Leading Change: Why Transformation Efforts Fail

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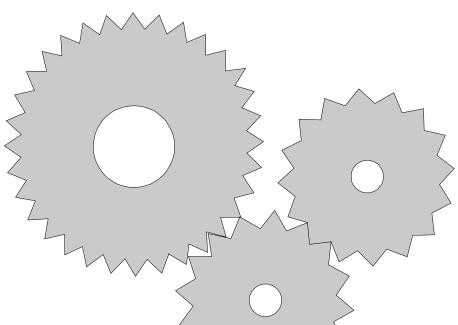


Over the past decade, I have watched more than 100 companies try to remake themselves into significantly better competitors. They have included large organizations (Ford) and small ones (Landmark Communications), companies based in the United States (General Motors) and elsewhere (British Airways), corporations that were on their knees (Eastern Airlines), and companies that were earning good money (Bristol-Myers Squibb). These efforts have gone under many banners: total quality management, reengineering, right sizing, restructuring, cultural change, and turnaround. But, in almost every case, the basic goal has been the same: to make fundamental changes in how business is conducted in order to help cope with a new, morechallenging market environment.

A few of these corporate change efforts have been very successful. A few have been utter failures. Most fall somewhere in between, with a distinct tilt toward the lower end of the scale. The lessons that can be drawn are interesting and will probably be relevant to even more organizations in the increasingly competitive business environment of the coming decade.

The most general lesson to be learned from the more successful cases is that the change process goes through a series of phases that, in total, usually require a considerable length of time. Skipping steps creates only the illusion of speed and never produces a satisfying result. A second very general lesson is that critical mistakes in any of the phases can have a devastating impact, slowing momentum and negating hard-won gains. Perhaps because we have relatively little experience in renewing organizations, even very capable people often make at least one big error.

Error #1: Not Establishing a Great Enough Sense of Urgency.

Most successful change efforts begin when some individuals or some groups start to look hard at a company's competitive situation, market position, technological trends, and financial performance. They focus on the potential revenue drop when an important patent expires, the five-year trend in declining margins in a core business, or an emerging market that everyone seems to be ignoring. They then find ways to communicate this information broadly and dramatically, especially with respect to crises, potential crises, or great opportunities that are very timely. This first step is essential because just getting a transformation program started requires the aggressive cooperation of many individuals. Without motivation, people won't help and the effort goes nowhere. Compared with other steps in the change process, phase one can sound easy.

It is not. Well over 50% of the companies I have watched fail in this first phase. What are the reasons for that failure? Sometimes executives underestimate how hard it can be to drive people out of their comfort zones.

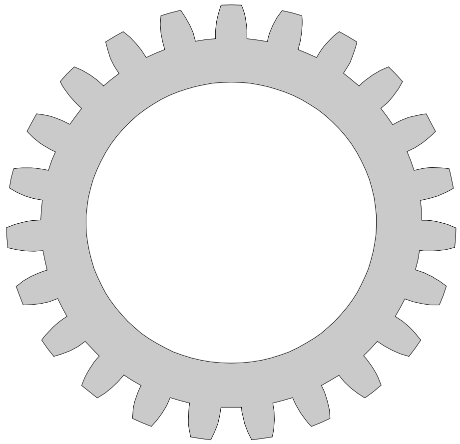
Sometimes they grossly overestimate how successful they have already been in increasing urgency. Sometimes they lack patience: “Enough with the preliminaries; let’s get on with it.” In many cases, executives become paralyzed by the downside possibilities. They worry that employees with seniority will become defensive, that morale will drop, that events will spin out of control, that short-term business results will be jeopardized, that the stock will sink, and that they will be blamed for creating a crisis.

A paralyzed senior management often comes from having too many managers and not enough leaders. Management’s mandate is to minimize risk and to keep the current system operating. Change, by definition, requires creating a new system, which in turn always demands leadership. Phase one in a renewal process typically goes nowhere until enough real leaders are promoted or hired into senior-level jobs.

Transformations often begin, and begin well, when an organization has a new head who is a good leader and who sees the need for a major change. If the renewal target is the entire company, the CEO is key. If change is needed in a division, the division general manager is key. When these individuals are not new leaders, great leaders, or change champions, phase one can be a huge challenge.

Bad business results are both a blessing and a curse in the first phase. On the positive side, losing money does catch people’s attention. But it also gives less maneuvering room. With good business results, the opposite is true: convincing people of the need for change is much harder, but you have more resources to help make changes.

But whether the starting point is good performance or bad, in the more successful cases I have witnessed, an individual or a group always facilitates a frank discussion of potentially unpleasant facts: about new competition, shrinking margins, decreasing market share, flat earnings, a lack of revenue growth, or other relevant indices of a declining competitive position. Because there seems to be an almost universal human ten-



dency to shoot the bearer of bad news, especially if the head of the organization is not a change champion, executives in these companies often rely on outsiders to bring unwanted information. Wall Street analysts, customers, and consultants can all be helpful in this regard. The purpose of all this activity, in the words of one former CEO of a large European company, is “to make the status quo seem more dangerous than launching into the unknown.”

In a few of the most successful cases, a group has manufactured a crisis.

One CEO deliberately engineered the largest accounting loss in the company’s history, creating huge pressures from Wall Street in the process. One division president commissioned first-ever customer-satisfaction surveys, knowing full well that the results would be terrible. He then made these findings public. On the surface, such moves can look unduly risky. But there is also risk in playing it too safe: when the urgency rate is not pumped up enough, the transformation process cannot succeed and the long-term future of the organization is put in jeopardy.

When is the urgency rate high enough? From what I have seen, the answer is when about 75% of a company’s management is honestly convinced that business-as-usual is totally unacceptable. Anything less can produce very serious problems later on in the process.

Error #2: Not Creating a Powerful Enough Guiding Coalition.

Major renewal programs often start with just one or two people. In cases of successful transformation efforts, the leadership coalition grows and grows over time. But whenever some minimum mass is not achieved early in the effort, nothing much worthwhile happens.

It is often said that major change is impossible unless the head of the organization is an active supporter. What I am talking about goes far beyond that. In successful transformations, the chairman or president or division general manager, plus another 5 or 15 or 50 people, come together and develop a shared commitment to excellent performance through renewal. In my experience, this group never includes all of the company’s most senior executives because some people just won’t buy in, at least not at first. But in the most successful cases, the coalition is always pretty powerful—in terms of titles, information and expertise, reputations and relationships.

In both small and large organizations, a successful guiding team may consist of only three to five people during the first year of a renewal effort. But in big companies, the coalition needs to grow to the 20 to 50 range before much progress can be made in phase three and beyond. Senior managers always form the core of the group. But sometimes you find board members, a representative from a key customer, or even a powerful union leader.

Because the guiding coalition includes members who are not part of senior management, it tends to operate outside of the normal hierarchy by definition. This can be awkward, but it is clearly necessary. If the existing hierarchy were working well, there would be no need for a major transformation. But since the current system is not working, reform generally demands activity outside of formal boundaries, expectations, and protocol.

A high sense of urgency within the managerial ranks helps enormously in putting a guiding coalition together. But more is usually required. Someone needs to get these people together, help them develop a shared assessment of their company's problems and opportunities, and create a minimum level of trust and communication. Off-site retreats, for two or three days, are one popular vehicle for accomplishing this task. I have seen many groups of 5 to 35 executives attend a series of these retreats over a period of months.

Companies that fail in phase two usually underestimate the difficulties of producing change and thus the importance of a powerful guiding coalition. Sometimes they have no history of teamwork at the top and therefore undervalue the importance of this type of coalition. Sometimes they expect the team to be led by a staff executive from human resources, quality, or strategic planning instead of a key line manager. No matter how capable or dedicated the staff head, groups without strong line leadership never achieve the power that is required.

Efforts that don't have a powerful enough guiding coalition can make apparent progress for a while. But, sooner or later, the opposition gathers itself together and stops the change.

Error #3: Lacking a Vision.

In every successful transformation effort that I have seen, the guiding coalition develops a picture of the future that is relatively easy to communicate and appeals to customers, stockholders, and employees. A vision always goes beyond the numbers that are typically found in five-year plans. A vision says something that helps clarify the direction in which an organization needs to move. Sometimes the first draft comes mostly from a single individual. It is usually a bit blurry, at least initially. But after the coalition works at it for 3 or 5 or even 12 months, something much better emerges through their tough analytical thinking and a little dreaming. Eventually, a strategy for achieving that vision is also developed.

In one midsize European company, the first pass at a vision contained two-thirds of the basic ideas that were in the final product. The concept of global reach was in the initial version from the beginning. So was the idea of becoming preeminent in certain businesses. But one central idea in the final version—getting out of low value-added activities—came only after a series of discussions over a period of several months.

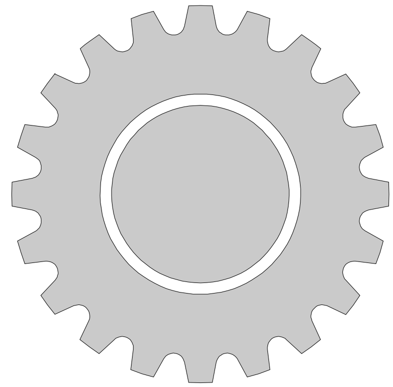
Without a sensible vision, a transformation effort can easily dissolve into a list of confusing and incompatible projects that can take the organization in the wrong direction or nowhere at all. Without a sound vision, the reengineering project in the accounting department, the new 360-degree performance appraisal from the human resources department, the plant's quality program, the cultural change project in the sales force will not add up in a meaningful way.

In failed transformations, you often find plenty of plans and directives and programs, but no vision. In one case, a company gave out four-inch-thick notebooks describing its change effort. In mind-numbing detail, the books spelled out procedures, goals, methods, and deadlines. But nowhere was there a clear and compelling statement of where all this was leading. Not surprisingly, most of the employees with whom I talked were either confused or alienated. The big, thick books did not rally them together or inspire change. In fact, they probably had just the opposite effect.

In a few of the less successful cases that I have seen, management had a sense of direction, but it was too complicated or blurry to be useful. Recently, I asked an executive in a midsize company to describe his vision and received in return a barely comprehensible 30-minute lecture. Buried in his answer were the basic elements of a sound vision. But they were buried—deeply.

A useful rule of thumb: if you can't communicate the vision to someone in five minutes or less and get a reaction that signifies both understanding and interest, you are not yet done with this phase of the transformation process.

Error #4: Undercommunicating the Vision by a Factor of Ten.



I've seen three patterns with respect to communication, all very common. In the first, a group actually does develop a pretty good transformation vision and then proceeds to communicate it by holding a single meeting or sending out a single communication. Having used about .0001% of the yearly intracompany communication, the group is startled that few people seem to understand the new approach. In the second pattern, the head of the organization spends a considerable amount of time making speeches to employee groups, but most people still don't get it (not surprising, since vision captures only .0005% of the total yearly communication). In the third pattern, much more effort goes into newsletters and speeches, but some very visible senior executives still behave in ways that are antithetical to the vision. The net result is that cynicism among the troops goes up, while belief in the communication goes down.

Transformation is impossible unless hundreds or thousands of people are willing to help, often to the point of making short-term sacrifices. Employees will not make sacrifices, even if they are unhappy with the status quo, unless they believe that useful change is possible. Without credible communication, and a lot of it, the hearts and minds of the troops are never captured.

This fourth phase is particularly challenging if the short-term sacrifices include job losses. Gaining understanding and support is tough when downsizing is a part of the vision. For this reason, successful visions usually include new growth possibilities and the commitment to treat fairly anyone who is laid off.

Executives who communicate well incorporate messages into their hour-by-hour activities. In a routine discussion about a business problem, they talk about how proposed solutions fit (or don't fit) into the bigger picture. In a regular performance appraisal, they talk about how the employee's behavior helps or undermines the vision. In a review of a division's quarterly performance, they talk not only about the numbers but also about how the division's executives are contributing to the transformation. In a routine Q&A with employees at a company facility, they tie their answers back to renewal goals.

In more successful transformation efforts, executives use all existing communication channels to broadcast the vision. They turn boring and unread company newsletters into lively articles about the vision. They take ritualistic and tedious quarterly management meetings and turn them into exciting discussions of the transformation. They throw out much of the company's generic management education and replace it with courses that focus on business problems and the new vision. The guiding principle is simple: use every possible channel, especially those that are being wasted on nonessential information.

Perhaps even more important, most of the executives I have known in successful cases of major change learn to "walk the talk." They consciously attempt to become a living symbol of the new corporate culture. This is often not easy. A 60-year-old plant manager who has spent precious little time over 40 years thinking about customers will not suddenly behave in a customer-oriented way. But I have witnessed just such a person change, and change a great deal. In that case, a high level of urgency helped. The fact that the man was a part of the guiding coalition and the vision-creation team also helped. So did all the communication, which kept reminding him of the desired behavior, and all the feedback from his peers and subordinates, which helped him see when he was not engaging in that behavior.

Communication comes in both words and deeds, and the latter are often the most powerful form. Nothing undermines change more than behavior by important individuals that is inconsistent with their words.

Error #5: Not Removing Obstacles to the New Vision.

Successful transformations begin to involve large numbers of people as the process progresses. Employees are emboldened to try new approaches, to develop new ideas, and to provide leadership. The only constraint is that the actions fit within the broad parameters of the overall vision. The more people involved, the better the outcome.

To some degree, a guiding coalition empowers others to take action simply by successfully communicating the new direction. But communication is never sufficient by itself. Renewal also requires the removal of obstacles. Too often, an employee understands the new vision and wants to help make it happen. But an elephant appears to be blocking the path. In some cases, the elephant is in the person's head, and the challenge is to convince the individual that no external obstacle exists. But in most cases, the blockers are very real.

Sometimes the obstacle is the organizational structure: narrow job categories can seriously undermine efforts to increase productivity or make it very difficult even to think about customers. Sometimes compensation or performance-appraisal systems make people choose between the new vision and their own self-interest. Perhaps worst of all are bosses who refuse to change and who make demands that are inconsistent with the overall effort.

One company began its transformation process with much publicity and actually made good progress through the fourth phase. Then the change effort ground to a halt because the officer in charge of the company's largest division was allowed to undermine most of the new initiatives. He paid lip service to the process but did not change his behavior or encourage his managers to change. He did not reward the unconventional ideas called for in the vision. He allowed human resource systems to remain intact even when they were clearly inconsistent with the new ideals. I think the officer's motives were complex. To some degree, he did not believe the company needed major change.

To some degree, he felt personally threatened by all the change. To some degree, he was afraid that he could not produce both change and the expected operating profit. But despite the fact that they backed the renewal effort, the other officers did virtually nothing to stop the one blocker. Again, the reasons were complex.

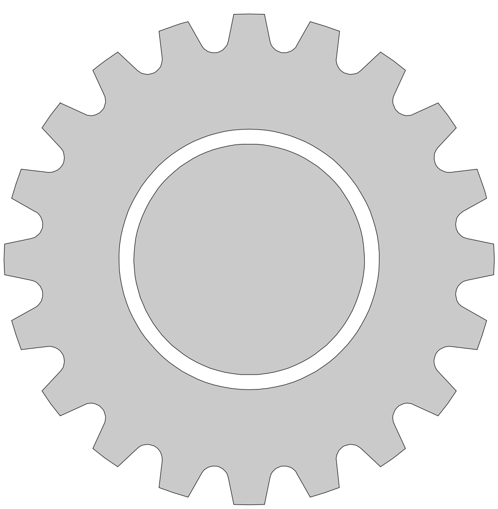
The company had no history of confronting problems like this. Some people were afraid of the officer. The CEO was concerned that he might lose a talented executive. The net result was disastrous. Lower level managers concluded that senior management had lied to them about their commitment to renewal, cynicism grew, and the whole effort collapsed.

In the first half of a transformation, no organization has the momentum, power, or time to get rid of all obstacles. But the big ones must be confronted and removed. If the blocker is a person, it is important that he or she be treated fairly and in a way that is consistent with the new vision. But action is essential, both to empower others and to maintain the credibility of the change effort as a whole.

Error #6: Not Systematically Planning For and Creating Short-Term Wins.

Real transformation takes time, and a renewal effort risks losing momentum if there are no short-term goals to meet and celebrate. Most people won't go on the long march unless they see compelling evidence within 12 to 24 months that the journey is producing expected results. Without short-term wins, too many people give up or actively join the ranks of those people who have been resisting change.

One to two years into a successful transformation effort, you find quality beginning to go up on certain indices or the decline in net income stopping. You find some successful new product introductions or an upward shift in market share. You find an impressive productivity improvement or a statistically higher customer-satisfaction rating. But whatever the case, the win is unambiguous. The result is not just a judgment call that can be discounted by those opposing change.



Creating short-term wins is ifferent from hoping for short-term wins. The latter is passive, the former active. In a successful transformation, managers actively look for ways to obtain clear performance improvements, establish goals in the yearly planning system, achieve the objectives, and reward the people involved with recognition, promotions, and even money. For example, the guiding coalition at a U.S. manufacturing company produced a highly visible and successful new product introduction about 20 months after the start of its renewal effort.

The new product was selected about six months into the effort because it met multiple criteria: it could be designed and launched in a relatively short period; it could be handled by a small team of people who were devoted to the new vision; it had upside potential; and the new product-development team could operate outside the established departmental structure without practical problems. Little was left to chance, and the win boosted the credibility of the renewal process.

Managers often complain about being forced to produce short-term wins, but I've found that pressure can be a useful element in a change effort. When it becomes clear to people that major change will take a long time, urgency levels can drop. Commitments to produce short-term wins help keep the urgency level up and force detailed analytical thinking that can clarify or revise visions.

Error #7: Declaring Victory Too Soon.

After a few years of. hard work, managers may be tempted to declare victory with the first clear performance improvement. While celebrating a win is fine, declaring the war won can be catastrophic. Until changes sink deeply into a company's culture, a process that can take five to ten years, new approaches are fragile and subject to regression.

In the recent past, I have watched a dozen change efforts operate under the reengineering theme. In all but two cases, victory was declared and the expensive consultants were paid and thanked when the first major project was completed after two to three years. Within two more years, the useful changes that had been introduced slowly disappeared. In two of the ten cases, it's hard to find any trace of the reengineering work today.

Over the past 20 years, I've seen the same sort of thing happen to huge quality projects, organizational development efforts, and more. Typically, the problems start early in the process: the urgency level is not intense enough, the guiding coalition is not powerful enough, and the vision is not clear enough. But it is the premature victory celebration that kills momentum. And then the powerful forces associated with tradition take over.

Ironically, it is often a combination of change initiators and change resistors that creates the premature victory celebration. In their enthusiasm over a clear sign of progress, the initiators go overboard. They are then joined by resistors, who are quick to spot any opportunity to stop change. After the celebration is over, the resistors point to the victory as a sign that the war has been won and the troops should be sent home. Weary troops allow themselves to be convinced that they won. Once home, the foot soldiers are reluctant to climb back on the ships. Soon thereafter, change comes to a halt, and tradition creeps back in.

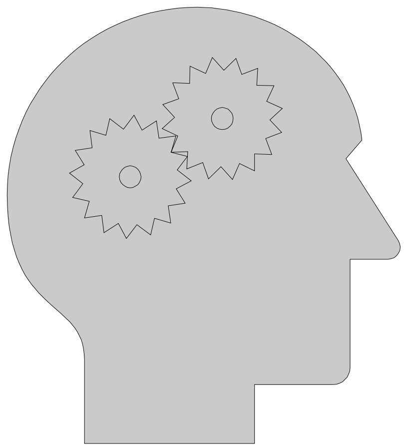
Instead of declaring victory, leaders of successful efforts use the credibility afforded by short-term wins to tackle even bigger problems. They go after systems and structures that are not consistent with the transformation vision and have not been confronted before. They pay great attention to who is promoted, who is hired, and how people are developed. They include new reengineering projects that are even bigger in scope than the initial ones. They understand that renewal efforts take not months but years. In fact, in one of the most successful transformations that I have ever seen, we quantified the amount of change that occurred each year over a seven-year period. On a scale of one (low) to ten (high), year one received a two, year two a four, year three a three, year four a seven, year five an eight, year six a four, and year seven a two. The peak came in year five, fully 36 months after the first set of visible wins.

Error #8: Not Anchoring Changes in the Corporation's Culture.

In the final analysis, change sticks when it becomes "the way we do things around here," when it seeps into the bloodstream of the corporate body. Until new behaviors are rooted in social norms and shared values, they are subject to degradation as soon as the pressure for change is removed.

Two factors are particularly important in institutionalizing change in corporate culture. The first is a conscious attempt to show people how the new approaches, behaviors, and attitudes have helped improve performance. When people are left on their own to make the connections, they sometimes create very inaccurate links. For example, because results improved while charismatic Harry was boss, the troops link his mostly idiosyncratic style with those results instead of seeing how their own improved customer service and productivity were instrumental. Helping people see the right connections requires communication. Indeed, one company was relentless, and it paid off enormously. Time was spent at every major management meeting to discuss why performance was increasing. The company newspaper ran article after article showing how changes had boosted earnings.

The second factor is taking sufficient time to make sure that the next generation of top management really does personify the new approach. If the requirements for promotion don't change, renewal rarely lasts. One bad succession decision at the top of an organization can undermine a decade of hard work. Poor succession decisions are possible when boards of directors are not an integral part of the renewal effort. In at least three instances I have seen, the champion for change was the retiring executive, and although his successor was not a resistor, he was not a change champion. Because the boards did not understand the transformations in any detail, they could not see that their choices were not good fits. The retiring executive in one case tried unsuccessfully to talk his board into a less seasoned candidate who better personified the transformation. In the other two cases, the CEOs did not resist the boards' choices, because they felt the transformation could not be undone by their successors. They were wrong. Within two years, signs of renewal began to disappear at



both companies.

There are still more mistakes that people make, but these eight are the big ones. I realize that in a short article everything is made to sound a bit too simplistic. In reality, even successful change efforts are messy and full of surprises. But just as a relatively simple vision is needed to guide people through a major change, so a vision of the change process can reduce the error rate. And fewer errors can spell the difference between success and failure.

