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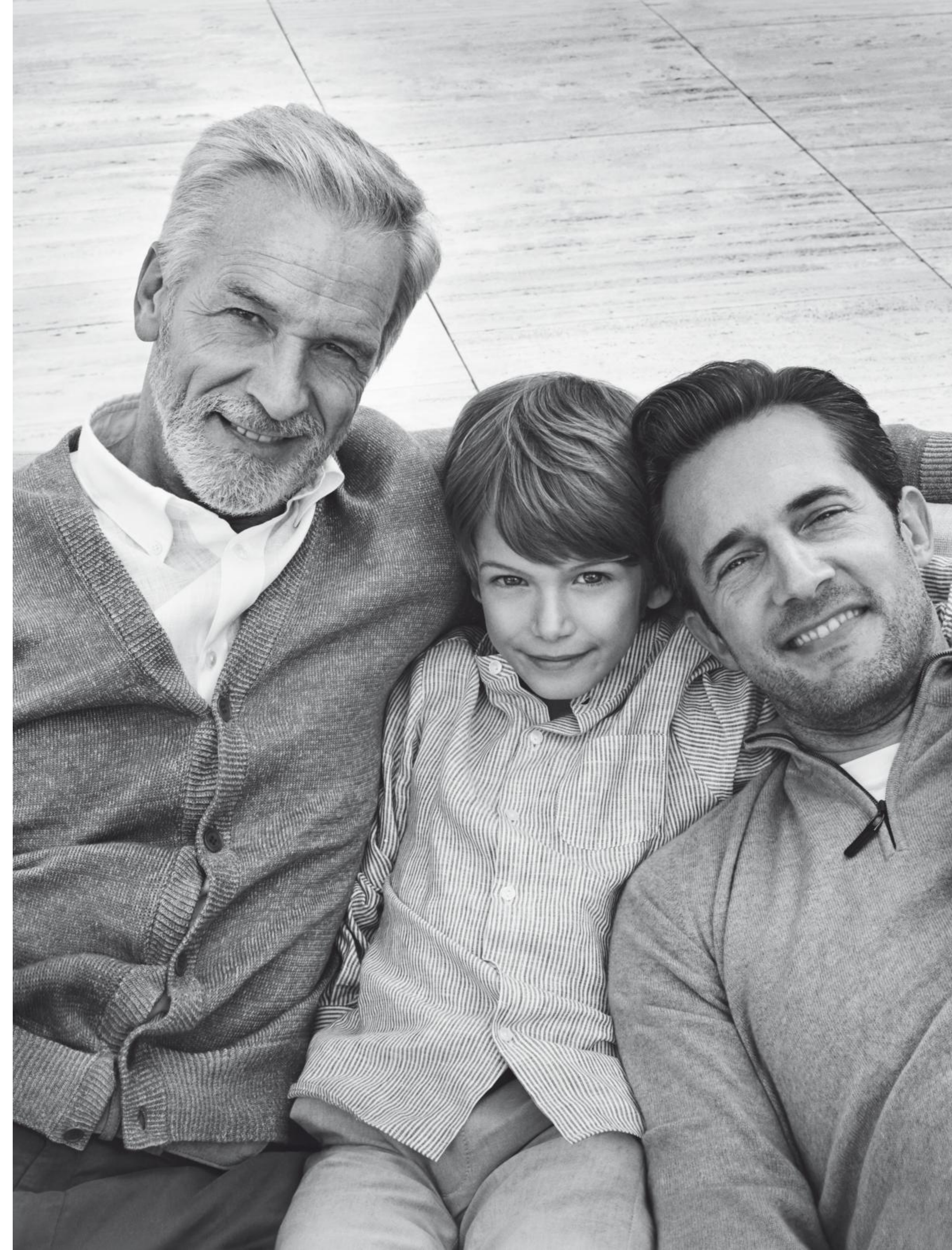

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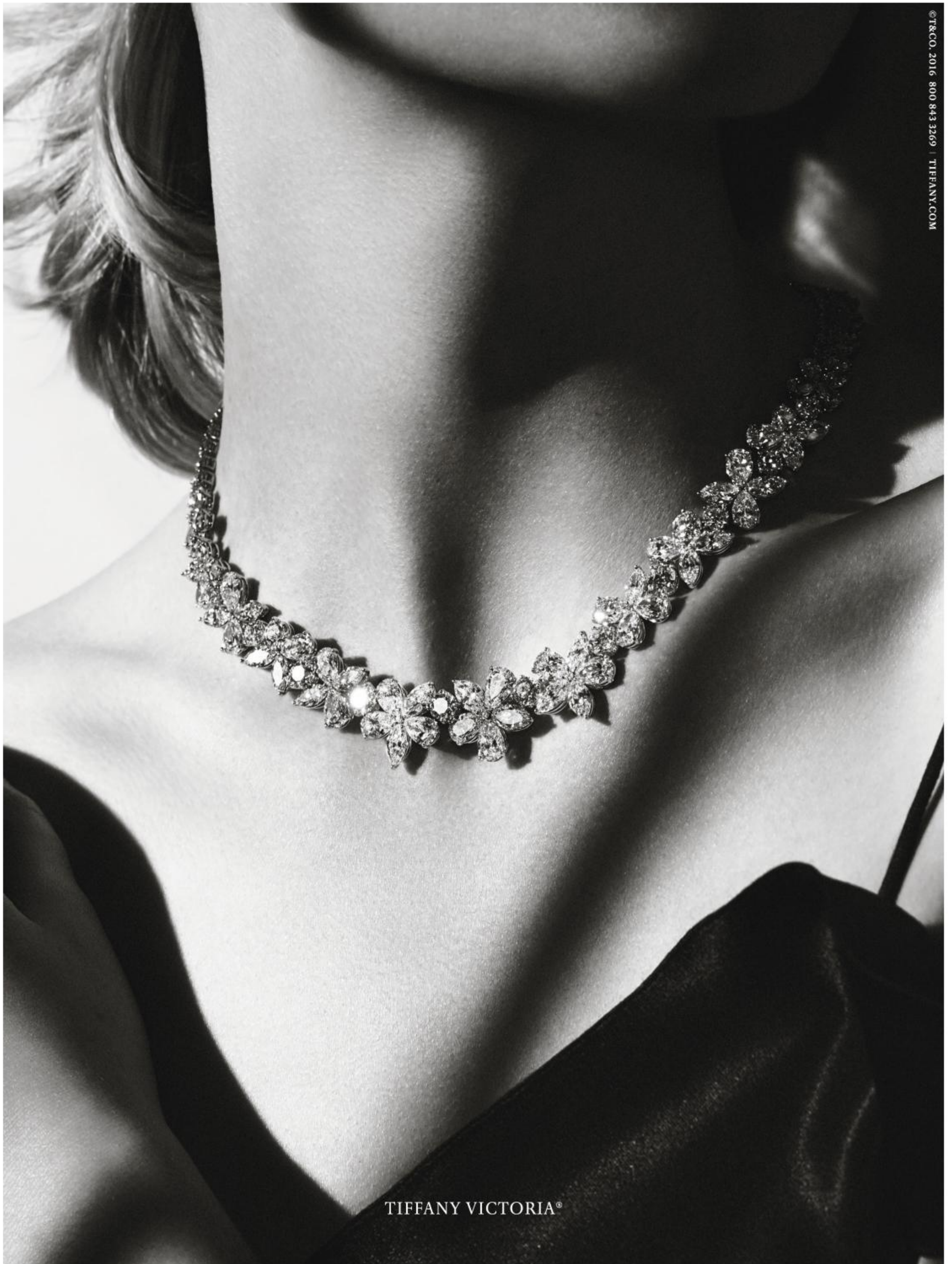
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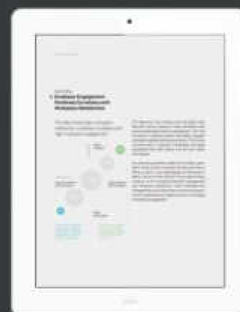

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MBAs are more likely to put their own interests first.
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From the Editor
Dealing with Unexpected Bias

Digital marketplaces have the potential to reduce discrimination. Indeed, on early platforms—think eBay circa 1999—transactions were anonymous. But as marketplaces evolved, they began including identifying information, such as names and photos. On Uber, Airbnb, and a host of other platforms, it's immediately clear whether you're black or white, male or female—and those details may affect the prices you pay as a buyer and command as a seller or even whether you can do business at all.

That's the disturbing conclusion of recent research by Harvard Business School's Michael Luca and two HBS colleagues, Benjamin Edelman and Daniel Svirsky. They found that on Airbnb, requests from guests with black-sounding names were 16% less likely to be accepted than those from guests with white-sounding names. Airbnb isn't the only platform touched by discrimination; the problem affects websites for freelance work, ride sharing, and even dog walking.

The researchers' insight has received a lot of media attention and, more important, has prompted Airbnb (among others) to start addressing bias. In "Fixing Discrimination in Online Marketplaces" (page 88), Luca and coauthor Ray Fisman, of Boston University, go beyond the research to offer ideas for taking on the challenge. As with all issues of self-awareness, the way forward involves first acknowledging the problem. Companies must then tackle matters of communication and design—work Luca is currently engaged in with Airbnb.

This is a difficult problem, but one we hope won't require years to work out. The search for a solution can begin right here.

Adi Ignatius, Editor in Chief

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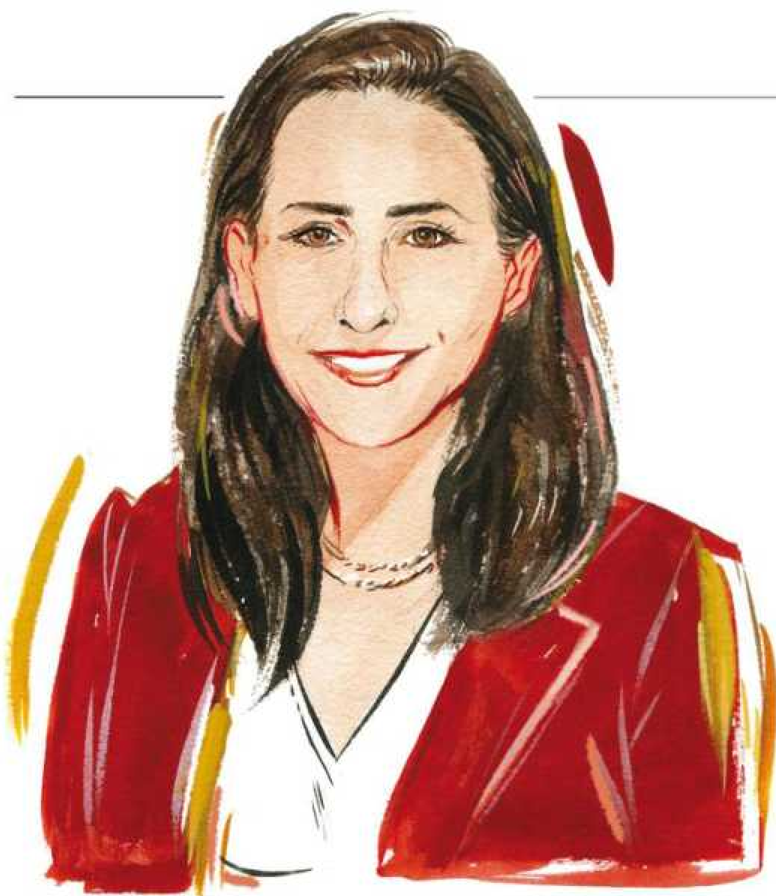
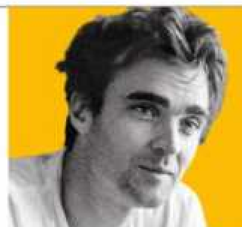


Leemore Dafny's affinity for science and medicine was clear by the third grade, when she borrowed a chromatograph from her dad's laboratory for a science fair project. She considered going into medicine but early on was detoured by a "riveting" intro economics course taught by Martin Feldstein, a chief adviser to Ronald Reagan. Feldstein urged her to get an advanced degree, and after a stint at McKinsey, she headed to MIT for a PhD in economics. As a scholar and a government economist, Dafny has been instrumental in shaping policies to drive innovation and efficiency in health care. Her article with Thomas Lee on health care competition appears on page 76.



Moving from his native Sydney to Los Angeles profoundly affected how **George Byrne** approached photography. "What I see and feel in LA is a haunting and accidental beauty on the streets," he has written. "There is something about the urban landscape here that…feels 'presented' and yet largely ignored." You can see his work in this month's Spotlight package (page 51) and at georgebyrne.com.

"Throughout my career I've seen great strategy and operations improvements negated because the succession transition was screwed up—including my own," says **Dan Ciampa.** When he stepped down after 12 years as chairman and CEO of a consulting firm, his handpicked successor failed within a year. "I take responsibility for that," Ciampa says. He returned to the firm as CEO, brought in an outside hire, and spent 18 months helping his second replacement acclimate before taking over. His article is on page 60.

When **Aldo Musacchio** taught an executive program at Harvard Business School, seven years ago, he found that his students were comfortable operating in big emerging countries such as Brazil, India, and China but were uncertain about how to enter less-developed countries such as Myanmar, Ethiopia, and Mozambique—even though they realized that such places held the most potential for growth. So he joined forces with Eric Werker, who was teaching in a Harvard program about competition in the less-familiar parts of the global economy. They share their research on page 40.

Manfred Kets de Vries, whose article on what to do if you hate your boss appears on page 98, is a pioneering scholar of the psychology of leadership. His interest in the subject stretches back to his childhood in Nazi-era rural Holland, where his family concealed 14 Jews for five years. In that time he came to understand on a very personal level just how much damage a bad leader can do.

VIVIAN SHIH; GEORGE BYRNE BY FREDERICUS I'AMI

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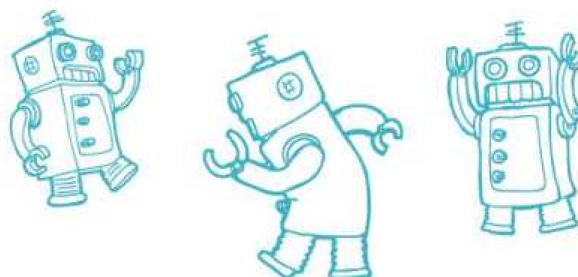

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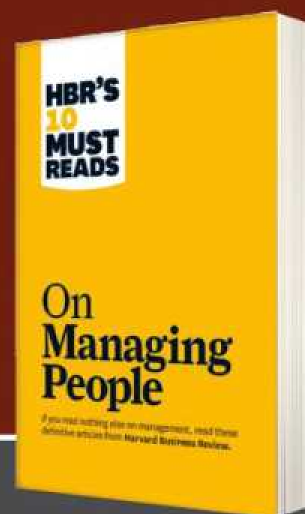

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Reducing Noise in Decision Making

HBR article by **Daniel Kahneman, Andrew M. Rosenfield, Linnea Gandhi,** and **Tom Blaser,** October

Organizations want consistency. Yet judgments can vary a great deal from one individual to the next, even when people are in the same role and supposedly following the same guidelines. This variability in decision making is called noise, and it's surprisingly costly to companies. The authors explain how to assess noise within an organization and remedy it. The most radical approach is to replace human judgment with algorithms, which return the same output for any given input.

One needs to distinguish between high-frequency decisions (such as credit approvals and complaint resolutions) and low-frequency decisions (such as which platform to base a product on and what company to acquire). With recurring decisions, the data required to develop and validate algorithms may be available, but rare decisions can involve a degree of uncertainty that may not be approached in an algorithmic manner.
Gahl Berkooz, chief of analytics, global connected consumer experience, General Motors

Decision tools (algorithms, checklists, group reviews, and so on) are not about creating and filing reports. They're designed to help employees make high-quality decisions quickly. In some arenas (like product design and strategy) creativity, trials, and course changes are important. In other arenas many similar decisions need to be made quickly, and people have only one opportunity to get them right. In those cases tools promote good decisions, especially under time pressure. They should actually decrease the amount of reporting, since managers can be more hands-off when they know that employees' decisions won't drift.

A perfect example is health care, where professionals need to weigh many complex factors in determining the best treatments. Decision tools are popular in that field because they allow faster, consistently accurate decisions and draw on the best available evidence. That's extremely important In situations where noisy decisions can cost patients their lives.
Tom Mullie, benefits realization consultant, Alberta Health Services

The key to using an algorithm-based decision method is to focus on the inputs rather than the output. It is the inputs that must be synthesized through the algorithm to improve precision, reduce variation, and avoid bias. An example of an output might be "select a platform to base a product on." Inputs here might be familiarity with suppliers, relationship with customers, and level of experience with similar products. If inputs are treated empirically, a recommended decision (even a low-frequency one) is more likely to be successful.
Lyle Hervert, senior business consultant, Glasshouse Consulting

In forecasting it has been shown that group judgment reduces noise and increases accuracy. To avoid groupthink, decisions are made individually and then combined. I think this would work with other decisions, too. And perhaps incentives could also reduce the possibility of groupthink.
Christina Jane Phillips, business analyst, ForLab, Bangor University

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BY JOSH BERSIN

Why Leadership Training Fails—and What to Do About It

HBR article by **Michael Beer, Magnus Finnström,** and **Derek Schrader,** October

Companies spend an enormous amount on employee training and education but aren't getting a good return on it. People tend to revert to old ways of doing things, and performance doesn't improve. The authors identify six barriers to change and offer steps for overcoming those barriers.

Too often a firm's top executives abdicate their responsibility for developing people to HR or a trainer while they get on with the "real work" of running the business. Of course, their people could be playing a vital role in running the business if they were coached and challenged properly by their own managers. Frankly, if leadership doesn't include developing those around you, bringing them along, and removing obstacles to their doing their best work, what is it about? If you just make all the decisions and tell people what to do, that's not leadership. It's being the boss—an outdated concept inspiring no one.
Blaire Palmer, author, keynote speaker, and CEO of That People Thing Ltd.

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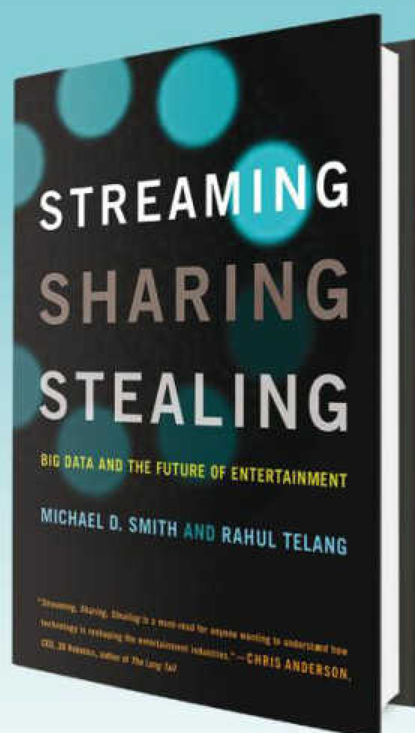
I've found that many people shy away from implementing the teachings of training because it adds work for no additional pay. People like to stay in their comfort zones. I had that experience with the coaching intervention for a very senior person. He kept postponing using what he'd learned, saying he didn't want to disrupt existing processes (even though they were not yielding results).
Charu Sharma, HR consultant

Leadership training has to start with the right enterprise culture and mindset. They are the soil in which you plant management techniques. Without them, people will forget the meaning of whatever techniques



"[The authors explain] gently yet firmly exactly how the internet threatens established ways and what can and cannot be done about it. Their book should be required for anyone who wishes to believe that nothing much has changed."
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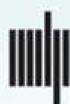

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they learn. Techniques have to be anchored in emotions and meaning.
Heinrich Anker, lecturer in business ethics

We need to recognize that leaders aren't trained. Training gives people who don't know how to do something the knowledge to do it. It's implied that you can accomplish this in one, two, or three days. Leaders are developed: That process takes a spark in someone, and with nurturing, mentoring, coaching, and some specific skills training, helps that person fulfill his or her potential. This requires more time and patience than most organizations are prepared to invest, but those that do it properly see dramatic results.
Matthew MacLachlan, head of intercultural training, Communicaid

Rethinking the Annual Performance Review

HBR article by **Peter Cappelli** and **Anna Tavis,** October

Traditional performance appraisals have been abandoned by more than a third of U.S. companies. Many are moving instead to frequent development-focused conversations between managers and employees. The authors explain the factors behind this shift, which include a tight labor market and the need for agility.

It would be interesting to combine the insights from this article with those from Daniel Kahneman's article on noise. As Cappelli and Tavis note, in an agile environment teams have a retrospective every two weeks. Comments at retrospectives about team members' collaborativeness could be used in a formula like the ones Kahneman describes, which could provide an overall score for each employee's performance. Anyone who was an outlier and fell more than a standard deviation below the average could be put on a watch list. This system would probably surpass the current one in identifying the most and least valuable employees.
Andy Webb, CIO, Execusolve

This article offers solid evidence of a phenomenon I call "trickle-down leadernomics": episodic training designed to help executives become better leaders, who inspire commitment rather than mere compliance, which results in a more productive work environment and happier employees, who ultimately improve the company's bottom line.

The trouble with this approach isn't just the "trickle-down" part. It tends to be a linear process rather than a reinforcing one. In other words, if you can't really measure the impact of an executive development program on an organization, it won't serve to inspire future investments in learning. And without a mechanism to implement learning, such as the cross-functional work teams described in the article, learning will never become evident in the organization in a meaningful way.

With the myriad challenges facing today's leaders, it will take more than gravity to ensure that investments made in leadership development flow down to the bottom line. The problem has to be addressed horizontally, rather than vertically. This is why I believe cross-functional teams of peers are one good answer.
Leo Bottary, adjunct professor, Rutgers University; and coauthor, *The Power of Peers: How the Company You Keep Drives Leadership, Growth & Success*

HBR SURVEY

Have our readers let power go to their heads, making them rude and reckless? A recent survey shows that:

41% of them frequently interrupt people

50% check their phones when others are talking in meetings

30% are spending far more money than they have in the past

12% have taken credit for a group effort

SOURCE "ASSESSMENT: IS YOUR POWER CORRUPTING YOU?" BY DACHER KELTNER

One thing I wasn't clear about from the article: What is wrong with managers' being held accountable for performance reviews?
David W. Bracken, principal, DWBracken & Associates

The problem is not with the condition of being accountable but with the use of the verb "being held." It suggests a cause and effect: that people cannot be accountable unless they are "held" so by others. If you encourage an organizational ethos in which people set stretch goals for learning and growth, they become accountable for their own actions, and the team will identify members who don't do so.
David K. Hurst, speaker, educator, and writer

STRATEGIC HUMOR

CAPTION CONTEST

"First they gave Gandalf an office, and now Bilbo? I knew we should have joined that quest."

This month's winning caption was submitted by **Mike Walters** of Ada, Michigan.

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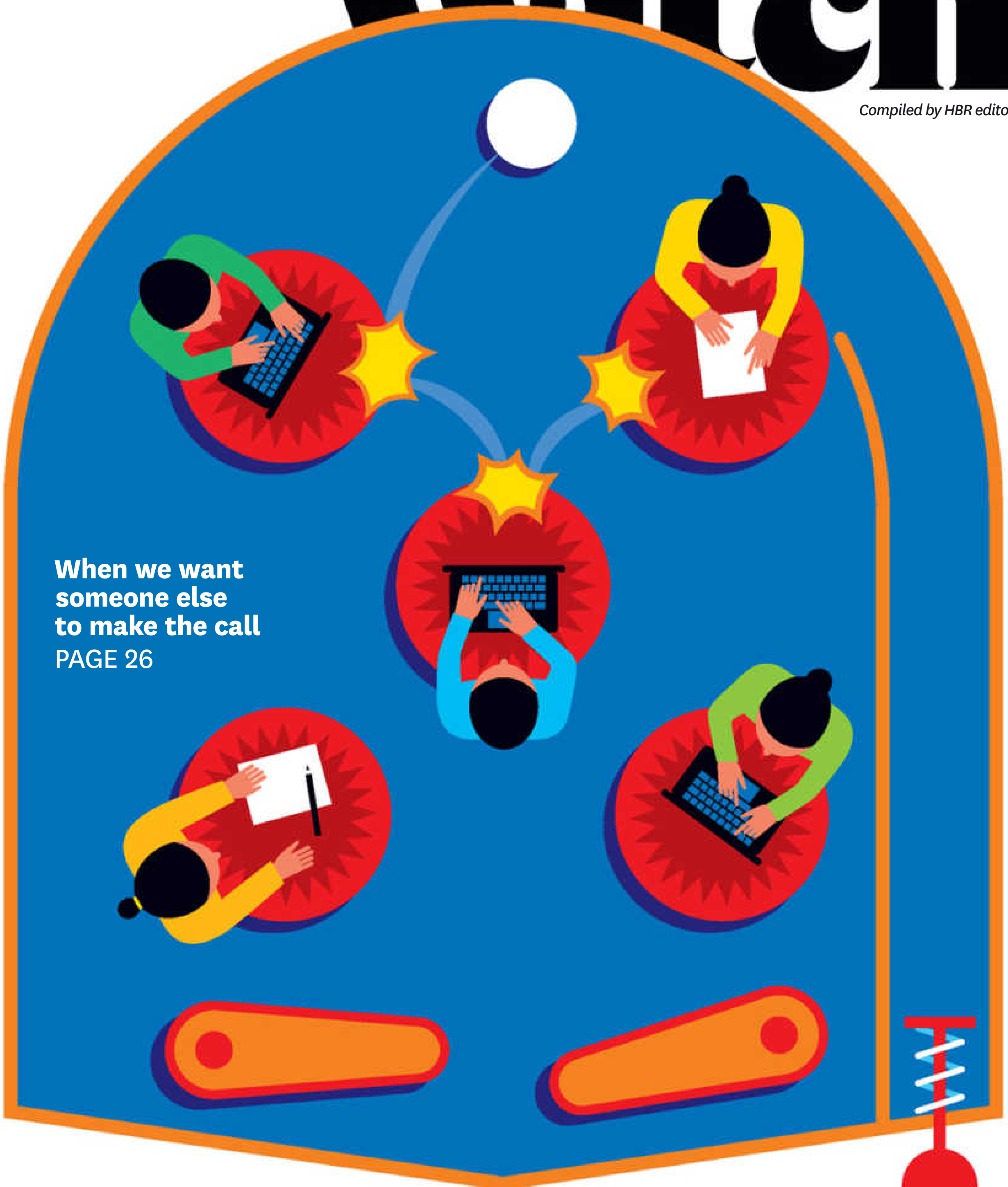
Should we be wary of executives with MBAs?

