of millions of dollars; in large companies, it can be billions.

Particularly now, as companies scrutinize budgets threatened by the Covid-19 pandemic, ROSI analysis can help CFOs improve organizational finances through sustainability investments that create value for investors, employees, customers, and the world at large.

HBR Reprint R2101G

HUMAN RESOURCES

Volunteer Programs That Employees Can Get Excited About

Jessica Rodell | page 94

Across society, volunteerism has been stagnant or trending slightly downward in recent years. In the corporate world, however, it has been on the rise. In fact, paid time off for volunteering is one of the few employee benefits that has increased significantly over the past five years.

The benefits of well-designed corporate volunteer programs have been clearly established: They boost productivity, increase employee engagement, and improve hiring and retention, to name just a few. But too often, firms' programs fall short.

In designing their volunteer programs, companies fall prey to common pitfalls: They blindly copy what other firms are doing, prioritize leaders' pet projects, or pressure employees to participate, essentially making volunteering mandatory.

Such errors diminish the value of the programs to the company, employees, and society. Instead, firms should prioritize meaning, balance top-down structure with bottom-up passion, and seek to involve a variety of stakeholders in their initiatives.

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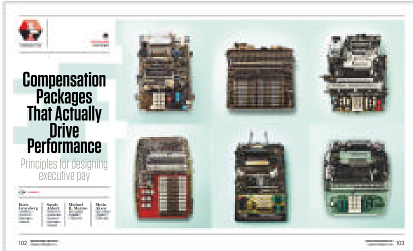
COMPENSATION



Compensation Packages That Actually Drive Performance

Boris Groysberg et al. page 102

By aligning executives' financial incentives with company strategy, a firm can inspire its management to deliver superior results. But it can be hard to get pay packages right. In this article four experts break down the key elements of compensation and explain how to put them together effectively.

When designing packages, boards must make decisions about the proportion of fixed versus variable pay, short-term versus long-term incentives, cash versus equity, and group versus individual rewards. Many look at the copious data available on executive pay and benchmark their plans against those of their industry peers. The mix is also driven by company size, region, culture, and risk appetite.

A good plan always begins with a firm's strategic goals, however. Is the company striving for profitable growth, a turnaround, or a transformation? Is it trying to compete with public companies as a private entity? Each scenario calls for a different plan design.

The Covid-related economic crisis may also alter plans. If targets become unachievable, incentives will lose their power and need to be revised—offering firms a chance to incorporate measures that serve stakeholders' interests better.

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MANAGING ORGANIZATIONS

Build a Family Business That Lasts

Josh Baron and Rob Lachenauer | page 112

Judging from how they're portrayed in the media, it would be easy to dismiss family businesses as hotbeds of power-playing, backstabbing, and favor-currying, ultimately destined to fail; think of the Murdochs and News Corp, or the Redstones and National Amusements, to name just two. But many family businesses have enjoyed success for decades, even centuries. The authors explore five aspects of ownership that are crucial to whether a family business thrives or perishes: the type of ownership (whether a sole owner, a partnership, or another arrangement); the governance structure; how "success" is defined; what information the owners will (and won't) communicate to other family members and stakeholders; and how to handle the transition to the next generation.