Changing the Role of Top Management: Beyond Structure to Processes

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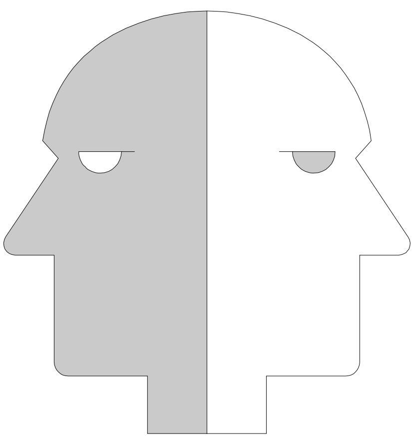

ABB Asea Brown Boveri, the $30 billion electrical engineering company, has received almost as much media attention for its novel global-matrix structure as for its bold strategic moves. Encompassing 1,300 separate operating companies, ABB's matrix requires the managers of each front-line unit to report to both a regional manager and a worldwide business head. Yet it is precisely the kind of structure that companies such as Digital Equipment, Citibank, and Westinghouse all tried and then abandoned after just a few years of frustrating experimentation.

Percy Barnevik, ABB's CEO and president, himself takes a dim view of complex formal business structures. They tend to be slow, inflexible, and bureaucratic, he notes. "Worse still," Barnevik says, "such organizations create barriers between themselves and their customers, take initiative away from those who need to exercise it, and attract and promote the kind of people who operate well in that kind of environment. We wanted to build an organization with the opposite characteristics."

Nevertheless, the global-matrix structure appealed to Barnevik because it enabled the company to capture and internalize the paradoxes it had to manage—"to be simultaneously global and local, big and small, centralized and decentralized," as he describes them. But while a global matrix could embrace those paradoxes, the structure itself could never resolve their tensions. To do that, Barnevik and his top management team have had to redefine key organizational relationships and basic management behaviors, a task that has taken several years to accomplish.

So, while the media touted the fascinating new structure ABB had installed, Barnevik and his top-level managers went on the road, often for 200 days or more a year, meeting with their operating-company managers to build processes that would make the company more competitive. They wanted to create an organization in which entrepreneurship could flourish in the front-line operating units, in which the competence and competitive strengths in those small units could be linked across organizational boundaries, and in which an ongoing renewal process would keep today's best practice from becoming tomorrow's inflexible dogma. As powerful as a new structure could be in achieving those aims, Barnevik knew that structure was only one instrument of organizational change—and a blunt one at that.

The Elusive Structural Solution.

In the first article in this series, we acknowledged that the strategy-structure-systems doctrine of management made possible the growth of huge corporations that operate multiple businesses in numerous markets. That classic doctrine gives top management three core responsibilities: to be the company's chief strategist, its structural architect, and the developer and manager of its information and control systems. However, it has become clear that the organizational model that follows from that doctrine—today's hierarchical structure supported by highly sophisticated management systems—no longer delivers competitive results.

From atop the hierarchy, the leader looks down on order, symmetry, and uniformity—a neat step-by-step decomposition of the company's tasks and responsibilities. From the bottom, frontline managers look up at a phalanx of controllers whose demands soak up most of their energy and time. The result, as General Electric's chairman and CEO Jack Welch puts it, is an organization with its face toward the CEO and its ass toward the customer.

Yet the continued reliance on structure as the chief organizing tool at most companies is understandable. The breakthrough creation of the divisional structure enabled management pioneers such as Alfred P. Sloan, Jr., at General Motors and Pierre S. du Pont at Du Pont to expand greatly their company operations. By creating an additional level of general management that could operate different businesses in different ways, they not only diversified their products and markets but also institutionalized diversification as a method of growth.

In the postwar era, when division managers were too busy meeting domestic demand to pay much attention to expanding foreign markets, top management again reached for the structural lever. Companies created international divisions, which facilitated another period of rapid growth. And when continued growth made even the divisional model too cumbersome to control, top management adjusted the basic structure by creating strategic business units to concentrate on particular businesses and by consolidating divisions into groups and sectors.

In the early 1980s, however, it became apparent that while those increasingly complex structural forms had indeed enabled companies to grow, the growth had come at some cost. No one puts the problem in clearer terms than Jack Welch in his assessment of the much admired and frequently emulated structure his predecessors had built at General Electric: "We had constructed over the years a management approach that was right for its time, the toast of the business schools. Divisions, strategic business units, groups, sectors—all were assigned to make meticulous, calculated decisions, and move them smoothly forward and upward. The system produced highly polished work. It was right for the 1970s, a growing handicap in the 1980s, and it would have been a ticket to the boneyard in the 1990s."

As their label clearly warns, divisions divide. The divisional model fragmented companies' resources; it created vertical communication channels that insulated business units and prevented them from sharing their strengths with one another. Consequently, the whole of the corporation was often less than the sum of its parts. Furthermore, the divisional structure kept the responsibilities and prerogatives of entrepreneurship with top managers. It was their job to allocate the resources that defined strategy. Those on the front line were implementers. Finally, the divisional structure proved ideal for refining the management of ongoing operations, but it had little built-in capability for renewal—for discarding old ideas and assumptions as they became obsolete. In other words, for all their growth, large companies were becoming increasingly inflexible, slow to innovate, and resistant to change.

To fix those problems, top management in many companies again turned to structural solutions. If frontline units were not innovating, management created skunk works, where innovation could thrive unimpeded by bureaucracy. If their companies could not build competencies internally by combining the skills of individual units, managers formed strategic alliances to gain access to the skills built in other companies. And if their companies could not achieve growth internally, managers bought it through mergers and acquisitions.

But skunk works, alliances, and acquisitions did not remove structural impediments to entrepreneurship, competence building, or renewal; they only sidestepped them. The hierarchy, with its top-down authority relationships and layers of bureaucracy, remained intact.

Finally, in an effort to solve the problems we now see so clearly as the consequence of hierarchical structure, compaworld have spent much of the past decade trying to adapt those structures. They have downsized by cutting out layers and laying off staff. In the process, some managers have taken the first small steps in a managerial revolution that will eventually overturn the way they think about their organizations.

The Organization As a Portfolio of Processes.

Managers have long recognized the importance of managing an organization's processes, but for half a century, the strategy-structure-systems doctrine has focused their attention on the vertical relationships of the classic hierarchical structure. Under that doctrine, information and capital requests were pulled to the top of the organization, enabling corporate executives to make decisions that drove resources, responsibilities, and control down to the frontline units. Such vertically driven, financially oriented, authority-based processes dominated the operation of most large companies. Horizontal processes that cut across organizational boundaries, if they even existed in more than concept, received scant management attention.

In recent years, however, managers have begun to notice that horizontal processes matter. Total quality management was such a process. It was not top down. It cut across the boundaries separating organizational units to invest quality in the company's products and activities. Likewise, reengineering showed companies how to integrate functionally separated tasks into unified horizontal work processes. Through such experimentation, managers are beginning to deal with their organizations in some fundamentally different ways. Rather than seeing them as a hierarchy of static roles, they think of them as a portfolio of dynamic processes.

To understand better the coming revolution, we have examined a group of 20 companies in Japan, the United States, and Europe whose top managements share with ABB's Barnevika surprisingly similar yet fresh view of their organizations. When they look at their companies, they do not see structure; they see processes. Their view extends beyond the currently popular reengineering of work activities.

They see core organizational processes that overlay and often dominate the vertical, authority-based processes of the hierarchical structure. Like Barnevik, they envision a process that produces creativity and entrepreneurship in frontline managers. They see another process that builds competence across the company's internal organizational boundaries. And they see a third process that promotes continuous renewal of the strategies and ideas that drive the business. We call the three—the entrepreneurial process, the competence-building process, and the renewal process—a company's core organizational processes.

The Entrepreneurial Process.

Perhaps the most widespread and deleterious effect of the growth of bureaucratic structures in corporations has been the erosion of managerial entrepreneurship—the externally oriented, opportunity-seeking attitude that motivates employees to run their operations as if they owned them. Few frontline initiatives survive the bureaucracy's smothering assumption that top managers are the best visionaries for their organizations and are alone responsible for leading their companies into new areas. Any bottom-up ideas that survive the top-down directives are likely to be crushed in the documentation, review, and approval processes that supply senior managers with the information and feedback they need to operate as their companies' strategic gurus.

However, we observed companies, such as 3M, Canon, and Intel, that maintained their entrepreneurial engines deep in the organization even as they grew into large corporations. And we saw others, such as ABB, GE, and Komatsu, where management has succeeded in rebuilding a previously compromised entrepreneurial process. In those and other companies, we found that top managers recognized they could not build their organizations on a model of top-down direction and delegation. Rather, they were committed to encouraging bottom-up ideas and initiatives. The difference is hardly minor. Essentially, it requires a company to drop its assumption that those at the top are in the best position to exercise entrepreneurial initiative.

A bottom-up entrepreneurial process can occur only when frontline management's role is transformed from implementer to initiator and when senior management's role is to provide a context in which entrepreneurship can happen.

At the foundation of an institutionalized entrepreneurial process is a culture that sets great store by the ability of the individual. That may seem a relatively simple matter for top management to recognize; in fact, many companies include in their annual reports such homilies as "Our employees are our most important assets." But in a hierarchical structure specifically designed to control behavior and minimize the risk of individual idiosyncrasies, it takes more than jawboning and sloganeering to reestablish a genuine faith in the ability of individual organization members.

A classic example is 3M, a $14 billion diversified industrial giant. Despite its humble origins in abrasives and adhesives—a business that could not seem more mature—it has grown to become one of the world's most innovative corporations. At 3M, respect for the individual is an unquestioned article of faith. Like many of the company's strongest beliefs, it was first articulated by William L. McKnight, the company's leader from 1929 to 1966 and its spiritual leader even today. McKnight's belief that the company was best served when management trusted those with direct knowledge of the market, the operations, or the technology was exemplified in a statement he made that became the basis for 3M management practice: "Mistakes will be made, but if a person is essentially right, the mistakes he or she makes are not nearly as serious in the long run as the mistakes management will make if it is dictatorial and undertakes to tell those under its authority how they must do their jobs."

That philosophy has rewarded 3M with thousands of breakthrough entrepreneurial initiatives, so it is little wonder that belief in the individual is one of 3M's core values, part of the organization's psychology. But to instill that psychology in a company in which it does not currently exist can take years. First, top managers really do have to hold in high regard individual employees' capabilities, and second, they have to persuade the organization that they do.

Percy Barnevik demonstrated his belief in the abilities of those deep in the ABB organization by reconstructing his corporation as 1,300 little companies that operate individual businesses in national markets worldwide. In doing so, he created a structural foundation of small, disaggregated frontline units, which we observed in all the companies that, like ABB, had developed strong entrepreneurial processes. At Canon, CEO Ryuzaburo Kaku split his company's numerous production and marketing units into separate companies; Andersen Consulting organizes and manages its operations as individual practice groups in each office; and at 3M, project teams, the basis of the company's 3,900 profit centers, are the basic building blocks of the organization.

However, the mere existence of small units does not guarantee that they will be innovative. In fact, traditional organizations usually break themselves into successively smaller entities to make it easier for top managers to allocate tasks and control performance. But those small units are mere administrative appendages to the central corporate body.

In contrast, generations of top management at 3M have viewed their organization as growing from the bottom—the project team—up. Under a principle the company calls "grow and divide," successful project teams, consisting of an entrepreneur with an idea and a small team that believes in it, grow into departments. Some of them become large enough to spin off as separate divisions that, in turn, seed their own projects. Thus, instead of carving smaller units out of larger ones in order to facilitate control, 3M encourages the small units born of innovation and entrepreneurship to grow into larger divisions and departments.

Similarly, Barnevik has made ABB's frontline companies the primary locus of the organization's assets and resources and the center of management's attention and support. Most of the operating companies are separate legal entities. All but a handful of ABB's employees have been redeployed to the frontline units, leaving corporate headquarters with fewer than 150 people, and the typical division office—or business area, in ABB terminology—with only 5 or 6. Likewise, the operating companies control more than 90% of ABB's $2.3 billion esearch and development budget. They also exercise considerable financial autonomy. They control their own balance sheets, borrow money independently, and retain a substantial portion of their earnings. By recognizing the frontline units as the company's basic building blocks, top management lays a foundation that enables unit managers to act as entrepreneurial champions.

Yet, even after seeing to the organization's anatomy (a structure built up, not down) and to its psychology (its eagerness to trust the individual), top management cannot assume that the desired bottom-up flow of ideas and proposals will occur spontaneously. The organizational physiology—the flows and relationships that link all the parts of the organization to one another—must also be made right.

For many of the companies we studied, that challenge was the most difficult and, for some, the most elusive step since it required senior management to achieve a sensitive balance between discipline and support. Empowerment of frontline managers does not mean abdication or anarchy. One of top management's most important tasks is to establish internal discipline and to set the performance standards that will motivate frontline managers to superior performance. As Barnevik is fond of reminding his organization, only when a company has developed a strong sense of self-discipline and control can its top management undertake the kind of radical decentralization ABB has achieved.

At 3M, the entrepreneurial freedom created in project teams, departments, and divisions is tempered by a clear set of company-wide expectations and management practices. For instance, the company requires that 25% of every unit's sales must come from products introduced within the past five years. Similarly, each part of the organization is expected to contribute to the corporate target of 10% growth in sales and earnings, 20% pretax profit margins, and 25% return on shareholders' equity. Ray Herzog, who was CEO and chairman from 1975 to 1979, summed up 3M's philosophy this way: "We recognize some of our business as established but none as mature."

Top management's objective must be to reduce reliance on formal control systems and increase self-discipline instead. In a self-disciplined organization, employees come to meetings on time, work toward agreement on defined agendas, and do not question in the corridors the decisions they agreed to in the conference room. Above all, they deliver on their promises and commitments.

For example, every management meeting at Intel must have a clear agenda and must close with decisions, action plans, responsibilities, and deadlines. Such rules do not mean that debate is restricted. In fact, the company calls its management style, shaped and modeled by CEO and president Andy Grove, constructive confrontation. Management expects everyone with opinions on an issue to contribute to the debate. But once an issue has been discussed fully and decisions have been made, dissension stops. The company's philosophy is clear: everyone is expected to agree or disagree but eventually to commit.

In companies with successful entrepreneurial processes, top management's efforts to infuse the organization with self-discipline must go hand in glove with a supportive and nurturing management style. At 3M, the balance between discipline and support is clear in the venerated practice known as “make a little, sell a little.” To qualify for the next round of funding, a product under development must meet clear objectives, and at each stage, management coaches, challenges, and encourages the entrepreneurial team. As long as the project is meeting its targets, the assumption is that the market is a far better judge of its value than some staff analysis or senior manager. Similarly, at Intel, constructive confrontation not only provides valuable input during each stage of a project’s development; it also allows top management to commit to the surviving projects knowing that frontline managers have scrutinized and endorsed them.

Those are the ways the top managers of the companies we studied changed their organizational structures, relationships, and values to create a context that encourages an entrepreneurial process. Only in such an environment can companies produce continuing innovation in frontline units.

The Competence-Building Process

In a world of converging technologies, large companies have to do more than match their smaller competitors’ flexibility and responsiveness. They must also exploit their big-company advantages, which lie not only in scale economies but also in the depth and breadth of employees’ talents and knowledge. To take advantage of those assets, large companies need a competence-building process that links and leverages the diverse resources that exist in individual frontline units.

Most managers recognize that need, as is clear in the excitement generated by the idea of managing a company as a bundle of core competencies. Yet, in the implementation if not the intent, the desire to create and use core competencies has often deteriorated into just another version of top-down corporate control. Many managers have interpreted the word core to mean that executives build and manage competencies and then make them available to operating units as they see fit. Headquarters-level groups have found in core competence a solution to the problem of their increasing marginalization and have used it as much for winning political power struggles as for revitalizing the company’s strategic capabilities.

In contrast, some of the companies we studied have attempted to build and use competence by conceiving the task as complementing rather than usurping frontline entrepreneurship. Their model is of distributed, rather than core, competence. They see top management’s role not as defining, controlling, or allocating that competence but rather as creating an environment that allows it to develop and diffuse deep within the organization.

Because the competence-building process is predicated on small frontline units’ ability to develop scarce skills, knowledge, and other resources, its structure is the same as that of the entrepreneurial process. In short, top management entrusts the operating units with the challenge of creating the competencies needed to pursue local opportunities. It limits its own role to seeing that those competencies are shared through cross-unit flows of resources, knowledge, and people.

Kao Corporation is an example of an organization in whicement has created a dense mesh of communications channels and decision-making forums to link the resources and expertise of its widespread laboratories, factories, and sales and administrative offices. Through that network, Kao was able to expand in just seven years from its historic position as Japan’s leading soap and detergent company to become its number two cosmetics company as well.

At the base of Kao’s ability to develop knowledge and leverage expertise across organizational boundaries are its highly sophisticated automated information systems, known as the value-added network. Kao VAN, as the company calls it, is not the typical corporate information system, designed to serve top management’s control needs by moving financial information up the hierarchy.

It is a true information network that gives frontline managers access to information throughout the organization. When the company developed its Sofina cosmetics line, for example, Kao VAN not only provided engineers with information from the company’s extensive database on fats, oils, surfactants, and polymers but also gave marketing personnel detailed data on consumers.

For example, one part of the network gathered sales data from retail outlets. Another part sifted the data for clues to customer needs, then matched those findings with ideas and latent technologies developed in Kao’s R&D labs. At the same time, the network compared findings from market research with unsolicited consumer comments from a telephone hot line to create what managers called “a direct window on the consumer’s mind.” All of that information and more was widely disseminated and formed the basis of intense discussions among research, manufacturing, and marketing managers.

Furthermore, Kao shared its “information advantage” with retailers to help them build volume and profits on the company’s products.

But the powerful information network provides only the raw material for the web of face-to-face meetings that have become a way of life at Kao. For instance, Kao encourages laboratories to host monthly technical meetings and invite researchers from any of the company’s worldwide facilities. As a result of those meetings, three laboratories collaborated to develop liquid-crystal emulsification, a technology that was key in Kao's new cosmetics. Then, in cross-functional meetings, the cosmetics team—made up of people from management, R&D, production, and marketing—monitored and discussed the field data as the new products were test-marketed and introduced. Because the team was cross-functional, it could react to new information almost immediately. One day, after receiving some feedback from a test market, the team decided to change a sample package at 3:30 p.m.; by 6:30 p.m., an engineer at the factory was already working on a new design.

Yoshio Maruta, chairman of Kao1, says his objective is to create a company that exhibits "biological self-control"—an organization that responds to crises just as the body does. "If anything goes wrong in one department," Maruta says, "those in other parts of the organization should sense the problem and provide help without being asked."

Intel's Grove uses a similar analogy. He tells his employees he wants them to display the commitment and dedicated teamwork that emergency workers must have to respond to natural disasters, putting aside self-interest and territoriality for cooperation and mutual support.

But biological self-control and disaster-response teamwork require more than sophisticated information systems and new communication channels and forums. Cooperation and individual action for the common good must also be deeply held cultural norms. That was the culture we saw top managers at Intel, 3M, Kao, and ABB striving to develop.

Corporate leaders must create a sense of community and help employees identify with the larger organization in a way that transcends personal interests and particular responsibilities. The leaders who have done that best are those who instill a sense of purpose in the organization, as we described in the earlier article. Employees who share an organization's ambitions and values and whose jobs allow them to contribute to those ambitions and values have a far stronger incentive to collaborate than do employees whose sole incentives are financial.

At Kao, Maruta has imbued his organization with the kind of ambition and values that are the bedrock of a company's purpose. Employees believe their challenge is "to develop and use innovative technologies to create products that are useful to society and offer real consumer value," Maruta says. Equally important, they understand Maruta's insistence that they operate as "an educational institution," in which everyone is both teacher and student. With such a culture, Kao experienced little difficulty in getting the technologists in its detergent plant to contribute their fine-powder expertise to its start-up cosmetics researchers.

That sort of culture and employee behavior is not unique to Japanese companies.

Thecore values at 3M, which promote individual identity, innovation, and entrepreneurship, are evident in such maxims as "Products belong to divisions, but technology belongs to the company." Through decades of cross-unit collaboration, scientists and engineers at 3M have developed such mutual respect and interdependence that management hardly needs to intervene. The number of applications the company finds for even the simplest innovation is often astounding. For example, a nonwoven material that was initially developed as a decorative ribbon spawned scores of other products straddling 19 divisions—from protective face masks to surgical tape to cleaning pads. Even technologies that fail in one application often work in others. The now ubiquitous Post-it note developed out of an experiment by a scientist who was trying to make a strong adhesive but instead created an extremely weak one.

To enable cross-unit collaboration, employees must accommodate multiple vertical and horizontal relationships and take responsibility for activities over which they have only limited control. Such behavior can occur only in a trust-based environment, in which people can rely on one another's judgments and depend on one another's commitments. To create and maintain that kind of environment, top management first must build fairness into its organizational practices. People must have confidence that those with whom they share responsibility will contribute equitably despite vague lines of authority. And they must believe that those who evaluate the outcome will deal with them fairly. A well-established sense of fairness serves as an organizational safety net for risk takers.

An example of such a safety net is a process Intel calls "buying options."

By deliberately backing more than one potential solution to a problem, management increases the chances that it will get a winner. But the practice also guarantees that management will have to pull the plug on a loser. To be fair and to retain the confidence of the unsuccessful team, management celebrates the discoveries made on the paths not taken with the same enthusiasm it shows for the contributions it does use. Those researchers did not fail; they provided valuable information about which path to take.

Organizational openness also contributes to building an environment of trust. Yoshio Maruta's belief in the value of individuals and his commitment to creating a learning environment at Kao has led him to build extraordinary transparency into his organization. Employees everywhere have access to all parts of the company's massive information system. Through computer terminals located throughout the company, employees "can check up even on the president's expense account," Maruta says. Decision-making processes are equally open. Every part of the company, from the tenth-floor executive offices down, has open meeting areas in visible locations called Decision Spaces. Anyone with an interest in a topic can pull up a chair and contribute ideas or ask questions.

Finally, top managers must create mutual dependence and reciprocity in their organizational environments. At 3M, technologists in more than 100 labs around the world work openly and easily with one another without secrecy, protectiveness, or the not-invented-here syndrome, which often inhibits free exchange in other companies.