Idea Watch

Compiled by HBR editors



When we want someone else to make the call
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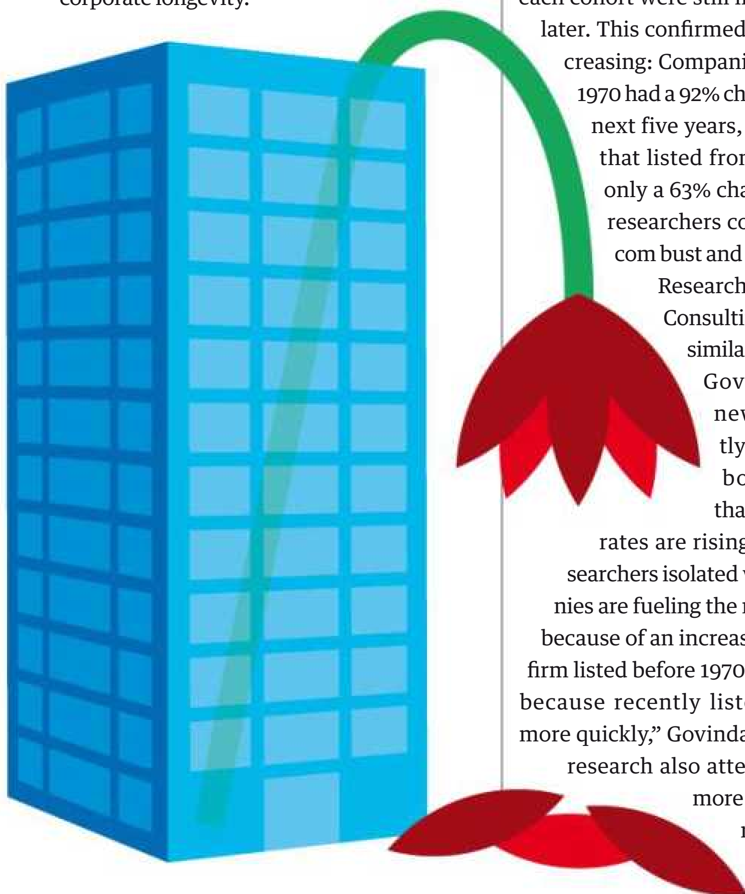
PATRICK GEORGE

STRATEGY
THE SCARY TRUTH ABOUT CORPORATE SURVIVAL

Companies really are failing faster. Here's why.

It's one of those stats that's constantly thrown around at conferences: 80% of the companies that existed before 1980 are no longer around—and another 17% probably won't be here in five years. Dartmouth professor Vijay Govindarajan heard versions of this so often that he eventually began using it himself—even though he didn't know whether it was accurate or, if it was, why it was true. So he and his colleague Anup Srivastava decided to take a rigorous look at corporate longevity.



Prior researchers had examined survival rates of the *Fortune* 500 and the S&P 500 firms, but the Dartmouth professors cast a wider net, including all 29,688 companies that listed on U.S. stock markets from 1960 to 2009. (They reasoned that the *Fortune* 500 and the S&P 500 represent only very large companies, which may be especially vulnerable to disruption.) They divided the companies into 10-year cohorts according to when they listed and examined how many in each cohort were still in business five years later. This confirmed that longevity is decreasing: Companies that listed before 1970 had a 92% chance of surviving the next five years, whereas companies that listed from 2000 to 2009 had only a 63% chance, even when the researchers controlled for the dot-com bust and the Great Recession.

Researchers from the Boston Consulting Group had done a similar analysis in 2015, but Govindarajan says the new findings are subtly different. Although both studies found that corporate mortality rates are rising, the Dartmouth researchers isolated what kinds of companies are fueling the rise. "This trend isn't because of an increasing likelihood that a firm listed before 1970 will fail—it's mainly because recently listed firms are dying more quickly," Govindarajan says. The new research also attempts to answer the more important questions raised by the finding: Why are these businesses failing, and how can managers prevent it?

To that end, the researchers dug into financial statements, closely analyzing how the companies that went public in different decades varied in their spending on physical assets (such as plants and equipment) and on organizational capital (things including personnel, patents, R&D, and intellectual property). They found that on average, firms listed after 2000 spent more than twice as much as earlier firms (in percentage terms) on organizational capital and half as much on physical assets. "The newer firms are grounded in novel business models, like digital services, that can be launched and distributed quickly," they write. "This gives them an advantage over production firms, [because] 'idea' companies don't require an expensive infrastructure of factories, warehouses, and suppliers." But that advantage is a double-edged sword, they add: "The good news is the newer firms are more nimble. The bad news for these firms is that their days are numbered, unless they continually innovate."

That pessimistic view is driven by a simple fact: Compared with companies that own factories, products, and supply chains, digital companies are far more vulnerable to quick imitation. Govindarajan rattles off examples. Not so long ago, everyone was suddenly using Evernote, the organization app. Now Microsoft OneNote, Apple's Notes, Google Keep, Simplenote, and other apps offer similar functionality. Skype, FaceTime, Viber, Jitsi, and Google Hangouts all battle in the video chat area. Then there's Dropbox, the pioneering user-friendly cloud storage company—whose basic functionality was quickly mimicked by Microsoft, Apple, Amazon, and Google. "Creative destruction has always been a force to be reckoned with, but in the physical world, the cycles were longer," Govindarajan says. "In the technology-based sectors, the cycles have accelerated."

Some of the implications of the shift from physical assets to digital business models are subtle and unexpected. For instance, Govindarajan points to the need to revamp standard business school accounting courses,

PATRICK GEORGE

1954

FROM THE ARCHIVE

"Politics is an enterprise which involves large reliance on myth and which makes a commonplace of exaggeration. It seems likely that during the last twenty years myth and exaggeration, as they involved relations between government and business, were not always subject to the required 90% discount."

"THE DEFENSE OF BUSINESS: A STRATEGIC APPRAISAL," BY JOHN KENNETH GALBRAITH (HBR, MARCH–APRIL 1954)

which tend to belabor inventory models (remember LIFO and FIFO?), the cost of goods sold, depreciation, and other concepts that made sense when balance sheets were laden with physical assets but are less relevant when many companies' products are downloadable bits and bytes. Govindarajan says that's just one example of how business schools' curricula don't adequately reflect the current economic environment.

The study also addresses the most important question raised by the primary finding: How can newer firms buck the trend and increase their longevity? The researchers suggest three strategies. First, companies could incorporate both technology and physical products into their business models to gain an edge; their competitors couldn't then simply hire programmers to quickly create me-too services. (Examples of digital-physical hybrids include Tesla, which has developed deep expertise in batteries and vehicle manufacturing, and Amazon, whose vast network of warehouses provides a bulwark against competition.)

Second, companies could strive for business models that include strong network effects. For instance, Facebook's one billion users create a competitive advantage, because people who might be tempted to jump to a rival platform would have to reconnect to friends and recreate the content they've uploaded—a steep switching cost. Third, firms could increase their focus on continual innovation—an idea Govindarajan has illustrated in a framework he calls "the three-box model" (which is the subject of a 2011 HBR article and a 2016 book).

The results also led Govindarajan to reflect on the common criticism that CEOs tend to think too much about the short term. "People blame Wall Street for this pressure, but in fact Wall Street demands that you look for a healthy balance between the short term and the long term," he says. "Otherwise you're not going to be there after the short term."

HBR Reprint F1612A

ABOUT THE RESEARCH "Strategy When Creative Destruction Accelerates," by Vijay Govindarajan and Anup Srivastava (working paper)

THE IDEA IN PRACTICE

"NOW THE BARRIER TO ENTRY IS USER ATTENTION"

Vibhu Mittal has experienced the challenge of creating competitive advantage from two distinct vantage points. During nine years as a senior scientist at Google, he helped a dominant technology company strengthen its position; and in the past seven years, while leading a series of education technology start-ups (he's currently the CEO of Edmodo), he worked to disrupt incumbents. He spoke with HBR about Silicon Valley's evolving view of creative destruction. Edited excerpts follow.

Has it become more difficult to create competitive advantage? Absolutely. The analogy I make is to open-source software. Companies used to do proprietary stuff, and they tended to innovate slowly. Today companies are willing to talk about their innovations more openly and to post code and have thousands of people look at it so that they can modify it, test it, and get more reactions. The rate of feedback from open sourcing is an order of magnitude greater, but you also get more imitation. The barriers to entry haven't entirely disappeared—but they've been moved a bit further along, beyond the product innovation stage. Now the barrier to entry is whether you can get user attention.

Is it easier to build moats around physical products? That's a valid point, but as 3-D printing becomes more common, you're going to see more companies displacing products in the physical space, too. If you outsource manufacturing to China, 3-D printing can shift the turnaround time to weeks rather than months.

Among digital start-ups, how much fear is there of copycat products? You often see a copycat make a slightly better version of a product, and a lot of people migrate from older versions. Companies can't afford to rest on their laurels anymore—you have to behave in a paranoid fashion. If you don't see a threat on the horizon, it's probably because you're missing something. One of the biggest reasons for creative destruction today is that the world has become far more interconnected—everybody can talk to anybody, and that has implications. People will copy any successful idea out there.

Forty percent of college students don't know what a consulting firm does—and of those who do, 35% learned it from entertainment sources such as the Showtime series *House of Lies*.

"WHERE THEY'RE GOING, THEY DON'T WANT ROADMAPS: GAUGING COLLEGE STUDENTS' PERCEPTIONS OF CONSULTING CAREERS," BY WALKER SANDS COMMUNICATIONS

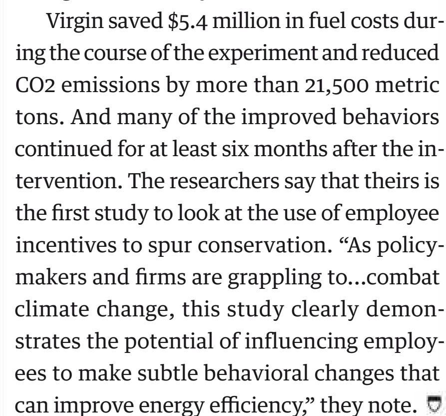
SUSTAINABILITY
HOW TO NUDGE EMPLOYEES TO CONSERVE ENERGY

What's the best way to get companies to minimize carbon emissions? One solution is to impose taxes or regulations. But a new study by researchers from the University of Chicago and the London School of Economics examines a different technique: the use of low-cost monitoring, goals, and incentives to encourage employees to voluntarily cut back on energy use.

The researchers worked with Virgin Atlantic Airways, using data on the firm's 335 captains during more than 40,000 flights. After looking at pilot behavior to establish baselines, they divided the captains into four random groups and conducted an intervention with three (the fourth group served as a control). Members of the first group were told that their performance would be tracked in three areas: preflight fuel efficiency (how well pilots optimize the load of fuel to avoid carrying more than necessary), in-flight efficiency (whether they choose the best routes, speeds, and altitudes), and postflight efficiency (whether they turn off one or more engines while taxiing to the gate). They would receive a monthly performance report.

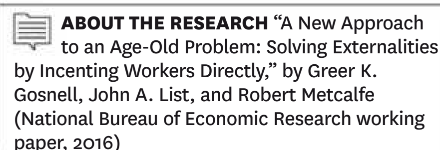
Members of the second group were also told that their performance would be tracked, and each was given a goal based on past behavior; the monthly reports would note whether he or she had hit that goal. Members of the third group were told they were being tracked, given individual goals, and offered an incentive: If they met their goals, the company would make a donation to the charity of their choice.

The behaviors of the four groups were then studied for eight months. All improved their fuel efficiency, with most of the gains coming from the mere awareness of being monitored: The vast majority of pilots improved in all three efficiency areas as soon as the study began. Adding a personal goal produced additional gains, but the donation



incentive yielded no further efficiency (although it did boost job satisfaction).

Virgin saved $5.4 million in fuel costs during the course of the experiment and reduced CO_2 emissions by more than 21,500 metric tons. And many of the improved behaviors continued for at least six months after the intervention. The researchers say that theirs is the first study to look at the use of employee incentives to spur conservation. "As policymakers and firms are grappling to…combat climate change, this study clearly demonstrates the potential of influencing employees to make subtle behavioral changes that can improve energy efficiency," they note.



ABOUT THE RESEARCH "A New Approach to an Age-Old Problem: Solving Externalities by Incenting Workers Directly," by Greer K. Gosnell, John A. List, and Robert Metcalfe (National Bureau of Economic Research working paper, 2016)

DELEGATING
WHY WE PASS THE BUCK

It's a balancing act every manager faces: when to take charge of decisions and when to entrust them to others. Countless studies have examined the reluctance to delegate; now new research looks at the circumstances under which people *want* someone else to make the call.

Researchers at Northeastern and Indiana universities and the University of Cincinnati conducted a series of experiments in which participants could either accept or hand off responsibility for choosing hotel rooms, meals, tasks, or investments for themselves or for someone else, under a variety of conditions. They discovered that participants were more apt to delegate decisions when the consequences would affect other people, especially when all the options were unappealing (when, say, the choice was among several poorly rated hotels). When both those conditions held, participants were two to three times as likely to have someone else decide as to do so themselves.

This pattern was driven by two things: a desire to avoid blame or criticism (although an offer of anonymity didn't altogether erase the tendency to delegate) and a wish not to feel responsible if something bad happened to another person. (People were more comfortable inflicting a negative outcome on themselves.)

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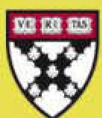

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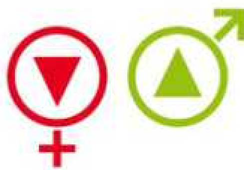


Having rated themselves on leadership competencies and then learned how peers had rated them, female MBAs downgraded their scores in subsequent self-assessments more sharply than male MBAs did.

"THE GENDER GAP IN FEEDBACK AND SELF-PERCEPTION," BY MARGARITA MAYO

It had little to do with the difficulty of the decision, the perceived importance of the result, or laziness. (Subjects opted to delegate rather than fall back on quicker alternatives, such as flipping a coin.)

Unsurprisingly, the researchers found that participants didn't delegate to just anyone—but the most salient factor turned out to be the surrogate decision maker's level of authority rather than his or her expertise. People delegated only when they could tap someone of equal or higher status—someone who would clearly be deemed responsible for whatever happened.

Participants were more apt to delegate decisions when the consequences would affect other people, especially if all the options were unappealing.

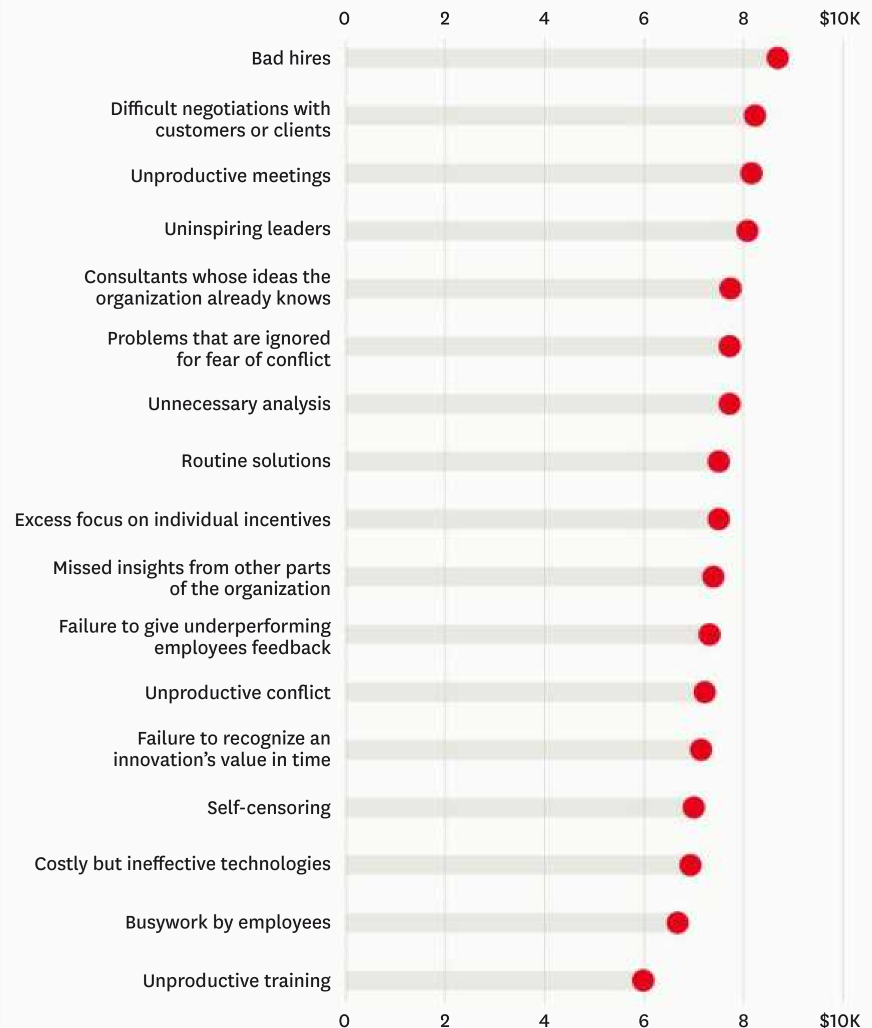
Understanding these dynamics can be helpful for young managers who are shifting into leadership roles where their decisions will have an impact on others. It's also useful given our increasing ability to offload decision making to algorithms (if things go awry when a machine is in charge, people probably won't find the sense of absolution they were hoping for).

And the findings have broader implications for companies looking to help their managers delegate appropriately. For example, when leaders should tackle a decision themselves—when they could rule more quickly or capably than others—reassurance that they won't be blamed for a bad result may help them do so. In addition, the researchers say, "encouraging people to think about the other[s] who may be affected by their decisions may make them feel more responsible for the outcome and thus more amenable to seeking counsel."

ABOUT THE RESEARCH "Passing the Buck: Delegating Choices to Others to Avoid Responsibility and Blame," by Mary Steffel, Elanor F. Williams, and Jaclyn Perrmann-Graham (*Organizational Behavior and Human Decision Processes*, 2016)

MANAGEMENT
PUTTING A PRICE ON "PEOPLE PROBLEMS"

Managing people is a time-consuming task—but how much money gets wasted in the process? Researchers surveyed 83 executives from a broad range of industries around the globe, asking them to estimate the daily cost to their firms of dealing with various people problems. The results should help companies understand that these issues aren't just sources of frustration; they also result in big hits to profits.



SOURCE *STOP SPENDING, START MANAGING: STRATEGIES TO TRANSFORM WASTEFUL HABITS*, BY TANYA MENON AND LEIGH THOMPSON (HARVARD BUSINESS REVIEW PRESS, 2016)

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

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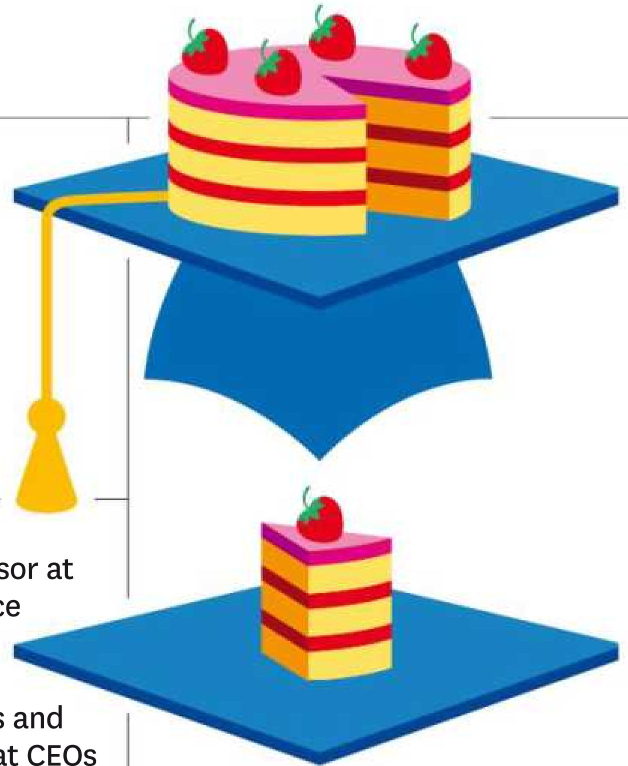
DEFEND YOUR RESEARCH
MBAS ARE MORE SELF-SERVING THAN OTHER CEOS



The research: Danny Miller, a research professor at HEC Montreal, partnered with Xiaowei Xu, an assistant professor at the University of Rhode Island, to analyze the performance of 444 celebrated U.S. CEOs—those featured on *Fortune*, *Forbes*, and *BusinessWeek* covers from 1970 to 2008. Miller and Xu tracked their firms' growth strategies and performance and the CEOs' compensation, and found that CEOs with MBAs were more likely to engage in behavior that benefited them but hurt their companies. Specifically, they pursued costlier growth strategies and were less able to sustain superior performance than their non-MBA counterparts.

The challenge: Does having an MBA make you likely to put your own interests first? Should boards be wary of executives who've gone to business school? **Professor Miller, defend your research.**

Miller: It would have been nice to find that MBAs were more effective and responsible managers than their counterparts without the degree. At worst, we expected no effect. Alas, that was not the case. CEOs with MBAs made up a quarter of our sample, and in the three years after they appeared on a magazine cover, their firms saw a market value decline that was 20% greater than that of firms run by non-MBAs. This performance gap remained significant even seven years after a cover story.

In addition, MBAs' expenditures on acquisitions were almost twice those of non-MBAs, after factoring in all our control variables, such as firm size and leverage. And in the year prior to their cover stories, the MBAs' firms had lower levels of cash flow and inferior returns on assets, which suggests that MBAs tended to pursue costly rapid growth.

HBR: How do those outcomes signal self-serving behavior? We argue that in companies, three elements constitute self-serving behavior on the part of the CEO: (1) success is achieved via rapid, hazardous expedients, such as some acquisitions; (2) that success is especially short-lived; and (3) the executive gains personally from it through unusually steep compensation increases.

Did the MBAs in your study get raises? Yes. Despite their poorer performance, their compensation increased more than that of non-MBAs after their cover stories ran. On average, the MBAs saw their compensation rise about 15% faster than non-MBAs' in the three years after a cover story ran, and they were paid about $1 million more each year.

Your study goes back to 1970. Are there more CEOs with MBAs today? Has an MBA become more important to business success? MBAs are far more common now than in 1970. Today the percentage of CEOs who have them exceeds 30%, whereas in the '70s it was about 12%, and in the '80s and '90s about 20%.

Why focus on people who were on magazine covers? Can that sample really represent all CEOs? We chose to examine executives who were successful enough to be celebrated publicly and who also had the opportunity to personally exploit that success. In this kind of sample there is significant scope for self-serving behavior.

Of course, although this is a large sample, it involves just major, successful public companies, many of which are well known. Our findings may not apply to smaller, less prominent, or private companies.

Other research has found that age, founder status, education quality, and

even gender may influence CEO behavior and performance. Did you test to see if any of those had an effect? Yes. Our analyses controlled for all those factors and more. The only two that seemed to relate to changes in performance after the CEO was on the cover were the quality of the schools people had attended and prior firm performance. Higher school quality led to better performance post-cover for all CEOs, and better firm performance prior to the cover led to worse performance after it for all CEOs—it is hard to stay on top. But firms of non-MBAs did not fall nearly as fast. We also saw that founders and MBAs did more acquisitions and that CEOs who went to better schools did fewer.

We discovered no gender differences, perhaps because there were so few women in our sample. However, we could not measure personality traits, which may play an important role.

Does business school promote self-serving behavior? It could be that. Many MBA programs emphasize bottom-line performance, financial and accounting measures and levers, stock prices, competition, and personal economic success. They place less emphasis on creative and scientific skills, intrinsic job satisfaction, social contribution, and the ethical treatment of stakeholders. On the other hand, it might be not the curricula but self-selection that explains our findings. Perhaps people with self-serving proclivities are more inclined to go into business programs than, say, the arts or sciences.

Also, our results could be driven in part by how others react to CEOs' behavior. Research suggests that making acquisitions is a more hazardous strategy than growing organically, and it may be that investors are more apt to penalize firms that grow by buying other firms.

Most important is that we do not claim that an MBA education causes CEOs to behave in negative ways. Our analysis establishes only association, not causality. We took pains to make that point in the paper.

How can organizations combat self-serving behavior? A good culture can reduce it. The values reflected in company goals, HR practices, socialization rituals, and how a company deals with its stakeholders will help ensure that the right kind of CEO—MBA or not—is appointed. Cultures also determine the criteria against which CEOs are evaluated. Isabelle Le Breton-Miller and I have been studying "thick cultures" in long-lived family businesses. There, an MBA degree is unlikely to have any bearing on CEOs' strategic conduct and their tendency to manage for the long run.

Incentive systems are also important. When CEOs are rewarded disproportionately for short-term performance, it reinforces exactly the kind of behavior we found. Tying pay to long-term results, financial as well as nonfinancial, is probably the way to go.

What should future research look at? Xiaowei Xu and I are now trying to extend our research to a broader sample of enterprises. It would also be useful to look into how much the content of specific MBA programs will mitigate the effects we found. For example, would a greater focus on sustainability, stakeholder service, and corporate social responsibility dampen self-serving instincts? Finally, we all have different personalities. How do those interact with education to drive managerial behavior?

So it's too soon to say, "Don't let MBAs run your company." A good deal has been written about the self-serving nature of MBAs, and Xiaowei and I were wondering whether or not the accusation was justified. After all, we do work for business schools. I have an MBA, and many of our colleagues have MBAs and are capable, ethical people. So don't use our study to disparage MBAs. But do be on the lookout for evidence of the kinds of opportunistic behavior we described, regardless of who the CEO is.

Interview by **Nicole Torres**
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PATRICK GEORGE

WINTER ISSUE ON NEWSSTANDS NOW

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HOW I DID IT... PAYPAL'S CEO ON CREATING PRODUCTS FOR UNDERSERVED MARKETS

by Dan Schulman

The Idea

While readying the company for its IPO, Schulman decided that part of its overall strategy would be "to bust the paradigm in financial services that it is 'expensive to be poor.'"