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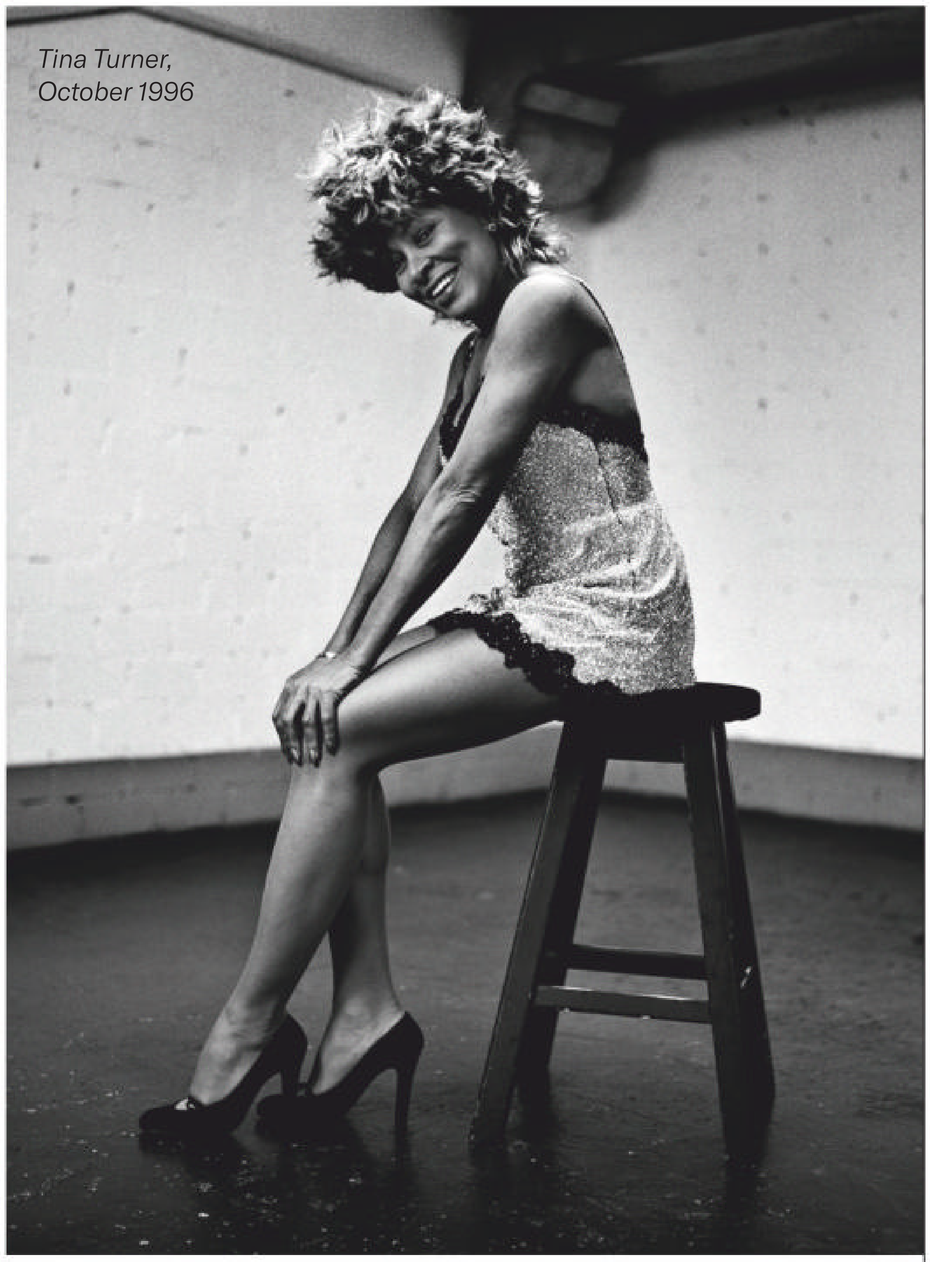
"I never considered giving up on my dreams. You could say I had an invincible optimism."


Tina Turner, October 1996

TINA TURNER

As a young girl growing up in Tennessee, Anna Mae Bullock liked to sing and recite movie dialogue to entertain her family. By age 20 she had a new name—Tina Turner—and a burgeoning music career with her partner, Ike. But behind the scenes, he was abusing her. Eventually, she found the courage to leave him and move on as a chart-topping, world-touring solo artist. She now lives out of the spotlight in Switzerland and recently released a new book, Happiness Becomes You.

Interviewed by Alison Beard

HBR: You've had so many ups and downs in your life and career. What have you learned?
TURNER: I used to be baffled about why I had to endure so much abuse, because I hadn't done anything to deserve it. After I began practicing Buddhism, I realized that my hardships could give me a mission—a purpose. I saw that by overcoming my obstacles, I could build indestructible happiness and inspire others to do the same. Then I could see everything that came my way, both the highs and the lows, as an opportunity for self-improvement and for sparking hope in others.

How else has your spirituality—your Baptist upbringing and your Buddhist practice—driven you?
Of everything I've done to succeed as an artist, spirituality has had the greatest influence. The Buddhist teachings of compassion and kindness, which have much in common with the principles of "Love thy neighbor" and "Do unto others" that I learned from the Baptist influences in my childhood, have always been guiding forces. After I began chanting *Nam-myōhō-renge-kyō,* I felt as if my true self came out. I became cheerful, confident, and resilient. My approach to life and work became calmer and more thoughtful, and my reactions were more tempered. I used to get angry first and ask questions later. But after I embraced Buddhism, it flipped. I could easily stay calm and figure out the details instead of jumping to conclusions. I came to understand that any achievement stems from inner change.

When you confronted discrimination as a Black woman, how did you respond?
When I started as a solo artist, I was a female Black singer in my forties with few prospects for gigs. Still, I kept a "never give up" spirit. I understood that although many people might have a limited view of me, I could help open their minds. Through hard work, I showed all the naysayers that maybe their preconceived doubts were wrong. The force of my positivity pushed all the discriminatory "isms" standing in my way right out the window.

When you were touring, how did you prep to take the stage?
I would chant for an hour before each show. I visualized my audience and prayed that I could be whoever each person needed me to be that day so that I could inspire their dreams and help them recharge their souls. For me, being onstage was the best—a great exchange of energy. Afterward, it felt like a blur of color, light, joy, and visions of the many smiling faces who had come to see me. Of course, we also had the usual preshow routines and sound checks!

In recent years you overcame a stroke and cancer. Did that require a new resilience?
Sometimes our problems seem like they will never end. A lot of us are feeling that way now. But as one of my favorite Buddhist sayings goes, "Winter always turns to spring." My challenges can either make me a better version of myself or break me apart. I have a choice as to which it will be.

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Anton Corbijn/Getty Images

FOR MORE FROM TINA TURNER, GO TO **HBR.ORG**.