Top management has organized wide, collegial networks that scientists throughout the company can tap into for advice and assistance. The Technical Council, made up of the heads of the major labs, meets monthly and holds a three-day annual retreat to discuss issues of common interest—inevitably including how to improve cross-unit technology transfer. The more broadly based Technical Forum, composed of scientists and technologists chosen as representatives, exists primarily to facilitate grassroots scientific communication.

One of its most important responsibilities is to organize chapters of employees with similar technical interests, which hold regular seminars with outside experts. During the company's three-day annual technology fair, 3M scientists showcase their latest findings for their colleagues, which helps everyone develop knowledge and expand a personal network.

As a result of the many channels 3M has created to reinforce its values, the company has grown from its base of expertise in abrasives and adhesives to develop a portfolio of more than 100 technologies. It routinely leverages new technologies across two or three divisions and applies them in multiple markets. It is the company's well-oiled competence-building process that has become 3M's real core competence.

The Renewal Process.

While the traditional divisional structure created a highly efficient implementation machine that allowed a company to refine its operations continuously, it has been less effective in renewing them. Indeed, Sears and General Motors, two of the pioneers of the divisional form and its strategystructure-system doctrine, have become prime examples of the failure of success: yesterday's winning formula ossifies into today's conventional wisdom before petrifying into tomorrow's tablets of stone. Such organizational sclerosis prevents companies from adjusting to new market realities or emerging strategic opportunities.

The failure of success often begins in the company's data processing systems. Those systems are designed to refine the rich, raw data and unpolished ideas that enter at frontline levels and move them up through the organization—abstracting, consolidating, and analyzing them at each level. By the time they reach the corporate level, those inputs, like bleached white flour, have had all the value ground out of them. What may have started as illuminating observation arrives at the top as homogenized received wisdom, usually filtered so that senior management will see what it wants to see.

Top managements then use the highly refined information to formulate unifying expressions—of strategic intent, of budget objectives, and of corporate policy—with which the organization is supposed to align. Although the vertical process of information up and control down has allowed organizations to develop highly efficient operations that support the expressed strategy, it contains no means for challenging that strategy. Unquestioned and unquestionable verities become enshrined as "the company way."

A renewal process, on the other hand, is designed to challenge a company's strategies and the assumptions behind them. It reverses the systems-supported process that converts data into information and information into knowledge, then uses that knowledge to formulate organizational policies and practices. In our study, we saw a handful of companies—Kao, Intel, and ABB, among them—that had created renewal processes that challenged conventional wisdom, overturned existing knowledge bases, and reconfigured the sources of data.

To facilitate the renewal process, top managers must take on a new role—one that disturbs the organizational equilibrium. We are not suggesting that top managers' job is to create chaos. Their role as shapers of corporate purpose still means they must provide direction and coherence. But we are saying that top managers must also direct some of their energy into more disruptive pursuits.

The top managers in several large companies describe their roles as agents of disturbance as much as agents of alignment. None addresses the issue better than Kao's Maruta: "Past wisdom must not be a constraint but something to be challenged. Yesterday's success formula is often today's obsolete dogma. My challenge is to have the organization continually questioning the past so we can renew ourselves every day."

Most top managers begin the task by supplementing their traditional call for compliance with another voice that challenges their organizations to stretch beyond the predictable goals set by long-range planning. As GE's Welch puts it, "An institution ought to stretch itself to the point where it almost comes unglued."

We saw such stretching occur in different ways. At 3M, the stretch took the form of a clear, simple, and quantifiable target. In early 1993, chairman and CEO Livio D. DeSimone raised the bar on 3M's much admired standard for new-product introduction. Despite the company's size and a torpid economy, DeSimone decreed that 30% of the company's sales must come from products fewer than four years old—a 50% increase over the old target.

At Kao Corporation, stretching is inherent in the purpose Maruta set for the company: to become a superior learning organization and to apply its accumulated knowledge to creating true consumer value. That goal encourages employees to see themselves and the organization not in terms of past constraints but of future possibilities. Its effectiveness is evident both in the way the old-line soap company has exploited its expertise in fats and liquid-crystal emulsification to become Japan's number two cosmetics maker and, even more strikingly, in the way it has used its knowledge of fine powders and coating technology to establish itself as a leading manufacturer of floppy disks.

Top management can also intervene directly to shake up operating units that have grown staid or comfortable. Goran Lindahl, a member of ABB's top-level executive committee, says one of his key roles is to identify areas of ABB where management has become complacent or where operations seem to be drifting.

When he spots such an area, he will "shake things up to create an environment of learning," he says, even in operations two or three levels below him. For instance, one of the dozen specialized power-transmission businesses reporting to him was having difficulty rationalizing the overlapping development and production facilities the company had built in several European countries. Lindahl got involved as soon as he saw negotiations among the unit's frontline managers stalling. Rather than providing Solomon-like judgment by deciding himself which plants and labs should be closed, he turned the problem over to the managers, told them which options were unacceptable, and gave them a tight deadline to find a solution.

When he realized that some managers were not fully committed to the kind of collaboration he was urging on his team, he replaced them. Lindahl calls his style "fingers-in-the-pie management," which he contrasts with the more conventional "abstract management," in which managers control operations from their offices through sophisticated systems.

Lindahl also routinely challenges his organization during bimonthly meetings with the dozen or so worldwide business heads who report to him. Instead of show-and-tell budget reviews, Lindahl uses the meetings for contingency planning exercises. He might, for instance, ask them to consider the opportunities or threats that could arise if certain environmental laws are enacted, the implications for ABB's investment in developing countries if North-South conflicts erupt, or the impact on the company's global supply network if trade negotiations reach some assumed resolution. Through such hypothetical scenarios, he hopes to prepare his executives, stimulate their thinking, and generate fresh initiatives.

In those and other ways, top management at such companies as ABB, Intel, and 3M have created an environment in which challenges to conventional wisdom are not just accepted; they are demanded. At Intel, Andy Grove's challenging style has institutionalized the company's norm of constructive confrontation. That norm gave employees permission to challenge management's commitment to one computer architecture by developing an alternative. As a result, management authorized a parallel product-development project. That project eventually produced the 16-bit 8086 chip—the mother of the multigenerational line that has allowed Intel to dominate the microprocessor industry.

At Canon, Ryuzaburo Kaku likens the renewal process to ecdysis—the biological process in which certain animals shed their shells so they can take on new forms. Because it practices its own form of ecdysis, Canon has achieved leadership in a constantly evolving line of businesses—from cameras to calculators to photocopiers and, most recently, to computer peripherals. People at Canon believe in creative destruction and the idea that the company should make its products obsolete by coming out with the next generation before the competition does. Consequently, even though Canon had developed the first laser printer and had a market share of more than 80%, frontline managers did not hesitate to support the development of a printer based on the bubble-jet technology accidentally created in the company's own labs. The fact that the new product would sell at half the price and generate lower margins did not stop them. The commitment to self-obsolescence was too strong.

Renewal is the one organizational process in which top management has a direct role to play because someone must resolve the healthy conflicts and challenges that are cultivated within an organization. However much an organization is conscious of the need to challenge continuously dogma and the assumptions that underlie it, the most far-reaching decisions about corporate renewal fall in top management's lap. They involve the kinds of directional choices and resource commitments that only those at the very top can make. "Time and again," Intel's Grove says, "top management has found itself at a fork in the road, having to choose one direction or risk hitting the divider." The ability of a company to renew itself ultimately depends on top management's ability to commit to a few key projects or proposals that will lift the organization into a new orbit.

Sometimes the decision involves

breaking a commitment to an earlier top-management decision, which makes the new choice even harder to make. When Grove and Intel cofounder Gordon Moore had to decide whether to sacrifice Intel's original memory-chip business in order to pursue its investment in microprocessor technology, Grove asked Moore, "What would a new top-management team do?" The blunt question forced both men to confront reality because the answer was obvious: exit their core business. "So," Grove said to Moore, "let's go out through the revolving door, come back in, and do it ourselves."

From Structuring Tasks to Shaping Behaviors.

The structural element of the strategy-structure-systems doctrine that most managers rely on today is about allocating resources, assigning responsibilities, and controlling their effective management. The purpose-process-people doctrine of management rests on a different premise: that the organizing task—accomplished through the three organizational processes we have described—is to shape the behaviors of people and create an environment that enables them to take initiative, to cooperate, and to learn.

The new philosophy of organization and management is built on different assumptions about motivation and behavior. The entrepreneurial process assumes that individuals can take initiative, and it creates the context and the mechanisms necessary to encourage them to do so. The competencebuilding process both assumes and shapes an environment for collaborative behavior. And the renewal process capitalizes on the natural human motivation to learn by creating the resources and tools that people need to do so. Developing an organization that fosters those behaviors is something structure alone cannot achieve. To create those fundamentally new organizational processes at the core of the organization requires top management to use all its tools—structure, systems, and culture.

Most senior managers recognize the need for a radical change in their thinking and behavior. Yet most shy away from making it. Why? "It is more reassuring for all of us to stay as we are, even though we know the result will be certain failure," says the European CEO of a major U.S. company, "than to jump into a new way of working when we cannot be sure it will succeed."

Percy Barnevik's fundamental objective in developing ABB's decentralized organization was to modify the behavior and transform the underlying values of all employees worldwide. To achieve that objective, he and his top-managemen team spent most of their time for more than five years building organizational processes designed to encourage entrepreneurship from those closest to customers; to integrate and leverage the resources and capabilities developed in the frontline units into a global company-wide asset; and, most of all, to supplement ABB's refinement of its operations with a commitment to a continuous renewal process.

Does it work? In 1989, ABB acquired part of Westinghouse's troubled power-transmission and distribution business. Like most of the units Westinghouse sold to ABB, the U.S. relays unit was a mature activity with an aging product line that generated only modest profits and expected only limited growth. Yet within three years of being taken out of the Westinghouse hierarchy and integrated into the ABB organization, the unit was behaving like a young growth company. Operating profits had doubled, and with the help of its sister companies, the unit had developed a significant new capability in microprocessor-based relay technology.

What is most striking about the story, however, is that Don Jans, the general manager of the relays unit and the key architect of its turnaround within ABB, was the same man who had been running the business for Westinghouse. Jans found ABB's entrepreneurial, competence-building, and renewal processes a refreshing change. "I am," he said after the turnaround, "a much broader manager today than I was at Westinghouse. Here, we are constantly challenged to look at the outside world as a market, a source of expertise, and a standard of performance. It is tough and demanding, but it can also be invigorating and fun. We feel we are rediscovering management."

1. Yoshio Maruta, who was chairman of Kao when research for this article was conducted, retired in April 1994 after 60 years with the company. He continues as an adviser to the company.

Changing the Role of Top Management: Beyond Strategy to Purpose

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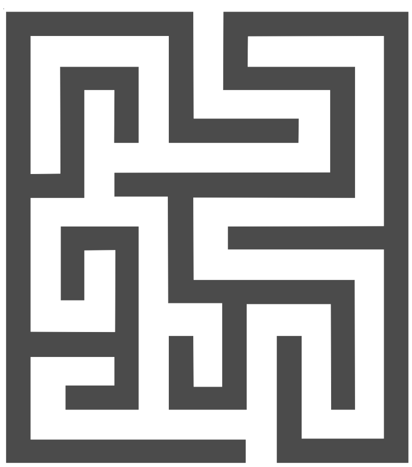


Structure follows strategy. And systems support structure. Few aphorisms have penetrated Western business thinking as deeply as these two. Not only do they influence the architecture of today's largest corporations but they also define the role that top corporate managers play.

Yet these aphorisms and the management doctrine to which they have given rise are no longer adequate. The job they prescribe for senior management is no longer the job that needs to be done. Senior managers of today's large enterprises must move beyond strategy, structure, and systems to a framework built on purpose, process, and people.

The concepts that still define most senior managements' understanding of their roles have their roots in the 1920s, when Alfred Sloan at General Motors and a few of his contemporaries were engineering a new strategy: diversification. Those pioneers discovered that diversification benefited from a divisional structure and that tightly designed planning and control systems in turn supported that structure. From then on, the strategy-structure-systems link has been an article of faith reflected in the design of MBA programs, reinforced in consultants' reports, and confirmed in the actions and mind-sets of practicing managers worldwide. Top-level managers view themselves as the designers of the strategy, the architects of the structure, and the managers of the systems that direct and drive their companies.

For decades, this philosophy served companies well. It supported successive waves of growth as companies integrated horizontally in the 1950s, diversified in the 1960s, and expanded into global markets in the 1970s and early 1980s. But over the last decade, technological, competitive, and market changes have eroded its effectiveness. The problems of companies as diverse as GM and IBM in the United States, Philips and Daimler-Benz in Europe, and Matsushita and Hitachi in Japan can be traced, at least in part, to top management's cleaving to this philosophy too tightly and for too long.

The great power—and fatal flaw—of the strategy-structure-systems framework lay in its objective: to create a management system that could minimize the idiosyncrasies of human behavior. Indeed, the doctrine held that if the three elements were properly designed and effectively implemented, large, complex organizations could be run with people as replaceable parts. Over time, as corporate size and diversity expanded, strategies, structures, and reporting and planning systems became more and more complex. Employees' daily activities became increasingly fragmented and systematized.

In the benevolent, high-growth environment that followed World War II, strategy, structure, and systems offered much-needed discipline, focus, and control. Today's economic environment is different. Overcapacity and intense competition are the norm in most global businesses. The lines separating businesses have blurred as technologies and markets converge, creating new growth opportunities where traditional businesses intersect. And, most notably, the scarcest corporate resources are less often the financial funds that top management controls than the knowledge and expertise of the people on the front lines.

Analysts have many prescriptions for these challenges, and executives have rushed to adopt them: from focusing on strategic intent to inverting the organizational pyramid; from corporate reengineering to employee empowerment. Yet after five years of research in which we studied 20 large, vigorous European, U.S., and Japanese companies, we believe that these prescriptions address the artifacts of the problems and not their causes. They focus on partial, operational solutions. What managers need, however, is a fundamental change in doctrine.

Consider some examples. Over 30% of 3M's sales come from products introduced in the last five years. How has 3M managed to retain its innovative capability and entrepreneurial spirit despite its $14 billion bulk? What enabled ABB to transform two also-ran companies into the leaders in the global power-equipment industry while world markets wre in recession? How has Canon managed to grow and renew itself, expanding from cameras to calculators to copiers to computers? And what has kept other large, complex companies like AT&T, Royal Dutch/Shell, Intel, Andersen Consulting, Kao, and Corning from succumbing to the so-called inevitable decline of large corporations?

Although the strategies, structures, and systems of these companies have little in common, their leaders share a surprisingly consistent philosophy. First, they place less emphasis on following a clear strategic plan than on building a rich, engaging corporate purpose. Next, they focus less on formal structural design and more on effective management processes. Finally, they are less concerned with controlling employees' behavior than with developing their capabilities and broadening their perspectives. In sum, they have moved beyond the old doctrine of strategy, structure, and systems to a softer, more organic model built on the development of purpose, process, and people. In this article, we examine the first element of the changing role of top management: shaping organizational purpose.

Such a transformation can start only with top management. Before senior managers can realign behavior and beliefs throughout the corporation, they need to change their own priorities and ways of thinking.

From Setting Strategy to Defining Purpose.

Formulating strategy has long been the domain of top management. From Alfred Sloan to Lee Iacocca, the powerful, even heroic image of the CEO as omniscient strategist is ingrained in business history and folklore.

When companies were smaller and less diversified, setting business strategy was a straightforward task. As companies grew larger and more complex, however, senior executives needed elaborate systems and specialized staff to ensure that headquarters could review, influence, and approve the strategic plans of specific business units. Over time, the workings of increasingly formalized planning processes eclipsed the utility of the plans they produced: sterile generalities to which front-line managers felt little affinity or commitment.

Ironically, disaffection only increased as senior managers ceded responsibility for unit-level strategy to the divisional managers and shifted their own attention to crafting an overall corporate framework and logic. That shift led senior managers to explore the elusive concept of business synergies, to work on balancing cross-funded strategic portfolios, and, in recent years, to articulate notions of broad strategic vision or highly focused strategic intent. Meanwhile, the people actually running business units grew increasingly confused about their roles. The elaborate contortions required to fit their strategies into the corporate rationale frustrated them. Classification of their complex businesses into simplistic, portfolio-funding roles demotivated them. And strategic visions that seemed vague or definitions of strategic intent that were overly constraining made them cynical. All in all, top management's efforts to provide strategic leadership often had the opposite effect.

The problem is not the CEO but rather the assumption that the CEO should be the corporation's chief strategist, assuming full control of setting the company's objectives and determining its priorities. In an environment where the fast-changing knowledge and expertise required to make such decisions are usually found on the front lines, this assumption is untenable. Strategic information cannot be relayed to the top without becoming diluted, distorted, and delayed.

CEO Andy Grove, for example, acknowledges that for a long time neither he nor other top Intel executives were willing or able to see how the competitive environment had undermined the company's strategy of being a major player in both memory chips and microprocessors. Yet for two full years before top management woke up to this reality, various project leaders, marketing managers, and plant supervisors were busy refocusing Intel's strategy by shifting resources from memories to microprocessors. Management, Grove confessed, might have been "fooled by our strategic rhetoric, but those on the front lines could see that we had to retreat from memory chips....People formulate strategy with their fingertips. Our most significant strategic decision was made not in response to some clear-sighted corporate vision but by the marketing and investment decisions of frontline managers who really knew what was going on."

Yet at the very time that top-level managers are acknowledging their own limits, many are also learning that the people who can "formulate strategy with their fingertips" are deeply disaffected. Neither the valueless quantitative terms of most planning and control processes nor the mechanical formulas of leveraged incentive systems nurture employees' commitment or motivation. In fact, even this fragile relationship is eroding as successive waves of restructuring, delayering, and retrenching weaken any reserve of corporate loyalty.

In most corporations today, people no longer know—or even care—what or why their companies are. In such an environment, leaders have an urgent role to play. Obviously, they ust retain control over the processes that frame the company's strategic priorities. But strategies can engender strong, enduring emotional attachments only when they are embedded in a broader organizational purpose.

This means creating an organization with which members can identify, in which they share a sense of pride, and to which they are willing to commit. In short, senior managers must convert the contractual employees of an economic entity into committed members of a purposeful organization.

Embedding Corporate Ambition.

Traditionally, top-level managers have tried to engage employees intellectually through the persuasive logic of strategic analyses. But clinically framed and contractually based relationships do not inspire the extraordinary effort and sustained commitment required to deliver consistently superior performance. For that, companies need employees who care, who have a strong emotional link with the organization.

Prescriptions for forging such links surface regularly. One that is currently fashionable calls for building a Zen-like focus on strategic intent to challenge and eventually overcome less focused rivals. To create an obsession with winning, top management identifies a specific stretch target (typically defined in competitive terms) and drives the organization toward that goal through a series of operating challenges.

The flip side of this technique, however, is strategic myopia and inflexibility, because a laserlike focus risks constraining rather than liberating the organization. Consider Komatsu. During the mid- to late 1980s, Komatsu was widely cited as an example of the power of strategic intent. But even as management students in the West were admiring the company's obsession with beating the market leader, Caterpillar, Komatsu's leadership had decided that "Maru-C" (surround Caterpillar) had led to stagnation and stereotyped thinking. Over the last four years, President Tetsuya Katada has reoriented Komatsu toward a corporate agenda reflected in a new slogan, "Growth, Global, Groupwide," or the "Three Gs" for short. He describes it as "a much more abstract challenge than one focused on catching and beating Caterpillar, but it will stimulate people to think and discuss creatively what Komatsu can be." (See the insert, "From Strategic Intent to Corporate Purpose: The Remaking of Komatsu.")

Obviously, strategic visions can be so broad that they convey little meaning or guidance to people deep in the organization. Andy Grove is characteristically blunt in labeling most strategic vision statements "pap." Yet some of the elements of both strategic intent and strategic vision are evident in the efforts that Grove and other top-level managers are making to shed their uncomfortable and increasingly inappropriate role as strategic gurus. Their objective is neither to impose a tight strategic agenda on their line managers nor to inspire them toward some ineffable goal. Rather, they are working to embed a clearly articulated, well-defined ambition in the thinking of every individual while giving each person the freedom to interpret the company's broad o creatively.

Three characteristics distinguish this approach from previous practices. The executives we observed articulated the corporate ambition in terms designed to capture employees' attention and interest rather than in terms related to strategic or financial goals. They engaged the organization in developing, refining, and renewing the ambition. And they ensured that it was translated into measurable activities to provide a benchmark for achievement and a sense of momentum.

Capture Employees' Attention and Interest.

Defining a company's objectives so that they have personal meaning for employees is hard. Most such statements are too vague to be useful to line managers, and often they are too out of touch with reality even to be credible. At AT&T, Bob Allen found himself atop a company that had to change from thinking and acting like a regulated utility and do so amidst industry turbulence. The formal planning process defined the key strategic task as loading more traffic onto he existing telecommunications network and developing products to meet the needs of an emerging infocom business. But Allen decided not to talk about AT&T's objectives in such rational and analytic terms. Nor did he choose a competitively focused strategic intent—countering Northern Telecom's invasion of AT&T's home market, for example—or a broad vision of futuristic information highways and virtual worlds. Instead, Allen chose very human terms, stating that the company was "dedicated to becoming the world's best at bringing people together—giving them easy access to each other and to the information and services they want and need—anytime, anywhere."

This simple statement captured AT&T's objective of providing network linkages as well as the attendant access to information and services—but in simple, personal language that anyone could understand. Equally important, employees could relate to and take pride in such a mission.

Other companies achieved a similar impact by focusing on the development of core capabilities. At Corning, for example, CEO Jamie Houghton challenged his organization to overlay its exceptional technological capability with a commitment to quality that would make the company truly world-class. To an organization that was feeling demotivated and even defeated, this commitment to quality provided a focus for rebuilding organizational pride and self-confidence while simultaneously boosting a crucial strategic competence.

Get the Organization Involved.

A statement of corporate ambition is only a touchstone for the larger process of gaining organizational commitment. The statement must be broad enough to invite—and indeed require—the organization's involvement in interpreting, refining, and making it operational. In practice, this means tapping into the reservoir of knowledge and expertise that is widely distributed throughout the company. As Andy Grove observed about Intel's shift out of the memory business and the importance of inviting organizational discussion and debate, "The more successful we are as a microprocessor company, the more difficult it will be to become something else....We need to soften the strategic focus at the top so we can generate new possibilities from within the organization."