CODY PICKENS

About a decade ago, when I was the CEO of Virgin Mobile, a colleague and I accepted an unusual challenge: Spend 24 hours living on the street in New York City as a homeless person would, with no money or credit cards, no cell phones, and just the clothes on our backs. Virgin had been supporting a charity for homeless youth, and during an employee event someone from the charity told us that the only way we could learn about the importance of its work was to experience the lives of the people it was serving. I agreed to do it. It was one of those experiences you never forget. We panhandled, and I wasn't very good at it—it took me six hours to solicit enough money to buy a little food. Most people looked right past me, as if I were invisible. We spent a lot of time trying to find a safe place to sleep—we kept getting kicked out of places, and eventually we ended up in a skateboard park. I lived like that for only 24 hours, which of course is nothing—and it was during the summer, so the weather wasn't terrible—but it was enough to give me a large dose of empathy for people who have to live on the street.

High Costs for the Poor

A few years later, when I was leading a division at American Express, I joined my leadership team in a variation on that experiment: We had to spend an entire day paying bills and moving money using methods available to people without bank accounts or credit cards. We stood in line at storefront check-cashing places, which are often in dangerous parts of the city. We went to retail establishments to pay utility bills with cash. We wired money. Managing finances this way can feel like a part-time job because of all the time spent in lines, and it's very expensive—the fees are extremely high. We came away with a newfound appreciation for how costly it is to be poor, which helped drive our work at American Express to create new payment systems for people without access to traditional banks.

Since I joined PayPal as its chief executive, in 2014, this awareness of how difficult it is for less-affluent people to manage and move money has energized our strategy. PayPal is best known as a payment method for people making purchases on e-commerce websites, and that remains a vibrant part of our business—but we're also aggressively expanding to become a software platform for a variety of financial transactions. Many people need these services.

Since 2014 an awareness of how difficult it is for less-affluent people to manage and move money has energized our strategy.

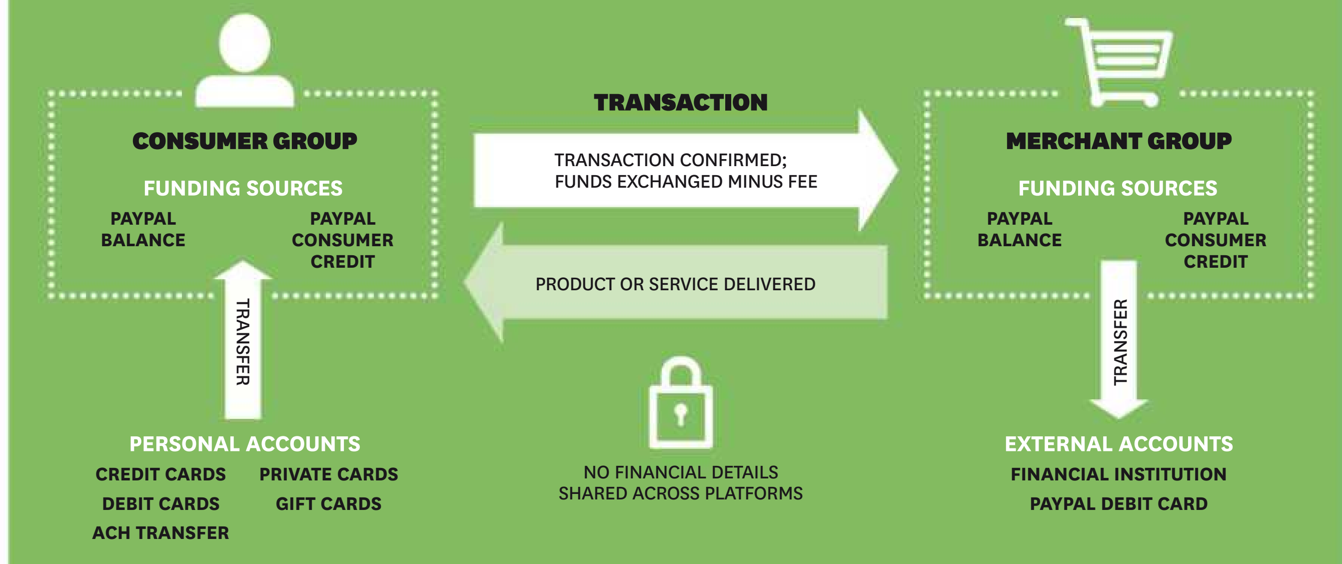
Data from the Federal Reserve shows that 47% of Americans could not raise $400 in case of an emergency—say, a car repair in order to get to work—within a month's time. Two-thirds of Americans live from paycheck to paycheck. These are huge segments of the population, and if we can reimagine the ways in which they manage money and find new ways to help them save, we can make their lives better and also create business opportunities. As smartphones give people around the world access to powerful applications and platforms, we can go beyond traditional thinking about the "banked" versus the "unbanked" to reconceive how basic consumer financial transactions take place.

Marrying Two Goals

I grew up in New Jersey. My parents were professionals—my dad was a chemical engineer, and my mom was a college administrator—but we were far from affluent. We lived in a small apartment in Newark. My family had a history of caring about issues of social justice. My grandfather had been a union organizer, and my mother was a civil rights activist. They taught me from an early age to be concerned about people who didn't have the advantages we did.

After college I joined AT&T, where I ended up spending 18 years. I changed roles quite often, which gave me an opportunity to learn the various functions of a business. I was a salesperson. I was in charge of customer service and strategy. I eventually ran our large consumer division, a $22 billion business. From AT&T, I went to Priceline as CEO. No matter how much experience you have running big divisions within a company, being the CEO is completely different—you have responsibilities to the board, to shareholders, to all the employees, and to all the customers. It was not an easy transition.

I left Priceline to start Virgin Mobile USA. We felt we could create a prepaid phone business that catered to less-affluent customers. While I was leading Virgin, I saw for the first time how a company could marry two goals—serving shareholders and being a force for good in the world. Richard Branson was my boss, and I learned a ton from him about being a champion for consumers—advocating for those who may not have a voice and working tirelessly to help ease pain points for them. As a leader, I try to define my role as dealing with the facts of any



situation while providing inspiration to employees—finding something they can get excited about. If your company's vision is about making life better for a group of consumers, that can motivate employees around a larger mission.

During my four years at American Express, I always looked at PayPal with some envy. PayPal had reached critical scale, both with consumers and with merchants, and it was more than a payment system—it was a technology-driven software company. I wasn't looking to leave Amex, and when John Donahoe, then the CEO of eBay (which owned PayPal), called me about this job, I told him I wasn't interested in running PayPal if it was going to remain a division of eBay. John confided that eBay wanted to spin off PayPal into an independent company, and that interested me. We spent a day together talking about leadership and the type of leader PayPal needed. By the end of the day, I was ready to leap at the opportunity—it seemed as if the position was tailor-made for me.

I joined PayPal in September 2014, and we immediately jumped into preparing the company for its IPO, slated for July 2015. But I also spent a great deal of time thinking about our overall strategy. PayPal had an amazing legacy—it had grown the number of transactions on its platform by 25% in the previous year, to almost 4 billion. Nobody else was close. It had done incredible work in improving its risk management and customer service. This was a successful company, and that in itself created challenges. For instance, it wasn't outwardly evident that we needed to change. Sometimes it's easier for a leader to come into a turnaround situation, where a company has no choice but to alter its way of doing things. PayPal had had tremendous success over its 15-year history, which made it harder to pivot toward new opportunities and create a feeling of urgency about seizing a new future.

A Champion for Customers

After six months of listening to employees and customers, I held a town hall meeting to talk about our strategy for long-term growth. One of the questions I had been asked frequently was "Are we a tech company or a financial services company?" It might have been easy to choose one or the other, but instead I said I wanted to become a customer-champion company—a company that focuses on various segments of the market and solves real problems for people. To inspire employees behind this strategy, I showed them where our current trajectory would take us and compared that with being a customer champion. For merchants, we needed to be much more than just a button on a website.

We needed to evolve our technology platform to enable sellers to have more-intimate relationships with customers using mobile and software. In effect, we had to become the underlying operating system for digital commerce. And for consumers, we needed to create capabilities that would allow underserved citizens throughout the world to manage and move their money in a more secure, faster, easier, and less expensive manner. We needed to bust the paradigm in financial services that it is "expensive to be poor." It was an inspirational vision of how PayPal could make a difference in the world.

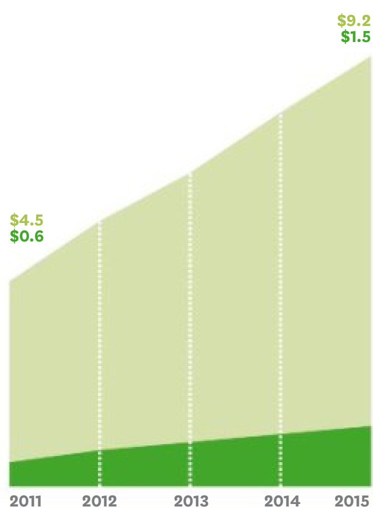
I decided that we had to reorganize PayPal to implement the new strategy. The company had been organized by function, with engineering separate from products. We reorganized into just two groups: merchants and consumers. That forced us to focus on the real needs of both sets of customers and on our goal of creating innovative and compelling value propositions for them.

A Suite of Targeted Products

Within those two segments, we have created or acquired a suite of products that target different markets. For instance, Venmo is our payment product that serves the Millennial market. It uses smartphones and social networks. Suppose you go to a concert with a friend and you need to pay him back for the ticket. Instead of handing him cash or a check, you can transfer the money on Venmo. There's a social aspect to it that's very important. Your friends can see what you're doing with whom on your social networks through your payments. The secret sauce of Venmo is that we turned a basic transaction into a social experience. As a result, it has become an extremely popular way to move money, and *Time* magazine ranked it the third most popular app in the country.

PayPal Facts & Financials

FOUNDED 1998 (as Confinity)
HEADQUARTERS San Jose, California
EMPLOYEES 16,800



We've also acquired a company called Xoom, which is the leading international player in digital payments. Xoom gives people the ability to move money internationally via their mobile phones. So there's no standing in lines. It costs half what traditional international remittance providers charge. It's the perfect example of meeting a consumer need by making it easier and less expensive to manage money.

For merchants we created a product called PayPal Working Capital, which lends money to small businesses that use our service. Unlike most lenders, we don't rely on credit scores. We have a proprietary algorithm that looks at a merchant's history with PayPal, and that data gives us the confidence we need to make a loan. We've lent more than $2 billion, and if you look closely at the data, you can see interesting trends. One-quarter of the loans have gone to businesses located in U.S. counties that have seen 10 or more bank branches close over the past several years. The companies we've lent to have grown by an average of 22%, whereas a control group of comparable companies have averaged growth of less than 2%.

We've also opened up our platform and partnered with a variety of companies, including Facebook and Visa. As the explosion in mobile devices continues, partnerships become more important. And we're working closely with governments, regulators, the International Monetary Fund, and the World Bank. Digitizing money requires an ecosystem—you can't do it alone.

I still carry some cash, but over the past decade I've learned what an inefficient form of currency it is. For one thing, it's not secure—think of all the theft and loss, and of how much businesses spend trying to protect their cash. Even for consumers, the existing system of money is expensive. Last year in the United States, people spent $138 billion on unnecessary fees and interest attached to moving and managing money. If our technology platform can help them save 50% of that—and provide incentives to save and invest more—we can help drive financial health and, we hope, enable consumers to realize their hopes and dreams. PayPal is already the world's leading financial technology company. As we shift to being a customer champion, we'll be able to drive even more shareholder value. There's no disconnect at all between those things. Solving pain points for customers is always the right thing; it's both a competitive advantage and a legacy of which we can be proud.

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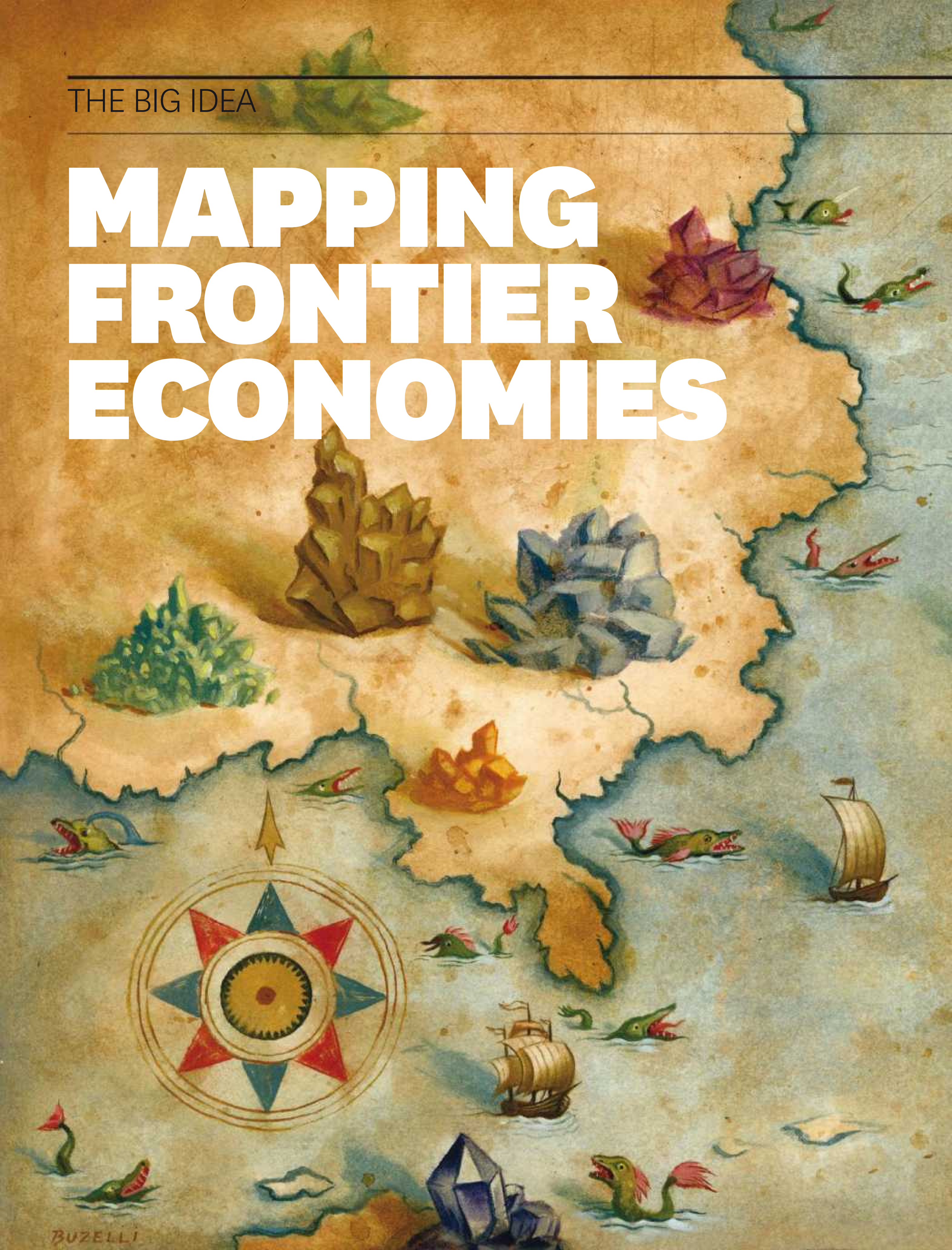
MAPPING FRONTIER ECONOMIES



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WHERE TO PLAY AND HOW TO WIN

BY ALDO MUSACCHIO AND ERIC WERKER

CHRIS BUZELLI

Global players in search of double-digit growth are running out of opportunities. Emerging-market giants such as Brazil, Russia, and China are experiencing an economic slowdown. They are increasingly expensive as a base for operations, and it's harder to export to and import from these countries than it used to be.

As a result, multinationals are paying more attention to low-income, high-risk countries both as new markets for selling goods and services and as platforms from which to export them elsewhere.

These "frontier economies," as we call them, may not seem like promising terrain; they are characterized by politically manipulated markets, weak legal systems, and either low per capita income or faltering GDP. Yet of the 25 countries forecast to grow the fastest over the next five years, 19 are frontier economies. Among them are Myanmar, Mozambique, Vietnam, and Rwanda. Many are home to the world's largest untapped sources of minerals and metals, and despite the current soft commodity prices, global investment in developing these resources will continue to boost income and growth. That's important because it means that growth in frontier economies depends relatively little on overall global economic trends, and first movers can reap better returns on foreign investments than the sometimes alarming country risk factors might suggest.

Some of those risks, moreover, turn out to be overblown, as smart companies are discovering. Politically engineered market distortions in frontier economies are often limited to sectors characterized by very large capital investments, such as natural resource extraction or infrastructure. By contrast, sectors where relatively smaller sums of money are involved (such as value-added work on resources) tend to attract less political interest, and there is scope for competing on value and rapidly growing underdeveloped sectors. For example, Tiffany & Company has successful diamond-polishing operations in Cambodia, Botswana, Mauritius, and Vietnam, along with operations in Belgium.

Even in industries where competition is skewed by government manipulation, foreign players that target the right sectors with the right strategies can prosper. In fact, companies operating in frontier economies often encounter significantly less competition than they'd face in a BRIC or tiger economy and are therefore likely to enjoy higher profit margins for longer periods.

In the following pages we offer a framework to help you figure out whether and where to play and how to win in the spaces you choose to compete in.

Mapping the Opportunities

The first step in identifying opportunities in a frontier economy is to assess the competitive environment of its industries along two dimensions: (1) the degree to which profitability is determined by competition between firms and not by government policies and actions and (2) whether the industry is focused primarily on domestic sales or on exports. Industries will fall into one of four categories.

Workhorses. In this category, relatively small companies sell to domestic customers and compete with one another using normal business strategies, seeking competitive advantage through product differentiation, operational efficiency, marketing, and human resource development. Typical examples of workhorse firms include local manufacturers (furniture makers and water bottlers, for example), service providers (small construction firms, taxi drivers), retailers (grocery stores, pharmacies), and small

Idea in Brief

THE CHALLENGE
Global players in search of double-digit growth are finding it in low-income, high-risk countries such as Myanmar, Mozambique, Vietnam, and Rwanda, where first movers can be handsomely rewarded.

MAPPING THE OPPORTUNITIES
Compare a country's industries along two dimensions: the degree to which profitability is determined by competition between firms rather than government influence, and whether the industry is focused on domestic sales or on exports.

STRATEGIES FOR SUCCESS
Each of four industry categories is associated with a distinct strategy, ranging from the conventional (leverage existing capabilities, adapt to local tastes) to the unfamiliar (make yourself indispensable to powerful local players).

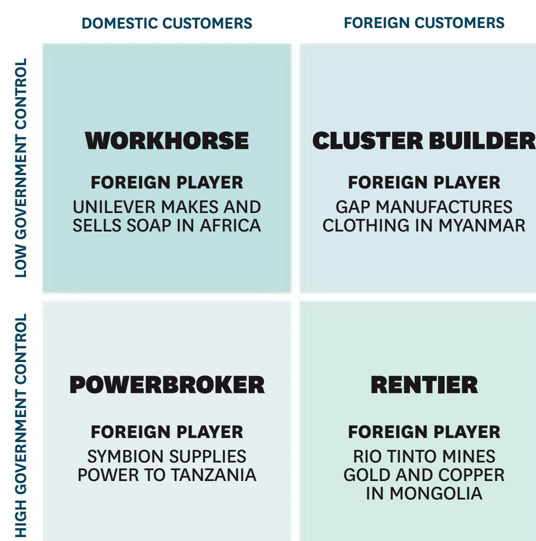
farms serving the domestic or local market. In most frontier economies, workhorse businesses employ the majority of the labor force. An example of a foreign company operating in this category is Unilever making and selling detergent to local consumers in African countries.

Cluster builders. Companies in this category compete with one another in export businesses, often as supply chain partners to large foreign corporations serving developed markets. Such firms typically locate in industry "clusters" to take advantage of low production costs, availability of skilled or cheap labor and other inputs, the presence of multiple and sophisticated suppliers, or demand from the local market. Because export cluster firms compete on price and quality, they benefit from clear and business-friendly laws and regulations, and they require well-developed institutions around contract enforcement. Typical players include electronics and garment manufacturers and international service providers such as shipping lines or call centers. Gap's clothing manufacturing in Myanmar falls into this category.

Powerbrokers. Companies in this category serve the domestic market, as workhorses do, but they operate in industries where political influence has a big role. Typical players include large telecommunications companies, utilities, infrastructure providers, cement manufacturers, and gasoline distributors. An example of a foreign entrant in this space is Washington, D.C.–based Symbion Power, an energy company that develops and operates power plants in Tanzania, Kenya, Madagascar, and other frontier markets. In developed countries, businesses of this kind are usually regulated to promote competition or protect customers. In frontier economies, however, regulation primarily directs profits to the government or privileged interests.

The Frontier Matrix

Frontier matrices help you locate competitive opportunities in a country by assessing customer orientation (domestic or export) and the degree of government interference and control (high or low).



Rentiers. Companies in this category are export oriented, but the terms of their operation, including taxes, royalties, and other obligations, are spelled out in contracts with the government. Often large, they operate in the "concession" space—that is, on the basis of government licenses—and include oil, gas, mineral, and other resource extractors. Enforcement of regulations and agreements in this category is typically weak, often resulting in safety and environmental problems. Profits are a function of the bottom line—how cheaply firms can conduct their operations—but revenues are greatly affected by how much the government takes off the top. Mining giant Rio Tinto's massive copper and gold mine in Mongolia operates in the rentier space.

What Is a Frontier Economy?

We define a frontier economy as a country possessing one or more of three characteristics:

Faltering prosperity. The country has not established dependable prosperity for its citizens. Either it has an annual per capita income of less than $1,500 or it has experienced a drop in real GDP per capita of 20% or more in a six-year period over the past two decades or both. Venezuela, for example, is a frontier economy, because although its per capita income is well above $1,500, its GDP fell by nearly 25% from 1998 to 2003.

Corruption. The country's industries are driven by politically engineered market distortions or state-given concessions rather than innovation or competitive differentiation. Frontier economies score below 35 on Transparency International's Corruption Perceptions Index, a measure that assesses the extent to which public power is misused for private benefit.

Arbitrary enforcement of rules and regulations. The country's leaders have broad power to do as they please without checks and balances. Frontier economies score lower than 3 on the Polity IV "executive constraints" measure, widely used by economists to assess the extent of institutionalized constraints on the decision-making power of country leaders.

It's important to note that industries may fall into different categories in different countries. Take consumer electronics. Samsung is an export business in Vietnam, but in Kazakhstan its sales are largely domestic. It's also important not to define industries too broadly. Many sectors may hinge on government policies and actions, for example, but contain significant workhorse pockets. In the oil industry, extractors negotiate concession terms with governments and assume expropriation risk, while oil service firms compete for business from the oil majors through the usual channels.

Once you've completed the industry categorization, you can segment the GDP of the frontier economy accordingly. This enables you to see how the country's economy breaks down, exposing the dominant local interests, and gives you a sense of the scale of your opportunity there. (The exhibit "Mapping Frontiers" shows how two very different frontier economies stack up.)

The exercise of mapping industries to the four categories not only reveals where your best opportunities lie but also helps identify your best strategy for pursuing them. That's because each category is associated with a particular dominant strategy and is exposed to a distinct menu of risks. Let's begin by looking at strategies and risks for workhorse industries.

Strategies for Workhorses

Successful workhorse firms look like successful firms anywhere: They adapt and leverage existing capabilities and adjust their marketing and distribution strategies to reflect local tastes and constraints. Big multinationals might expect to outperform local competitors, but this is far from universally the case. Domestic companies know the market conditions intimately and have developed the relationships with stakeholders necessary to succeed. (For an example of a strong homegrown competitor, see "Competition May Be Tougher Than You Think.")

For foreign entrants, competing with strong local businesses often requires some disruptive innovation that challenges the dominant business model in the target country and may well require redefining the entrant's product or service as well. Take the case of Unilever. Supermarkets and modern retail stores—key players in its typical supply chain—serve only a small fraction of the trade in frontier markets in Africa. Consumers there make less than $2 a day, so they buy small sachets of detergent, toothpaste, or cooking fat on a daily basis in informal shops in their communities. Store owners buy big packs of these products in nearby towns or from distributors and then prepare unbranded packets themselves, which they sell at extremely high prices per ounce or gram.

Drawing on the experience of its subsidiary Hindustan Lever, in India, Unilever realized that there was an opportunity in Africa to serve customers by cutting out the middleman and producing and directly distributing its own small-format packages at a lower price. As it had done in India, Unilever developed a network of salespeople in rural areas, employing a multitiered distribution system with regional distributors in charge of taking the product to local distributors, who provided training and supplies to the salespeople on the ground. Although the margins per unit were low because of packaging and distribution costs, there was potential for huge volume. In other African markets, Unilever has changed not just packaging but characteristics of the products themselves; for instance, it has developed margarine that does not require refrigeration.

Workhorse pockets in rentier or powerbroker sectors are often good target markets for foreign entrants and can serve as a platform for future growth.

Take the case of Nigeria-based Sea Trucks Group. Founded in 1977 by Dutch entrepreneur Jacques Roomans, Sea Trucks started as an insurance broker to oil and gas companies in the Niger Delta. Today, the company provides a range of technologically sophisticated products and services, including SURF (subsea umbilicals, raisers, and flowlines), subsea infrastructure, and rigid-pipeline laying. Sea Trucks maximizes local Nigerian participation in planning, engineering, implementation, and delivery of projects for Nigeria-based clients. Roomans, the CEO and president of the group, and the senior team have continued to work out of Lagos even as the company has globalized to other emerging and frontier countries, winning contracts in Malaysia, Angola, Ghana, Brazil, Russia, and Mexico.

Strategies for Export Clusters

Many companies source manufactured goods from suppliers in frontier economies or set up their own manufacturing facilities there, the attraction generally being the availability of cheap labor. In some frontier economies, however, abuses are widespread, and local governments don't always take action to correct them for fear of losing export opportunities. Consumers in the developed world, however, are increasingly sensitive to labor conditions, environmental damage, and government oppression in frontier economies; their behavior can change the economic picture dramatically.