For many top-level managers, softening the strategic focus isn't easy. They worry that the organization will interpret such an approach as strategic fuzziness, or worse, indecision. But these concerns evaporate when senior managers realize that they are not abandoning their responsibility for the strategic direction but rather improving the quality of its formulation and the odds of its implementation.

At AT&T, for example, Bob Allen challenged his entire organization to interpret and operationalize the deliberately broad "anytime, anywhere" statement. He also created a Strategy Forum and invited the company's 60 most senior managers to participate in two- or three-day meetings held five times a year. There they discussed and refined AT&T's overall objectives and direction.

Create Momentum.

Top management's third challenge is to build and sustain commitment to the objectives the organization has helped to develop. Everyone needs to believe that the articulated ambition is legitimate and viable; that it is more than public relations rhetoric or motivational hype. By making tangible commitments to the defined objectives, senior managers substantiate such belief. They also provide people deep in the organization with the motivation that comes from making perceptible progress.

Jamie Houghton demonstrated the seriousness of his belief in Corning's quality crusade by appointing one of the company's most capable and respected senior managers to head the effort. Furthermore, despite a severe financial crunch, Houghton allocated $5 million to create a new Quality Institute to lead the massive program of education and organizational development. He also committed to boost training to 5% of every employee's total working hours. Corning's quality program quickly achieved Houghton's aim. As one executive committee member said, "It did a lot more than just improve quality. It put self-respect and confidence back in our people."

Bob Allen also backed his statement of corporate ambition with tangible commitments. The Strategy Forum's discussions led to the conclusion that "bringing people together anytime, anywhere" would require major investments in several complementary information technologies likely to become vital in the new communications highways. The resulting decisions to acquire NCR for $7.5 billion and McCaw Cellular for $12.6 billion were strong evidence of the vision's organizational legitimacy and a powerful mental jump-start to a belief in its viability.

Instilling Organizational Values.

There are few more powerful or public signals of what a company stands for than the ways it defines and measures performance. Most companies focus almost entirely on financial results: the strategic objective to become number one or number two in the industry justifies the pressure to meet the budgeted 15% increase in sales. That goal in turn is crucial for the company to achieve its overall aim of a 20% return on net assets by mid-decade.

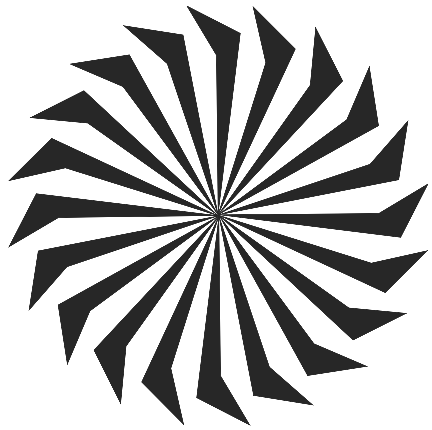
If managers' interest in such quantitative objectives flags or signs of organizational exhaustion appear, top management often responds by presenting the objectives in a more compelling way—linked to a highly leveraged incentive program, for example, or motivated by a crisis—real or manufactured.

But often, corporate leaders simply continue to explain and justify the objectives in greater detail in the hope that acceptance will follow understanding. GE's Jack Welch hoped that a more detailed explanation of his demanding profit objectives would build commitment to them, but it didn't help. In 1988, Welch made a highly polished presentation to top-level managers in which he depicted the company as a "growth engine" powered by a balanced capability to generate and apply funds. His charisma notwithstanding, Welch failed to generate the interest, excitement, and commitment he had hoped for. Instead, his dramatic but stark imagery increased some line managers' frustration with and alienation from a company that was already driving them hard. The presentation confirmed their feeling that they were little more than cogs in a perpetual-motion money machine.

Although achieving acceptable financial objectives is clearly important for a company's survival, a target ROI will rarely galvanize an organization into action. If people are to put out the extraordinary effort required to realize company targets, they must be able to identify ith them. As one disaffected manager said, "It's fine to emphasize what we must shoot for, but we also need to know what we stand for."

Identifying, communicating, and shaping organizational values is more difficult than articulating a strategic vision because it relies less on analysis and logic and more on emotion and intuition. Moreover, although every well-established company operates on a set of beliefs and philosophies, they usually remain implicit. Some companies even repress them so as not to distract employees from the business agenda or offend people who have other views. Financial objectives are popular performance measures in part because they are "safe"; people won't dispute them.

Companies that assert more boldly what they stand for typically attract and retain employees who identify with their values and become more deeply committed to the organization that embodies them. "In the end," observes Goran Lindahl, ABB's group executive vice president responsible for the company's power transmission and distribution business, "managers are loyal not to a particular boss or even to a company



but to a set of values they believe in and find satisfying."

Nowhere is this powerful alignment between company and employee beliefs more evident than in The Body Shop, the U.K.-based beauty products retailer. Founder Anita Roddick has articulated a strong, clear business philosophy, which she acknowledges is "quirky." Nonetheless, the values she has created have attracted a group of employees (and a following of customers) who identify with the organization's commitment to environmental causes and with its belief that companies can be agents of social change. As Roddick describes her approach, "Most businesses focus all the time on profits, profits, profits. I think that is deeply boring. I want to create an electricity and passion that bonds people to the company. Especially with young people, you have to find ways to grab their imagination. You want them to feel they are doing something important. I'd never get that kind of motivation if we were just selling shampoo and body lotion."

Social altruism isn't the only way to give employees a strong emotional link to their companies. Ask the managers at Lincoln Electric how their little company has outlasted giants like Westinghouse and Airco to dominate the fiercely competitive welding equipment and supplies businesses. Lincoln Electric managers attribute most of the company's success to a philosophy that has allowed them to develop the industry's most productive workforce. Founded on a strong belief in the power of unfettered capitalism, the company is driven by a highly leveraged incentive program that retains many of the characteristics of a nineteenth-century piecework system. The program has survived because the company attracts employees who identify strongly with Lincoln's unshakable belief in individual accountability and the power of pure meritocracy.

For companies that have been less clear and consistent about what they stand for, the challenge is difficult but still achievable. Drawing again on the experiences in our study, we discerned three lessons for top management. First, build the new philosophy around the company's existing value and belief system. Second, maintain a high level of personal involvement in this activity over many years. And third, translate broad philosophical objectives into visible and measurable goals.

Build on Core Values.

Today it is a truism that a company's culture—the values it embodies—influences the decisions and choices of its managers. As a result, some CEOs are using the same didactic methods to change their companies' values that they once reserved for driving down profit objectives. Moreover, they try to impose these new value sets almost as often as they used to revise budget targets. The result is an organizational cynicism that brushes off any new initiative as the "culture of the month."

New values cannot be instilled through a crash program, nor should existing belief systems be chucked or subverted without careful consideration of the effect on the relationship between the organization and its members. In fact, the goal for most companies should be to build on the strengths and modify the limitations of the existing set of values, not to make radical changes in values. And where value confrontation is essential, it requires careful attention, not a broadside attack.

Consider Corning. When Jamie Houghton assumed its leadership in 1983, Corning was experiencing difficult times. A major restructuring had reduced its worldwide payroll from 45,000 to 30,000. Its core businesses, mostly in mature segments, were under attack by foreign competition. To make matters worse, global recession seemed to guarantee that Corning's long-term decline in financial performance would continue. Within the company, a sense of drift and a lack of confidence were eroding the family-like atmosphere that had long bonded employees to Corning.

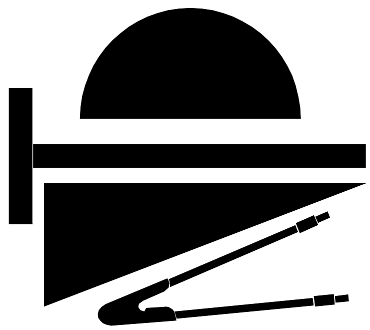
Houghton knew he had to eliminate the paternalism that had sustained a country-club culture at Corning for years. But he also understood that much in the company's existing but largely implicit value system—respect for the individual and a commitment to integrity, for example—were important and worthwhile. He wanted to highlight those values and sharpen their focus.

Houghton also wanted to add other values that he believed would be important to Corning's future self-identity. So he began to talk about the importance of corporate leadership and performance accountability, not only because they were crucial in the emerging competitive environment but also because they reflected the belief system of a new generation of Corning employees whom he wanted to attract. Gradually, Houghton overlaid these new values on the old.

Sow the Message.

Planting new values takes more than inspiring speeches. At best, the speeches can only confirm the message sent by senior executives' daily actions. Management is the message; speeches only call attention to it.

Houghton set himself the task of visiting ten different corporate facilities each quarter to "talk, listen, and feel the atmosphere." During these visits, he reiterated Corning's new values and told stories that reflected their impact. This was no mere jawboning, however. Houghton translated abstract statements into action to make them real and relevant to all members of the organization. For example, to signal that he was serious about performance accountability, he terminated any budget presentation that did not meet corporate targets. Furthermore, he incorporated broad idealistic values into action programs—for example, one to break the company's glass ceiling for women, minorities, and non-U.S. nationals. Finally, he made sure that the company's business strategies were consistent with its core values. He divested or spun off businesses that did not match the company's professed iden-



tity as a market and technology leader.

Measure Progress.

Despite their best efforts, many companies find that strategic and operating imperatives block or erode the values they strive to build. The reason is that such goals and objectives are inevitably quantified, whereas value statements usually offer neither clearly defined goals nor satisfactory methods for gauging their accomplishment. Unavoidably, the hard drives out the soft, and commitment to the desired values dissipates.

Like many companies, Corning had long allowed financial targets to dominate its objectives and thus had calibrated its performance in terms of growth, profitability, and ROI. Houghton realized that Corning needed an equally compelling way of tracking progress toward attaining its new culture.

In describing what he wanted Corning to become, Houghton repeatedly used the words "a world-class company." To ensure that this was not just empty rhetoric, he established a corporate objective: by the mid-1990s, Corning would be broadly and publicly recognized as among the world's most respected companies—by, for instance, its inclusion in the annual Fortune CEO poll of "America's most admired corporations." This standard included outstanding financial results but also encompassed superior performance on dimensions such as quality, innovation, and corporate responsibility. Equally important, employees could identify with the standard and take pride in achieving it.

Giving Meaning to Employees' Work.

In the end, every individual extracts the most basic sense of purpose from the personal fulfillment he or she derives from being part of an organization. Creating that sense of fulfillment is the third challenge senior managers face as they strive to develop an energizing corporate purpose. Institutions like churches, communities, even families, which once provided individuals with identity, affiliation, meaning, and support, are eroding. The workplace is becoming a primary means for personal fulfillment. Managers need to recognize and respond to the reality that their employees don't just want to work for a company; they want to belong to an organization. More than just providing work, companies can help give meaning to people's lives.

To realize the value of a committed employee, an organization must bring its big ideas and bold initiatives down to a personal level. Senior managers must establish and maintain a link between the company and each of its employees. This is not to say that North American companies must shift from their characteristic impersonal contracts to the Japanese model of lifetime employment. But a link does imply a mutual commitment, in which the employer treats the employee not as a cost to be controlled but as an asset to be developed.

Employees for their part commit not only their time but also their emotional energy to making their company as effective and competitive as they can. In short, the objective is to change the relationship from one in which employees feel they work for a company to one in which they recognize they belong to an organization. It is the difference between hiring out as a mercenary and becoming a Marine.

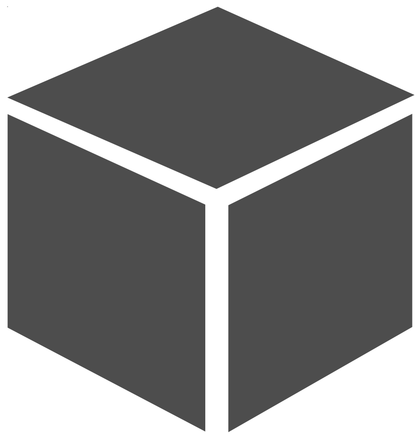
In the companies we studied that were best at achieving this new kind of relationship, top-level managers focused on three activities. They recognized employees' contributions and treated them like valuable assets. They committed to maximizing opportunities for personal growth and development. And they ensured that everyone not only understood how his or her role fit into the company's overall organizational purpose but also how he or she might contribute personally to achieving it.

Recognize Individual Accomplishments.

As companies grow larger and more complex, employees can come to feel more like cogs in a machine than members of a team. To retain some sense of humanity, companies may publish in-house newsletters, sponsor social functions, or implement a casual dress code. But the impact of such exercises is seldom significant or enduring. Indeed, their very existence emphasizes the awkwardness and impersonality of organizations that can respond to human needs only in mechanistic ways.

Further, while most senior managers understand the need to recognize and celebrate the major contributions of star performers, few realize the importance of acknowledging the ongoing efforts of those who sustain the organization. IKEA, the world's largest home furnishings manufacturer and retailer, is an exception. Even after the company had grown to almost 50,000 employees in 20 countries, founder Ingvar Kamprad still tried to visit each of the chain's 75 outlets and meet every employee. He would often invite a store's employees to stay after closing for dinner at the in-house restaurant. It was a ritual that frontline associates would go to the buffet first, then managers, and last Kamprad. He would circulate and offer praise, encouragement, and advice to the people who worked for him.

Personal recognition must reflect genuine respect. People on the front lines are quick to recognize empty public relations gestures or attempts at manipulation. Andy Grove built an enormous reservoir of



credibility and goodwill when he took extraordinary measures to retain employees during the memory-products bloodbaths of the mid-1980s. Grove tried to retain as many of the people as possible who had built this business for Intel, recognizing them as genuine company assets. To avoid layoffs, he first chose to sell a 20% interest in Intel to IBM in order to finance the company through its crisis. Next, he implemented the "125% solution" by asking employees to work ten hours more a week without compensation. Then followed the "90% solution," a 10% across-the-board pay cut to minimize separations. Only after that did Grove resort to layoffs in the face of a $200 million loss.

Through actions such as these, born of genuine respect and concern for individual employees, senior managers develop the basis for mutual commitment. They can then build on this foundation by demonstrating equal concern for the growth and development of all the organization's members.

Commit to Developing Employees. As companies have delayered, restructured, and downsized, employees who were already feeling distanced and detached have become more disillusioned and even cynical. Too often, layoffs have been the aftermath of grand corporate visions that promised personal opportunities. Companies tout the "partnerships" they have with their organization's members, then shower them with pink slips. It's not surprising that employees are unlikely to commit to new goals or values until they're convinced that the future holds new opportunities for them.

Top-level managers must take a broader view of employee training and development and make a much stronger commitment to it than they traditionally have. Instead of simply training employees for job skills, companies must develop their capacity for personal growth. In her colorful way, Anita Roddick explained The Body Shop's decision to establish an education center offering not only courses on company products, skin care, and customer service but also sessions on topics like sociology, AIDS, aging, and urban survival. "You can train dogs," says Roddick. "We wanted to educate our people and help them realize their full potential."

Poul Andreassen, CEO of Danish-based ISS, believes that one reason his commercial cleaning business has grown in $2 billion enterprise employing 114,000 people in 16 countries is his respect for workers, which he backs by investing in their development. Despite a strong philosophy of decentralization—headquarters has only 50 people—ISS still manages training centrally. Andreassen believes that training is key to transforming workers into professionals. Beyond teaching his employees basic job skills, he uses training as "a demonstration of caring" that motivates, bonds, and gives people confidence. For cleaning-team supervisors, for example, a five-stage training program covers basic skills and broader topics such as financial knowledge, interpersonal skills, problem solving, and customer relations. These people, once regarded as little more than work-gang bosses, have grown to be effective team builders and new-business generators. ISS's labor turnover is 40% below the industry average, and its cleaning crews have become an important source of innovative practices and entrepreneurial ideas for the company.

Andersen Consulting views the development of its people as a goal in itself and makes no proprietary claims to the skills and knowledge it develops. Its recruiting brochure promises that "after training with us, you could work for anyone anywhere—or you could work for yourself." The result is an exceptionally well-trained and extremely loyal group of associates.

Foster Individual Initiative. In a few companies, individual effort and personal contribution still constitute the bedrock of organizational process. 3M is one. Since the 1920s, when the company's fortunes were turned around by the development of waterproof sandpaper and adhesive tape, 3M management has valued the enormous potential of the entrepreneurs in its midst. Management developed a culture that recognizes individual initiative as the source of the company's growth, and it confirmed and institutionalized that strongly held belief through its policies and procedures.

For example, the "15% rule" allows employees to spend up to 15% of their time on bootleg projects that they believe have potential for the company. As bootlegged innovations developed into major businesses, company folklore became filled with stories of entrepreneurial heroes whose impact was direct and tangible. Through the stories and its organizational infrastructure, 3M keeps alive the highly motivating belief that individual effort is important and has real impact on the company's performance.

Likewise at Kao, the Tokyo-based branded packaged-goods company, CEO Yoshio Maruta has developed an organizational culture and management philosophy that rejects authoritarianism and fosters individual initiative in a variety of ways. First, the company shares information openly; everyone can know what anyone can know and can use the information to do his or her job more effectively. Further, Kao's internal environment encourages cooperation, and the twin tasks of teaching and learning are ingrained as a major responsibility of every employee.

Finally, the decision-making process is open and transparent—literally, in open-space areas—so that those with relevant knowledge and expertise are embraced by the process, not locked out of it. By translating his philosophy into norms and practices, Maruta built an organizational environment in which employees right down to the front line know that they are connected with and are contributing to overall corporate goals.

From Economic Entity to Social Institution.

A fundamental philosophical difference separates senior executives who see themselves as designers of corporate strategy from those who define their task more

broadly as shaping institutional purpose. Strategy makers view the companies they head as profit-maximizing entities with a narrowly defined role in a large and complex social environment. In their view, companies are simply agents of economic exchange in a broader marketplace. They are dependents of their shareholders, customers, employees, and larger communities, and the purpose of strategy is to manage these often conflicting dependencies for the maximum benefit of the company they serve.

This minimalist, passive, and self-serving definition grossly understates reality. Corporations are one of the most, if not the most, important institutions of modern society. A company today is more than just a business. As important repositories of resources and knowledge, companies shoulder a huge responsibility for generating wealth by continuously improving their productivity and competitiveness. Furthermore, their responsibility for defining, creating, and distributing value makes corporations one of society's principal agents of social change. At the micro level, companies are important forums for social interaction and personal fulfillment.

Purpose is the embodiment of an organization's recognition that its relationships with its diverse stakeholders are interdependent. In short, purpose is the statement of a company's moral response to its broadly defined responsibilities, not an amoral plan for exploiting commercial opportunity.

The three aspects of top management's task in building a sense of purpose are mutually interdependent and collectively reinforcing. If corporate ambition begins to focus on the company's narrow self-interest, it eventually loses the excitement, support, and commitment that emerge when objectives are linked to broader human aspirations. When organizational values become merely self-serving, companies quickly lose the sense of identification and pride that makes them attractive not only to employees but also to customers and others. And when management's respect for and attention to its employees' ideas and inputs is diluted, motivation and commitment fade.

Purpose—not strategy—is the reason an organization exists. Its definition and articulation must be top management's first responsibility.

From Strategic Intent to Corporate Purpose: The Remaking of Komatsu.

When he succeeded his father as Komatsu's president in 1964, Ryoichi Kawai articulated an objective that the company would pursue for more than 20 years. Komatsu's strategic intent, Kawai announced, was to "catch up with and surpass Caterpillar."

The management approach Kawai adopted to pursue this goal became a well-studied and widely emulated model in the

West. Each year, Kawai would define a clear and specific operating priority—for example, improving quality, reducing costs, or expanding exports—that used Caterpillar's performance as a standard and cited Caterpillar itself as the competitive target. Then each year's priority would be translated into detailed action plans through PDCA (plan, do, check, act), Komatsu's tightly controlled management system.

Kawai's strategy worked well, and by 1982, when he was choosing his successor, Komatsu had grown from a tiny local competitor with poor product quality to Cat's most serious global challenger in the construction equipment market. But the market was about to change. By 1989, when Tetsuya Katada became the third resident to follow Kawai, worldwide demand for construction equipment was down, competition was up, and Komatsu's profits were in steady decline.

As Katada saw the situation, Komatsu's management had become so obsessed with catching Caterpillar that it had stopped thinking about strategic choices. For instance, its product development efforts were biased toward Cat's high-end bulldozers rather than toward smaller, lower-priced products like hydraulic excavators, for which market demand was growing. Katada worried that Komatsu's top management had stopped questioning the business the company was in. Further, he was concerned that the inflexible, top-down style that had become embedded at Komatsu had crushed "the spirit of enterprise" among middle and frontline managers.

Managers, Katada decided, "can no longer operate within the confines of a defined objective. They need to go out and see the needs and opportunities and operate in a creative and innovative way, always encouraging initiative from below." In other words, he told the company, "I want everyone to stop concentrating simply on catching up with Caterpillar."

At meetings and discussions, Katada challenged managers at several levels to find ways for the company to double its sales by the mid-1990s. What emerged from these and subsequent discussions was a new definition of the company. Rather than thinking of Komatsu as a construction equipment company trying to catch Cat, management began to describe it as a "total technology enterprise" with an opportunity to leverage its existing resources and expertise in electronics, robotics, and plastics.

Under a new banner of "Growth, Global, Groupwide" (the Three Gs), Katada encouraged management at all levels to find new growth opportunities through expanding geographically and leveraging competences. He appointed a Committee for the 1990s to determine how Komatsu could enrich its corporate philosophy, broaden its social contributions, and revitalize its human resources. His objective was to create an organization that could attract and stimulate the best people. "Compared with our old objective," Katado acknowledged, "the Three Gs slogan may seem abstract, but it was this abstract nature that stimulated people to ask what they could do and respond creatively."

More than a strategy, Komatsu now had a corporate purpose, to which its managers could commit and in which they had a voice. In the first three years after Katada articulated the Three Gs, Komatsu's sales, which had been declining since 1982, perked up. That surge was driven almost entirely by a 40% growth in Komatsu's nonconstruction equipment business.

Managing for Organizational Integrity

Paine, Lynn Sharp - Harvard Univ. Graduate School of Business Administration

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Many managers think of ethics as a question of personal scruples, a confidential matter between individuals and their consciences. These executives are quick to describe any wrongdoing as an isolated incident, the work of a rogue employee. The thought that the company could bear any responsibility for an individual's misdeeds never enters their minds. Ethics, after all, has nothing to do with management.