In 2001 more than half of Myanmar's $850 million in garment exports went to the United States. But in response to grassroots activism and boycotts protesting Myanmar's authoritarian regime, followed by a 2003 U.S. embargo on imports from the country, U.S. clothing companies exited Myanmar, and its exports plunged. The pendulum can swing back, of course—with the release of Aung San Suu Kyi, in 2010, investors, multinationals (including U.S. clothing giant Gap), and development agencies started queuing up again in Myanmar.

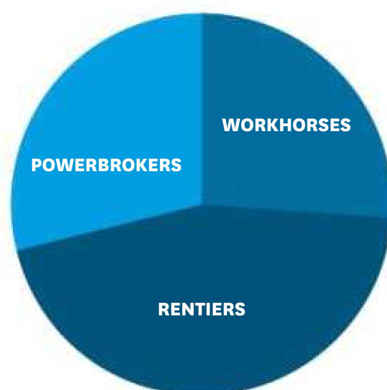
If companies are to maintain an enduring manufacturing presence in frontier economies, their strategies must be about more than just access to cheap labor; they must act as cluster builders. Smart companies increasingly recognize the long-term synergies—in terms of labor skills, density of suppliers, and regulatory support—that can result when many firms of the same export industry colocate in a frontier economy. Clusters also help to unblock legal restrictions in the developed markets they serve and act as a magnet for aid and development investment.

Consider the Integrated Tamale Fruit Company (ITFC), a nucleus-and-outgrower organization in Ghana's poor northern region that exports organic mangoes directly to the European market. ITFC has its own 400-acre, professionally run commercial farm, but it also works with more than 1,200 smallholder farmers in the surrounding area (the "outgrowers"). In exchange for an interest-free, in-kind loan and extensive training, the smallholders agree to grow mangoes on an acre or two of their land using organic techniques and to sell them through ITFC's marketing channels. The proceeds are used to repay the loans. By nurturing this cluster of farmers, the company can operate at greater scale without

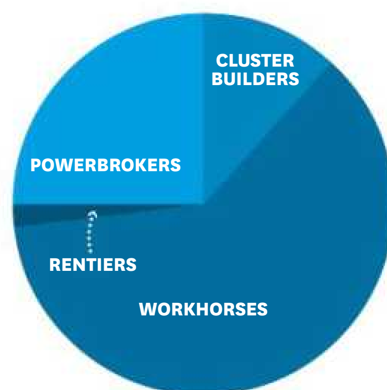
Mapping Frontiers

These charts compare GDP across the four industry categories—workhorses, cluster builders, powerbrokers, and rentiers—for two frontier economies. Companies can use this approach to identify frontier economies that offer the best opportunities.

ANGOLA



THE DOMINICAN REPUBLIC



ANGOLA is heavily dependent on natural-resource extraction for foreign exchange and government revenue, and thus does not hold much promise for companies that require a strong manufacturing base. Because of its high cost of doing business and an appreciated real exchange rate from resource exports, there are effectively no export clusters in Angola—but multinationals that know how to tap into state power and navigate politically driven business landscapes have opportunities to thrive.

THE DOMINICAN REPUBLIC offers fertile ground for companies seeking to compete in domestically oriented sectors or establish a base for exporting. It has limited natural resources, which means the government relies on export cluster builders to meet its hard-currency needs. Its economic zones attract low-end manufacturers, particularly in garments, creating a positive business environment in which workhorses and cluster builders can thrive. Corruption exists, but not to the point where it threatens competitiveness.

the tedious and uncertain process of assembling acreage in an area with communal and chieftaincy-organized land use.

ITFC's efforts, which have led to transformational income growth for local farmers, have attracted the attention of development agencies such as the African Development Bank and the U.S. government's Millennium Challenge Corporation, as well as the Ghanaian government. These organizations have stepped in to bolster and expand the cluster scheme and to finance improvements in rural roads.

Cluster building in frontier economies is happening in high-tech industries as well. Socialatom Ventures, a U.S.-based venture capital firm, invests in start-ups that sell services globally using Latin American talent. In Medellin, Colombia, it has partnered with Ruta N, a public corporation charged with promoting innovation in the city, to develop a local cluster of start-ups and programmers. Socialatom has also teamed up with local universities to improve their engineering curricula. And through its nonprofit foundation Coderise, it runs boot camps in design thinking and coding skills for children from disadvantaged areas.

Strategies for Powerbrokers and Rentiers

Staking out and protecting interests in rentier or powerbroker sectors is usually harder than operating in a workhorse sector or an export cluster. In many cases, rentier or powerbroker projects take on very public identities that carry significant political risks.

The so-called Water War in Bolivia is a case in point. In 1999, the government of Bolivia privatized SEMAPA, the state-owned water company in Cochabamba. Aguas del Tunari, a joint venture between Bechtel, Edison, and the Spanish energy company Abengoa, was awarded the contract to revamp water provision in the midsize city. (Some 40% of the population often did not have potable water. Low-volume users, who were relatively poor, paid more per cubic meter than wealthier high-volume users. The very poorest, who had no connection to the system at all, had to buy water from tanker trucks at exorbitant prices.) Aguas del Tunari rapidly expanded the supply of water to 30% more of the population. To help the company pay for this and future improvements, the government allowed an increase in water tariffs of 35% in January 2000. NGOs and local social groups immediately condemned the price hike as abusive, and thousands of people took to the streets of Cochabamba to demand that the government terminate the concession. In April the government caved, rolling back the price hikes and eventually revoking the contract.

Foreign firms can reduce this type of risk by increasing and diversifying stakeholders in their success. One way to do that is to create workhorse pockets through CSR programs. Take the case of mining giant BHP Billiton (BHPB), which made a massive investment in Mozambique with its aluminum smelter

Which Fast-Growing Markets Are Frontier Economies?

Although most countries on this list are hampered by the hallmarks of frontier economies, they offer opportunities for multinationals seeking double-digit growth.

	COUNTRY	ANNUAL GROWTH RATE	FRONTIER MARKET	CORRUPTION	ARBITRARY ENFORCEMENT	FALTERING PROSPERITY	
						INCOME < $1,500	DROP IN REAL GDP PER CAPITA > 20% (OVER 6 YRS)
1	BHUTAN	8.47%	NO				
2	LIBYA	8.04%	YES	✓	✓		✓
3	MYANMAR	7.88%	YES	✓	✓	✓	
4	CÔTE D'IVOIRE	7.71%	YES	✓		✓	
5	INDIA	7.58%	NO				
6	LAO P.D.R.	7.37%	YES	✓			
7	MOZAMBIQUE	7.16%	YES	✓		✓	
8	CAMBODIA	6.94%	YES	✓		✓	
9	SENEGAL	6.92%	YES			✓	
10	RWANDA	6.86%	YES			✓	
11	BANGLADESH	6.84%	YES	✓		✓	
12	ETHIOPIA	6.80%	YES	✓		✓	
13	NIGER	6.75%	YES	✓		✓	
14	TANZANIA	6.72%	YES	✓		✓	
15	DJIBOUTI	6.70%	YES	✓			✓
16	KENYA	6.31%	YES	✓		✓	
17	PANAMA	6.30%	NO				
18	PHILIPPINES	6.28%	NO				
19	VIETNAM	6.22%	YES	✓			
20	CHINA	6.14%	NO				
21	BRUNEI	6.11%	NO				
22	GHANA	5.94%	YES			✓	
23	UGANDA	5.85%	YES	✓		✓	
24	BURKINA FASO	5.74%	YES			✓	
25	UZBEKISTAN	5.71%	YES	✓	✓		

NOTE AVERAGE GROWTH PER ANNUM, FORECAST 2016–2020. **SOURCE** INTERNATIONAL MONETARY FUND, *WORLD ECONOMIC OUTLOOK;* CORRUPTION PERCEPTIONS INDEX 2015; POLITY IV XCONST INDEX

project. In 2001, working with the Mozambican government and the International Finance Corporation, BHPB set up the Small and Medium Enterprise Empowerment and Linkages Program. The program gave local contractors the skills necessary to compete for contracts with BHPB and trained their workers. This stimulated the development of local engineering firms and disseminated best practices in procurement, materials handling, and engineering services. BHPB began to offer local businesses large shares in its value chain, bringing many positive benefits to the community.

It's important for foreign firms to realize that when they engage stakeholders, the commitment

Competition May Be Tougher Than You Think

There's a tendency to assume that multinational entrants into workhorse sectors will be able to exploit superior organizational capabilities and practices and beat the local competition.

But this is by no means always the case; homegrown firms are often equally sophisticated, know how to operate under domestic market conditions, and have a superior understanding of the customer.

Take the case of Securico, a security services firm operating in Zimbabwe, a country characterized by political turmoil and economic chaos. Founded and run by Divine Ndhlukula, one of Africa's top female entrepreneurs, it is a classically competitive, and very modern, venture. It was the first ISO-certified security company in Zimbabwe, which gives large corporate and diplomatic clients in the country confidence that its services meet international standards.

The company's focus is on employees and client relationships. All new employees undergo an industry-leading 14 days of training; workers are always paid on time (even during hyperinflation); female guards are specifically sought and their value communicated to clients; and a clear path to promotion exists. This has resulted in an employee turnover rate of about 5% in an industry characterized by high labor mobility. On the client side, managers check in regularly to solicit feedback and adjust the service offering accordingly.

In less than 20 years, Securico has carved out a substantial portion of the market and continues to grow.

must be long term. The Canadian resource company Sherritt understands this. Its Ambatovy project, in Madagascar, required the labor of approximately 11,000 locals for the construction phase, which made Sherritt the largest employer in the country. The company's workforce was a powerful constituency that would complain if the government were to cancel Sherritt's contract. But employees would also be unhappy about the layoffs that were inevitable as construction wound down. In order to sustain goodwill for the 30-year project, therefore, Sherritt decided to continue to support the construction workers after the construction phase. Sherritt's CEO at the time, Ian Delaney, explained: "We developed a system to feed the locals we had hired for the project [and who were no longer employed with us] at least a meal a day. We also avoided a major income shock to them and their country by paying them $5 to $15 a month going forward."

As an alternative to engaging with multiple stakeholders, firms can make themselves indispensable to powerful local players in multiple ways, even some that are removed from the core business. Sherritt took this approach in Cuba. The company required a specific kind of ore for its refinery in Alberta, and in 1994 it chose to develop a mine in Cuba. In order to protect its position, Sherritt set up a joint venture with the Cuban government, sharing ownership of both the Cuban mine and the Canadian refinery. In addition, Sherritt undertook to train workers and helped the Cuban government draft a foreign investment law.

A few years after the mine's operations started, the government, cash-strapped and without access to international markets, asked Sherritt to help it find financing to develop some abandoned oil fields in Cuba. Sherritt issued a bond in Toronto and invested in a new joint venture with the Cuban government. Together they created other joint ventures to produce energy for the resort town of Varadero and to operate a hotel, a mobile phone company, and a soy-processing plant. Sherritt's good relationship with the government, not to mention its ability to provide the government with much-needed hard currency, has made it a stable and profitable player in Cuba since 1994.

MANY ANALYSTS see the current environment of rising interest rates and lower commodity prices as a reason to stay away from frontier economies. But following that advice might lead to the same regrets felt by the many multinationals that pulled out of emerging markets after the Asian financial crisis of 1998: They missed a decade and a half of bumper returns. Since equity markets are not deep enough for most investors to get exposure to frontier economies, investments in these places will necessarily be direct and boots-on-the-ground, and may require a decade or more to realize the investment thesis. Patience, careful analysis of long-run growth potential, and an appropriate choice of strategy will reward those companies that stake out a position in today's frontier economies.

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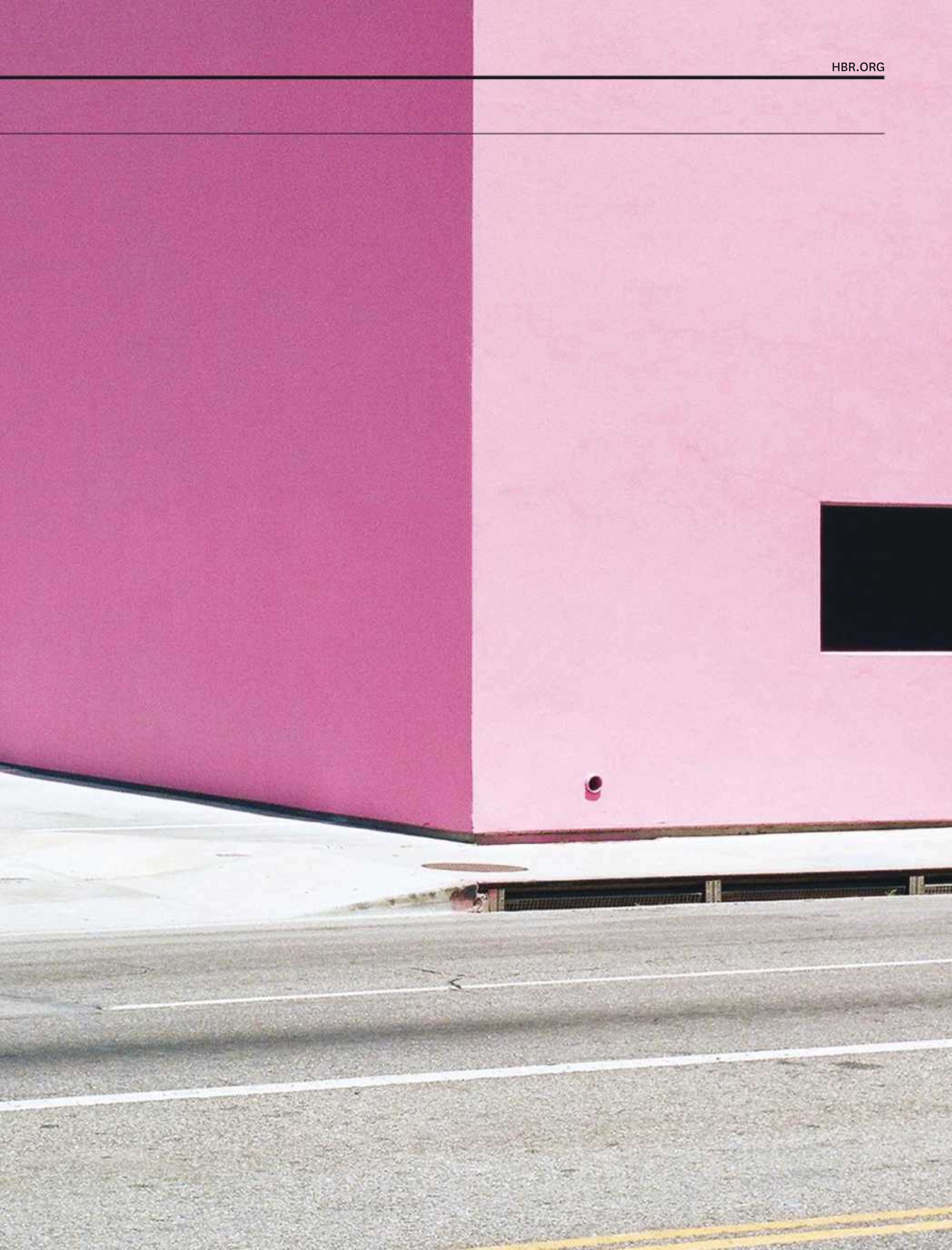
SPOTLIGHT

Ram Charan is a business adviser to CEOs and corporate boards, a director of several boards, and the author of more than 20 books, including *Boards That Lead* (with Dennis Carey and Michael Useem, Harvard Business Review Press, 2014).

The Secrets of Great CEO Selection

An insider's guide

BY RAM CHARAN



Nothing good comes of having the wrong CEO. Mentoring, coaching, senior team members with complementary skills, and special help from the board can't compensate. The misses are devastating—and very public. Yet some boards still pick chief executives who aren't right for the job—repeatedly. The revolving doors at HP before Meg Whitman, at Apple before Steve Jobs's second tenure, and at Yahoo during the past decade are only a few of many recent examples.

On the other hand, I've seen some surprising CEO appointments that turned out extraordinarily well, such as Lou Gerstner at IBM, Alan Mulally at Ford, and Steve Jobs in his return to Apple.

Why are some boards great at hiring company leaders, while others struggle? For more than three decades, I've been involved in CEO successions in the United States, China, Japan, India, Brazil, and Europe, as a director, an adviser, or a member of the selection committee. I've observed firsthand situations in which the board made a terrible choice, and I've worked with boards that were extremely skilled at selection and whose choices created enormous value. Throughout the years I've noticed that great succession decisions were really driven by one or two directors, whose judgment and expertise the board relied on, and I've worked to distill their common approaches and "mental algorithms."

In my experience, board members who are adept at picking CEOs do four things others don't: They work painstakingly to clarify the essential qualities needed to succeed in the job; they keep an open mind about where the best candidate will come from; they go deep to understand which candidate is the best fit; and they allow for imperfections in the chosen candidate.

Rigorous succession planning is essential. But it takes you only so far. Eventually a decision must be made, and when it comes to choosing among two or three final candidates, judgment really matters. Here's what directors that excel at it do to make sure their judgment is sound.

Finding "the Pivot"

Boards should always have a viable pool of CEO candidates and, in case of a sudden succession crisis, a so-called name in the envelope. But when the moment of truth is imminent, directors who make great CEO picks set those lists aside. They start by understanding the current and future requirements of the job, zeroing in on the critical capabilities that will make or break the company. The result is not a

Succession planning takes you only so far. When you're choosing the final candidate, judgment about the fit matters.

Idea in Brief

THE OBSERVATION

What distinguishes directors who are great at picking CEOs? They zero in on the two or three capabilities a chief executive needs to succeed at that particular firm (the "pivot" on which the succession decision turns), keep an open mind about where the best candidate will come from, go deep to understand who is the best fit, and allow for imperfections.

THE CHALLENGE

Every firm has a distinct pivot. Directors must define it in specific terms and get it right. For example, to compete against Amazon, a retailer likely needs a CEO who can focus on the end-to-end consumer experience and grasp how digital technology can transform the business. An entertainment company might need a CEO who can imaginatively apply algorithms, amass digital properties, and reorganize resources and people.

THE KEY PLAYERS

Choosing the directors who will lead the process is also critical. Often they are current or former CEOs, respected for their wisdom and judgment. Other board members add objectivity through their questions, and the outgoing CEO helps the decision makers learn more about the company and internal candidates.

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laundry list of leadership traits any CEO should have, nor is it a single item. It's a strand of two or three capabilities that are tightly interwoven and required for the new leader to succeed. This is what makes the decision turn toward one candidate over another. That's why I call it "the pivot."

Each situation is distinct, and so is each CEO job's pivot. It's important to identify the pivot in very specific terms—and to get it right. Consider the retail industry. Today legacy retailers need leaders who can credibly go up against Jeff Bezos and Amazon. Their pivots should include the ability to focus on the end-to-end consumer experience, deep familiarity with digital innovations (such as in-store geotracking and digitally driven logistics), and the ability to shape the retailing ecosystem of vendors and delivery services. A legacy entertainment company, in contrast, might need a CEO who can amass digital properties, create a team that will use streaming and algorithms to put the company on offense, and make the necessary shifts in people and resources. For a traditional automotive parts supplier, the pivot might include sufficient knowledge of technologies OEMs are using to engage in discussions about industry standards and direction, the ability to build advanced technology into the organization's core competence, and skill at partnering with upcoming digital-born companies.

Directors who choose the right CEOs do a lot of work before arriving at the pivot. They take the time to fully understand the company's current challenges and how the external context is changing. They read analyst reports, talk to insiders, and consult outside experts to expand their thinking. They go both broader and deeper than board members typically do. They don't dismiss complexities or contradictions; they cut through them and deduce what skills and capabilities are essential, iterating until they hit on the right combination.

Take Tom Murphy, former CEO of Capital Cities/ABC, and the late Jim Burke, former CEO of Johnson & Johnson, who tapped Lou Gerstner to take the helm of IBM in 1993. IBM was failing at the time, and the outgoing CEO had already announced its imminent breakup. Directors Murphy and Burke spent a month visiting customers and industry experts around the world, listening to their issues to better understand what was happening externally. What they learned convinced them that the company's problems were more business-oriented than technological. They didn't rule out CEO candidates from the tech industry, but they saw that tech company experience was not the most important thing. As the business press hotly debated which technologist the board would ultimately choose—a *New York Times* article titled "Help Wanted: Computer Skills a Must" named John Sculley from Apple, Ben Rosen from Compaq, and George Fisher from Motorola as likely options—the IBM directors turned elsewhere. The pivot they were looking for was a mix of proven business acumen, customer orientation, and the ability to make a large organization more decisive and accountable.

The position was first offered to Jack Welch, the celebrated CEO of GE, whose business acumen and ability to deliver results were legendary. When he declined, they asked if GE would buy IBM. No again. Then they turned to Larry Bossidy, a Welch disciple who had demonstrated the skills they sought as vice chair at GE and as head of AlliedSignal. After he rejected them, they reached out to Gerstner, a marketing whiz who had delivered a decade of profitable growth at American Express. Having left Amex when he hit a ceiling there, and not quite liking his new post as CEO of RJR Nabisco, Gerstner was game for the challenge. And as history shows, he rose to it.

Within weeks of taking the job, Gerstner diagnosed IBM's problems. The mainframe business wasn't

dead; it had a bloated cost structure, and the pricing was wrong because the company didn't have the right people setting it. IBM didn't need to be broken apart; on the contrary, its ability to give customers a single access point for a mix of offerings was a competitive edge. Gerstner knew this from his years at American Express, a longtime customer of Big Blue's. He could also see that IBM needed to shift away from hardware toward software and services, allow compatibility with competitors' products, and reduce its bureaucracy so that it could execute better.

Gerstner acted quickly, announcing plans to cut prices by roughly 30% and costs by some $7 billion. The results were almost immediate. By the third quarter of 1993, solvency was no longer an issue, and by 1994 the bottom line had swung from an $8 billion loss to a $3 billion profit. The stock price doubled in less than three years. The firm's performance continued to improve year by year, creating enormous value, and IBM became a leader in U.S. business and in the global technology industry once again.

Clarity about the pivot also helped Apple get back on track after it ran into trouble in the 1990s. One morning in 1997, I got a call from Ed Woolard, the former CEO of DuPont who had just become Apple's lead director. In the 12 years since Steve Jobs had been pushed out, the company had suffered a string of disastrous product releases and seen its market share erode, and bankruptcy was becoming a distinct possibility—the sad result of three consecutive failed CEO selections. Woolard and I had worked together for many years. He wanted me to find out if Michael Dell was interested in purchasing the company.

The response from Dell was a flat no. Dell, in fact, would later tell a crowd of several thousand tech executives at the ITxpo97 that Apple should just shut down completely and give its shareholders their money back. Nobody—not Compaq, AT&T, or IBM—wanted to buy the company.

Apple's one last chance, Woolard figured, was a new CEO, and he began to ponder what the job would really require. The company had a soul, an exceptional brand, and a large contingent of diehard customers even though it was in decline. Apple products were higher-end and higher-priced, and customers loved their ease of use and aesthetics.

Woolard identified the pivot: Apple needed a CEO who was imaginative with a flair for creating a highly differentiated experience that consumers wanted. The CEO had to be an innovator and a game changer. Searching for candidates who fit that description, he called me again. "Do you know of anyone?" he asked. I didn't. "What do you think of bringing back Steve Jobs?" he asked.

Jobs's mercurial behavior was legendary, and NeXT, another company he had started, had floundered. But his third venture, the computer-animated-film pioneer Pixar, had pulled off a highly successful IPO. As we talked I could see that Woolard's instincts were right: Jobs had a strong innovative streak and a feel for the consumer.

Woolard stayed in close touch with his fellow board members throughout the process, sharing with them the data he gathered on how quickly the company was deteriorating. They eventually came around to fully backing the move to replace the incumbent CEO with Jobs. They even agreed to give up their board posts—a condition Jobs imposed. To ensure a smooth transition, Woolard became a mentor to Jobs, so much so that when Jobs called Woolard's home and Woolard's wife answered, she would call out, "Ed, your son is on the phone!"

We all know the outcome of the decision to bring Jobs back. The iPhone and the iPad are among the blockbuster innovations that followed, and Apple became the world's most valuable company, in part because its lead director understood the pivot.

What if you get the pivot wrong? Consider what happened at a large Chinese real estate company. Its chairman was a bold thinker with ambitions to grow quickly. He bought a lot of land by borrowing heavily and built offices and apartments at a very fast pace—too fast for the market to absorb. Quality was slipping, inventory was piling up, and cash flow was increasingly negative. Meanwhile, tensions were rising between headquarters and the field.

As he set out to hire a CEO, the chairman remained squarely focused on executing his growth vision, raising substantial funds from Hong Kong, and preparing the company for an IPO within two years. He hired an experienced leader with great contacts in Hong Kong who promised to raise the necessary money and ready the firm for the public offering.

Four months later it was clear that the CEO could not deliver the funding, and the internal problems had worsened. The chairman removed the CEO. He then revised the pivot: The company needed someone who could sell off inventory, cut costs, and get project managers to work with headquarters to generate cash. The IPO could wait. Shortly thereafter

Directors who excel at selection are willing to expand the lens, to look at leaders a few levels below the CEO.

he hired a new CEO, who in his first few months improved execution by an order of magnitude and turned the cash drain into cash reserves.

Keeping an Open Mind

When drafting the final short list of candidates who might fit the pivot, skilled board members start with a clean slate. They realize that in a fast-paced business world, a company's needs can shift suddenly and the entire set of candidates their succession plan identified may now be irrelevant. They back off from longtime favorites and keep an open mind. They battle against hidden assumptions and biases—their own and other people's—as they home in on two or three prospects and, ultimately, a final choice.

Of course, at companies that take succession planning seriously, directors make a point of getting to know the company's top leaders over time. They observe them during boardroom presentations, talk with them over cocktails and dinner, and sometimes make site visits, where they see the leaders working with their teams. But along the way, directors often develop favorites, especially if they've coached someone in the succession pool. Those psychological bonds can be hard to break.

I've seen directors form definite opinions about a person in their first encounter and never change their views, be it positive or negative, even in the face of lots of contradictory evidence. I saw one director advocate for a particular individual who clearly lacked an important capability the board had agreed on, because he had been impressed by the sharpness of the person's boardroom presentations early on.

Directors who are great at selection strive for objectivity as they review candidates. They don't take the existing front-runners or the CEO's recommendations as a given. And they don't assume an insider or outsider is best. Many boards use headhunters to add a few external candidates to the final list, if only for the sake of due diligence. (That step shouldn't be perfunctory; the search firm has to understand the pivot so that it doesn't offer up just the usual accomplished CEOs.) When considering outsiders, astute CEO selectors don't let themselves be unduly influenced by a candidate's celebrity or the halo effect of having worked at a marquee company.

Ivan Seidenberg, the former CEO of Verizon, who is a veteran of more than half a dozen boards, including those at BlackRock, Boston Properties, Honeywell, and Wyeth, is decidedly good at picking CEOs. He has noted a recent trend toward thinking that only an outsider can do the CEO job. In my experience some directors go the opposite way, always favoring insiders. Seidenberg avoids such foregone conclusions. As he neared his own retirement, he made sure he gave the board lots of exposure to the handful of internal leaders he saw as top contenders. "My point was to give the board options," he recently told me, "so the board would feel comfortable with its decision, whether or not it decided to go outside. I always tried to keep the process dynamic."

Sometimes it's assumed that leaders must report directly to the CEO to be in the running. But directors who excel at selection are willing to expand the lens, to look at leaders a few levels below the CEO. Especially in this digital age, years of experience probably matter less than they once did, and they could even be an impediment to necessary change. We've seen many examples of leaders below the age of 35 who grew their leadership skills as fast as their companies, from Michael Dell and Bill Gates to Mark Zuckerberg and Larry Page. Frank D'Souza, who put Cognizant on a tear, was 38 when he was named CEO.

Every CEO has an open flank. Trade-offs are inevitable. Often the gap can be plugged by a coach or chief operating officer.

Finding the Fit

When you're down to the final few potential successors, each will have passed multiple filters and is likely to be a highly accomplished leader. Savvy CEO selectors go deeper than most to understand how well each person matches up against the pivot. They create a complete and accurate picture of each candidate to determine not the best leader but the best *fit*.

Of course, interviews between directors and final candidates are standard at many companies, but in my experience there is startling variation in the depth of those conversations. One way to be more thorough is through a mechanism I saw the search committee of a large midwestern insurance company use. Once it had defined the pivot, it advanced two internal and three external candidates to the final stage. The six committee members then set aside a weekend for the sole purpose of doing interviews. They broke into two teams, and each team interviewed the candidates one at a time for about an hour and a half apiece.

The team members talked after each interview, and toward the end of the weekend, the two teams compared their opinions. Each team had drilled into a different line of questioning, but remarkably they ended up with similar views. The directors thought one outside candidate had imaginative ideas for taking the company into new areas, but they weren't sure he could execute. Another, they concluded, was essentially used to building through acquisitions and had no organic growth experience.

The more the search committee members mulled over the candidates, the less sure they were that any of them could make the firm successful. They had been searching for a leader who would move the business into adjacent market segments, but the interview process made them see that there was room to grow within the industry. By the end of the weekend, the committee had rejected all five candidates, even the internal ones some members had initially supported, and redefined the pivot. The firm's headhunter went back to work and recommended two more outside candidates. The committee repeated the small-group interview process, and a new top contender emerged. After the board approved his hiring, the new CEO performed very well.

Ultimately, every board member has to be comfortable with a CEO appointment. Seidenberg says, "I always thought it was important to go around the table at the board meeting and ask every director to weigh in on the choice. The conversation and the issues people raise are always illuminating, both positive and negative. Even the most experienced board members benefit from that conversation."

Reference checking is important too, and great directors do their own. Headhunters can provide an enormous amount of useful background data, but people tell me they will be more candid with a director because they are concerned that the headhunter may keep their comments on file for future use. Direct conversations with people who know a candidate well also give a feel for the strength of their convictions.

Jack Krol, the former CEO of DuPont, who has helped hire more than a dozen CEOs, likes going to people who have managed candidates and asking what results those candidates produced and how they developed other people. Board members who are superficial and overly impressed by things like great communication skills, quickness, and "presence" won't get much out of the conversations, but discriminating directors ask questions that get past the generalities to what candidates actually did and under what conditions. People don't hesitate to discuss the positives, so you can learn a lot about

where a person's greatest talent lies. That's the best way to know if a prospect matches the pivot.

Planning for Imperfection

Every CEO has an open flank. The typical vetting process will bring candidates' quirks and flaws to the surface, but wise selectors accept imperfection when they make their decision. Trade-offs are inevitable. For example, many CEOs who come from strategy, planning, or finance backgrounds are weak on people skills or operating skills. Meanwhile, leaders who are strong in digital technology may be weak on finance.

When the directors of one of the world's largest technology companies were seeking a new CEO, they winnowed a field of 20 candidates down to two strong ones: an insider who understood technology and had successfully run a P&L center, and a proven CEO with stellar performance at two nontech companies. Two questions loomed: If they chose the CEO, would he have the expertise and intuition to make fate-changing technology decisions? If they chose the insider, who was untested as a chief executive, would he be able to expand into the broader role? The board members bet that the tech-savvy candidate would grow into the job, and so far their choice is proving to be right.

One board was convinced it had the right next CEO, but the directors also knew he was likely to overpay for acquisitions. They decided they could live with that. Later, when as CEO he proposed a significant acquisition, one of the directors persuaded him to pass on the deal unless the price was cut dramatically. Another board felt that its top choice for CEO was probably not tough enough, so the directors might have to push him occasionally. These boards focused squarely on the pivot, and their selections turned out to be good ones.

Sometimes the gaps can be easily filled. I've known directors to suggest plugging them with a coach or by hiring a chief operating officer or an expert in government relations. Venture capitalists like Andreessen Horowitz are famous for supplementing the skills of their entrepreneurial CEOs by connecting them with people who can help with organizational design or the business model. The VCs do whatever they can to make the CEO successful.

At Delphi in 2009, filling the gap saved the CEO and arguably the company. A new group of investors had stepped in as the firm worked its way out of bankruptcy, and the board had just been reconstituted to include independent directors and representatives from hedge funds. Krol recalls that immediately after he joined as chairman, the hedge funds told him that he would have to fire the CEO, who, they argued, was not communicating well with Wall Street.

Krol believed that the decision to choose a CEO should begin with the dominant needs of the company. Relations with the investment community were important, but so was internal transformation. The pivot, in Krol's view, was operational excellence, a focus on technology, the ability to work with OEMs as Delphi expanded its customer base, and the ability to mobilize the workforce.

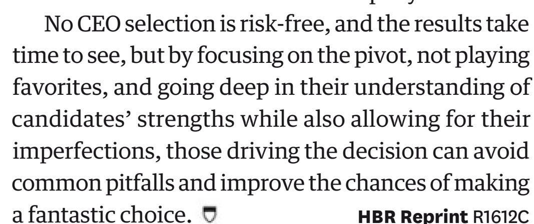
The board members ultimately came together and agreed on the pivot—and that the incumbent CEO had the necessary skills in spades. What about the gap? They addressed it by hiring a strong CFO, and the combination worked beautifully. The CEO's performance until his retirement, in 2015, was nothing short of outstanding. The once-struggling company is today one of the world's largest suppliers of automotive technology to a full range of large OEMs. It also boasts a world-class cost base and outstanding financial performance. The board's move to fill the gap was spot-on.

Selecting the Search Leaders

Choosing a CEO is the responsibility of the full board, but picking the directors who will lead the process is critical. If the wrong people take charge, you'll run into difficulties. Steer toward those who have earned their colleagues' trust and respect. More often than not, they are committee or board chairs or lead directors already. Frequently, they're former CEOs with proven business acumen and very strong values. Their leadership of the search emerges naturally, and their colleagues should welcome it.

Other board members add objectivity through their questions and comments, which any good search leader will welcome. The current CEO also has a role to play in building a cadre of executives the board might choose from and helping the directors learn more about them and the company.

No CEO selection is risk-free, and the results take time to see, but by focusing on the pivot, not playing favorites, and going deep in their understanding of candidates' strengths while also allowing for their imperfections, those driving the decision can avoid common pitfalls and improve the chances of making a fantastic choice.



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SPOTLIGHT

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After the Handshake

Succession doesn't end when a new CEO is hired.

BY DAN CIAMPA

The mood inside the boardroom was celebratory. For months the directors of this multibillion-dollar industrial and consumer-goods company had been searching for a successor to their longtime CEO. After interviewing multiple candidates, they'd unanimously voted to make an offer. The outside recruit—let's call him Harry—had an exceptional record of growing sales while running a large

ARTWORK George Byrne, *Melrose Ave,* 2015
Archival pigment print

division of a multinational known as a training ground for world-class CEOs. In interviews he was polished and poised. He asked insightful questions about the company's strategy, raising issues the board hadn't considered previously. His references were effusive. To the directors' delight, Harry, who was simultaneously in the running for two other CEO jobs, accepted their offer—largely because he felt that this company offered the most autonomy and upside. The board announced the appointment at the annual meeting, in April; shortly afterward, the outgoing CEO departed, and Harry started. The directors congratulated themselves on a job well done. The arduous work of succession—their most important duty—was complete.

Except it wasn't, because the board, the outgoing CEO, and the chief human resources officer hadn't laid the groundwork for Harry to succeed. They hadn't discussed with him how decisions were made, how innovation took place, or who had the most influence in the company. As a result, in his first weeks on the job, the new leader was not prepared as he got acquainted with the people he'd inherited and learned the political dynamics of the senior group. For one thing, the CFO was bitterly disappointed at having been passed over for the CEO job and had a reputation for being conniving and power-hungry. For another, although Harry did his best to understand the corporate culture, he failed to fully appreciate the strength of the company's bias toward cost control and its resistance to change. Crucially, in the three months before his first board meeting, in late June, no directors bothered to meet with the new CEO—and he, preferring to keep his own counsel, didn't reach out to them either. "Some of us thought he was so good that there wouldn't be anything we could add," one director recalls. "The net result was that we all decided we should get out of his way."

When, at that first board meeting, Harry laid out an aggressive new strategy—which included combining two divisions and taking on debt to make an acquisition—the directors were taken aback. They'd hired him to drive growth, but they'd expected an evolutionary, incremental approach rather than a rapid, expensive overhaul. They resisted, frustrating the CEO. Over the following months, the CFO's back-channel communications with key directors eroded their confidence in Harry. Fifteen months after signing him, the board forced its star hire to resign—and the company's stock dropped sharply at the news.

A Shared Responsibility

Whether new CEOs are hired from the outside or promoted from within, they should be aware of a daunting statistic: One-third to one-half of new chief executives fail within their first 18 months, according to some estimates. Some of these flameouts can be attributed to poor strategic choices by the new leader, and some result when the board makes an imperfect choice—overestimating a candidate's abilities and potential or hiring a leader whose skill set doesn't fit the context. Sometimes the new leader is obviously responsible for a handoff gone wrong, and other times the board is rightly blamed. But a close look shows that it's rarely that simple. When a succession fails, the responsibility is almost always shared.

Whether coming in directly as CEO or into the number two spot expecting to move up, failing newcomers make these common mistakes:

- They don't read the political situation well enough to build necessary relationships and coalitions.
- They don't achieve the cultural changes their strategic and operational agendas require.
- They overestimate the willingness or the capacity of the people they inherit to abandon old habits and behaviors.

Meanwhile, boards and key executives typically:

- Fail to grasp the complex nature of succession and assume that CEO handoffs are as simple as those at lower levels.
- Fail to carefully consider the cultural and political aspects of the company that will be problematic for the new leader in his early months.
- Set one-dimensional or generic expectations of the new leader—in particular, emphasizing only

Boards often fail to grasp the complex nature of succession, assuming that CEO handoffs are like those at lower levels.

Idea in Brief

THE PROBLEM
One-third to one-half of new CEOs, whether they're hired from outside or from within, fail within their first 18 months, according to some estimates.

WHY IT OCCURS
Newcomers misread the political situation or overestimate the organization's willingness to abandon old behaviors. Meanwhile, boards and key executives fail to grasp the complex nature of CEO succession or set one-dimensional expectations of the new leader.

WHAT CAN BE DONE
A comprehensive succession process begins when a candidate accepts the position and lasts for several months after his or her arrival. The outgoing CEO, the chief human resources officer, and the board should all have roles in helping the newcomer navigate company culture and politics.

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financial and operational goals and not including equally specific cultural, political, and personal ones.

The purpose of a comprehensive approach to transitioning a CEO is to avoid those mistakes. When the transition is done well, the company is prepared for a new leader with a change agenda, and the new leader is more tuned in to power dynamics and how the culture will influence a strategy shift or what cultural changes will be necessary to support it. The transition establishes a solid path toward productive relationships between the CEO and key stakeholders—including, most crucially, board members.

In the United States, presidential candidates typically name a transition team and begin planning for a new administration months before a single vote is cast on Election Day, because they want to be prepared in the event they win. In corporate life, however, too many CEO transitions are informal or improvised. In a 2010 survey conducted by the executive search firm Heidrick & Struggles and Stanford's Rock Center for Corporate Governance, half the companies surveyed reported providing no formal transition plan for a new leader. James Citrin, who leads the North American CEO practice at the recruiting firm Spencer Stuart, estimates that of the companies that *do* have a transition process, fewer than 20% extend it beyond the new CEO's first week.

A CEO transition is *not* the same as onboarding, which is a formal, short-term, agenda-driven orientation program of briefings and meetings. An onboarding plan can be a useful component of the transition process, just as the formal events at a college's freshman orientation can provide valuable information to new students. But like a college student's assimilation, which takes place slowly and informally (the most valuable moments often occur in dorms and dining halls), a CEO's transition is a longer process of interactions both formal and informal, planned and impromptu. Handled correctly, the process will begin when the board's choice accepts the position and will last for months after she arrives.

The transition is also properly viewed as the second part of a comprehensive succession. Although many people tend to think of succession as the process of identifying and assessing internal and external candidates, defining the characteristics the next CEO will need, and ultimately settling on a final choice, that's really only half the job. Succession should include activities that occur after the new CEO takes the job—activities designed to maximize her chances of success. In many ways, the later stages are more difficult than the recruitment and assessment phases. They involve emotions, ego, beliefs about what the organization should become, and, in particular, company culture and politics. Declaring victory too soon can leave a leader ill equipped to build a base of support. That increases the odds of a succession failure, the costs of which can be substantial—for shareholders, for employees, and for individual careers.

The Three Variables

In the creation and implementation of a comprehensive CEO transition process, three key variables affect structure and timing. First, is the new CEO from inside or outside the company? Second, will he take on that role immediately or spend time as a "designated successor," working alongside the outgoing CEO while typically carrying the title of president or chief operating officer? Third, whether or not the transfer of power is immediate, will the outgoing CEO continue to be a presence in the company, as chairman of the board or as an adviser?

Many companies skimp on or forgo a transition program for an internal candidate who's promoted to CEO. On the surface that makes sense: An internal

candidate has already navigated a career with the company, so onboarding may seem superfluous. However, even an internal candidate will benefit from a transition program that recognizes several specific challenges to be faced in the new job. For example, most people promoted from inside have never been a CEO before and must learn to handle a level of responsibility for which they have had little preparation. Furthermore, they will inherit a team made up of former peers, some of whom may have been rivals for the top job, and will benefit from assistance in dealing with that dynamic. And insider CEOs need to forge new relationships with directors, because reporting to and managing a board is vastly different from making periodic presentations to it.

The Role of the Outgoing CEO

In some cases the outgoing CEO plays no role in succession—such as when she has been fired or pushed out. But in a planned succession (which typically involves a retirement), the outgoing CEO can help the incoming one adjust to and understand the company. Not every new leader appreciates having his predecessor stay on for an extended period, but according to a 2012 study by Patrick Wright, of the University of South Carolina, 40% of departing CEOs remain involved with the company (usually as board members or advisers) after giving up the title.

An incumbent CEO plays a particularly important role if the successor joined the organization as an heir apparent. Such an extended transition should begin with defining the roles the two will play. The successor must have substantive responsibilities, objectives closely tied to strategic and operational success, a platform for proving his abilities, and a clear sense of the timetable for ascending to the top job. The two leaders will need to agree on the details of their relationship: On what issues will they collaborate? Do they want the board and the senior team to view them as true partners? Which decisions will the incumbent run by the successor before making them? What milestones or phases will mark their progress, and will the transition of power and responsibility be incremental or all at once?

In these situations, incumbent CEOs direct the transition process. They must remain fully engaged with their current duties and responsible for short-term performance, but they should also devote significant time to ensuring their eventual replacements' early success.

Consider one CEO of a multinational conglomerate who excelled in this role. After 10 years as chairman and CEO, this executive—let's call him Bob—prepared to pass the role to his successor, Greg, who'd been a direct report and headed up the company's largest unit. Like the best successions, this one was planned well in advance: Two years before he intended to retire, Bob led the board through a careful process of defining what characteristics the next CEO would need, assessing potential internal candidates, and examining external options. Once Greg emerged as the board's choice, Bob took ownership of helping him transition into the CEO role.

Unlike many departing CEOs, Bob created a feeling in his executive team that every member had some responsibility for the transition. He assigned each subordinate specific tasks to help Greg prepare, and he made a list of tasks and assignments for himself, too. He analyzed his network of critical relationships and systematically introduced Greg to key contacts. He prepared detailed briefings on how he had made decisions involving regulatory issues, markets, talent, finances, and so on. He offered comprehensive and insightful thoughts on self-management: how he had spent his time, dealt with conflicting requests, managed the administrative system that supported him, kept his energy up, and countered stress. He outlined the strengths and weaknesses of the current executive team and described how he'd tried to reduce tension and conflict among its members. The two men spent hours alone discussing these issues and traveled together to meet customers, regulators, and alliance partners.

Throughout the process, Bob behaved more like a coach than a boss. He visibly stepped back at times

Most CEOs promoted from inside will inherit a team of former peers, some of them rivals for the top job.

while still in office, allowing Greg to be in the spotlight and to make key decisions. Greg, to his credit, received Bob's counsel adeptly, translating what Bob offered in a way that worked for him, deciding what to accept and what to reject, but all the while behaving respectfully toward his mentor. The transition was not easy for either of them. There were awkward moments, and meetings at which employees seemed confused about who was the definitive decision maker. But when the CEO title passed to Greg, he was far more prepared than he would have been without Bob's coaching.

Not every outgoing chief executive has the personality or the ability to excel in this role without some help. And of course, if the outgoing CEO leaves abruptly, someone else must step in to coach or mentor the new leader.

The Role of the CHRO

Although the board is accountable for CEO succession, and an outgoing CEO should direct the process, someone needs to attend to the day-to-day details. That person should be the company's chief human resources officer. CHROs should be deeply involved in all aspects of succession (they often choose and manage the relationship with executive recruiters, for instance), and will thus have an advantage in organizing the transition. They usually interact with outside candidates earlier than anyone else in the company does.

CHROs should aim not only to coordinate a new leader's transition into the company, but also to become her primary counsel on people, politics, and culture. In this regard they should think of themselves as communicators, interpreters, and sounding boards. The new CEO will find it easy to obtain strategic, operational, and financial data while getting up to speed, but will need someone to explain other executives' personal backstories and interrelationships and why and how some of the company's more idiosyncratic practices evolved. Ideally, a CHRO can also offer candid feedback on how the new leader's early words and actions are perceived in the organization. If the new leader begins in the number two role, the CHRO is also in the best position to observe the developing relationship between her and the incumbent CEO and to advise both on navigating it. If the new leader encounters a problem during the transition, the CHRO should be the first to receive a call.

This work shouldn't wait until the new leader actually joins the organization. When a large retail company recruited an outsider to succeed the CEO, the company's CHRO called him the next day and explained that although they'd spent time together during the search process, he wanted a meeting to discuss an onboarding plan and the company's political structure. The CHRO traveled to the new CEO's distant city, and they spent hours talking about the challenges of transition. The new leader found it invaluable. "Once I'd accepted the job, all my thoughts were on how to leave [my current company]," and the conversation with the CHRO "focused my attention on what was ahead," he says. "There was a lot I didn't know, and the onboarding plan he went over was a good start." The CHRO reflects on the conversation: "Talking to him on his turf was important, and I wanted it to be informal and away from our offices." The two even spent time considering how the new CEO would inform his current boss and ease his departure, because the CHRO had a lot of experience with resignations. "He really appreciated it—it was a good icebreaker, and I think he got a sense of how I would be of help to him," the CHRO says. Reaching out positioned him to evolve into the new CEO's key counselor.

Unfortunately, not every company has a CHRO who's up to this task. Many HR department heads lack the skills for it or haven't earned enough stature with the CEO or the board to be entrusted with this duty. And some don't aspire to or see the potential for a role as influential as the CFO's or the CMO's. In such a case, the CEO should upgrade the position well before a succession takes place, and the board should be involved in specifying the expectations for the CHRO. An adept CHRO will be the company's go-to resource on topics of culture and talent and will have developed the interpersonal and political skills necessary to be listened to by peers and the CEO.

The Role of the Board

For directors, an important question during a CEO transition is how much distance they should keep. Directors aren't at a company full-time and thus see managers in action only periodically. They cannot and should not micromanage—but there is danger in being too remote. Directors often want to give a new CEO room as an expression of confidence, but this respectful gesture can keep them out of touch. And the new CEO may perceive it as a lack of interest

or a message to sink or swim alone. The best boards strike a fine balance between being uninvolved and overinvolved.

When boards fail to find that balance, they're usually too distant. Incoming CEOs routinely report that they don't get enough transition support from directors—or that it doesn't last as long as they might wish. According to a 2012 study conducted by RHR International of 23 major CEO transitions, 57% of CEOs promoted from inside and 83% hired from outside said their boards were "less involved" than they should have been.

Clear expectations are among the most crucial things directors can provide. What kind of between-meetings communication do they expect? Do they prefer to weigh in or vote on fully formed, deeply researched plans and proposals, or do they want to have a hand in guiding nascent strategic ideas? One way to start the conversation is for the nonexecutive chair or the lead director to ask the new CEO to prepare answers to three questions: (1) What information do you need from the board to be able to do the best job you can? (2) What behavior on the board's part would best enable us to have a trusting relationship at board meetings, between them, and in one-on-one conversations? (3) From your experience during the search process and in your first meeting or two as CEO, what one thing about how the board operates would you change to help make our relationship all it must be?

Directors must realize that a CEO's relationship with the board as a whole is really a collection of relationships with individual directors. Experienced business leaders like Mark Thompson, who served as the CEO of two British media companies before becoming the chief executive of The New York Times Company in 2012, understand the importance of cultivating individual relationships with directors. When Thompson arrived at the Times Company, he devoted significant energy to doing just that. (See the sidebar "Inside One CEO's Transition.") Building those relationships may not come naturally or seem like a priority to first-time CEOs, however. If that's the case, directors should take the initiative, and the CHRO should help.

For a board, a CEO succession is a critical moment in the life of the company—a time when the directors should expect to be meeting, talking, and contributing more than they ordinarily do, much as they would during a merger or an acquisition. Though a CEO succession may require fewer emergency meetings, directors should treat it as an all-hands-on-deck period.

Clear expectations are among the most crucial things directors can provide.

MOST NEW leaders fail not because their financial or operational abilities are inadequate but because their style or political skills render them unprepared to manage the organization's culture. Helping new leaders understand that culture and improve their "soft skills" to successfully navigate it may be the best way to increase their chances of success.

An energetic and resourceful leader with intuition, perception, and strong interpersonal skills can certainly succeed on her own—but not without expending more time and energy than would be required in an organized transition process. As one CEO puts it, "My onboarding experience was just not helpful on the things I most needed. It wasn't horrible or even difficult—it was just sort of useless. I figured out on my own what I needed, but it could have been a lot easier and happened a lot faster."

Even when a company takes the comprehensive approach to succession suggested here, it's important to recognize that the formal transfer of title is not the end of the process. The new leader cannot be considered truly embedded until he wins the loyalty of the organization's most influential managers. That is the culmination of succession, and it may not occur until months after the formal handoff of power. It is signified not by an event but by behavior. Former Xerox CEO Anne Mulcahy describes observing such a moment in a meeting after the title had passed to her chosen successor, Ursula Burns: "Everyone was looking at her rather than me—the whole team's attention had just shifted, without a lot of drama. That's the way it should be."

And that's one sign of a successfully executed transition process.

IAN SPANIER

Inside One CEO's Transition

Mark Thompson calls it the "golden period"—the time between when a company's new CEO is announced and when he or she officially starts the job.

Thompson, who left the BBC to become CEO of The New York Times Company in 2012, had an unusually long golden period: Owing to the London Olympics and a commitment to lecture at Oxford, he waited three months before beginning work. The interval gave Thompson time to prepare and reflect—and it also allowed the Times Company to craft a two-week agenda of all-day meetings in the month before his arrival, which James Citrin, of Spencer Stuart, who led Thompson's hiring, calls the most comprehensive CEO onboarding program he's ever seen.

That thoroughness was driven in part by Thompson's unusual background. Although he'd led two large British media companies, he'd never worked at a U.S. company or in newspapers, and he was the Times Company's first external CEO in more than a century. In a 75-minute conversation with HBR's Daniel McGinn, Thompson reflected on the activities that were most helpful as he transitioned into the role. The highlights:

"Everyone is watching the whole time, looking to understand what your values are."

A successful transition starts during the interviews. Every job candidate asks questions to learn more about the company, but Thompson, who began his career as a TV journalist, dug deep, calling friends at the Times Company and competing organizations and asking, What is it like to work there? Does the organization really want to change? And if so, does the culture allow change to happen? "You never get a complete answer to that," Thompson says. "You have to flip to instinct. But I felt that many people—and collectively, the board—were really aware of the need to change." (The board had fired Janet Robinson, the prior CEO, in December 2011.)

Demeanor during onboarding is crucial. Thompson attended 29 sessions led by dozens of Times Company executives, on topics ranging from overall strategy and finances to travel-and-expense policies and the pension plan. He listened and spoke carefully. "Everyone is watching the whole time—it's a fishbowl," he says. "They're looking to understand who you are and what your values are. Do you listen to what they say? Are you indecisive? Are you impulsive? It's all done in a very friendly way, but you're on show. How you respond to the PowerPoint presentations is really important....You're not just absorbing stuff."