In fact, ethics has everything to do with management. Rarely do the character flaws of a lone actor fully explain corporate misconduct. More typically, unethical business practice involves the tacit, if not explicit, cooperation of others and reflects the values, attitudes, beliefs, language, and behavioral patterns that define an organization's operating culture. Ethics, then, is as much an organizational as a personal issue. Managers who fail to provide proper leadership and to institute systems that facilitate ethical conduct share responsibility with those who conceive, execute, and knowingly benefit from corporate misdeeds.

Managers must acknowledge their role in shaping organizational ethics and seize this opportunity to create a climate that can strengthen the relationships and reputations on which their companies' success depends.

Executives who ignore ethics run the risk of personal and corporate liability in today's increasingly tough legal environment. In addition, they deprive their organizations of the benefits available under new federal guidelines for sentencing organizations convicted of wrongdoing. These sentencing guidelines recognize for the first time the organizational and managerial roots of unlawful conduct and base fines partly on the extent to which companies have taken steps to prevent that misconduct.

Prompted by the prospect of leniency, many companies are rushing to implement compliance-based ethics programs. Designed by corporate counsel, the goal of these programs is to prevent, detect, and punish legal violations. But organizational ethics means more than avoiding illegal practice; and providing employees with a rule book will do little to address the problems underlying unlawful conduct. To foster a climate that encourages exemplary behavior, corporations need a comprehensive approach that goes beyond the often punitive legal compliance stance.

An integrity-based approach to ethics management combines a concern for the law with an emphasis on managerial responsibility for ethical behavior. Though integrity strategies may vary in design and scope, all strive to define companies' guiding values, aspirations, and patterns of thought and conduct. When integrated into the day-to-day operations of an organization, such strategies can help prevent damaging ethical lapses while tapping into powerful human impulses for moral thought and action. Then an ethical framework becomes no longer a burdensome constraint within which companies must operate, but the governing ethos of an organization.

How Organizations Shape Individuals' Behavior.

The once familiar picture of ethics as individualistic, unchanging, and impervious to organizational influences has not stood up to scrutiny in recent years. Sears Auto Centers' and Beech-Nut Nutrition Corporation's experiences illustrate the role organizations play in shaping individuals' behavior—and how even sound moral fiber can fray when stretched too thin.

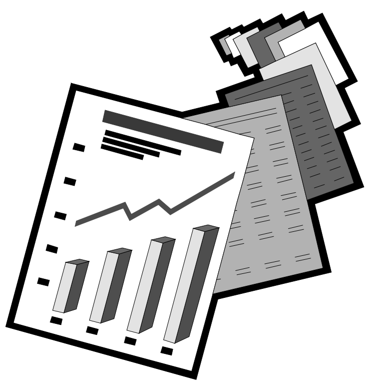
In 1992, Sears, Roebuck & Company was inundated with complaints about its automotive service business. Consumers and attorneys general in more than 40 states had accused the company of misleading customers and selling them unnecessary parts and services, from brake jobs to front-end alignments. It would be a mistake, however, to see this situation exclusively in terms of any one individual's moral failings. Nor did management set out to defraud Sears customers. Instead, a number of organizational factors contributed to the problematic sales practices.

In the face of declining revenues, shrinking market share, and an increasingly competitive market for undercar services, Sears management attempted to spur the performance of its auto centers by introducing new goals and incentives for employees. The company increased minimum work quotas and introduced productivity incentives for mechanics. The automotive service advisers were given product-specific sales quotas—sell so many springs, shock absorbers, alignments, or brake jobs per shift—and paid a commission based on sales. According to advisers, failure to meet quotas could lead to a transfer or a reduction in work hours. Some employees spoke of the "pressure, pressure, pressure" to bring in sales.

Under this new set of organizational pressures and incentives, with few options for meeting their sales goals legitimately, some employees' judgment understandably suffered. Management's failure to clarify the line between unnecessary service and legitimate preventive maintenance, coupled with consumer ignorance, left employees to chart their own courses through a vast gray area, subject to a wide range of interpretations. Without active management support for ethical practice and mechanisms to detect and check questionable sales methods and poor work, it is not surprising that some employees may have reacted to contextual forces by resorting to exaggeration, carelessness, or even misrepresentation.

Shortly after the allegations against Sears became public, CEO Edward Brennan acknowledged management's responsibility for putting in place compensation and goal-setting systems that "created an environment in which mistakes did occur." Although the company denied any intent to deceive consumers, senior executives eliminated commissions for service advisers and discontinued sales quotas for specific parts. They also instituted a system of unannounced shopping audits and made plans to expand the internal monitoring of service. In settling the pending lawsuits, Sears offered coupons to customers who had bought certain auto services between 1990 and 1992. The total cost of the settlement, including potential customer refunds, was an estimated $60 million.

Contextual forces can also influence the behavior of top management, as a former CEO of Beech-Nut Nutrition Corporation discovered. In the early 1980s, only two years after joining the company,



the CEO found evidence suggesting that the apple juice concentrate, supplied by the company's vendors for use in Beech-Nut's "100% pure" apple juice, contained nothing more than sugar water and chemicals. The CEO could have destroyed the bogus inventory and withdrawn the juice from grocers' shelves, but he was under extraordinary pressure to turn the ailing company around. Eliminating the inventory would have killed any hope of turning even the meager $700,000 profit promised to Beech-Nut's then parent, Nestle .

A number of people in the corporation, it turned out, had doubted the purity of the juice for several years before the CEO arrived. But the 25% price advantage offered by the supplier of the bogus concentrate allowed the operations head to meet cost-control goals. Furthermore, the company lacked an effective quality control system, and a conclusive lab test for juice purity did not yet exist. When a member of the research department voiced concerns about the juice to operating management, he was accused of not being a team player and of acting like "Chicken Little." His judgment, his supervisor wrote in an annual performance review, was "colored by na vet and impractical ideals." No one else seemed to have considered the company's obligations to its customers or to have thought about the potential harm of disclosure. No one considered the fact that the sale of adulterated or misbranded juice is a legal offense, putting the company and its top management at risk of criminal liability.

An FDA investigation taught Beech-Nut the hard way. In 1987, the company pleaded guilty to selling adulterated and misbranded juice. Two years and two criminal trials later, the CEO pleaded guilty to ten counts of mislabeling. The total cost to the company—including fines, legal expenses, and lost sales—was an estimated $25 million.

Such errors of judgment rarely reflect an organizational culture and management philosophy that sets out to harm or deceive. More often, they reveal a culture that is insensitive or indifferent to ethical considerations or one that lacks effective organizational systems. By the same token, exemplary conduct usually reflects an organizational culture and philosophy that is infused with a sense of responsibility.

For example, Johnson & Johnson's handling of the Tylenol crisis is sometimes attributed to the singular personality of then-CEO James Burke. However, the decision to do a nationwide recall of Tylenol capsules in order to avoid further loss of life from product tampering was in reality not one decision but thousands of decisions made by individuals at all levels of the organization. The "Tylenol decision," then, is best understood not as an isolated incident, the achievement of a lone individual, but as the reflection of an organization's culture. Without a shared set of values and guiding principles deeply ingrained throughout the organization, it is doubtful that Johnson & Johnson's response would have been as rapid, cohesive, and ethically sound.

Many people resist acknowledging the influence of organizational factors on individual behavior—especially on misconduct—for fear of diluting people's sense of personal moral responsibility. But this fear is based on a false dichotomy between holding individual transgressors accountable and holding "the system" accountable. Acknowledging the importance of organizational context need not imply exculpating individual wrongdoers. To understand all is not to forgive all.

The Limits of a Legal Compliance Program.

The consequences of an ethical lapse can be serious and far-reaching. Organizations can quickly become ntangled in an all-consuming web of legal proceedings. The risk of litigation and liability has increased in the past decade as lawmakers have legislated new civil and criminal offenses, stepped up penalties, and improved support for law enforcement. Equally—if not more—important is the damage an ethical lapse can do to an organization's reputation and relationships. Both Sears and Beech-Nut, for instance, struggled to regain consumer trust and market share long after legal proceedings had ended.

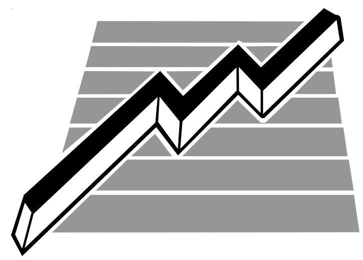
As more managers have become alerted to the importance of organizational ethics, many have asked their lawyers to develop corporate ethics programs to detect and prevent violations of the law. The 1991 Federal Sentencing Guidelines offer a compelling rationale. Sanctions such as fines and probation for organizations convicted of wrongdoing can vary dramatically depending both on the degree of management cooperation in reporting and investigating corporate misdeeds and on whether or not the company has implemented a legal compliance program. (See the insert "Corporate Fines Under the Federal Sentencing Guidelines.")

Such programs tend to emphasize the prevention of unlawful conduct, primarily by increasing surveillance and control and by imposing penalties for wrongdoers. While plans vary, the basic framework is outlined in the sentencing guidelines. Managers must establish compliance standards and procedures; designate high-level personnel to oversee compliance; avoid delegating discretionary authority to those likely to act unlawfully; effectively communicate the company's standards and procedures through training or publications; take reasonable steps to achieve compliance through audits, monitoring processes, and a system for employees to report criminal misconduct without fear of retribution; consistently enforce standards through appropriate disciplinary measures; respond appropriately when offenses are detected; and, finally, take reasonable steps to prevent the occurrence of similar offenses in the future.

There is no question of the necessity of a sound, well-articulated strategy for legal compliance in an organization. After all, employees can be frustrated and frightened by the complexity of today's legal environment. And even managers who claim to use the law as a guide to ethical behavior often lack more than a rudimentary understanding of complex legal issues.

Managers would be mistaken, however, to regard legal compliance as an adequate means for addressing the full range of ethical issues that arise every day. "If it's legal, it's ethical," is a frequently heard slogan. But conduct that is lawful may be highly problematic from an ethical point of view. Consider the sale in some countries of hazardous products without appropriate warnings or the purchase of goods from suppliers who operate inhumane sweatshops in developing countries. Companies engaged in international business often discover that conduct that infringes on recognized standards of human rights and decency is legally permissible in some jurisdictions.

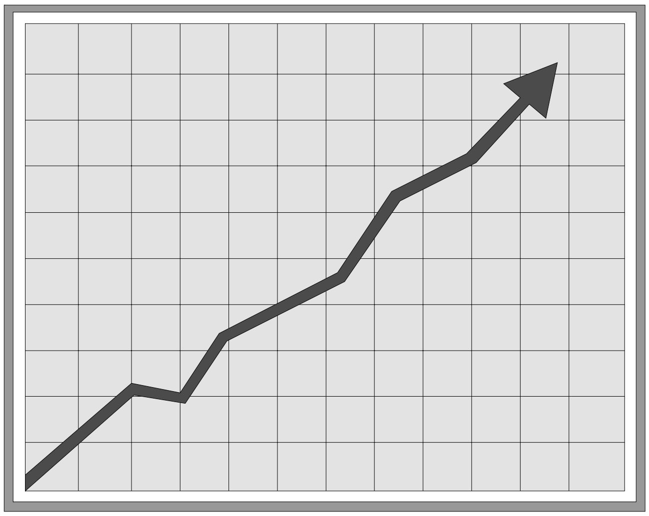
Legal clearance does not certify the absence of ethical problems in the United States either, as a 1991 case at Salomon Brothers illustrates. Four top-level executives failed to take appropriate action when learning of unlawful activities on the government trading desk. Company lawyers found no law obligating the executives to disclose the improprieties. Nevertheless, the executives' delay in disclosing and failure to reveal their prior knowledge prompted a serious crisis of confidence among employees, creditors, shareholders, and customers. The executives were forced to



resign, having lost the moral authority to lead. Their ethical lapse compounded the trading desk's legal offenses, and the company ended up suffering losses—including legal costs, increased funding costs, and lost business—estimated at nearly $1 billion.

A compliance approach to ethics also overemphasizes the threat of detection and punishment in order to channel behavior in lawful directions. The underlying model for this approach is deterrence theory, which envisions people as rational maximizers of self-interest, responsive to the personal costs and benefits of their choices, yet indifferent to the moral legitimacy of those choices. But a recent study reported in Why People Obey the Law by Tom R. Tyler shows that obedience to the law is strongly influenced by a belief in its legitimacy and its moral correctness. People generally feel that they have a strong obligation to obey the law. Education about the legal standards and a supportive environment may be all that's required to insure compliance.

Discipline is, of course, a necessary part of any ethical system. Justified penalties for the infringement of legitimate norms are fair and appropriate. Some people do need the threat of sanctions. However, an overemphasis on potential sanctions can be superfluous and even counterproductive. Employees may rebel against programs that stress penalties, particularly if they are designed and imposed without employee involvement or if the standards are vague or unrealistic. Management may talk of mutual trust when unveiling a compliance plan, but employees often receive the message as a warning from on high. Indeed, the more skeptical among them may view compliance programs as nothing more than liability insurance for senior management. This is not an unreasonable conclusion, considering that compliance programs rarely address the root causes of misconduct.



Even in the best cases, legal compliance is unlikely to unleash much moral imagination or commitment. The law does not generally seek to inspire human excellence or distinction. It is no guide for exemplary behavior—or even good practice. Those managers who define ethics as legal compliance are implicitly endorsing a code of moral mediocrity for their organizations. As Richard Breeden, former chairman of the Securities and Exchange Commission, noted, "It is not an adequate ethical standard to aspire to get through the day without being indicted."

Integrity as a Governing Ethic.

A strategy based on integrity holds organizations to a more robust standard. While compliance is rooted in avoiding legal sanctions, organizational integrity is based on the concept of self-governance in accordance with a set of guiding principles. From the perspective of integrity, the task of ethics management is to define and give life to an organization's guiding values, to create an environment that supports ethically sound behavior, and to instill a sense of shared accountability among employees. The need to obey the law is viewed as a positive aspect of organizational life, rather than an unwelcome constraint imposed by external authorities.

An integrity strategy is characterized by a conception of ethics as a driving force of an enterprise. Ethical values shape the search for opportunities, the design of organizational systems, and the decision-making process used by individuals and groups. They provide a common frame of reference and serve as a unifying force across different functions, lines of business, and employee groups. Organizational ethics helps define what a company is and what it stands for.

Many integrity initiatives have structural features common to compliance-based initiatives: a code of conduct, training in relevant areas of law, mechanisms for reporting and investigating potential misconduct, and audits and controls to insure that laws and company standards are being met. In addition, if suitably designed, an integrity-based initiative can establish a foundation for seeking the legal benefits that are available under the sentencing guidelines should criminal wrongdoing occur. (See the insert "The Hallmarks of an Effective Integrity Strategy.")

But an integrity strategy is broader, deeper, and more demanding than a legal compliance initiative. Broader in that it seeks to enable responsible conduct. Deeper in that it cuts to the ethos and operating systems of the organization and its members, their guiding values and patterns of thought and action. And more demanding in that it requires an active effort to define the responsibilities and aspirations that constitute an organization's ethical compass. Above all, organizational ethics is seen as the work of management. Corporate counsel may play a role in the design and implementation of integrity strategies, but managers at all levels and across all functions are involved in the process. (See the chart, "Strategies for Ethics Management.")

During the past decade, a number of companies have undertaken integrity initiatives. They vary according to the ethical values focused on and the implementation approaches used. Some companies focus on the core values of integrity that reflect basic social obligations, such as respect for the rights of others, honesty, fair dealing, and obedience to the law. Other companies emphasize aspirations—values that are ethically desirable but not necessarily morally obligatory—such as good service to customers, a commitment to diversity, and involvement in the community.

When it comes to implementation, some companies begin with behavior. Following Aristotle's view that one becomes courageous by acting as a courageous person, such companies develop codes of conduct specifying appropriate behavior, along with a system of incentives, audits, and controls. Other companies focus less on specific actions and more on developing attitudes, decision-making processes, and ways of thinking that reflect their values. The assumption is that personal commitment and appropriate decision processes will lead to right action.

Martin Marietta, NovaCare, and Wetherill Associates have implemented and lived with quite different integrity strategies. In each case, management has found that the initiative has made important and often unexpected contributions to competitiveness, work environment, and key relationships on which the company depends.

Martin Marietta: Emphasizing Core Values.

Martin Marietta Corporation, the U.S. aerospace and defense contractor, opted for an integrity-based ethics program in 1985. At the time, the defense industry was under attack for fraud and mismanagement, and Martin Marietta was under investigation for improper travel billings. Managers knew they needed a better form of self-governance but were skeptical that an ethics program could influence behavior. "Back then people asked, 'Do you really need an ethics program to be ethical?'" recalls current President Thomas Young. "Ethics was something personal. Either you had it, or you didn't."

The corporate general counsel played a pivotal role in promoting the program, and legal compliance was a critical objective. But it was conceived of and implemented from the start as a company-wide management initiative aimed at creating and maintaining a "do-it-right" climate. In its original conception, the program emphasized core values, such as honesty and fair play. Over time, it expanded to encompass quality and environmental responsibility as well.

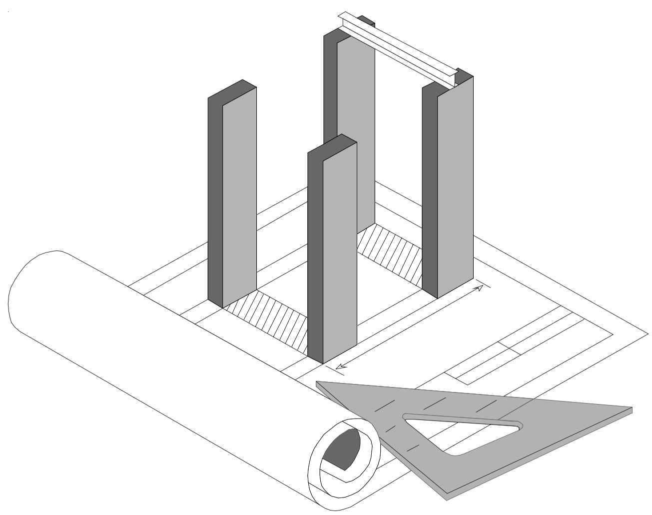
Today the initiative consists of a code of conduct, an ethics training program, and procedures for reporting and investigating ethical concerns within the company. It also includes a system for disclosing violations of federal procurement law to the government. A corporate ethics office manages the program, and ethics representatives are stationed at major facilities. An ethics steering committee, made up of Martin Marietta's president, senior executives, and two rotating members selected from field operations, oversees the ethics office. The audit and ethics committee of the board of directors oversees the steering committee.

The ethics office is responsible for responding to questions and concerns from the company's employees. Its network of representatives serves as a sounding board, a source of guidance, and a channel for raising a range of issues, from allegations of wrongdoing to complaints about poor management, unfair supervision, and company policies and practices. Martin Marietta's ethics network, which accepts anonymous complaints, logged over 9,000 calls in 1991, when the company had about 60,000 employees. In 1992, it investigated 684 cases. The ethics office also works closely with the human resources, legal, audit, communications, and security functions to respond to employee concerns.

Shortly after establishing the program, the company began its first round of ethics training for the entire workforce, starting with the CEO and senior executives. Now in its third round, training for senior executives focuses on decision making, the challenges of balancing multiple responsibilities, and compliance with laws and regulations critical to the company. The incentive compensation plan for executives makes responsibility for promoting ethical conduct an explicit requirement for reward eligibility and requires that business and personal goals be achieved in accordance with the company's policy on ethics. Ethical conduct and support for the ethics program are also criteria in regular performance reviews.

Today top-level managers say the ethics program has helped the company avoid serious problems and become more responsive to its more than 90,000 employees. The ethics network, which tracks the number and types of cases and complaints, has served as an early warning system for poor management, quality and safety defects, racial and gender discrimination, environmental concerns, inaccurate and false records, and personnel grievances regarding salaries, promotions, and layoffs. By providing an alternative channel for raising such concerns, Martin Marietta is able to take corrective action more quickly and with a lot less pain. In many cases, potentially embarrassing problems have been identified and dealt with before becoming a management crisis, a lawsuit, or a criminal investigation. Among employees who brought complaints in 1993, 75% were satisfied with the results.

Company executives are also convinced that the program has helped reduce the incidence of misconduct. When allegations of misconduct do surface, the company says it deals with them more openly. On several occasions, for instance, Martin Marietta has voluntarily disclosed and made restitution to the government for misconduct involving potential violations of federal procurement laws. In addition, when an employee alleged that the company had retaliated against him for voicing safety concerns about his plant on CBS news, top management commissioned an investigation by an outside law firm. Although failing to support the allegations, the investigation found that employees at the plant feared retaliation when raising health, safety, or environmental complaints. The company redoubled its efforts to identify and discipline those employees taking retaliatory action and stressed the desirability of an open work environment in its ethics training and company communications.



Although the ethics program helps

Martin Marietta avoid certain types of litigation, it has occasionally led to other kinds of legal action. In a few cases, employees dismissed for violating the code of ethics sued Martin Marietta, arguing that the company had violated its own code by imposing unfair and excessive discipline.

Still, the company believes that its attention to ethics has been worth it. The ethics program has led to better relationships with the government, as well as to new business opportunities. Along with prices and technology, Martin Marietta's record of integrity, quality, and reliability of estimates plays a role in the awarding of defense contracts, which account for some 75% of the company's revenues. Executives believe that the reputation they've earned through their ethics program has helped them build trust with government auditors, as well. By opening up communications, the company has reduced the time spent on redundant audits.

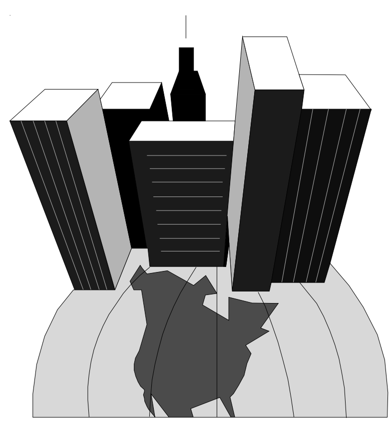
The program has also helped change employees' perceptions and priorities. Some managers compare their new ways of thinking about ethics to the way they understand quality. They consider more carefully how situations will be perceived by others, the possible long-term consequences of short-term thinking, and the need for continuous improvement. CEO Norman Augustine notes, "Ten years ago, people would have said that there were no ethical issues in business. Today employees think their number-one objective is to be thought of as decent people doing quality work."

NovaCare: Building Shared Aspirations.

NovaCare Inc., one of the largest providers of rehabilitation services to nursing homes and hospitals in the United States, has oriented its ethics effort toward building a common core of shared aspirations. But in 1988, when the company was called InSpeech, the only sentiment shared was mutual mistrust.

Senior executives built the company from a series of aggressive acquisitions over a brief period of time to take advantage of the expanding market for therapeutic services. However, in 1988, the viability of the company was in question. Turnover among its front-line employees—the clinicians and therapists who care for patients in nursing homes and hospitals—escalated to 57% per year. The company's inability to retain therapists caused customers to defect and the stock price to languish in an extended slump.

After months of soul-searching, InSpeech executives realized that the turnover rate was a symptom of a more basic problem: the lack of a common set of values and aspirations. There was, as one executive put it, a "huge disconnect" between the values of the therapists and clinicians and those of the managers who ran the company. The therapists and clinicians evaluated the company's success in terms of its delivery of high-quality health care. InSpeech management, led by executives with financial services and venture capital backgrounds, measured the company's worth exclusively in terms of financial success. Management's single-minded emphasis on increasing hours of reimbursable



care turned clinicians off. They took management's performance orientation for indifference to patient care and left the company in droves.

CEO John Foster recognized the need for a common frame of reference and a common language to unify the diverse groups. So he brought in consultants to conduct interviews and focus groups with the company's health care professionals, managers, and customers. Based on the results, an employee task force drafted a proposed vision statement for the company, and another 250 employees suggested revisions. Then Foster and several senior managers developed a succinct statement of the company's guiding purpose and fundamental beliefs that could be used as a framework for making decisions and setting goals, policies, and practices.

Unlike a code of conduct, which articulates specific behavioral standards, the statement of vision, purposes, and beliefs lays out in very simple terms the company's central purpose and core values. The purpose—meeting the rehabilitation needs of patients through clinical leadership—is supported by four key beliefs: respect for the individual, service to the customer, pursuit of excellence, and commitment to personal integrity. Each value is discussed with examples of how it is manifested in the day-to-day activities and policies of the company, such as how to measure the quality of care.

To support the newly defined values, the company changed its name to NovaCare and introduced a number of structural and operational changes. Field managers and clinicians were given greater decision-making authority; clinicians were provided with additional resources to assist in the delivery of effective therapy; and a new management structure integrated the various therapies offered by the company. The hiring of new corporate personnel with health care backgrounds reinforced the company's new clinical focus.

The introduction of the vision, purpose, and beliefs met with varied reactions from employees, ranging from cool skepticism to open enthusiasm. One employee remembered thinking the talk about values "much ado about nothing." Another recalled, "It was really wonderful. It gave us a goal that everyone aspired to, no matter what their place in the company." At first, some were baffled about how the vision, purpose, and beliefs were to be used. But, over time, managers became more adept at explaining and using them as a guide. When a customer tried to hire away a valued employee, for example, managers considered raiding the customer's company for employees. After reviewing the beliefs, the managers abandoned the idea.

NovaCare managers acknowledge and company surveys indicate that there is plenty of room for improvement. While the values are used as a firm reference point for decision making and evaluation in some areas of the company, they are still viewed with reservation in others. Some managers do not "walk the talk," employees complain. And recently acquired companies have yet to be fully integrated into the program. Nevertheless, many NovaCare employees say the values initiative played a critical role in the company's 1990 turnaround.

The values reorientation also helped the company deal with its most serious problem: turnover among health care providers. In 1990, the turnover rate stood at 32%, still above target but a significant improvement over the 1988 rate of 57%. By 1993, turnover had dropped to 27%. Moreover, recruiting new clinicians became easier. Barely able to hire 25 new clinicians each month in 1988, the company added 776 in 1990 and 2,546 in 1993. Indeed, one employee who left during the 1988 turmoil said that her decision to return in 1990 hinged on the company's adoption of the vision, purpose, and beliefs.

Wetherill Associates: Defining Right Action.

Wetherill Associates, Inc.—a small, privately held supplier of electrical parts to the automotive market—has neither a conventional code of conduct nor a statement of values. Instead, WAI has a Quality Assurance Manual—a combination of philosophy text, conduct guide, technical manual, and company profile—that describes the company's commitment to honesty and its guiding principle of right action.

WAI doesn't have a corporate ethics officer who reports to top management, because at WAI, the company's corporate ethics officer is top management. Marie Bothe, WAI's chief executive officer, sees her main function as keeping the 350-employee company on the path of right action and looking for opportunities to help the community. She delegates the "technical" aspects of the business—marketing, finance, personnel, operations—to other members of the organization.

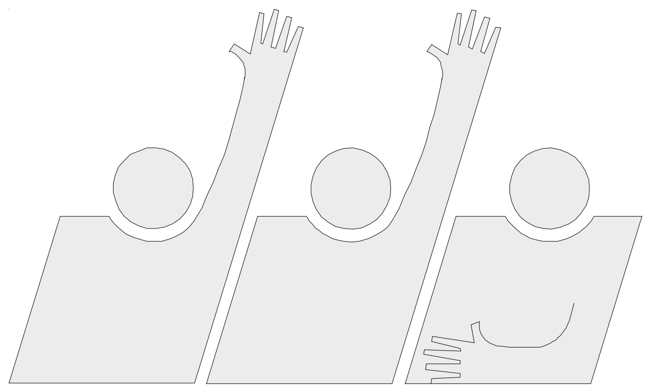
Right action, the basis for all of WAI's decisions, is a well-developed approach that challenges most conventional management thinking. The company explicitly rejects the usual conceptual boundaries that separate morality and self-interest. Instead, they define right behavior as logically, expediently, and morally right. Managers teach employees to look at the needs of the customers, suppliers, and the community—in addition to those of the company and its employees—when making decisions.

WAI also has a unique approach to competition. One employee explains, "We are not 'in competition' with anybody. We just do what we have to do to serve the customer." Indeed, when occasionally unable to fill orders, WAI salespeople refer customers to competitors. Artificial incentives, such as sales contests, are never used to spur individual performance. Nor are sales results used in determining compensation. Instead, the focus is on teamwork and customer service. Managers tell all new recruits that absolute honesty, mutual courtesy, and respect are standard operating procedure.

Newcomers generally react positively to company philosophy, but not all are prepared for such a radical departure from the practices they have known elsewhere. Recalling her initial interview, one recruit described her response to being told that lying was not allowed, "What do you mean? No lying? I'm a buyer. I lie for a living!" Today she is persuaded that the policy makes sound business sense. WAI s known for informing suppliers of overshipments as well as undershipments and for scrupulous honesty in the sale of parts, even when deception cannot be readily detected.

Since its entry into the distribution business 13 years ago, WAI has seen its revenues climb steadily from just under $1 million to nearly $98 million in 1993, and this in an industry with little growth. Once seen as an upstart beset by naysayers and industry skeptics, WAI is now credited with entering and professionalizing an industry in which kickbacks, bribes, and "gratuities" were commonplace. Employees—equal numbers of men and women ranging in age from 17 to 92—praise the work environment as both productive and supportive.

WAI's approach could be difficult to introduce in a larger, more traditional



organization. WAI is a small company founded by 34 people who shared a belief in right action; its ethical values were naturally built into the organization from the start. Those values are so deeply ingrained in the company's culture and operating systems that they have been largely self-sustaining. Still, the company has developed its own training program and takes special care to hire people willing to support right action. Ethics and job skills are considered equally important in determining an individual's competence and suitability for employment. For WAI, the challenge will be to sustain its vision as the company grows and taps into markets overseas.

At WAI, as at Martin Marietta and NovaCare, a management-led commitment to ethical values has contributed to competitiveness, positive workforce morale, as well as solid sustainable relationships with the company's key constituencies. In the end, creating a climate that encourages exemplary conduct may be the best way to discourage damaging misconduct. Only in such an environment do rogues really act alone.

Corporate Fines Under the Federal Sentencing Guidelines.

What size fine is a corporation likely to pay if convicted of a crime? It depends on a number of factors, some of which are beyond a CEO's control, such as the existence of a prior record of similar misconduct. But it also depends on more controllable factors. The most important of these are reporting and accepting responsibility for the crime, cooperating with authorities, and having an effective program in place to prevent and detect unlawful behavior.

The following example, based on a case studied by the United States Sentencing Commission, shows how the 1991 Federal Sentencing Guidelines have affected overall fine levels and how managers' actions influence organizational fines.

Acme Corporation was charged and convicted of mail fraud. The company systematically charged customers who damaged rented automobiles more than the actual cost of repairs. Acme also billed some customers for the cost of repairs to vehicles for which they were not responsible. Prior to the criminal adjudication, Acme paid \$13.7 million in restitution to the customers who had been overcharged.

Deciding before the enactment of the sentencing guidelines, the judge in the criminal case imposed a fine of \$6.85 million, roughly half the pecuniary loss suffered by Acme's customers. Under the sentencing guidelines, however, the results could have been dramatically different. Acme could have been fined anywhere from 5% to 200% the loss suffered by customers, depending on whether or not it had an effective program to prevent and detect violations of law and on whether or not it reported the crime, cooperated with authorities, and accepted responsibility for the unlawful conduct. If a high ranking official at Acme were found to have been involved, the maximum fine could have been as large as \$54,800,000 or four times the loss to Acme customers. The following chart shows a possible range of fines for each situation:

The Hallmarks of an Effective Integrity Strategy.

There is no one right integrity strategy. Factors such as management personality, company history, culture, lines of business, and industry regulations must be taken into account when shaping an appropriate set of values and designing an implementation program. Still, several features are common to efforts that have achieved some success:

The guiding values and commitments make sense and are clearly communicated. They reflect important organizational obligations and widely shared aspirations that appeal to the organization's members. Employees at all levels take them seriously, feel comfortable discussing them, and have a concrete understanding of their practical importance. This does not signal the absence of ambiguity and conflict but a willingness to seek solutions compatible with the framework of values.

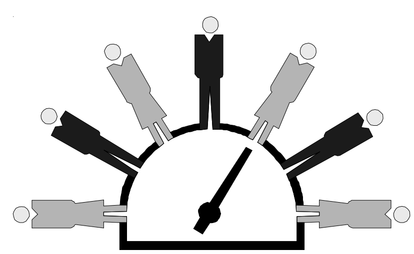
Company leaders are personally committed, credible, and willing to take action on the values they espouse. They are not mere mouthpieces. They are willing to scrutinize their own decisions. Consistency on the part of leadership is key. Waffling on values will lead to employee cynicism and a rejection of the program. At the same time, managers must assume responsibility for making tough calls when ethical obligations conflict.

The espoused values are integrated into the normal channels of management decision making and are reflected in the organization's critical activities: the development of plans, the setting of goals, the search for opportunities, the allocation of resources, the gathering and communication of information, the measurement of performance, and the promotion and advancement of personnel.

The company's systems and structures support and reinforce its values. Information systems, for example, are designed to provide timely and accurate information. Reporting relationships are structured to build in checks and balances to promote objective judgment. Performance appraisal is sensitive to means as well as ends.

Managers throughout the company have the decision-making skills, knowledge, and competencies needed to make ethically sound decisions on a day-to-day basis. Ethical thinking and awareness must be part of every managers' mental equipment. Ethics education is usually part of the process.

Success in creating a climate for responsible and ethically sound behavior requires continuing effort and a considerable investment of time and resources. A glossy code of conduct, a high-ranking ethics officer, a training program, an annual ethics audit—these trappings of an ethics program do not necessarily add up to a responsible, law-abiding organization whose espoused values match its actions. A formal ethics program can serve as a catalyst and a support system, but organizational integrity depends on the integration of the company's values into its driving systems.



QUANTUM
MANAGEMENT
SYSTEMS

Whatever Happened to the Take-Charge Manager?

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Many managers felt that the emergence of new managerial ideas during the 1980s signaled the rejuvenation of U.S. business. By readily adopting innovations such as total quality programs and self-managed teams, managers believed that they were demonstrating the kind of decisive leadership that kept companies competitive. But such thinking doesn't jibe with the facts. American managers did not take charge in the 1980s. Instead, they abdicated their responsibility to a burgeoning industry of management professionals.

The 1980s witnessed the spectacular rise of management schools, consultants, media, and gurus who fed on the insecurities of American managers fearful of foreign competition and economic decline. Mistrustful of their own judgment, many managers latched on to these self-appointed pundits, readily adopting their latest panaceas. Off-the-shelf programs addressing quality, customer satisfaction, time-to-market, strategic focus, core competencies, alliances, global competitiveness, organizational culture, and empowerment swept through U.S. corporations with alarming speed.

Adopting "new" ideas became a way for companies to signal to the world that they were progressive, that they had come to grips with their misguided pasts, and that they were committed to change. After all, the worst thing one could do was stick with the status quo.

For some businesses, the new ideas worked. They enabled companies to stem decline and challenge their foreign competitors. But in the majority of cases, research shows, the management fads of the last 15 years rarely produced the promised results.

Between 1980 and 1990, market share in most key U.S. industries declined as much as or more than it had between 1970 and 1980. Recent surveys at the Harvard Business School, McKinsey & Company, and Ernst & Young and the American Quality Foundation suggest that managers themselves are dissatisfied with the new management programs. In a study we conducted in 1993 at the Harvard Business School, we polled managers at nearly 100 companies on more than 21 different programs and found 75% of them to be unhappy with the results in their organizations.

What accounts for such disastrous results? We believe it is the failure of U.S. management to address its most serious problem: a lack of pragmatic judgment. The widespread adoption of trendy management techniques during the 1980s allowed managers to rely on ready-made answers instead of searching for creative solutions. Although some companies are starting to question this reliance on quick fixes, the adoption of off-the-shelf "innovations" continues at a disturbing rate.

If managers want to reverse this trend, they must start by reclaiming managerial responsibility. Instead of subscribing impulsively to fads, they must pick and choose carefully the managerial ideas that promise to be useful. And they must adapt those ideas rigorously to the context of their companies.

Managers will often profit most by resisting new ideas entirely and making do with the materials at hand. However unfashionable this may seem, it is precisely as it should be. The manager's job is not to seek out novelty; it is to make sure the company gets results. Pragmatism is the place to start.

"Flavor of the Month" Managing.

Given that managerial innovations disappoint with such regularity, we are surprised that companies continue to adopt them with such abandon. The lure of new management fads remains irresistible to managers looking for easy answers. And some companies seem particularly vulnerable to the gurus' hype.

We have identified three basic syndromes that perpetuate the adoption of ineffective, off-the-shelf solutions. The first might be called the "we didn't get it right the first time, let's do it better this time" syndrome. In this case, managers attribute the failure of an imported practice or concept to some missing element in how the idea was formulated and implemented. Old management consultants and champions are thrown out, and new ones are brought in. Eager to succeed where others have failed, the new pundits introduce variations on the original idea that promise to set things right.

Unfortunately, in most cases, this syndrome has led only to a proliferation of ideas, each one claiming—with little justification—to be the correct one. Consider, for example, today's increasingly fuzzy notion of total quality management (TQM). The Ernst & Young and American Quality Foundation study surveyed 584 companies and found they used a total of 945 standardized programs, each promoted by different "experts."[1] In such an environment, managers find themselves adrift in a sea of competing ideas, increasingly insecure about whether the right approach will ever be found.

Frustration with this all-too-common scenario leads to a second pattern, which we term the "flavor of the month" syndrome. In this scenario, managers cast aside old ideas as misguided and introduce new ones that will finally—this time—deliver the business to the promised land. Thus, for instance, TQM programs are derided for their incremental nature, while reengineering is championed as the key to achieving "breakthrough" performance. The half-life of such ideas is becoming so short that we find managers shifting abruptly from one idea to the next. Employees wise up to this syndrome very quickly. Experience teaches them not to get terribly enthused about any new idea. They learn to shrug it off, reasoning, "If we wait until Monday, this too shall pass."

Other companies fall into a third syndrome: they "go for it all." We know of one large U.S. bank where the vice president of HR proudly declared that his organization had implemented every new management program it could find. It had more than 1,000 self-managed teams, over 500 quality initiatives, more than 300 reengineering initiatives, and a host of other programs. Of course, if you probed a bit, you discovered that the majority of these initiatives addressed such crucial management issues as what color to paint the walls. Employees found all their time taken up participating in initiatives of varying importance. And this was happening in an organization where the core business was eroding at an alarming rate.

What happens when managers or their gurus are confronted with the situations we have been depicting? In our experience, they tend to respond with a few unchallengeable replies: "It's only natural to expect some failures—look at the great successes that other companies have had;" "It's not easy to change decades of existing practice;" or, "In time, we'll see results." By deflecting all possibility of judgment into the future like this, it is possible to sustain faith in a managerial promised land almost indefinitely.

But what about the success stories of the new management? Certainly, there have been some, but they have happened because managers used their ingenuity to adapt new ideas, such as TQM, to the particular contexts of their companies. When tailored to fit specific situations, and often changed beyond recognition, these new ideas can prove invaluable. This is pragmatic management at its best.

The Four Faces of Pragmatism.

We are calling for a return to pragmatism as espoused by the nineteenth-century American pragmatists: to judge any idea by its practical consequences, by seeing what it allows you to do, rather than by chasing after an elusive notion of truth. Or as the pragmatist philosopher William James put it, "Theories are instruments, not answers to enigmas in which we can rest." Every managerial situation, we believe, demands a pragmatic attitude. For purposes of discussion, we can divide this approach into four general components: sensitivity to context, willingness to make do, focus on outcomes, and openness to uncertainty.

Sensitivity to Context.

We cannot stress enough that the central concept of pragmatic management is the need to adapt ideas to a given context. Being able to judge the parameters of a particular situation and decide what ideas and actions will work in that context is what distinguishes the truly effective manager.

Context includes both the macro and micro—from the cultural milieu of a host country, for example, to the personalities of employees on a management team. Managers who are sensitive to context have a keen sense of the company's history, including the successes and failures of past management programs. They know the company's resources intimately, from physical assets to human capital. And they understand the organization's and the employees' strengths and weaknesses, so they can discern what actions are possible and how much the organization can be stretched.

Pragmatic managers understand that a change initiative that worked in one context could just as easily fail in another and that programs must be continually reevaluated as circumstances evolve. Otherwise, change programs can get stuck at lofty levels of abstraction and ambiguity and have little relevance to the day-to-day workings of the corporation. Even when an overall program like TQM has been adopted, managers should make frequent pragmatic judgments about how best to implement it. Management gurus may peddle a glossary of rules that describe how to do this, but universal answers rarely meet particular needs.

Many of the most successful managerial innovations in recent years have come from companies that have adapted, rather than adopted, popular ideas. Consider an example that has been much in the news in recent years, GE's Work-Out program.2 Before developing Work-Out in the late 1980s, GE tried to implement the popular Japanese quality circles, teams of employees dedicated to significant quality improvement, throughout the company.

In Japanese quality circles, people are isolated in small groups that often receive substantial direction from above. This approach, GE soon discovered, had limited value in an American context, however. CEO Jack Welch believed the top-down model would never foster the trust necessary to convince line employees to buy into major change. Nor would it sway many middle and upper level managers, whom he saw as "actively resistant to new ideas."

In 1989, Welch began replacing quality circles with the broader, homespun Work-Out program. Instead of gathering in small groups, workers and managers met in large forums dedicated to airing new ideas, the more radical the better. Frequency and duration of work-outs were flexible, according to need, and the town-meeting-like settings fostered a sense of community while ensuring the visibility of individual contributions. The public setting also forced reticent managers to face up to pressures for change. Welch insisted that managers give on-the-spot responses to employee proposals. Nothing was considered sacred in the Work-Out program. Even major changes like overhauling an existing business process (now hyped as reengineering) could be brought up and dealt with in less than a day. In sum, by following the pragmatic strategy of tailoring a program to fit the company, GE was able to avoid the pitfalls of generic quality management.

Homespun solutions are not always the answer, however. Sometimes it makes the most sense for companies to abandon ideas entirely, even those touted as "the next big thing." Some companies have discovered, for example, that just-in-time manufacturing, while beautiful theoretically, doesn't make sense in their manufacturing contexts. Even some Japanese companies that use JIT at home have found that American marketing methods and distribution systems make JIT less attractive in the United States.

In stressing the importance of sensitivity to context, however, we are not advocating a rejection of any idea that originates outside the company. We would hate to see managers conclude too quickly, "It won't work because our context is so different." That will stop the flow of ideas. We are urging only that innovative ideas, such as TQM, and basic management practices, such as strategic planning, be adopted with an acute sensitivity to the situation at hand. Careful forethought and monitoring should etermine how practices are used and to what extent they are followed. Managers should also bear in mind that a solution that works today may fail tomorrow. After all, even the best management ideas, such as portfolio planning, have had a half-life of no more than 10 to 15 years.

Willingness to Make Do.

Pragmatic managers, we have found, are particularly adept at "making do." They know what resources are available and how to round up more on short notice; they seek pragmatic answers based on the materials at hand.

We call this aspect of pragmatism bricolage, a word French anthropologist Claude L vi-Strauss used to describe the thought processes of primitive societies.

Against prevailing stereotypes of these societies as intellectually inferior, L vi-Strauss argued that they have ingenious, nonrational ways of thinking. They reason inductively, deriving principles from their daily experience to guide them. For example, these societies have developed elaborate systems of medicine by continually experimenting with local herbs and flowers until they discover the right mixtures to cure their ailments.

Effective managers are bricoleurs in this same sense. They play with possibilities and use available resources to find workable solutions. They tinker with systems and variables, constantly on the lookout for improved configurations.

One of our favorite examples of bricolage comes from a director we met a few years ago at a large telecommunications company. While most other people were focusing on the massive IT overhaul the company needed, she directed her attention to how it could use the existing computer resources more creatively.