A good executive assistant can be a cultural translator. Thompson could have brought over his existing EA from the BBC. Instead he said that he "wanted an executive assistant who was the opposite of me—someone who was a deeply experienced Times person, who really understood the way the company worked and knew everyone," he says. The result: Mary Ellen LaManna, a 33-year company veteran. "Mary Ellen has been one of the most important people in the whole process," Thompson says. "She could really read the cultural issues in a way that I was blind to."

Participate in early decisions. Even before his official start date, Thompson began offering guidance on matters that needed immediate action. He interviewed candidates and helped lead the hiring of an SVP for video, a key growth area. He weighed in on (and supported) the board's nascent plans to sell the *Boston Globe* and the company's stake in About.com. When executive editor Jill Abramson and chairman Arthur Sulzberger Jr. were debating whether to publish investigative reporting on financial improprieties by top Chinese officials—a story likely to create business problems in China—they brought Thompson into the discussion. "They asked, 'Do you think we should run it?'" he recalls. "It was a very early test. The answer, of course, was yes."

Get out of the office. Thompson visited the company's London and Paris offices and then, in his first weeks on the job, Abramson invited him to join her on a three-day swing through Silicon Valley, meeting with Tim Cook and Sheryl Sandberg, among others. The European visits gave him perspective, and the California trip helped him forge a relationship with Abramson in a company whose "church-state" divide gives the newsroom great power. "There's a real risk that the new CEO will spend the first six months in the C-suite, locked in rooms with the finance and strategy teams," he says. "That is part of what you do, but it's useful to get a sense of what it feels like away from headquarters."

Meet, greet, and eat. Once he'd taken charge, Thompson set out to meet the company's top 100 executives. Most days, he entertained small groups at in-office breakfasts and lunches. "Night after night, I'd take one person out for a drink and then have dinner with somebody else," he says. He avoided the temptation to assess talents and ability immediately and approached the task partly as a politician. "As a CEO, you need a network," he says. "You can't change organizations by e-mail edict, so you're trying to find parts of the organization that will help you drive change." He also met with individual board members in his early months.

Find the balance between impulsive and slow moving. Perhaps the trickiest piece of the transition for an outside CEO is appearing sure-footed from day one without overstepping. Thompson says, "Most people expect you to start telling them what you want them to do on your first morning. That's not reasonable or possible. But it helps if you've already met them and have begun understanding the world from their point of view....The temptation is to shoot from the hip, to start forming snap judgments and barking out orders. If you don't do any of that, it's probably a problem. But the other extreme is to go into listening mode, where you can look very passive. So you're trying to find a spot on the landscape somewhere between those two extremes." Thompson says that many new CEOs talk about a 100-day plan, but he thinks a longer transition is more realistic. "You have a year to prove you're the right person for the job," he says. "I think a CEO who's not working out after a year is probably not going to work out."

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SPOTLIGHT

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BY EBEN HARRELL

All CEOs will inevitably leave office, yet research has long shown that most organizations are ill-prepared to replace them. In this article, we review the most salient studies of succession planning and offer context from experts on the process of picking new leaders for organizations.

Boards Aren't Ready for Succession

Each year about 10% to 15% of corporations must appoint a new CEO, whether because of executives' retirement, resignation, dismissal, or ill health. In 2015, in fact, turnover among global CEOs hit a 15-year high. Activist investors are increasingly forcing out leaders they deem underperforming. Yet despite these trends, most boards are unprepared to replace their chief executives. A 2010 survey by the search firm Heidrick & Struggles and the Rock Center for Corporate Governance at Stanford University revealed that only 54% of boards were grooming a specific successor, and 39% had no viable internal candidates who could immediately replace the CEO if the need arose.

An organization's top executive is one of the few variables over which boards have total control—and their failure to plan for CEO transitions has a high cost. A study of the world's 2,500 largest public companies shows that companies that scramble to find replacements for departing CEOs forgo an average of $1.8 billion in shareholder value. A separate study reveals that the longer it takes a company to name a new CEO during a succession crisis, the worse it subsequently performs relative to its peers. Finally, poor succession planning often extends the tenure of ineffective CEOs, who end up lingering in office long after they should have been replaced. A study by Booz & Company found that, on average, firms with stock returns in the lowest decile underperformed their industry peers by 45 percentage points over a two-year period—and yet the probability that their CEOs would be forced out was only 5.7%. The authors commented that "boards are giving underperforming CEOs more latitude than might be expected."

Lack of preparedness is only part of the problem, however. An equal challenge, the consultant Ram Charan wrote in 2005, is that all too often, "CEOs are being replaced badly." Boards aren't finding the right man or woman for the job. Estimates suggest that up to 40% of new CEOs fail to meet performance expectations in the first 18 months.

Planning Takes Years, Not Months

So what can directors do not only to prepare for succession events but to ensure they make a winning pick when the time comes? A first step is to integrate executive development programs with CEO succession planning so that the best internal candidates are identified early and flagged at the board level. The proof that such an approach works can be found in companies with prestigious leadership-training programs. Researchers at Santa Clara University and Indiana University who examined the track records of chief executives groomed at "CEO factories," such as General Electric, IBM, and Procter & Gamble, found that the stock market reacted positively when they were appointed and that they delivered superior operating performance over the next three years. The researchers concluded that certain firms "are efficient in developing leadership skills" because "they are able to expose executives to a broad variety of industries and help them develop skills that can be transferred to different business environments."

Internal grooming of promising executives can create value beyond the avoidance of costly interregnums. In his book *Succession,* Noel Tichy, a management professor at the Ross School of Business at the University of Michigan, argues that by putting potential successors in charge of new projects, companies can accelerate change while also testing candidates' suitability for the top spot. Few boards of directors seize that opportunity, however. Research by the Conference Board, the Institute of Executive Development, and the Rock Center found that most directors lack detailed knowledge of the skills, capabilities, and performance of senior executives just one level below the CEO. Only 55% of directors surveyed in the study claimed to understand the strengths and weaknesses of those executives well or very well. Seventy-seven percent did not participate in the performance evaluations of their firm's top executives other than the CEO. And only 7% of companies formally assigned a director to mentor senior executives below the CEO.

Some commentators believe this lack of involvement is the result of CEOs' efforts to stymie boards: The absence of clear successors keeps incumbents in the job longer and gives them more bargaining power with boards. A packed governance agenda may also be to blame. When the consulting firm Mercer Delta surveyed directors about the amount of time they spent on nine key activities, a large majority reported devoting more and more hours to monitoring accounting, risk, and financial performance and other governance duties. Directors also indicated that they spent less time interacting with potential CEO successors than on any other activity.

Michael Useem, a professor of management at the University of Pennsylvania's Wharton School, believes a shortage of directors with experience in hiring top executives also contributes to poor succession planning. He advocates for more current and former CEOs on boards. "People who know how to hire and manage top executives will better understand what a company needs in executive talent and which of the final candidates best brings that to the table," he says.

In his book *It's Not the How or the What but the Who,* Claudio Fernández-Aráoz of the search firm Egon Zehnder lays out six succession-planning guidelines for busy directors: First, start early, ideally the moment a new CEO takes charge. Second, create strict performance metrics and a process for evaluating the CEO against them. Third, identify and develop potential successors within the firm and then benchmark them against external talent. (Useem says directors can go deep during vetting by interviewing all the direct reports of the internal front-runners.) Fourth, look externally to widen the pool of candidates, through executive search firms that don't use contingency arrangements or charge percentage fees (which Fernández-Aráoz believes create perverse incentives). Fifth, require the board to conduct periodic emergency succession drills. And finally, put in place an extensive transition process to help with onboarding, which is especially important given that 80% of CEO appointees have never served in a chief executive role before.

Insiders Versus Outsiders?

Boards often face a binary choice: Go with an internal candidate, or recruit an executive from another company? Traditionally, internal candidates favored by boards have progressed through positions with responsibility for larger and more complex P&L centers. They might start off by managing a single product and then move into an overseas "head of country" position before returning to the main corporate office to supervise a business unit and then run an entire division. Such a tightly choreographed internal trajectory is increasingly rare in a world of job hopping and frequent executive shuffles, however. Consider that in 1988, an executive typically worked for fewer than three employers in his or her lifetime; 10 years later the average had risen to more than five.

Increasingly, CEO vacancies are being filled by external candidates. In 2013, 20% to 30% of boards chose to replace an outgoing CEO with an external hire. In contrast, just 8% to 10% of newly appointed CEOs at S&P 500 companies were outsiders during the 1970s and 1980s.

This trend toward external hires has been strongly criticized by some scholars, including Harvard Business School's Rakesh Khurana, who argues in his book *Searching for a Corporate Savior* that too often boards hire charismatic outsiders even when their experience and abilities are not right for companies' needs. He also blames high-priced executive search firms for driving up demand for external candidates and censures the business press and the investor community for helping fuel what he calls "the cult of the outsider."

Khurana may have a point: Candidates that are headhunted from other firms are paid more than internally promoted candidates. According to the

Twenty percent to 30% of boards now replace outgoing CEOs with external hires rather than internal executives, up from 8% to 10% in the 1970s and 1980s.

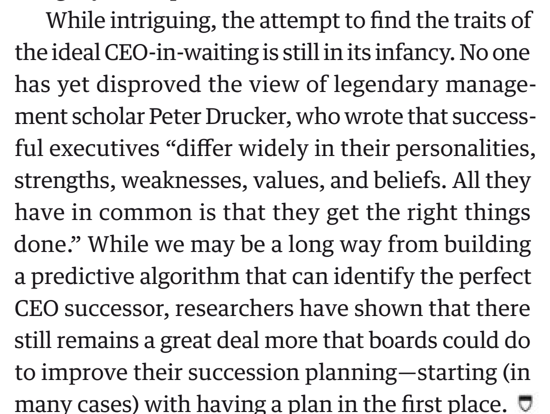
executive-compensation research firm Equilar, the median pay of CEOs who are outsiders is $3.2 million more than the median pay of insiders. Far from deserving such a premium, externally appointed CEOs seem to underperform their internally promoted counterparts over the long run. A 2010 study by Booz & Company found that insider CEOs had delivered superior market-adjusted shareholder returns in seven out of the preceding 10 years. And Gregory Nagel of Middle Tennessee State University and James Ang of Florida State University used elaborate multiple regression analyses to show that, on average, going outside the company to fill the top office was justified in just 6% of cases.

These studies might not be capturing the whole picture, however. Companies tend to look outside their own ranks for leaders when recent financial results are poor, which suggests that external hires might struggle simply because they're walking into challenging conditions at underperforming companies. What's more, multiple studies have concluded that the CEO's influence on corporate performance pales in comparison with other, uncontrollable effects—which is to say, it's very hard to ascertain if a CEO is lucky or good. Furthermore, studies indicate that outsiders who join the company three to four years before they become CEO do just as well as insiders with much more experience at the firm, a crossover category of executive that Harvard Business School's Joseph Bower calls "inside-outside" leaders. For these and other reasons, says David Larcker, a professor at Stanford Business School, "it is difficult to conclude whether internal or external candidates are systematically better operators."

What Are the Traits of a Great CEO?

Whether they're searching for a successor in a firm's internal ranks or an external pool, directors would benefit from knowing which qualities best predict success in the top job. Unfortunately, while much ink has been spilled on the topic of individual leadership, very little of it can be scientifically supported. In an influential book published in 1991, the University of San Diego's Joseph Rost pointed out that writers had defined leadership in more than 200 ways since 1900, often with nothing but conjecture or personal experience to back up their claims. That's slowly changing as researchers look for correlations between personal biographies and leadership success. For instance, one study found that CEOs who had previously served on the boards of large public companies seemed to outperform those without such experience. Another study found that CEOs with military backgrounds were less likely to engage in fraudulent activity. Yet another found that CEOs who spent lavishly in their personal lives were more likely to oversee corporations with loose internal financial controls. Age may also be relevant: Researchers at Mississippi State and the University of Missouri found that younger CEOs outperformed their older counterparts, even after accounting for the fact that younger CEOs were more likely to work in fast-growing industries such as technology. And charismatic CEOs seemed to outperform during periods of upheaval and uncertainty but provided no boost during more stable times.

The private equity industry, which has vast experience hiring CEOs, may also offer some clues about what qualities make for strong CEOs. A recent survey of managing partners at 32 firms found that when choosing a chief executive, they paid less attention to attributes such as track record and industry experience and gave more weight to softer skills such as team building and resilience. But the PEs valued urgency much more highly than empathy—a finding more in keeping with a separate assessment of CEO personalities at venture-backed and private-equity-owned corporations, which suggested that attributes having to do with execution (such as speed, aggressiveness, persistence, work ethic, and high standards) were more predictive of strong performance than interpersonal strengths (such as listening skills, teamwork, integrity, and openness to criticism).



While intriguing, the attempt to find the traits of the ideal CEO-in-waiting is still in its infancy. No one has yet disproved the view of legendary management scholar Peter Drucker, who wrote that successful executives "differ widely in their personalities, strengths, weaknesses, values, and beliefs. All they have in common is that they get the right things done." While we may be a long way from building a predictive algorithm that can identify the perfect CEO successor, researchers have shown that there still remains a great deal more that boards could do to improve their succession planning—starting (in many cases) with having a plan in the first place.

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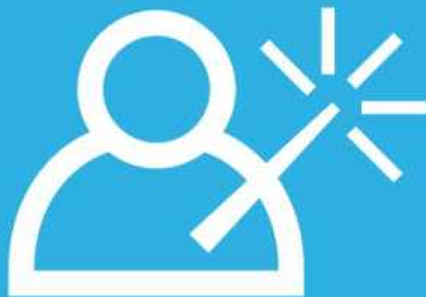

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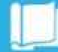
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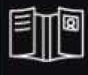

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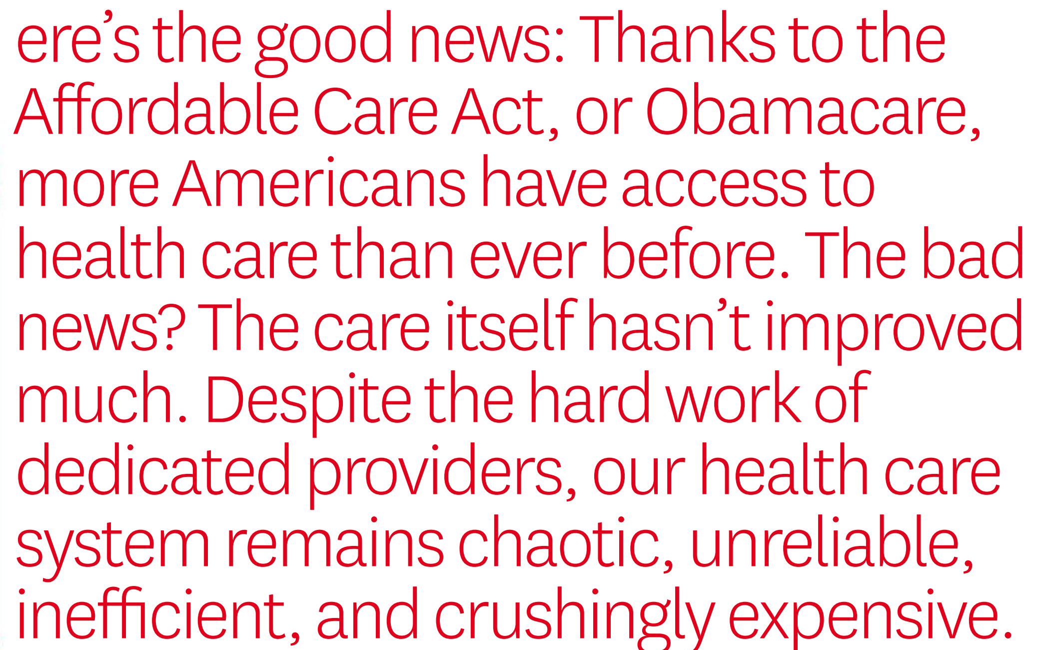
BY LEEMORE S. DAFNY
AND THOMAS H. LEE

Health Care Needs Real Competition

MATT CHASE

And every stakeholder has a role.



Here’s the good news: Thanks to the Affordable Care Act, or Obamacare, more Americans have access to health care than ever before. The bad news? The care itself hasn’t improved much. Despite the hard work of dedicated providers, our health care system remains chaotic, unreliable, inefficient, and crushingly expensive.

There is no shortage of proposed solutions, many of which have appeared in these pages. But central to the best of them is the idea that health care needs more competition. In other sectors of the economy, competition improves quality and efficiency, spurs innovation, and drives down costs. Health care should be no exception.

Industry executives may think they have more than enough competition already. They spend their days fighting to keep patients from being lured away by competitors, new entrants, and alternative sources of care. Their cost of delivering care continues to climb while hard-bargaining insurers hold the line on reimbursements, or even reduce them. Compounding the problem, the services that account for most of providers’ profits, such as radiology and ambulatory surgery, are the ones most vulnerable to poaching. It’s hard to sleep at night when every one of Michael Porter’s five forces is arrayed against you.

Many health care organizations have sought to stymie competition by consolidating, buying up market share and increasing their bargaining power with insurers and suppliers. From 2005 to 2015, the number of U.S. hospital mergers per year doubled (see the exhibit “Hospital Mergers on the Rise”).

Leaders of proposed health care mergers usually tout their potential to enhance value. But when asked to name a merger that has improved outcomes or lowered prices, they generally fall silent. That shouldn’t be a surprise. Years of research by one of us (Dafny) and others show that provider consolidation typically raises prices, with no measurable impact on quality. Indeed, merging with a competitor that has the same fundamental problems you do often increases the scale of problems without creating solutions. State and federal antitrust agencies have successfully quashed some mergers that looked like they would reduce competition, but the government can’t possibly challenge every case. It’s an endless game of Whac-A-Mole, and providers continue to bet that they’ll be among the “moles” to win.

Despite its short-term appeal, consolidation for the purpose of increasing negotiating clout will diminish the potential for the health care sector

Idea in Brief

THE PROBLEM
The U.S. health care system is inefficient, unreliable, and crushingly expensive. In other sectors, competition improves quality and efficiency, spurs innovation, and drives down costs. Yet health care organizations are actively consolidating in order to stymie competition.

THE SOLUTION
Health care payers and providers must stop fighting the emergence of a competitive health care marketplace and make competing on value central to their strategy.

THE WAY FORWARD
All stakeholders in the health care industry can catalyze change in five ways: Put patients at the center of care, create choice, stop rewarding volume, standardize value-based methods of payment, and make data on outcomes transparent.

to create value and thrive in the long run. A new competitive marketplace is emerging in health care today, and organizations must decide whether to continue to deflect competition or make competing on value central to their strategy. In this article, we describe the fundamental shifts that are under way and outline the roles that all key stakeholders—regulators, providers, insurers, employers, and patients themselves—must play to transform health care.

Barriers to Competition

To compete on value, providers must meet patients' needs better or at a lower cost than their competitors do, or both. But this kind of competition has been slow to arrive, because four interrelated barriers have blocked the way.

Limited reimbursement-based incentives. For the most part, providers have not been rewarded financially for delivering value, nor have they been meaningfully penalized for failing to do so. Many hospitals are able to hit their financial targets by competing on the strength of their brand and marketing messages—for example, claiming to have the latest technology, best facilities, or highest magazine rankings. A provider's brand is often unrelated to its actual performance on outcomes, but it can enhance

the provider's ability to negotiate favorable reimbursement rates with insurers. Because providers' revenues have not been contingent on the value of the care they deliver, they've had little incentive to compete on that basis.

Limited market-share incentives. Even when providers have improved value, they have not been sufficiently rewarded with increased market share. Consumers have been largely insulated from costs and thus have had little need to bargain hunt—and insurers haven't done it for them—so lowering costs rarely generates an influx of new patients. Nor have providers gained market share by demonstrating improved quality. Most publicly available quality metrics are process measures (such as mammography and cervical cancer screening rates) that vary little among providers. Patients have been only mildly interested in such data—they assume providers are following guidelines—and have been unwilling to switch providers on the basis of them.

Conversations at patients' kitchen tables are becoming as important to providers as contract talks at the negotiating table.

Inadequate data on value. Good data on outcomes and costs is essential to designing and optimizing value-based care; unfortunately, there's very little of it available. To the extent that providers have gathered data on outcomes, their collection and analysis methodologies have rarely been standardized, so the data sets are difficult to use for comparison, competition, or learning. Data on costs, at the level of individual patients or procedures, has been rudimentary at best, the result of a business environment with rampant cross-subsidization. Lucrative commercially insured patients, for example, subsidize lower-paying Medicare and Medicaid patients. Profitable services (such as radiology) subsidize unprofitable services (such as mental health care). Many providers find that using revenue from profitable services and contracts to cover losses elsewhere is simpler than doing the brutal work of measuring service- and patient-level costs and identifying ways to reduce them without compromising quality. In the absence of meaningful data on outcomes and costs, value-focused work has generally gone undetected and thus unrewarded.

Inadequate know-how. Finally, health care has suffered from a simple know-how problem. In the absence of financial incentives to pursue value and without good data to guide leadership, the management skills necessary for transforming care delivery have not developed. Health care leaders have not learned how to achieve consensus quickly, overcome cultural resistance to change, or nurture high-performing teams. They have not mastered the principles of lean management or high-reliability cultures. And they have not gained experience in making tough, data-driven strategic choices in the face of powerful resistance, such as when and where to cut services in order to improve efficiency.

Falling Barriers

These intertwined barriers have blocked competition in health care for decades, but we are at a critical turning point. A combination of market trends, advances in information technology, and a turnover in health care leadership is shifting the environment.

Increasing reimbursement-based incentives. In January 2015, Sylvia Mathews Burwell, the secretary of the U.S. Department of Health and Human Services, announced plans to shift 30% of Medicare fee-for-service payments—$362 billion in 2014—to alternative models that explicitly reward value. That change is slated to take effect by the end of 2016; the figure will rise to 50% by the end of 2018. Under the new contracts, providers that perform well on both quality and cost will see their reimbursements increase; underperformers will see them fall. Soon after Burwell's announcement, Cigna declared that it was committing to the same goals, and other payers are following suit.

Even if insurers fall short of these targets, the message is clear: They've become ever more hostile to fee-for-service payment increases. We spoke with the leaders of a major hospital system about a recent contract negotiation with a commercial insurer. The system sought an 8% increase and were stunned

by the insurer's counteroffer: a 20% decrease. After public threats from both sides, the parties agreed on a contract that gave the provider no increase in the first year and small decreases in the next two years.

That provider's leaders and most others we've spoken with agree: Providers can no longer negotiate and cross-subsidize their way out of their financial challenges. As personnel, equipment, and drug costs rise faster than revenues and as the path to higher revenues increasingly depends on better performance, the need for new value-oriented business models has become pressing.

Growing market-share incentives. Until recently, consumers had little reason to seek out value in health care. But as their cost burden rises, their behavior is changing. They're increasingly signing up for lower-cost narrowed networks that limit access to more-expensive providers and choosing high-deductible or tiered insurance products that require them to pay more out of pocket for higher-cost care.

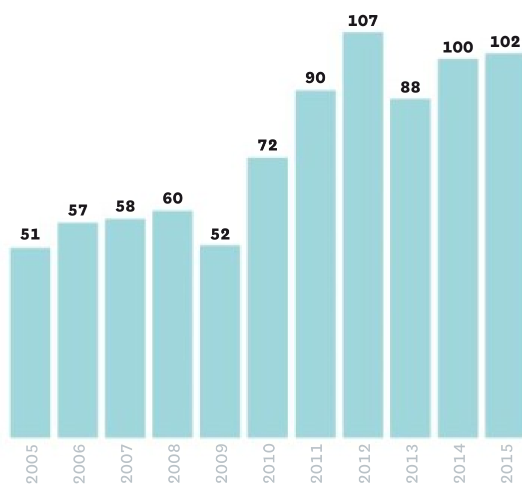
In addition, faster flows of information are allowing insurers to steer patients to similar—but cheaper—options more often and more effectively. For example, a patient who is scheduled for an elective operation might get a phone call from her insurer informing her that she'll pay a lot less out of pocket if she has the same operation by the same surgeon in an ambulatory facility rather than the hospital where it has been scheduled. Presented with options like this, patients tend to call the surgeon—who may be indifferent to where the operation is performed—and the site gets switched.

Thus even if providers manage to renew their contracts with insurers at the same payment levels, they can still lose market share because their customer base is defecting to lower-cost alternatives. Conversations at patients' kitchen tables are becoming as important to providers as their own contract discussions at negotiating tables—perhaps more so.

Meanwhile, increasing numbers of large employers and some insurers are implementing bundled payment programs that provide incentives to patients to get cancer care or major operations at medical centers with outstanding reputations for value. These employers and insurers are figuring out which kinds of patients will travel and how far and tailoring their programs accordingly. The pain from loss of market share is still minimal at most organizations, but the fear of patient defection is real and growing.

HOSPITAL MERGERS ON THE RISE

Health care providers may seek to blunt competition by consolidating. Over the past decade, the annual number of hospital mergers in the U.S. has doubled.



SOURCE AMERICAN HOSPITAL ASSOCIATION AND IRVING LEVIN ASSOCIATES

Improving data. Two developments are dismantling the data barrier: (1) the emergence of consistent standards and incentives for measuring outcomes and (2) the widespread adoption of technologies that enable data sharing. The National Quality Forum provides a gold standard for quality measures, and the International Consortium for Health Outcomes Measurement is defining minimum sets of outcomes measures for use in evaluating care for common conditions. In addition, Medicare bundled-payment programs increasingly include monetary incentives for publicly reporting outcomes. Given Medicare's prior pattern with patient-experience data (reporting was voluntary at first, then mandatory), we expect a similar trajectory with disclosure of outcomes data.

Outcomes data is also becoming easier to collect and compare, in part because electronic medical records (EMRs) now sit on nearly every clinician's desk. Clinicians have legitimate gripes about EMRs, but their continually improving interoperability across delivery systems has major implications for competition. When clinicians can readily see notes

and lab results for patients receiving care in other organizations, they can make informed determinations about which ones provide the greatest value—and favor those providers by referring patients there.

Consider Atrius Health, an organization in the Boston area with nearly 750 physicians and 16 hospital affiliates. Atrius has functional access to EMRs for all those clinicians and providers, so its doctors can coordinate care effectively with them. All those hospitals can—and do—compete for Atrius's business.