The engineers who maintained the huge telecommunications network stored data on a trio of aging, overstuffed, and incompatible mainframes. Most people believed it was time to scrap them and install a new, cutting-edge information architecture that would integrate all the company's computer resources. The director concurred that the mainframes would eventually have to go, but she believed it didn't have to happen right away, and, given the time necessary for planning such a change, it couldn't. Why not get the most we can from the mainframes in the interim, she asked. Why not use computer workstations to simulate the multimillion-dollar information architecture that the company would have in the future? With little direction from above, she and her team developed a series of software applications that delayed the need for mainframe replacement while, at the same time, cutting the system-project time from months to weeks.

When a bricoleur is making do, solutions are never fixed or final. This innovative director's project evolved constantly from the day it was conceived until it was sent on-line. Indeed, being a bricoleur entails a willingness to take actions without a clear sense of how things are going to unfold in the future. This doesn't mean that bricoleurs don't care about results, but that they are willing to experiment to get there.

Motorola CEO Bob Galvin's skillful management of a change effort during the 1980s is another good example of bricolage. In 1983, Motorola had just come off a very good year, but Galvin waware of rumblings throughout the company that the organizational structure wasn't working because it was too bureaucratic. A recent trip to Japan had also convinced him that Motorola was slow to respond to changes in the marketplace.

Rather than waiting for a crisis to erupt, postponing action until he could come up with the perfect strategy, or hiring outside consultants to implement a prepackaged program, Galvin plunged his managers into the change process. At a May meeting of more than 100 senior officers, he announced that the corporation would begin a large-scale change initiative. What he neglected to say was how.

Understandably, the officers were confused. No one was clear about the CEO's agenda or what anyone was expected to do. And this is precisely what Galvin was after. He wanted the officers to be creative and to experiment with different ways of addressing the problems they were confronting in their particular situations. While some managers became preoccupied with "not really knowing what Galvin wanted," others used his challenge as a jumping-off point for experimentation. They came up with numerous structural changes and product innovations, from more market-driven business units to a new line of cellular products, which enabled Motorola to weather an economic downturn and emerge as the most powerful player in the cellular industry. An intuitive pragmatist, Galvin had created a situation that allowed those closest to the problems to come up with solutions.

Focus on Outcomes.

Pragmatists are concerned with getting results. But they don't get overly hung up on how to get them. The telecommunications director didn't mind a Rube Goldberg approach to system design if it could make a positive contribution to the business. The managers who rejected just-in-time manufacturing realized that the most elegant theory would mean nothing if it couldn't improve delivery time.

Failure to focus on outcomes can spell disaster. Consider the case of the large bank we referred to earlier that had "gone for it all," adopting every change program in the book. Progress was defined in terms of the number of people who had received quality training and the number of quality and reengineering teams that had been established. This had created the illusion of progress. But the bank's performance continued to decline.

Allen-Bradley, a Rockwell-owned manufacturer of industrial controls, learned the hard way about the value of focusing on outcomes. The company's early experience with team-based management at its Industrial Computer and Communications Group had been successful because the teams had a clear mission: to deliver an innovative computer-integrated manufacturing product as quickly as possible. Their focus on outcomes made them flexible and pragmatic; when it was more reasonable for a few people to tackle a problem instead of a team, they went off on their own and did it.

When ICCG switched the whole organization to teams, however, the mission became more diffuse. Teams became a virtue unto themselves, and suddenly all problems had to be solved through teams, whether or not this was the most pragmatic solution. People became caught up in the novelty of teams, and the company took on a summer-camp atmosphere. "Whoever dies with the most teams wins," an employee joked.

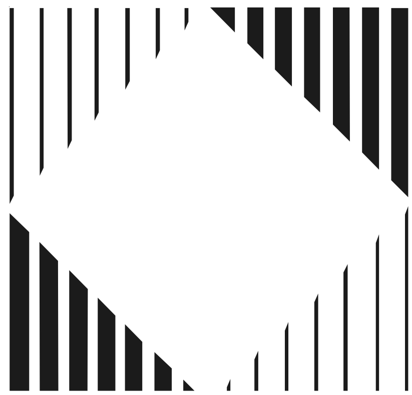
Eventually, senior managers noticed that the proliferation of teams had led to a lack of discipline, while failing to get rid of the negative bureaucratic elements of the old system. Chastened by this experience, ICCG began using teams much more cautiously. Today senior managers decide when, where, and how teams are used. First, they ask three critical questions: Is a team necessary? What will we gain? How will we measure our gains? The emphasis is less on fostering camaraderie than on seeing concrete results.

An incident at a major computer company shows what happens when a manager focuses on the wrong outcome. After years of indifferent performance, the company's PC division was finally beginning to show some signs of life. The hardware group had developed a full line of PCs that could compete on price. A third-party software group had made promising alliances with major software vendors. And an internal software development group had produced a networking product that had great market potential.

To promote these new products, the managers of each group asked the division's marketing director to assign additional people to their marketing efforts. Had this director been thinking pragmatically, she might have assigned a couple of key staff members to each group. But she refused because she did not want to take the focus off her first priority, improving the performance of her overall marketing department.

With this goal in mind, she hired internal and external consultants to initiate a formal strategic planning exercise. To empower her people and maintain a spirit of participation, she solicited input at a series of off-site meetings and undertook team-building exercises. Of course, while all this was going on, the three managers felt like Nero was fiddling while Rome burned. Eventually, they appealed to the division's vice president, who intervened and broke up the marketing department. He assigned the director's star employees to the three groups and left her with only a skeletal staff. The marketing director had become so caught up in developing a trendy new strategy for her department that she had lost sight of the outcomes critical to her company's success. And she lost her employees in the process.

Openness to Uncertainty. The last important component of a pragmatic attitude is a willingness to embrace uncertainty and surprise. We believe that most of



today's off-the-shelf managerial innovations foster a regimentation that discourages managers from dealing effectively with the unexpected. The fashionable emphasis on being "proactive" can give a false sense that all circumstances can be anticipated. But more often than not, managers are thrown into situations in which they must act quickly and without certainty. To quote economist Kenneth Arrow, in many situations, "we must simply act, fully knowing our ignorance of possible consequences."

For those who associate pragmatism with conservatism or prudence, stressing an openness to uncertainty may seem counterintuitive. But the two concepts are linked. Pragmatists understand that it is unrealistic to try to avoid uncertainty. Attempts to deny or ignore it can blind managers to the real contexts in which they are working and prevent them from responding effectively. Instead of fearing sudden changes, pragmatic managers welcome them as unanticipated opportunities. They learn to capitalize on the unexpected, whether implementing a companywide change initiative or making a critical business decision.

Reebok CEO Paul Fireman is a manager who knows how to profit from uncertainty. At a shoe manufacturers' show in Europe in 1989, Fireman was unimpressed by the merchandise displayed on the floor. He noticed that members of the trade press, looking for a good story, seemed bored with the show as well. Fireman realized that this situation presented an opportunity for Reebok; if he could come up with something new and exciting, he could generate a lot of publicity. A Reebok product that was still in development, THE PUMP, boasted an innovative, inflatable technology that could give the wearer a close personal fit. He knew it would make a great story. But the marketing plan for the shoe had not been completed, and many details had not been worked out, including the price. But Fireman decided to "just do it." He introduced THE PUMP at the show.

The early launch turned out to be a hit. These rave reviews, according to Fireman, not only created market anticipation for the shoe but also helped "light a fire inside the company to get the product developed and released quickly." It was produced in record time and turned out to be a huge success in the marketplace.

Fireman's boldness could have gotten the company in trouble had Reebok not been able to deliver on time. Many companies have been skewered in the press for making new product promises they couldn't keep. But Fireman's move was not quite as brash as it seemed. He based it on a quick but careful assessment of the state of the industry, his company's capabilities, and just how much Reebok could be stretched in a pinch. Because he understood the context in which he was operating, Fireman was able to seize the moment. No time-to-market program could have produced such positive results. No companywide initiative can ever be a substitute for the pragmatic judgment of an individual manager.

American management is at a crossroads. It must decide whether to continue on its present path, on the fruitless quest for managerial Holy Grails, or whether to face up to the challenge of pragmatism. It is worth noting that in many academic disciplines, this sort of pragmatism has witnessed something of a revival. American management may stand to gain the most from looking back to this indigenous style of thought, particularly to its pragmatic successes of the past.

A case in point is the long list of uncommon accomplishments of the United States during World War II. Planes were designed, built, and flown safely in combat in less than two years. Today it takes more than ten years to accomplish the same. During the war, ships were built in weeks; today it takes years. And one could go on and on with stories of achievements that now seem beyond the realm of possibility. A crisis like World War II focuses people on pragmatic action in an uncommon way. It unites national and personal interests. Of course, it may be nearly impossible to replicate such conditions, but creating this kind of urgency is exactly what effective managers have always known how to do. And they have always been able to create urgency with or without the invocation of a brand-new management paradigm.

We are by no means arguing that the new ideas hyped to managers are without worth or that managers should go back to focusing on the much-maligned bureaucratic practices of the past. Instead, we are saying that the time has come to reconsider the relative balance between management innovations and management fundamentals. If the eighties were the time for the flowering of new perspectives on managerial practice, the remainder of the nineties may be the time for a sober reevaluation of managerial responsibility.

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2. Work-Out is discussed in detail in Noel M. Tichy and Stratford Sherman, Control Your Destiny or Someone Else Will: How Jack Welch Is Making G.E. the World's Most Competitive Corporation (New York: Doubleday, 1993).

Double-Edged Pragmatist: An Interview with Shikhar Ghosh.

Shikhar Ghosh was a partner at the Boston Consulting Group, specializing in creating responsive organizations until 1988, when he became CEO of the Appex Corporation, a start-up cellular communications company. Now called EDS Personal Communications Corporation and a division of Electronic Data Systems, it is an $8 billion business and one of the fastest growing information management enterprises.

A self-avowed pragmatist, Ghosh speaks about his experience as an outsider who has recommended change strategies to corporations and as a CEO who implements change from within. He also discusses his role as a bricoleur, a pragmatic manager who constantly tinkers with systems and variables to create a stronger organization.

How would you define pragmatism as it relates to organizational change programs?

Being pragmatic is creating a balance between a company's objectives and constraints. The constraints may be its finances, history, relationships, or employees' ability to learn. You have to adjust constantly the objectives of any change program to conform to what a company can learn and absorb.

Do any organizational change fads you've seen live up to the hype?

Many have merit, but they often represent only particular truths. When you combine these change fads with the reality of a company, you get very mixed results. Quality and reengineering are not bad in themselves, but management gurus underplay the practical difficulty of implementing them in an organization. Gurus represent these programs as complete solutions, when most of them deal with only one facet of an organization's problems.

Most programs view companies as machines. But companies are more like organisms. If you do something to them, they react. And a program has to be fine-tuned constantly based on those reactions.

What kind of organizational problems did you encounter at Appex? Appex had no structure. When I arrived, I called a meeting of the 25 employees to say that we needed some rules. I said that people had to be in by 10 A.M., or they had to call in. Someone got up and said, "What right do you have to tell us anything?"

So what did you do? I implemented a Japanese circular structure to instill discipline without losing informality or building in too much hierarchy. I was in the center of the organizational chart, and groups were around me in concentric circles. People doing different functions were at the same level, and the boundaries between groups were blurred. For example, customer service flowed into engineering; engineering flowed into marketing.

The structure was based on Japanese principles of flat organizations, but we didn't just pull it out of a textbook. We designed the structure pragmatically to reflect the way people really worked.

How did it work?

We found that we could respond very quickly to changes in the market. And we were far more innovative than many competitors. But in a short while, we realized that we were growing too rapidly to allow for this level of informal communication. There was no standardized way of doing things. If work didn't get done, no one knew who was accountable.

What happened next?

Within six months, we went to the other extreme and opted for a functional organization. Department managers reported to me, and lower level managers reported to them. To some extent, this went against the grain. But by this time, employees saw the need for more structure. We were missing deadlines. Too much work was falling between the cracks.

Choosing a functional organization was initially a pragmatic move in that it addressed an urgent problem: the need for procedures and accountability. Within a few months, however, Appex developed the traditional symptoms of bureaucracy: lack of flexibility and responsiveness. There was no teamwork, and people started to align themselves more with their functions than with overall company goals.

And the next move?

Teams. People served on cross-functional teams that focused on one line of the business. This approach worked reasonably well for seven months, until we realized that we had too many products and not enough general management talent to direct all the teams.

So we restructured the company, tailoring the team concept to our own constraints. We consolidated the teams so that each one handled several lines of work. And we turned them into self-contained divisions. Traditional wisdom said we were too smallo divide the company, but because of our needs and limitations, it was the pragmatic choice for us.

Were your employees starting to feel dizzy from all these changes?

In the beginning, employees would say, “Wait, not another structure!”

But then they got used to change and saw its value. After a while, an organizational structure becomes a tool you’re using to create a balance between conflicting modes of organizational behavior, such as flexibility and consistency. Each structure emphasizes one type of behavior and deemphasizes another. By continuing to change, you can balance the needs of the organization.

Some of what is learned from an organizational change program stays with employees long after the program is replaced. People get to know one another; they understand other functions. And because the organization is constantly changing, people don’t have time to develop a power base within a particular structure. They have to identify with the broader objectives of the company.

So, are you a bricoleur? Yes, I guess I am. While it seems as if we implemented changes every six months, in reality, we were constantly changing. We weren’t satisfied with off-the-shelf solutions. We were always tweaking the structure we had in place. And when we bumped against too many constraints, we would change the structure once again.

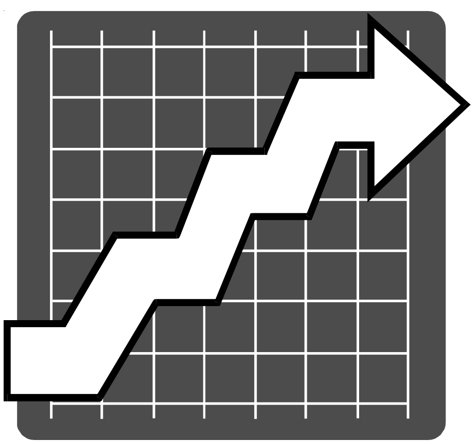
When you change often, you know that nothing is permanent. You don’t have to have all the answers before you try something. You can afford to experiment because the current structure doesn’t have to be “just right.”

Managing is a matter of constantly looking at the way you do things and adjusting the process to reflect your goals and resources.That’s pragmatism. You use the resources you have to get where you need to go.

Changing the Mind of the Corporation

Martin, Roger - Monitor Company

HARVARD BUSINESS REVIEW, Nov/Dec 1993, p. 81



Changing the Mind of the Corporation.

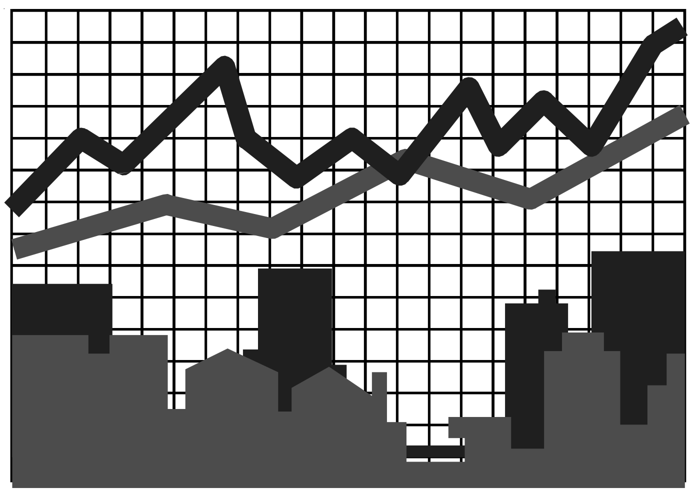
The most exasperating fact about big companies in crisis is that they got there by doing what once made them big. They come by their troubles honestly. This irony may seem manageable to people hoping to turn things around; but I have been in the business of strategy consulting for 13 years, and I am only now beginning to appreciate how mechanically organizations resist newer truth and how strong the emotions are that underlie these mechanisms. Perhaps I should begin with a story.

One of my first clients was the CEO of a packaged foods company with whom I supposed I had been working extremely well, analyzing data on customers, competitors, and new technologies the technical evidence. About a year into our relationship, the company was given the opportunity to acquire a snack business, which I was sure it should pass up. I proved with bulletproof logic that the company in question was the third competitor in a market where only two could survive. There was room for one brand leader and one low-cost producer; there was no point in being the challenger in either category.

For many months, the CEO and I reviewed this bit of strategic reasoning, and I was certain that my client understood the point. Yet a few months later, I discovered that he bought the snack business anyway, as soon as the price dropped "to an incredibly good number."

Obviously, something other than pure strategic reasoning had been poised to assert itself all along something powerful but unacknowledged beneath the surface of our conversation, something my client was inevitably going to fall back on as soon as the right conditions presented themselves. In fact, this something was the assumption, second nature to the whole of top management since virtually the company's inception, that a consumer packaged foods company with brand recognition, good advertising, and acceptable market share was bound to make money, deserved to make money. Besides, the unarticulated argument continued, any company can be turned around with a little elbow grease, especially if you buy it cheap enough.

And then again, maybe not. In practice, the company has lost money on the snack business every year since acquiring it. But the case stands out in my mind not for what the client learned but for what I learned. As a consultant, my product was supposed to be strategic action, not just strategic brilliance. If my client failed to get the message, then I hadn't done my job. In fact, this is the story of a consultant, locked in his own inertial assumptions, becoming as blind to the needs of the client as the client was to the dynamics of the market. I had not yet come to realize that to catalyze change, I would have to see beyond cognitive instruction, beyond studies and presentations, to a process of learning more subtle and compassionate than anything I and most of my colleagues in the profession have practiced up to now. All change managers need lessons of this kind.



The key to the process is self-examination. Chris Argyris has written about how individuals in companies, even highly educated professionals, engage in what he calls organizational defensive routines to preserve their status and abiding sense of security (see "Teaching Smart People How to Learn," HBR May-June 1991). In searching for the source of any problem, they always look outside themselves and often outside the company, blaming the stupidity of the customer or client, the vagueness of strategic goals, or the unpredictability of the environment. In my view, however, organizations defend against change not because they are just like insecure individuals, but because they are made up of individuals (many of whom are, indeed, insecure) who are working at what always has worked. So what change managers first need to understand is the peculiar ways their company's practices provide an unfolding context for inertia.

Now, some will say the great challenge for change managers is to get employees to understand customers, not their own company. But it turns out that they can't understand customers unless they've understood themselves, and this means, first of all, understanding something like their company's life story.

If a company can be said to have a "mind," managers cannot change it merely by frightening themselves with reports of quarterly losses. Rather like individuals the collective leadership of companies needs first to look back, to find out the good reasons why they have come to act the way they do. They get control of their future by examining their past. They change by looking in, not out.

The Tragic Life of Troubled Companies

The experience of troubled companies is a syndrome with four discernible stages. There may be more, but I have found these enough to stimulate the right kind of debate among senior managers. First is the articulation of a founder's vision; second, the consolidation of steering mechanisms; third, the deterioration of necessary feedback; and, fourth, the proliferation of organizational defensive routines. By the last stage, corporations have created a world in which managers not only cannot see what is salient in their markets, they have gradually become impervious to learning of every kind.

The Founder's Vision.

Every company begins with a vision, comprised of two wedded elements: a product concept aimed at a particular market and a notion of the way the company needs to be organized to make the most of the market opportunity. Henry Ford did not simply develop a standard car for a mass market, he developed a system of mass production in which, not coincidentally, his own workers might afford the very cars they built. Similarly, Bill Gates's Microsoft not only designs software for personal computers, the company is its own best evidence that individuals networked by personal computers can be organized into value-adding teams.

Ford Motors and Microsoft are, of course, extraordinary examples of the ways the market vision and the corporate organization may develop reciprocally, which is why they have become signature companies of their respective times. But all big companies once originated a vision of competitiveness that was more or less valid for their market and industry.

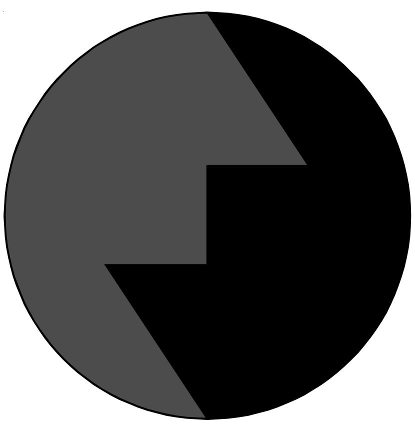
Implicitly or explicitly, the founders correctly assessed customer needs, barriers, and rivals and went for broke. They married their original assets to activities and processes that got them customers and cash. Then they reinvested, developing new assets financial, physical, human, and scientific trying to pattern these in ways that were new but still served their original vision. The Model A did not have to be black like the Model T, and, eventually, Henry Ford learned to live with the UAW. More recently, the MS-DOS handbook has been superseded by graphical interfaces.

In short, companies survive by growing in virtuous ways: growing into what once seemed pristine competitive space; growing a complex mix of financial, material, and knowledge assets; growing their market scope; growing the practical routines that make winning with customers replicable and standard. The problem is that competitive spaces shift, customers change, new technologies appear, and, ironically, it is when responding to markets transformed by intense and unpredictable change that big businesses are most confounded by patterns of past success. IBM's mainframe data processors, its proprietary distribution channels, even its gray-flannel suits, seemed positively avant-garde back in the 1950s.

Crisis is the privilege of survival. Companies fail to make the most of new opportunities because they are still doing their best to make the most of old ones.

Steering Mechanisms.

All of this raises the question of how the company operationalizes the founder's vision, that is, how managers put critical elements of the vision into practice and, in so doing, deliberately but also inadvertently structure the perceptions and acts of their employees. This structure consists of dozens of nearly imperceptible steering mechanisms with which the company learns to keep itself afloat and on course as it grows. Steering mechanisms are thus the processes, assumptions, rules, and behaviors that are woven into systematic choice at



all levels of the organization and in every discipline: budgeting and resource allocation, hiring and training, codes of conduct, strategy development, product development, norms of authority and succession. Steering mechanisms proliferate with the growing complexity of the company's task and make sense of otherwise chaotic market evidence.

Steering mechanisms are usually conceived with just two purposes in mind: to keep the organization aligned with the founder's vision and to keep the vision aligned with the economic environment. Each is indispensable to the company's success. At the same time, the inherent tension between the two is serious. In my experience, most companies have many steering mechanisms controlling for internal alignment with the vision. Fewer, sadly, control for changes in markets. And it is precisely when top managers try to catch up with an escaping market that the inertial force of their mechanisms becomes gallingly apparent.