Expanding know-how. As the old guard that has long dominated medicine's leadership exits the stage, the know-how barrier is falling. In the past, leaders of health care organizations were physicians who prized autonomy above all else. Today's leaders are younger physicians who value teamwork over autonomy, recognize that managerial skills are essential, and actively seek out opportunities to acquire them.

Rousing speeches can generate some enthusiasm for change, but fear of losing market share to a competitor is uniquely effective in mobilizing organizations.

These emerging leaders are pursuing degrees in management and strategy at business schools and participating in training programs for health care executives. The venerable two-year fellowship at the National Institutes of Health that used to launch physicians into leadership roles has been replaced with stints at consulting firms or management positions in other parts of health care or business. Look at the top ranks of health care organizations, and you'll see 70-year-old physicians being replaced by MD/MBAs in their 40s.

Leaders today are not being picked for their skill in defending the status quo and pushing back at external foes. They are selected for their ability to lead performance improvement—giving organizations the ability to compete and win.

Catalyzing Competition

As barriers to competition crumble, the health care industry must take action to create positive change. There are five ways to accelerate progress.

Put patients first. A central tenet of most businesses is that customers come first. For many providers, though, keeping peace with internal stakeholders (particularly physicians) often takes precedence. But it's only when organizations prioritize patient welfare that they can improve and compete on value.

Consider the initiative launched by the Cleveland Clinic in 2011 to offer same-day appointments to patients. At the time it was common for patients who needed specialty care to wait weeks or even months for appointments, often enduring anxiety during the delays and occasionally suffering complications that might have been averted with more timely care. Providers had little incentive to solve the problem; indeed, at academic medical centers, some physicians famously took pride in the length of their waiting lists. When the Cleveland Clinic began asking patients who called for appointments whether they'd like to be seen that day, other care centers rapidly followed suit. Although waits are still all too common, a web search for "same-day appointments" at academic medical centers now delivers thousands of hits. This simple development underscores the power of a patient-first approach to catalyze competition.

To be sure, reorganizing care delivery to meet patients' needs is not easy. Unlike same-day appointments, which are fairly straightforward to implement, other changes can be highly disruptive. For example, the first step in any customer-centric strategy is segmentation. But segmenting patients into groups with similar needs, and assembling multidisciplinary teams to care for those groups, challenges the entrenched organizational structure of medicine and the flow of money within it. Thus it's often met with resistance, particularly from the old guard.

But even the old guard knows that teams are better than individuals at providing coordinated, integrated, efficient care. And in a value-driven marketplace, teams are not just nice to have—they're essential to competitiveness.

Create choice. For change to take hold in health care, decision makers at every level need real

choices: consumers when picking health insurance products, patients when choosing clinicians, and clinicians when selecting the facilities where their patients receive care. When choices exist, clear winners and losers emerge, creating relentless pressure on all providers to improve. Rousing speeches by executives and policymakers can generate some enthusiasm for change, but fear of losing market share to a competitor is uniquely effective in mobilizing organizations. Organizations that are hungry or afraid—be they new entrants or established players—are often the most innovative, generating new choices and stimulating competition.

Take Advocate Health Care, a Chicago-based provider system formed in 1995 in a market dominated by famous academic medical centers like the University of Chicago and Northwestern. Advocate believed that the sustainable strategy in the long run was to offer patients a new choice—a clinically integrated health system focused on increasing quality of care while holding the line on total costs. After the Affordable Care Act was passed, Advocate committed to reorganizing and optimizing patient care in order to succeed under "shared savings" arrangements, which reward providers for beating cost benchmarks while meeting quality goals, and global capitation contracts, which pay providers a fixed amount of revenue per member, per month.

It was a bold move: To succeed, Advocate had to reduce the total cost of care while improving quality and service. But fee-for-service contracts, which dominated the reimbursement landscape at the time, actually punish providers for reducing spending—and fail to compensate them for activities that improve efficiency.

Advocate's gamble paid off. It is thriving under global capitation, which accounts for nearly 40% of its revenues today (up from 11% in 2011), and generates another 30% to 35% of revenues from shared savings arrangements. Advocate has reduced spending growth to below local averages and has partnered with insurers to pass the savings along to consumers through more-affordable, narrow network products. Today Advocate is the largest health system in Illinois and has the state's largest physician network. Growth via acquisitions and affiliations has played a supporting role in Advocate's strategy, but its success derives not from its size but from its commitment to offering patients innovative new choices.

To seriously challenge market leaders, health care needs the kind of hunger demonstrated by Advocate—and by a senior executive we spoke to

at the number two provider in another region. "We see [the market leader] as our competition, but they don't think of us as theirs," she told us. "It's perfect. We are eating their lunch, and they are just waking up to it." That provider has launched a wide range of patient-centric initiatives and organizational improvements, some of which have earned the most sincere form of flattery from its rival—imitation.

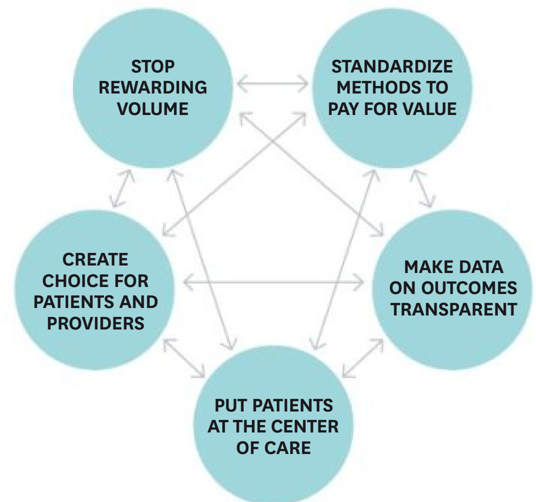
Stop rewarding volume. Value-based payments may be ramping up, but the vast majority of money in health care still moves through the fee-for-service system, which encourages inefficiency and overutilization. Simply layering modest incentives to offer services that might reduce costs—care coordination, for example—atop a fee-for-service chassis only results in more volume, even if it is better coordinated. Indeed, there's no evidence that overall health care costs go down when the main intervention is adding services, however well intended. So don't hold your breath waiting for savings to accrue from compensating physicians for developing end-of-life care plans with patients, for example. What leads to cost savings is reorganizing care around the delivery of health rather than health care.

One step in the right direction is to pay providers one lump sum to treat a patient's condition over the entire episode of care or a defined period of time. Bundled payments are a prime example. As Michael Porter and Robert Kaplan detail in their July–August 2016 HBR article, "How to Pay for Health Care," bundles are not a new idea, and their ability to drive value improvement in focused areas like transplantation is well established. But for bundles and other non-fee-for-service models to move from theory to practice on a broad scale, the incentives must be compelling and inescapable.

Standardize methods to pay for value. Both public and private payers must do more than push financial risk onto providers. They need to agree on the rules of the game. That means identifying segments of patients with similar needs—typically groups with the same condition (such as heart failure or prostate cancer)—and agreeing on the outcomes measures that will be used to assess the quality of care for the conditions. Payers should propose common methods for collecting and analyzing data, using input from providers, government agencies, and health care IT experts. And they should agree on a common payment structure for episodes of care so that providers can focus on improving care delivery rather than navigating the reimbursement maze. Insurers, meanwhile, can use the standardized data to identify and reward the highest-value providers.

CATALYSTS FOR COMPETITION

Five interrelated actions can spur value-based competition in health care.



While patients can't be perfectly divided into all-inclusive, mutually exclusive categories, some movement in this direction is surely better than none. Working with providers, payers can change the game in health care by defining some rules.

Make outcomes transparent. Even when health care providers collect data on outcomes, and even when the data is standardized, providers often resist sharing results publicly. But real competition will emerge only if outcomes data is made available to decision makers, be they patients, payers, or other providers. Data transparency has already driven improvement in clinical outcomes in transplantation, cardiac surgery, in vitro fertilization, and patient experience. Consumers may initially pay the data little heed, but providers will still vie to earn the highest marks, and payers and referring physicians will ultimately shift volume toward those that do.

Such transparency unnerves many providers, who worry that factors beyond their control will negatively impact their results and that reported data will be misinterpreted. For example, "safety net"

institutions that serve poorer populations and teaching hospitals that attract the sickest patients can look worse than those with healthier patient populations. Although risk adjustment methodologies can mitigate the effects of differences among patient populations, transparency will sometimes lead to rankings of providers that are not fair. Nevertheless, transparency can be more effective than financial incentives in driving quality improvement—and it's often cheaper.

Stakeholder Roles

As the competitive marketplace emerges, no one wants to be the last to embrace the rapid changes under way. Here are some of the ways key stakeholders—governments, providers, payers, employers, and consumers—could be (and in many cases are) responding to the new landscape.

Government as regulator. Governments and their myriad agencies perform important regulatory functions, ranging from establishing and enforcing insurer-solvency requirements to specifying which health care facilities need backup electricity generators. But government also has a vital role to play in protecting and promoting competition. In particular, the Federal Trade Commission, the antitrust division of the Department of Justice, and state attorneys general all have a mandate to enforce competition law. However, the volume of health care mergers and the pace of change in business practices exceed the resources available to investigate them.

Increasing funding for these agencies is a wise long-term investment in the productivity of the health care sector. Entrenched anticompetitive practices—such as Blue Cross Blue Shield's "exclusive territory" agreements, which preclude affiliates from competing against one another in most geographies—are difficult to challenge and undo. Dissolving mergers that prove anticompetitive is costly and exceedingly difficult as well. It is much more effective to get ahead of the gamesmanship.

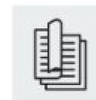
Governmental agencies can also promote competition by monitoring and reporting on changes—particularly prospective mergers—in local health care markets. This will require new resources, but the business adage about spending money to make money (or in this case, to save it) applies.

One agency playing this role is the Massachusetts Health Policy Commission (HPC), established and funded by state legislation enacted in 2012. The HPC requires all providers to disclose merger and acquisition plans and conducts analyses of sizeable transactions. Merging entities may be asked to describe how their deals will benefit consumers and, after the fact, to report publicly on their progress toward goals. The HPC also set a target of 3.6% for the annual growth rate of total health care spending over the period 2013 through 2017—a figure that matched the projected growth in state GDP from 2013 to 2015. Providers complained that this target was arbitrary, but it had the intended effect: In contract negotiations with insurers, providers shifted their demands for reimbursement increases downward to reflect the goal.

Finally, regulators should seek to lower barriers for new entrants into payer and provider marketplaces. State legislatures can repeal (or not enact) laws that protect incumbents rather than consumers. Such laws are common: Texas, for example, requires that patients see a physician face-to-face in order to pursue a telehealth consultation, even when there are no legitimate health or safety justifications for such a requirement. Some states have created similar obstacles for retail health clinics that otherwise could safely and effectively serve patients. These barriers to competition reflect the tendency of state medical societies to resist challenges to traditional health-care-delivery models and demonstrate the need for government to ramp up efforts to promote delivery innovations, particularly in regions where competition among traditional providers is weak.

Government as payer. Medicare and Medicaid have emerged as potent leaders of change—developing innovative payment mechanisms, setting ambitious targets, and using their sheer scale to move the marketplace. Consider Medicare's Comprehensive Care for Joint Replacement (CJR) program under which hospitals in 67 regions receive a lump sum for the entire episode of care involving total hip and knee replacements, rather than individual payments for discrete services (radiology, anesthesia, surgery, and so on). The key difference between the CJR and Medicare's earlier bundled payment initiatives is that prior programs were voluntary; the CJR is mandatory.

Instead of meeting to discuss *whether* to participate in the CJR, hospital leaders now meet to discuss *how* to do so. Hospitals that organize to improve quality and efficiency can expect to share in the savings; those that do not should be prepared to lose money. In July, the Centers for Medicare & Medicaid Services announced plans to implement the approach for



FURTHER READING

For more on competition in health care, read these articles at HBR.org.

"The Strategy That Will Fix Health Care"
Michael E. Porter and Thomas H. Lee

"How to Pay for Health Care"
Michael E. Porter and Robert S. Kaplan

"The Risks of Health Insurance Company Mergers"
Leemore Dafny

acute myocardial infarction, coronary artery bypass graft surgery, and femur fracture surgery. Those programs are slated to launch in July 2017.

Medicaid is becoming a change agent on a state-by-state basis as well. In Arkansas, Tennessee, and Ohio, Medicaid programs have recently implemented mandatory bundled payment programs that cover more than a dozen conditions, including asthma, pregnancy, attention deficit disorder, and congestive heart failure. Regulations in Arizona, Pennsylvania, and South Carolina require that commercial insurers covering Medicaid enrollees generate 20% to 30% of their revenues from value-based payment methods over the next three years. New York State has declared that 80% to 90% of Medicaid payments must be delivered through value-based models by 2020.

Consumers can energize the marketplace by creating real consequences for the winners and losers.

The incentive for providers to comply with these mandates is compelling. In many states, the Medicaid-covered share of the population is now pushing 25%. If those patients go elsewhere, many providers won't have the critical mass they need to stay afloat. A decade ago, the idea of providers actively pursuing Medicaid patients would have defied credulity; the fact that they are now competing fiercely to hold onto that market share is a sign of the magnitude of the change under way.

Providers. Health care providers must be the protagonists in this unfolding story. Boards of directors have to ask questions at the heart of strategy: "What is our goal? How are we going to differentiate ourselves?"

Providers instinctively avoid new payment models, but they need to recognize the writing on the wall and embrace models that reward value, despite their risks and imperfections. They should work with other providers as well as insurers to develop new care-delivery schemes such as bundles and to engage in the open-ended work of making them better. Where a provider's rivals are paralyzed, there is a competitive opportunity both to redesign care delivery so that it improves value and to reshape the payment models that reward it.

The emergence of the Health Care Transformation Task Force, a consortium of patients, payers, providers, and purchasers committed to improving health care, is compelling evidence that the landscape is changing. The task force includes 26 provider organizations that have committed to generating more than 75% of their revenues via payment arrangements that hold them accountable for cost and quality by 2020. The providers have also declared their support for voluntary reporting on outcomes for patients undergoing surgery as part of Medicare's CJR bundle program.

These are not small providers under the spell of charismatic leaders. They include enormous delivery systems, such as Trinity Health, Advocate Health Care, Ascension, Dignity Health, Partners HealthCare, and Providence Health & Services. Nor are they merely paying lip service to the need for change: Task force providers and payers reported that 41% of their business was in new value-based payment models at the end of 2015—an increase from 30% at the end of 2014.

One path providers should *not* pursue is consolidation that does not directly lead to improved value for patients. Some providers argue that the Affordable Care Act encourages mergers as a means to create larger organizations that are more resilient in the face of financial risk. However, the real goal of health care reform is to encourage alliances that are better, not just bigger. There has been a good deal of horizontal consolidation (among competing hospitals, for example), but these deals often change little about the way care is delivered. In contrast, vertical integration (for example, between hospitals and nonacute facilities) may have greater potential to improve quality and efficiency—and in many cases can be achieved via joint ventures rather than mergers.

Too often, providers seek to grow by searching for targets with similar values and complementary geographic footprints. Instead, providers seeking growth should first consider how they can serve patients better, and only then ask if an acquisition

is the way to do it. If managers can't explain how an acquisition will improve the value of care, boards should question whether to pursue it.

Commercial insurers. Private insurers historically have battled with providers to secure the lowest reimbursement for each service. A better way for insurers to keep prices low is to foster and reward competition among providers on value.

First, commercial insurers should align themselves with the Centers for Medicare & Medicaid Services in making value-based payment the norm and adopt a similar structure for bundled payments. Early experience with bundles suggests that providers are more likely to be successful when they reorganize care delivery for all patients, not just those of a single payer, and when they implement bundles for multiple conditions, not just one. For this reason, commercial insurers should work together to create common definitions and outcomes measures for bundles and other value-based payment models.

At the same time, insurers should compete vigorously with one another for market share on the basis of creative new product offerings. Like providers, they should engage in more market segmentation (for example, creating insurance plans designed for families with young children). Simply getting bigger is not a strategy. The insurance industry is already highly consolidated; meanwhile, the pace of new-product design and levels of customer satisfaction are disappointing, to say the least.

Commercial insurers should continue to resist fee-for-service payment increases. This will keep a lid on costs and compel providers to focus on value rather than volume. Insurers should also combat provider consolidation by creating programs that effectively expand the market, such as offering patients incentives to travel to other regions to get quality care at a lower cost and negotiating prices on the basis of regional or national benchmarks.

Patients and employers. Consumers can energize the marketplace by creating real consequences for the winners and losers. If patients choose to receive care from high-value providers, which may mean traveling farther, then providers will focus their energy on improving care delivery. Patients should no longer settle for care that is not coordinated, compassionate, safe, and technically excellent. When it falls short, they should be vocal—or leave. Consumers should also demand a broader set of insurance choices from their employers—perhaps via private insurance exchanges—so that they can vote with their feet and switch to products that best suit their needs. Only then will payers find it profitable to introduce easy-to-navigate plans that reward low-cost, high-quality providers.

Employers also wield considerable influence. Major corporations such as Walmart are already collaborating with providers and insurers to create programs that encourage employees to seek out high-value care. Other entities that work on behalf of employees are proving similarly catalytic. The California Public Employees' Retirement System (CalPERS), which provides health insurance coverage for 1.3 million people, is a case in point. CalPERS was seeing wide variation in prices for many procedures its members received, depending on where they got their care. For example, it was paying anywhere from $12,000 to $75,000 for joint replacement surgery, although there was no clear difference in the quality of the services. To address the problem, CalPERS introduced a "reference price" of $30,000—the maximum it would pay—and assembled a list of high-quality providers willing to accept it. Patients who chose to go to more expensive providers had to pay the difference out of pocket.

Patients responded by shifting their business to lower-cost providers. Faced with the threat of losing market share, most providers cut their prices. From 2011 to 2015, the number of California hospitals charging less than $30,000 for joint replacement increased nearly 60%, from 46 to 72. That kind of change could never have been achieved at the negotiating table; it took the fear of losing business to focus providers' attention. Once it was clear that some well-regarded hospitals in California could meet CalPERS's price, it did not take long for others to follow.

WE DON'T underestimate the turmoil that the health care sector faces in the years ahead. We know that every scenario for transforming the sector will yield unpleasant or unintended consequences for some stakeholders. But the consequences of failing to compete on value will be worse: chaotic, costly care of uneven quality, with a growing toll on individuals and the economy. Real competition must be the path forward. Health care organizations that try to deflect competition are on the wrong side of history and the wrong side of strategy.

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BY RAY FISMAN AND MICHAEL LUCA

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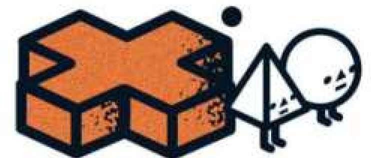
FIXING DISCRIMINATION IN ONLINE MARKETPLACES

Airbnb, Uber, and others are facing the unintended consequences of their platforms' design choices.



STEPHEN CHAN

IN THE LATE 1980S, LAW PROFESSORS IAN AYRES AND PETER SIEGELMAN SET OUT TO LEARN WHETHER BLACKS AND WOMEN GOT THE SAME DEALS AS WHITE MEN WHEN BUYING A NEW CAR. THEY TRAINED 38 PEOPLE—SOME WHITE AND SOME BLACK, SOME MALE AND SOME FEMALE—TO NEGOTIATE A PURCHASE USING A FIXED SCRIPT, AND UNCOVERED DISTURBING DIFFERENCES: ACROSS 153 DEALERSHIPS, BLACK AND FEMALE BUYERS PAID MORE FOR THE SAME CARS THAN WHITE MEN DID, WITH BLACK WOMEN PAYING THE MOST—ON AVERAGE, NEARLY $900 MORE THAN WHITE MEN. ALTHOUGH THE FINDINGS WEREN'T A SURPRISE TO MOST PEOPLE, LEAST OF ALL TO BLACKS AND WOMEN, THEY WERE A COMPELLING DEMONSTRATION OF JUST HOW DISCRIMINATORY MARKETS CAN BE.

Fast-forward a dozen years to the early days of internet commerce. Entrepreneurs were experimenting with web-based sales of everything, including automobiles. Economists Fiona Scott Morton, Florian Zettelmeyer, and Jorge Silva-Risso analyzed this new mode of selling cars and found that it did away with the racial and gender discrimination that, they also found, persisted in off-line automobile sales.

Indeed, the first generation of online marketplaces, including eBay, Amazon, and Priceline, made it hard for sellers to discriminate. Transactions were conducted with relative anonymity. A user could negotiate a purchase without providing any identifying information until the seller had agreed to the deal. As a *New Yorker* cartoon famously put it, "On the Internet, nobody knows you're a dog."

Except that platforms—and now their users—do know whether you're black or white, male or female, human or canine. And the internet has recently been revealed as a source of discrimination, not an end to it: With their identities uncovered, disadvantaged groups face many of the same challenges they have long confronted in the off-line world, sometimes made worse by a lack of regulation, the salience photos give to race and gender, and the fact that would-be discriminators can act without ever personally confronting their victims.

What happened, and what can we do about it?

The Emergence of Digital Discrimination

In the early days of e-commerce, shopping online often required a leap of faith. An eBay seller in Florida might post, say, a Topps baseball card for Nolan Ryan's 1974 season with the California Angels, along with a description of its condition. A collector in Massachusetts could bid on the card sight unseen, on the basis of that description. A card in mint condition might be valued at $60, but a dog-eared one would be worth just a fraction of that. What was to

Idea in Brief

THE PROBLEM
Online marketplaces such as eBay, Uber, and Airbnb have the potential to reduce racial, gender, and other kinds of discrimination that affect transactions in the off-line world. But recent research shows that the opposite has occurred.

THE REASON
Early platforms kept the identities of buyers and sellers relatively anonymous. But the addition of photos, names, and other means of identification to listings has inadvertently encouraged discriminatory behavior.

THE ANSWER
To create markets that are both efficient and inclusive, platform designers need to be mindful of the potential for discrimination and open to experimentation as they make choices about automation, algorithms, and the use of identifying data.

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prevent the seller from passing off a well-worn card as pristine? Very little: A study by economists Ginger Jin and Andrew Kato found that in the early 2000s, eBay merchants often misrepresented the quality of sports trading cards.

The problem with early e-commerce was that one side of the market tended to know things the other side didn't—the condition of a baseball card, the reliability and care with which goods would be packaged, and so on. These challenges arise in all markets, but they were particularly severe for online platforms, for two main reasons. First, it's harder to overcome information asymmetries when you can't hold a product in your hand. Second, online sellers were, almost by definition, new to the business, since the business itself had been around for just a few years. There were no established brands, such as Sotheby's and Sears, to assure buyers they wouldn't be cheated.

Over time, buyer reviews and other feedback have allowed e-commerce sellers to build up reputations. But why stop at collecting feedback when so much potentially useful information could be mined from buyers' and sellers' identities? For example, in a 2012 study of peer-to-peer lending by Jefferson Duarte, Stephan Siegel, and Lance Young, subjects rated potential borrowers' trustworthiness after viewing photographs of them. It turned out that people who "look trustworthy" were more likely to have their loan requests granted. More surprisingly, they were also more likely to repay the loans. The implication was that if this type of fine-grained information could help market participants assess a transaction's prospects, it made sense to provide it.

On the websites of services ranging from freelancing to ride sharing to dog walking, many sellers now have discretion over whom they do business with on the basis of looks or even just a name. The availability of such information is platform-specific, with some sites preserving a fair amount of anonymity while others hark back to practices long banned in off-line markets. Similarly, on many sites, including Etsy and CustomMade, potential buyers see not only products but also the names and photos of sellers. Although having details about prospective transaction partners may make people more comfortable, a growing body of evidence shows that it facilitates discrimination.

The short-term-rental marketplace Airbnb is a case in point regarding the emergence of discrimination in online markets and the ways in which design choices influence the extent of it. When a would-be renter searches listings, he sees descriptions and pictures of both the property and the host. And hosts can see the names—and in many instances the pictures—of potential tenants before accepting or rejecting them.

One of us (Mike, working with Benjamin Edelman and Daniel Svirsky) has investigated racial discrimination on Airbnb. In a study focused on the U.S. market, the group constructed 20 user profiles and sent rental requests to roughly 6,400 hosts. The profiles and requests were identical except for one detail—the user's name. Half the profiles had names that (according to birth records) are common among whites, while half had names common among blacks.

Requests with black-sounding names were 16% less likely than those with white-sounding names to be accepted. And the discrimination was pervasive, occurring with cheap listings and expensive ones, diverse neighborhoods and homogeneous ones, rooms in the host's own dwelling and separate units rented out by landlords with multiple listings. Most of the hosts who declined requests from black-sounding profiles had never hosted a black guest—suggesting that some hosts are especially inclined to discriminate on the basis of race. (In response to this study and to a growing chorus of criticism

from users and regulators, Airbnb commissioned a task force to identify ways to reduce discrimination, which proposed a series of changes in September 2016. We will discuss aspects of the announced policies below.)

Researchers have now documented racial discrimination in a variety of areas online, from labor markets to credit applications to housing. It is enabled by two features: markers of race, most obviously photographs but also subtler indicators, such as names; and discretion on the part of market participants over whom they transact with. As we will discuss in the next section, both are choices made by platform designers.

Another feature of online commerce has at times, also counterintuitively, nurtured rather than suppressed discrimination: the use of algorithms and big data. The search results Google serves up, the books Amazon suggests, and the movies Netflix recommends are all examples of machines' replacing imperfect human judgment about what customers want. It's tempting to assume that eliminating human judgment would eliminate human bias as well. But that's not the case.

In fact, algorithm-generated discrimination occurs in ways that humans would probably avoid. In an eye-opening study, computer science professor Latanya Sweeney sought to understand the role of race in Google ads. She searched for common African-American names—such as Deshawn and, well, Latanya—and recorded the ads that appeared with the results. She then searched for names, such as Geoffrey, that are more common among whites. The searches for black-sounding names were more

likely to generate ads offering to investigate possible arrest records.

Of course, Google didn't set out to show arrest-record ads to people who searched for African-American names. That happened because an algorithm "decided," on the basis of past searches, that someone searching for "Deshawn" is more likely than someone searching for "Geoffrey" to click on an arrest-related ad (and hence generate revenue for Google). That is, the choice was made, if unwittingly, by Google's algorithm designers.