The senior managers of a global telecom company I've worked with all agree that a new global product for tourists should not encroach on an offering designed for business travelers. But trying to get the managers of consumer products to collaborate with the managers of corporate accounts without inciting a turf war turf staked out with great pain back when the company was broken into strategic business units is a different story altogether.

Disrupted Feedback.

The most dangerous thing about obsolete steering mechanisms is the way they degrade market signals and fill managers' ears with noise. When a product concept goes wrong, we see managers seeking answers to the wrong questions. They gather reams of data, and all of it is more or less worthless because it supports a product strategy that is more or less worthless. Digital Equipment Corporation, for example, gathered extensive information on what customers wanted from its proprietary word-processing software without realizing that the age of proprietary minicomputers was over.

But something even worse can happen. Rigid steering mechanisms can cause managers to ignore complaints and other forms of unwelcome feedback that might be extremely valuable if they were put to appropriate use.

Take the case of a law firm I know whose founder's vision was simply the practice of "great law." When I asked the senior partners what their clients valued most about the firm, they said, "Insight, quickness, a 'can-do' attitude, congeniality." "Service" came last. In fact, these responses were more or less on target for some of the firm's most prized clients legally sophisticated executives, many of them former lawyers, who came to the firm with special problems and who constituted its original bread and butter. But when some newer clients began to demand such things as detailed billing and greater timeliness, the senior partners began to resent their demands and lack of appreciation, as if the clients were asking thoroughbreds to deliver the milk.

What the firm failed to grasp was that, since its founding, it had migrated into another market, a necessary and lucrative market made up of corporate counsels whose priorities were more pedestrian and procedural. The firm might well have treated these corporate counsels differently, putting them into a distinct business category of their own, one focused on service, detail, and cost-effectiveness. But the partners were stuck in a pattern of response appropriate to delivering genius, not hand-holding.

People in companies fall back on rigid steering mechanisms as a matter of course, because this is what steering mechanisms are for. They "hard-wire" the strategy. They guide action when the unexpected happens when there is a downturn in demand, say, or a crisis in recruiting. In this sense, steering mechanisms disrupt good feedback precisely because they are what provided good feedback when the company's earlier strategy was on target. They obscure new evidence with reaches for the older truth.

In the best of worlds, steering mechanisms would report on changes in the market and force the company to respond, and corporate learning would be continuous. This is not our world. There has never been a corporation that reinvents itself as a matter of course, and it is an open and fascinating question whether there ever could be.

Defensive Routines. But some, eventually many, signs of trouble do get through. There are losses, defections, product failures; the stock price goes south. And when senior managers focus afresh on the future shape of their business when, that is, they call in people like me the exercise can be as disappointing as it is heady. I remember how in my earlier years as a consultant, the CEO and I would call urgent meetings, research customer needs from the bottom up, outline new and more efficient organizational structures and human resource policies, then articulate all of these findings as principles of action in a comprehensive, voluminous strategic plan only to find that these principles, if not openly assaulted, died by a thousand cuts, while the strategic plan, if not openly rejected, was more or less systematically ignored.

The word "systematically" is critical, because few strategic plans are the victims of bad faith or employee sluggishness. To use terms of art borrowed once again from Chris Argyris, it is rather that any newly espoused strategy, however explicit and sensible, inevitably comes up against an implicitly enacted strategy supported by all the aged, compounded steering mechanisms that the company already has in place.

Why is this? Because people are not at their best when faced with a largely uncertain future. Traumatized by past events, they determine never, never to make the same mistake again and wind up mistaking the old crisis for the new one. They fear for their jobs or for the jobs of the people who have been counting on their judgment. They fear their bosses or their boards. They avert their eyes from quantitative evidence contradicting their expectations. They snap at people who give voice to their repressed doubts. They demonize the competition, scoff at customers, infantilize themselves, and parentalize the CEO.

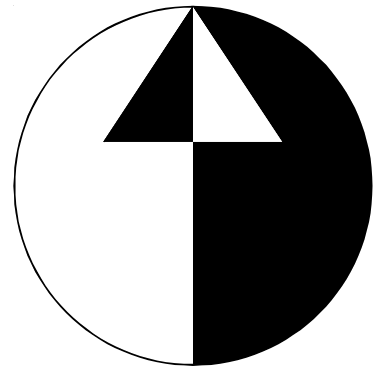
In short, people in corporate crisis are in no frame of mind to learn new facts of life, which is just what they need to do. The two most common defensive reactions I have seen implicitly glorify the past, and with the past, current failing practice. First, managers act out of a deep fear of inadequacy with respect to the founder. They think, "Billion-dollar visions do not grow on trees; who are we to question the manifest demonstrations of the founder's competence?" The inference for action is self-accusation: "Let us redouble our efforts; the problem is in our execution."

This kind of thinking almost killed the Ford Motor Company after Henry Ford died; it clearly hampered Digital Equipment's ability to refocus on personal computers right up until Kenneth Olsen's retirement. Even in businesses that are generations removed from their founders, the reputations of past leaders can weigh on the shoulders of current management like alps. Think about the residual weight of Alfred Sloan's decentralized divisional structure at General Motors.

A second reaction, parallel with the first, is the tendency of managers to idealize sunk assets. They travel from a European mill to a South American mine and take pride in the scope and grandeur of their company's activities. But this pride, a positive thing in good times, can become a serious handicap when dramatic change is in the offing.

The top managers of an integrated apparel company I know have come to understand that they are increasingly in a logistics business and that they will have to be low-cost producers upstream no matter how prosperous the corporation's various downstream businesses may become. But this does not mean that managers of weaving mills will readily agree to shut down inefficient plants, not as long as they can shift costs to cut-make-and-trim plants through transfer pricing. This practice was taken for granted, even encouraged, back when the company had come to the conclusion that vertical integration was the source of premiums and the wave of the future besides. Now it had become a crippling flaw.

Consulting companies are hardly immune to the troubled-company syndrome, though our defensiveness is usually couched, predictably, in misconceptions about the



ways our clients change. When I began in this business in the early 1980s, strategy consultants all assumed that change was purely a technical problem witness my approach to the packaged foods client. We thought we could teach managers their own competitive advantage. We thought companies in crisis had simply not yet understood their industry structure, or did not understand their competitor's position, and that clever analytical use of our more subtle models of competitive advantage would surely lead clients to a kind of epiphany.

When my colleagues and I started our own company, we advanced this idea a step or two. Because our clients often had trouble wrapping their minds around the radical and counterintuitive ideas we so often came up with, we determined that we would teach clients everything we knew our strategic language, our methodologies, our frames of reference in gradually deepening levels of nuance and detail. We worked in teams with our clients' employees; they would, we thought, internalize both the process and results of our deliberations.

This our own founder's vision worked well enough. We put ourselves on the map; we made good livings. But we still often engendered diagnosis without action, analysis without catharsis. I was often exasperated, like a revivalist preacher who prompts a chorus of "amens" during the evening but inspires precious little virtue the next morning. And, like those lawyers I had consulted to, we had developed our very own defensive routine, which was secretly to belittle clients for their lack of imagination. It took us some time to learn how to unpack our own embedded assumptions, to learn the difference between business ignorance and business tragedy.

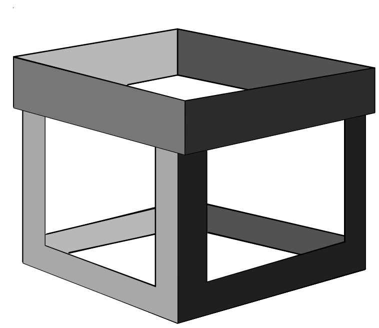
Structuring the Debate

How should managers set about changing the company's mind? How does one get action? If there is a governing principle, it is that change managers need to be as curious and serious about the psychodynamics of their organizations as they are about their technical analyses. They need to cultivate a mature sense of how people learn and cope not something freshly minted MBAs commonly have a talent for at the same time as they begin to work on strategic analysis. And the task, by the way, is both/and, not either/or. A manager or consultant who starts employees talking about their feelings without any reference to the company's measurable activities will launch bull sessions not strategic debate.

The key, in other words, is to structure the course of rigorous strategic debate in a way that takes into account the dignity and defenses of people facing hard choices. There is no one way to do this, but the most successful managers I've worked with begin by acknowledging the tragic pattern of corporate crisis that I've just mapped out. The CEO makes clear to everyone that the company is in crisis not because people have damaged it, but because good practices have outlasted their useful lives.

No blame that's crucial. The question all managers should be encouraged to ask and it is often helpful to have outsiders come in to help ask it is what things did we do right in order to get into the crisis we now face? What was our founder's vision, and what mechanisms did we put in place to make it come to life, day after day, year after year? And what data do we need to see how much of that vision still works?

Recently, I've been working with a furniture maker whose genius has been to design high-quality, ergonomically correct office furniture that can nevertheless be mass-produced. For a generation, competition in this niche was



negligible, and margins were handsome. No more. So the senior managers and I gathered for two days, simply to tell and retell the story of the company's successes. In retrospect, perhaps the most important piece of the exercise was giving each senior manager an opportunity to formulate some personal wisdom about the company's founding. In this atmosphere of positive reminiscence vaguely like the atmosphere of mourning, and having many of the same virtues defensiveness fell away.

What had gone wrong? No one was quite sure. Most expressed enormous pleasure in the company's designs. Many took satisfaction in the civility of the workplace. Still, what clearly emerged from everybody's version was that despite its espoused customer-oriented strategy, the company had never actually segmented its customers senior managers literally didn't know who the customers were.

Ordinarily, this might have been cause for some embarrassment. But in the context of positive soul-searching, the fact that the company had never segmented its customers didn't seem so egregious. After all, they had been successful with an enacted strategy that one of my colleagues has called the Field of Dreams approach "If you build it, they will come." Now that the time had come for the company to behave more deliberately, segmentation could be the first priority.

Reverse Engineering the Enacted Strategy

In the course of discovering how a company got into trouble, it is critical to find out what the company is really thinking. By this I do not mean finding out what managers believe the strategy to be, but rather what makes up the company's "unconscious" the buried principles of strategy enacted in what managers routinely do with customers, suppliers, employees, and each other.

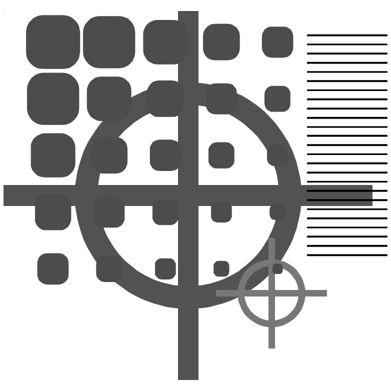
How do you do this? In effect, you reverse engineer the whole corporate "mind" by looking in detail at just what the company does those steering mechanisms I spoke about. I once worked with an auto parts supplier that espoused a strategy of upgrading to meet the quality program of the automaker that was its customer. The automaker, in turn, espoused a close, cooperative, long-term partnership with its suppliers. This partnership was supposed to involve data sharing, long lead times, exclusive contracts all the certainties that allow suppliers to be cost-effective, innovative, and reliable.

Upon closer inspection, however, both my client and its customer were engaging in so much wishful thinking. The automaker, historically afraid of dependency on any one supplier, routinely controlled the design and refused to share much of anything about the design process. Moreover, it dictated prices and pushed down suppliers' margins about as far as they could go.

My client reacted by refusing to invest in innovation, fearing every improvement would only create a premium that the auto company would skim. It also refused to share financial data, anticipating an even greater squeeze on margins. Both companies played their hands closer and closer to the vest, with predictable consequences. My client, in the words of a senior manager, "got constantly jerked around new specs, bad forecasts, no continuity." On its side, the automaker failed to get the world-class suppliers it needed to be internationally competitive.

The only way out of this impasse was to plot out the enacted strategies of both companies and show them how they were hostage to steering mechanisms fit for a different form of competition in this case, the world of "price takers" that worked in the U.S. auto industry so long as the Big Three were a virtual monopoly. Managers at the automaker took a good look at the actual behavior of procurement officials, design engineers, and financial analysts. Supplier executives looked hard at the investments and quality improvements they were actually making. Once managers on both sides could put a name to what they were really doing, they could begin to stop. If they had continued to assume that their espoused strategies were real, they would simply have continued to irritate and undermine each other.

Or take the case of a large commercial baking company I worked with in Canada. The founder's vision had matured



successfully, and the company plausibly considered itself the country's premier supplier of branded bread products. In theory, the company's strategy was to focus on consumers, whom it reached, in theory, with high-value-added, well-advertised products. However, when we began to look together at the strategy the company was actually enacting, we could clearly see that the sales force was focused overwhelmingly on the supermarket private-label trade. And retailers dictated the proportion of private-label to brand-name bread, the breadth of the product line, and relative pricing. The company, meanwhile, had dramatically cut back on its consumer advertising.

Through its steering mechanisms, the company was acting out the role of commodity producer for the trade. Its stated strategy, by encouraging an air of congenial unreality, was now only a barrier to seeing what the company had actually become. V clav Havel once wrote that corruption begins when people start saying one thing and thinking another. So does cynicism and the management dysfunctions that inevitably flow from it.

At the baking company, middle managers heard their CEO speak of winning by building the business on "unique new product introductions supported by high levels of advertising." They then saw salespeople caving in to supermarkets and the chief financial officer telling the board that margins were too thin to sustain the current advertising budget. They quite naturally concluded that their leaders simply did not mean what they said and that they had better be equally sly if they were going to survive.

Cynicism is a fate that seems to lie in wait especially for companies like this bakery, producers of well-known branded products whose managers have grown complacent in the prestige that universal recognition of the brand confers on them, like aging prima donnas too comfortable in their fame. Managers in such companies are quick to claim the prestige of their brand yet fear saying anything "demoralizing." Their skittishness produces relations that always look supportive. Even in critical meetings, people never vehemently disagree; everyone tries to "build on the comment" of the person just before. What generally follows these meetings is intense behind-the-scenes politicking and cutthroat memo writing.

A Dialogue of Science

Common sense tells us that a CEO has a simple choice once the enacted strategy has been surfaced: either explicitly go ahead with what the steering mechanisms are causing the company to do anyway, or endeavor to change course. And that is precisely the choice. I work with clients to explore the logic that underlies their enacted strategies, and in a way this exploration makes it possible for the company's leaders to test their convictions about what the company should do.

This usually means, first and foremost, analysis of customers. Think of that furniture company that had never done a simple market segmentation. Once the enacted strategy came into relief, it was obvious that fundamental market research was warranted indeed, people were suddenly eager for it. That apparel company, too, began to look with renewed interest at the demand for cloth, the shifts in cotton prices, the long-term prospects of fabric suppliers getting out or coming in. In both companies, managers became curious about quantitative market data of all kinds, because they now knew just what hypotheses needed to be validated or disproved.

Another way of saying this is that the collective exercise of teasing out the enacted strategy unleashes senior managers' scientific imagination. The question "What do we do now?" does not. Indeed, looking at enacted strategy should be encouraged in the whole of management ultimately, the whole of the company. I don't mean publishing decisions that have already been taken say, announcing in the company newsletter the purchase of a mill. On the contrary, CEOs who think that they get change by the force of command or that they preserve prestige by preserving secrets are mired in the status quo.

To get change in a great old company, thousands of grown men and women whose children depend on their acting prudently must see the rationale for change and view it with favor. They must see the reasoning behind a new strategic direction and understand the methods used to shape the supporting data so that everybody can make or imagine themselves making the calculations for themselves. Besides, people are naturally scientific: they make hypotheses, collect information, criticize each other's demonstrated conclusions. The challenge is to channel this energy into an open discourse on the fate of the company, not into an underground discourse on the prejudices of the CEO.

There are, of course, many ways to

generate and develop strategic dialogue of this kind: meetings, off-site gatherings, quality circles. The most exciting way my colleagues and I have found is computer-generated, competitive simulations war games, as it were in which managers model the competitive battlefield and practice a kind of company doctrine with one another. (The plummeting costs of computer processing power and software is making this more and more feasible, even for midsize companies.)

Of course any strategic dialogue has to focus on what we might call the strategic curriculum methodologies, language, the ways data will be researched and captured in the future and needs to include a discussion of how to conduct the discussion itself organizational boundaries, role definitions, decision processes, codes of conduct, reward systems. Companies have to get used to the fact that the new competition will force them to "burn themselves down" and rebuild every few years. Setting the terms of a continuing strategic conversation will help make people more willing to expose their implicit models (of products, markets, customers) for testing and inquiry.

Can this strategic dialogue be permanent? Can a company introduce steering mechanisms that keep all other steering mechanisms open for reevaluation? Perhaps this is a convoluted way of asking whether or not so-called learning organizations are really possible. My answer is that they are. They must be, given the new competition. But even if they are not possible, managers need to act as if they were.

At that telecom company we've worked with, where globalization is the new and somewhat daunting imperative, we interviewed dozens of managers and surfaced all manner of undiscussable problems. We asked managers what contradictions they saw between the globalization strategy and protecting the turf of their business units, what political problems they saw getting in the way of serving customers. Then we brought the answers, many of them extremely vexed, to senior managers and insisted on public debate. We also insisted on more public recognition for product teams that negotiated alliances with each other. We developed an analytical model to reckon the real demand for various products so that the profitability of various cross-team configurations could be debated with hard data and not as political footballs.

And then we did something more. We asked what kinds of training programs, knowledge-capturing systems, and management styles the company would need to put in place if the strategic dialogue were to become a more or less routine part of doing business. We asked how the knowledge assets of the company could be continuously improved. We urged the company to settle on new strategic models, outlined the data it would need to animate the models, and proposed the terms of an ongoing dialogue. It is not yet clear whether or not this initiative will succeed. It is clear that management is betting the company on it.

New Methods, New Terms of Art

Just how companies come to decide about their strategic opportunities is, of course, another matter. Suffice it to say that companies have to look at buyers, suppliers, points of differentiation, relative cost position, the threat of new entrants, the determinants of substitutability, the intensity of rivalry all the considerations Michael Porter has urged on us in his justly famous "five forces" analysis. It is important to keep in mind, however, that to uncover a discrepancy between enacted and espoused strategy is not necessarily to abandon one for the other. Rather, it is the occasion for determining real competitive advantage and for developing the means to pursue it.

Take that law firm I mentioned earlier. There was a case where the enacted strategy the firm had inadvertently adopted that of serving two very different client groups was actually the right course for it. What the firm then had to do was develop a number of new practices to cope with corporate counsels who wanted better service.

The bread company, on the other hand, was squandering its brand hence, its capacity for differentiation by becoming a commodity supplier to the trade. But it could not go back to being a prima donna either. Rather, it had to go forward in a new strategic direction and ecome a low-cost differentiator excellent at flexible manufacturing and logistics but aggressive in pursuit of niche markets.

As for the auto parts company, there was nothing wrong with its espoused strategy. The problem was that the company and its main customer were caught in a cycle of mutual suspicion: both talked the talk, neither walked the walk.

But let us assume for the sake of argument that the full complement of a company's managers can come to agreement on whether to keep or abandon the enacted strategy and even on what new market opportunities require. The next step is to develop metrics that express how well the company is advancing toward its new strategic goals.

At this moment, something subtle and exciting happens. In using the metrics that tell how they are doing, managers suddenly begin to become the new company their terms of discussion, their terms of art, propel them into choices and realities that are not yet quite born. That integrated apparel company I spoke about had suffered eight quarters of losses before its CEO and president told senior managers to unpack its founder's vision that of a company whose mills and factories in government-dominated, low-wage countries had given it a reliable price advantage in distribution channels.

Once top management determined that the company would have to attend to shareholder value, a whole new strategic language began to emerge. Accordingly, managers all began to speak about pieces of the company mills, logistics, consumer businesses in a new financial vernacular. Were mills “value enhancing” or “value diluting”? Did the net present value of the downstream factories justify swapping them for lower cost upstream assets? The company began to become a leaner logistics business in the way managers began to buy into a new language of explanation, a new way of shaping data.

Or think of Motorola’s Six Sigma program a near archetype of managing change by changing the language around the strategy. At Motorola, every employee was brought into the loop. Even the bakers in the company cafeteria produced a quantitative measure for Six Sigma muffins. This is not as fanatical as it sounds. The fact is, companies do not change until a new strategic language finds its way to every corner. There are too many steering mechanisms in any company for the CEO to pilot everything from the bridge.

Getting Courage

Let me see if I can summarize the lesson: acknowledge the tragic pattern of corporate crisis; reverse engineer the steering mechanisms; subject the assumptions of the enacted strategy, especially market data, to measurable tests; open a strategic dialogue within the company; aspire to the freedom and discipline of scientists; redefine competitive advantage; develop measures to plot progress toward victory and a new strategic language to describe it.

That leaves one final point.

You cannot change an organization without courage, and you cannot induce courage from above, not even by example. What you can do, though, is make goals and methods transparent enough that your employees will be willing to take some calculated risks. You want hundreds of people making informed choices and taking timely action. You do not want them all second-guessing each other or wondering if the boss really means what he or she says.

Think again of that auto company procurement manager. Imagine that she awarded, say, a balance-shaft contract to a single supplier and then the supplier failed to deliver, shutting down the whole engine line in the process. In a company that had seriously enacted a strategy of manufacturing reform just-in-time and total quality in which everybody understood the point of the strategy and had access to the data on which it was based, the decision to rely on that supplier, however dismaying, would appear a noble failure. In a company that had not gone through the process of clarifying its strategy, the decision would seem to be sheer recklessness.

Of course, it would be greater recklessness for the company to stick to a world of price taking and supplier gouging. But it is too much to ask of any one employee to make the case for a whole strategy while trying to save her own neck. To have risked a single-source contract in the first place, she needs confidence that her colleagues understand her intentions that there are widely shared and understood measures by which she can either justify her decision or learn something from her mistake.

In his essay, “Shooting an Elephant,” George Orwell confesses that, like other imperial policemen in Burma, he acted mostly against his will, mostly out of the desire not to “appear like a fool.” People in companies act out of much the same impulses. The world inevitably changes; existing practices and principles of action inevitably become unreasonable. The point is, employees do not look foolish sticking to them. Only the company does.