Toward Smarter Market Design

Platforms—even when they're in the same industry—often differ in their design features, which can lead to different levels of vulnerability to discrimination. Take the decision whether and when to post user pictures. Uber does not provide drivers with photos of potential passengers, but its competitor Lyft does. This makes Uber less vulnerable than Lyft to discrimination by drivers. Similarly, the main search-results page of the vacation rental marketplace HomeAway displays photos only of the property for rent and withholds host photos until a later page (if it shows them at all), whereas Airbnb requires that hosts include photos of themselves on its main search-results page.

Companies also have varying approaches to investigating possible discrimination and taking remedial action. For example, eBay worked with a team of social psychologists to explore whether male sellers get higher prices than female sellers for similar items (they do). More commonly, though, businesses avoid the issue. Although many executives acknowledge that discrimination occurs and express interest in reducing it, we've seen few earnest efforts like eBay's to gauge its extent. So researchers looking to study online discrimination must run their own experiments or scrape decidedly imperfect data from websites. (And we know of cases where company lawyers have gone after such efforts in an attempt to block race-related research.)

Even companies with the best of intentions may not choose the best approach to fighting discrimination, because, to our knowledge, no system exists for thinking through the available design choices and their implications. Our aim in what follows is to offer a framework for companies that want to design and manage a thriving marketplace while minimizing the risk of discrimination.

We don't expect every market designer to make the same decisions. Just as competitors make differing design choices about other situations (for instance, Lyft lets riders tip through its app, but Uber doesn't), they will make differing choices about confronting discrimination; among other reasons, they place differing premiums on avoiding discrimination (although we believe that platforms should hold themselves to a high standard in this regard). Our goal is to help designers fully consider the implications and trade-offs of their design choices.

Below we offer two guiding principles for platforms struggling with this market-design challenge. We then evaluate four design choices that are likely to affect discrimination.

IT'S TEMPTING TO ASSUME THAT ELIMINATING HUMAN JUDGMENT WOULD ELIMINATE HUMAN BIAS AS WELL. BUT ALGORITHM-GENERATED DISCRIMINATION OCCURS IN WAYS THAT HUMANS WOULD PROBABLY AVOID.

PRINCIPLE 1: Don't ignore the potential for discrimination. Platforms should start with more-careful tracking. Currently, most don't know the racial and gender composition of their transaction participants. A regular report (and an occasional audit) on the race and gender of users, along with measures of each group's success on the platform, is a necessary (though not sufficient) step toward revealing and confronting any problems. It can shed light on areas where discrimination is an issue and reveal progress over time. It can also be a good-faith first step toward reducing discrimination. For example, Airbnb should regularly report the acceptance rates of guests broken out by factors such as race and gender. Making this information public would help raise user and regulator awareness and keep pressure on companies to deal earnestly with discrimination problems that arise as their platforms evolve. (Public disclosure of discrimination-related data is one dimension on which Airbnb's announced policies fall far short—but it's needed to ensure that

the company's broad, laudable goals translate into concrete results.)

PRINCIPLE 2: Maintain an experimental mindset. Platforms should do what they do best—experiment. Companies including Facebook, Yelp, and eBay have baked experimental thinking into their development of new products and features. To test design choices that may, along with other interventions, influence the extent of discrimination, companies should conduct randomized controlled trials. Airbnb should be applauded for a recent experiment in withholding host photos from its main search-results page to explore the effects on booking outcomes (although it has not made the results public).

IN MANY CASES, THE SIMPLEST, MOST EFFECTIVE CHANGE A PLATFORM CAN MAKE IS TO WITHHOLD POTENTIALLY SENSITIVE USER INFORMATION, SUCH AS RACE AND GENDER, UNTIL AFTER A TRANSACTION HAS BEEN AGREED TO.

DESIGN DECISION 1: Are you providing too much information? In many cases, the simplest, most effective change a platform can make is to withhold potentially sensitive user information, such as race and gender, until after a transaction has been agreed to. Some platforms, including Amazon and eBay, already do this. For many others, however, it would mean departing from the way they do business. An executive of a platform with a billion-dollar valuation told us that his firm would never consider eliminating photos or names.

In addition to choosing what information to reveal, platforms choose how salient to make it. And a large body of evidence has shown that salience matters. On some platforms, for example, shipping costs are separate from—and less salient than—the base price. In an influential experiment, economists Jennifer Brown, Tanjim Hossain, and John Morgan demonstrated that in this situation, a lower base price increases the chance that an item will sell, even when it is offset by a higher shipping charge. In other words, a customer is influenced not only by the information he sees but also by which information is most prominent.

To see how this insight might be applied, recall the comparison of Airbnb, which displays host photos on its main search-results page, and HomeAway, which does not. (In September, Airbnb stated that it will test alternative ways of presenting photos and other race-relevant information, although it did not commit to specifics.) By reducing the salience of race, platforms could reduce discrimination.

DESIGN DECISION 2: Could you further automate the transaction process? When using Uber, you tap the screen to order a ride; only after confirming do you learn who will pick you up. In theory, you can then cancel if you don't like the driver's rating or looks. But that takes effort, and this small "transaction cost" is probably just enough to deter most looks-based cancellations. Uber could just as easily have allowed riders to see the driver before tapping confirm or cancel, but it chose not to.

Having transactions occur before race and gender are revealed makes it more difficult for people to discriminate. Consider the Airbnb feature known as "instant book," designed to make booking simpler and more convenient. A host using it allows renters to book her property without her having first approved them. Instant book is an opt-in feature: Landlords must sign up for it. Research has shown that default bias is strong: Most hosts will use whatever option is set up as the default. If Airbnb switched its default to instant book, requiring hosts to actively opt out of it, discrimination would most likely be lessened. The company might even consider making hosts pay for the privilege of screening customers—for example, it could charge a premium for opting out of instant book. (In September the company announced that it would accelerate the use of instant book, although it did not specify how it would accomplish this.)

We believe that increased automation and standard economic incentives, carefully implemented, could both reduce discrimination and—by eliminating some of the back-and-forth needed to complete a transaction—increase profits on a variety of platforms.

DESIGN DECISION 3: Could you make discrimination policies more top-of-mind? In a 2012 study, the research team of Lisa Shu, Nina Mazar, Francesca Gino, Dan Ariely, and Max Bazerman set

out to test whether something as simple as the location of a signature on a form could affect honesty. They observed that people are often asked to fill out information and then sign at the end to attest to its veracity. They wondered whether people would be less likely to cheat if they signed at the very beginning of the form—before filling it out. Indeed, signing at the top led to less cheating in both a lab experiment and a real-world experiment with an auto insurance company. It also worked in the context of tax returns.

There's a lesson here for marketplaces: If you want people to do something, think carefully about when to prompt them. Most platforms have policies prohibiting discrimination, but they're buried in fine print. For example, Airbnb hosts must agree not to discriminate—but they do so when first signing up to be a landlord. By the time a host is deciding whether to accept a potential renter, she has probably forgotten that agreement. Marketplaces could present antidiscrimination policies at a more relevant moment—and have the host's agreement not to discriminate occur during the actual transaction process. Some people would still violate the policies, of course, but that would require a much more conscious choice.

DESIGN DECISION 4: Should your algorithms be discrimination-aware? Design choices also determine the extent to which an algorithm leads to discrimination. Thus far many algorithm designers have ignored factors such as race and gender and just hoped for the best. But in many cases the probability that an algorithm will unintentionally achieve equality is essentially zero; recall how Google's algorithms handled ads for arrest records.

If an algorithm designer cares about fairness, she needs to track how race or gender impacts the user experience and to set explicit objectives. Does she want to ensure that black customers are not rejected at higher rates than white customers? That women are offered the same prices as men?

Google tweaked its algorithm in response to the arrest-record study, but companies can proactively monitor and respond to such problems. That might entail compensating for some users' discrimination. For example, suppose Uber noticed that some passengers consistently gave low ratings to black drivers who received five stars from most of their other riders. The company could underweight ratings from those passengers—who have revealed themselves to be discriminatory—when calculating black drivers' overall feedback scores.

A Lesson from Symphony Orchestras

Platforms exist within a larger social context, of course; we can't create a color- and gender-blind world simply by designing platforms that are less apt to facilitate discrimination. And it would be wishful thinking to imagine that every platform designer aspired to that goal; sometimes enabling discrimination is good for business. When that's the case, we can only appeal to business leaders' sense of social responsibility or hope that government regulation will intervene.

But there are many instances in which the idea of "doing well by doing good" does hold—times when platform businesses could reduce discrimination at a low cost or even while increasing profits. It's also possible that a few enlightened businesses could start a virtual cycle that forces better behavior from other market participants.

Consider how the challenge of creating diversity in U.S. symphony orchestras was met. In the mid-1960s, less than 10% of the musicians in the "big five" U.S. orchestras (Boston, Philadelphia, Chicago, New York, and Cleveland) were women. In the 1970s and 1980s, as part of a broader diversity initiative, the groups changed their audition procedures to eliminate potential bias. Instead of conducting auditions face-to-face, they seated musicians behind a screen or other divider. In a landmark 2000 study, economists Claudia Goldin and Cecilia Rouse found that the screen increased the success rate of female musicians by 160%. In fact, they attributed roughly a quarter of the orchestras' increased gender diversity to this simple change. And with selection based more squarely on musical ability, the orchestras were undoubtedly better off.

When we first read this study, many years ago, we were intrigued by the rare glimpse it provided into discrimination's effects and by the outsize impact of a small change. But the solution felt frustratingly context-specific. It was hard to imagine gender- or race-blind interactions between buyers and sellers or employers and job candidates.

The online era has changed that. Early on we witnessed the internet's potential to create marketplaces free of race, gender, and age considerations. We've now evolved far enough that platform designers can choose where and when to place virtual screens. We hope they will use that power to create a more inclusive society.

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Managing Yourself
Do You Hate Your Boss?

How to deal with it *by Manfred F.R. Kets de Vries*

SAM CHIVERS

Stacey really loved her job at a top tech company—that is, until her boss left for another firm. The new manager, Peter, seemed to dislike pretty much everyone on the team he had inherited, regardless of individual or collective performance. He was aloof, prone to micromanaging, and apt to write off any project that wasn't his brainchild. Within a year he had replaced a number of Stacey's colleagues.

At first Stacey (whose name, like others in this article, has been changed to protect her confidentiality) tried to win her new boss's trust and respect by asking for his feedback and guidance. But Peter was unresponsive. Despite her best efforts, Stacey couldn't make the relationship click. When, several months in, she finally decided to approach HR about the problem, she got nothing more than sympathy. The firm was not willing to sanction Peter, because his unit's performance had not materially deteriorated and no one else had lodged a complaint.

Unable to escape or change the dynamic with Peter, Stacey felt stressed, depressed, and increasingly unable to do good work. She worried that the only way out was to leave the company she loved.

Stacey's situation is not uncommon. According to the most recent Gallup "State of the Global Workplace" study, half of all employees in the United States have quit jobs at some point in their careers in order to get away from their bosses. The figures are similar or even higher for workers in Europe, Asia, the Middle East, and Africa.

The same survey, consistent with previous ones, also shows a clear correlation between an employee's engagement (that is, motivation and effort to achieve organizational

In a survey of 2,000 U.S. office workers, 19% admitted to playing Pokémon GO at the office.

AJILON

goals) and his or her relationship with the boss. While 77% of employees who said they were engaged at work described interactions with their managers in positive terms (for example, "my supervisor focuses on my strengths"), only 23% of those who were "not engaged" and a mere 4% of the "actively disengaged" did the same. This is worrying because research has shown that an engaged workforce is a key driver of organizational success, and yet according to Gallup, only 13% of employees worldwide fall into that category.

What are the "bad" bosses doing? Frequently cited grievances include micromanaging, bullying, avoiding conflict, ducking decisions, stealing credit, shifting blame, hoarding information, failing to listen, setting a poor example, slacking, and not developing staff. Such dysfunctional behavior would make anyone unhappy and unproductive. However, whatever sins your boss commits, managing your relationship with him or her is a critical part of your job. Doing it well is a key indicator of how effective you are.

In my work as a researcher, management coach, and psychoanalyst, I have spent many decades working with senior and high-potential executives to help them resolve dysfunctional dynamics with their managers. This article explores the options available to anyone in the same predicament. Much of it will feel like common sense. But I have found that people often forget that it's in their power to improve bad situations, so having the options systematically laid out can be very helpful.

Practice Empathy

The first step is to consider the external pressures your manager is under. Remember, most bad bosses are not inherently bad people; they're good people with weaknesses that can be exacerbated by the pressure to lead and deliver results. So it's important to consider not just how they act but why they're acting that way.

Most bad bosses are not inherently bad people; they're good people with weaknesses that can be exacerbated by the pressure to lead and deliver results.

Research has shown time and again that practicing empathy can be a game changer in difficult boss-subordinate relationships, and not just as a top-down phenomenon. Experts such as Stephen Covey and Daniel Goleman emphasize the importance of using this key aspect of emotional intelligence to manage up. Neuroscience also suggests that it's an effective strategy, since mirror neurons in the human brain naturally prompt people to reciprocate behaviors. Bottom line: If you work on empathizing with your boss, chances are he or she will start empathizing with you, which will benefit everyone.

It may seem difficult to feel for a manager who isn't giving you what you need or whom you actively dislike. But as Goleman showed years ago, empathy can be learned. And recent research from other scholars, including experts at the Menninger Clinic, suggests that if you practice empathy consciously, your perceptions of others' feelings will be more accurate.

I recall the case of George, a sales manager in a big U.S. firm, who had been going out of his way to please his boss, Abby—to no avail. George was extremely frustrated by Abby's lack of attention and support until a colleague told him to imagine being in the boss's shoes. George knew that Abby's own manager was a real taskmaster, famous for setting impossible stretch goals. Once George took that into account, he realized that Abby was not deliberately ignoring him; she simply didn't have time to be supportive, as she was working on several important new business initiatives at once.

Although it may be a conscious exercise, a display of empathy is still best delivered in an informal setting. You don't make an appointment; instead you look for the right moment when the other person will be receptive to your efforts. In George's case it came on a shared business trip to some high-profile accounts in Singapore. Over dinner the first day, he carefully offered Abby an opportunity to open up about the pressures she felt by asking how the new business projects in mainland China were coming along.

Abby turned out to be only too ready to share her stresses and frustrations, and the exchange marked a turning point in what eventually became a very satisfactory working relationship between the two. George worried less about the attention he was (or wasn't) getting, and Abby seemed readier to listen to his problems.

Consider Your Role

The second step is to look at yourself. In my experience, people who struggle to work well with their bosses are nearly always part of the problem themselves: Their behavior is in some way preventing them from being recognized and valued. This probably isn't what you want to hear, but by acknowledging that you might be doing something wrong,

figuring out what it is, and adjusting accordingly, you might be able to salvage the relationship.

Start with some introspection. Consider, as objectively as you can, any criticisms your boss has offered. In what areas do you need to improve? What aspects of your behavior or output might irk him or her?

Also ask yourself what might make your personalities clash. I often find after a fairly short discussion with clients that their managers are "transferential figures," representing authority figures from the past with whom the clients have unresolved issues. Transference of this kind has a powerful influence on behavior and should always be explicitly considered in figuring out dysfunctions in any boss-subordinate relationship.

One client, for example, told me that her boss reminded her of a primary school teacher who had bullied her and whom she had never been able to please. The two resembled each other physically and shared a similar peremptory manner of communicating.

When we surface transference, people can usually take steps to correct for it. After our sessions, my client reported that she found it easier to step back and separate her past resentments from her present reactions and view her boss's comments in a positive light.

Next, observe and seek advice from colleagues who work successfully with your boss. Try to understand his or her preferences, quirks, and hot buttons, and get some pointers on how you might do things differently. When you approach colleagues, though, make sure to frame any questions carefully. For instance, instead of asking a coworker why the boss always interrupts you when you speak, ask the person "How do *you* know whether to speak up or not? How can you tell when the boss does or doesn't want input? How do you express disagreement?"

Also take advantage of group training programs to get advice from peers. I remember the case of Tom, who, during a leadership development workshop, was asked (like everyone else in his small group) to present an issue that was troubling him. He confessed that he needed to improve his relationship with his boss; whatever he did, it never seemed good enough. His peers were frank in their responses. They said that he often sounded muddled in meetings when trying to explain his business unit goals and that he seemed to be doing a poor job of empowering his direct reports. In the view of his colleagues, this was why the boss was dissatisfied with Tom's performance.

They suggested he spend more time rehearsing and framing his presentations and, in particular, work on proposing less generic goals and identifying measures of success. They also recommended that he have his subordinates copresent with him and make reports on their own. Tom asked a few clarifying questions and left the workshop eager to apply the advice he'd received. At the next year's planning session, his boss congratulated him on the quality of his group's presentation and followed up with an e-mail praising the teamwork his unit was starting to display.

If feedback from your colleagues doesn't provide any insights into how your behavior might be hurting you, the next step is to try talking to your boss about the problem. Again, approach the conversation delicately, framing your questions in a positive way: "How can I better help you achieve your goals?" rather than "What am I doing wrong?" Position yourself as seeking advice or even mentoring. Request a one-on-one meeting to do this, and give your boss an idea of what you'd like to discuss: performance issues and the development of your management skills.

If you're lucky, he or she will appreciate your willingness to engage and will point out areas to improve, building the foundation for a closer relationship. If your boss stonewalls or rebuffs you, however, that's a clue that the problem isn't you, and you need to figure out what—if anything—you can do to alter things.

Mutiny and whistle-blowing can damage your future job prospects. Lodging a formal complaint, therefore, is definitely a last resort.

Offer a Chance to Change

If you conclude you're not the one derailing the relationship with your boss, only then should you openly suggest that the two of you don't seem to interact well and that you'd like to remedy the situation.

There are a number of ways into this conversation. If you have the opportunity, you can tack it on as an extension of a frank discussion you're already having. Jeanne, a French executive I once taught, told me about a visit she'd made with her British boss, Richard, to meet a customer. The client gave them both an extremely rough ride, which prompted an exchange between the two of them about what had gone wrong. This gave Jeanne an opening to express some of her frustrations

with her boss's behavior, and the two were able to work out how they could improve their own relationship.

If a moment like this does not present itself, you have to initiate the conversation yourself. Most conflict management experts recommend doing that in a private setting where you can't easily be interrupted and where it will be difficult for either of you to leave. To have a constructive talk, it's important that people feel they are in a "safe place." Invite your boss out to lunch, perhaps, at a restaurant where you are unlikely to meet colleagues. Explain that you have some private concerns you want to discuss away from the office. If a specific business problem, such as the failure to meet a crucial deadline, came about because of the friction between you, you can say you wish to talk about this event and its implications for other projects—the kind of postmortem that Jeanne and Richard had. Let your boss know to expect a difficult conversation—one that can't be sidestepped. If you just say you want to discuss interpersonal issues, the boss may find some crisis that takes priority.

When you begin a dialogue, you may even discover that your boss is not consciously aware of the degree of your discontent. With Jeanne, for example, one problem was that Richard never asked her for an opinion, listening only to colleagues (also largely British and male) who volunteered their ideas. When they talked about it, Richard explained that he didn't want to put her on the spot in meetings but he had no intention of silencing her.

Organize a Mutiny

If you can't improve things by changing your behavior or opening lines of communication with your boss, and if your colleagues feel the same way you do, you should consider alerting HR and the boss's bosses to the problem.

In taking this route, however, you need to make a substantial business case for why your boss is a liability—someone whose poor management will ultimately cause the team's, unit's, or organization's performance to suffer. You must also be prepared to make a credible threat of litigation against the corporation. You'll need documented evidence of the boss's negative impact and inappropriate behavior, such as witness statements and examples of correspondence that clearly breach company rules or HR guidelines. The more people willing to go on record with similar complaints and evidence, the harder it will be for senior managers to ignore or deny the problem.

In the absence of compelling data indicating a pattern of bad behavior, HR representatives are unlikely to be allies; very often they will take the boss's side. Maria, another executive I counseled who had had issues with her boss, initially went to HR for help. But her boss was extremely skilled at self-promotion and persuaded HR that in fact Maria was the problem. The head of HR not only declined to pursue the matter but even suggested that it was up to Maria to adapt to her boss.

Stories like that are all too common, and many subordinates who have not prepared a strong case against the boss have ended up losing their jobs rather than forcing a change of behavior or practice. Mutiny and whistle-blowing can also damage your future job prospects. Lodging a formal complaint, therefore, is definitely a last resort.

Play for Time or Move On

If you are unable to change your relationship with your boss by taking the steps described, and if there isn't potential for group action, then your options become more limited.

In these situations, most employees simply go through the motions at work and minimize contact with the boss. There is always the possibility, or hope, that he or she will move on. But remember that in playing for time, you also need to set a time limit, so that hanging in doesn't become a way of life. If it does, you will feel disengaged, disenchanted, and even embittered. And that may spill over to other realms, contributing to depression and a range of additional psychosomatic reactions.

The better solution is to look for another job while you're still employed, exiting on your own terms. Beef up your résumé, contact headhunters, line up references, and start interviewing. Having a bad boss isn't your fault, but staying with one is.

That's ultimately what Stacey concluded. After some soul-searching, she started to hunt for another job. It didn't take her long to find an interesting position in another organization working under a boss with whom she had great rapport. Some months later a former colleague told Stacey that Peter had left the company soon after her. Although his departure was announced as his own choice, the inside scoop was that top management had forced him out because he was losing too many valuable people.

HBR Reprint R1612H

FURTHER READING

For more about employee-boss relations, see the following:

HBR Guide to Managing Up and Across
Harvard Business Review Press, 2013

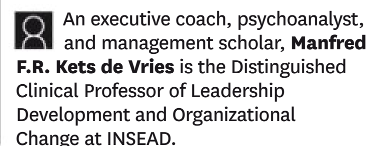
"Managing Your Boss"
John J. Gabarro and John P. Kotter
HBR, January 2005

"Why People Follow the Leader: The Power of Transference"
Michael Maccoby
HBR, September 2004

"What to Do When You and Your Boss Aren't Getting Along"
Rebecca Knight
HBR.org
August 18, 2016

"How to Work with Someone You Hate"
Amy Gallo
HBR.org
January 30, 2012

"Managing 3 Types of Bad Bosses"
Vineet Nayar
HBR.org
December 1, 2014



An executive coach, psychoanalyst, and management scholar, **Manfred F.R. Kets de Vries** is the Distinguished Clinical Professor of Leadership Development and Organizational Change at INSEAD.

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Case Study
Should You Rehire a Defector?

An entrepreneur reconsiders a colleague who left for a competitor.
by Jyotsna Bhatnagar and Nakul Gupta

Ram Kapur and his brother Shayam were covered head to toe in brightly colored paints. They'd been out celebrating—it was Holi, the festival of colors in India—and now they were returning to the home they shared with their parents, in Gurgaon, for their family's traditional meal together. Ram's phone rang just as they walked through the door, and he held up the screen to show Shayam the caller's name: Hari Shukla.

"Why is he calling you on Holi?" his brother asked, surprised.

Ram was the founder and CEO of Green Impact Consulting, a sustainable design firm, and Hari had been one of the young company's most valued employees—until two years ago, when he'd decamped to a rival firm.

"A job, I think," Ram replied. "We've been back in touch."

"No way! He abandoned you! You swore you'd never speak to him again!"

That was true. Hari had been Ram's right-hand man at Green Impact, overseeing the civil engineers onsite at the firm's residential and commercial real estate projects, while Ram led the technical analysis and design teams back at the office.

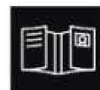
In the company's first year, it had been a struggle to convince local developers of the importance of sustainable building practices. But when Hari, who had eight years of experience, joined the firm in its second year, business began to improve.

Friends and colleagues, they had been the perfect team, and Ram was confident that Green Impact was on a path to becoming one of the top three sustainable building companies in India. But then Hari had blindsided him by resigning. He said he was leaving for "personal reasons," only to turn up at a larger competitor: the Sustainable Build Group.

Of course, Ram knew this was a risk of being an entrepreneur in India. The talent market was so tight that strong employees were often poached from small companies by bigger-name, more successful ones. But he still couldn't help feeling betrayed—even devastated.

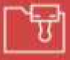
It was a tough year. Hari's unexpected departure left Ram in charge of both the office and the field teams. He was stretched too thin to tackle the growth plans he'd been dreaming of. He focused on serving existing clients and retaining his employees—he even had to raise salaries across the board to make sure others didn't follow in Hari's footsteps—but he had no time for marketing and barely kept the business going. He put on a brave face for his employees, the customers, and his parents. Only his brother knew how hard he'd struggled and how hurt he'd been.

"I can't believe you would speak to him." Shayam shook his head incredulously.



Jyotsna Bhatnagar is a professor of human resources management and the chairperson of alumni relationships at MDI, in Gurgaon, India. **Nakul Gupta** is an assistant professor and the coordinator for the Center for Entrepreneurship at MDI.

SAM CHIVERS



Case Study Teaching Notes

Jyotsna Bhatnagar and Nakul Gupta teach the case on which this one is based in their talent management and technology classes.

WHAT DREW YOU TO THIS STORY?
The protagonist was in one of our executive courses, and he shared his dilemma with the class. It was the primary reason he was taking a talent management course.

HOW DO STUDENTS RESPOND TO THE CASE?
Working executives tend to advocate for rehiring the employee. Younger students also think that's a smart idea, pointing to the boomerang talent policies at big firms as evidence. But some people feel that trust has been broken and can't be repaired.

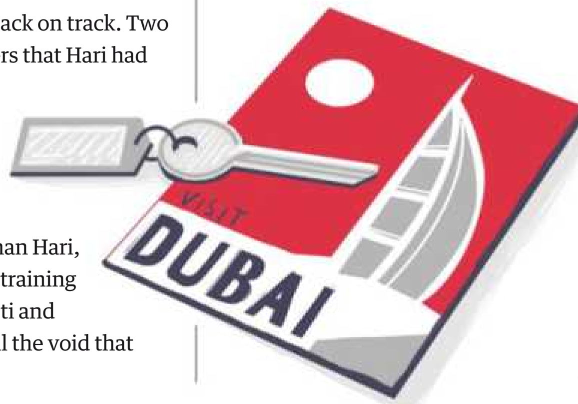
WHAT DO YOU HOPE THEY'LL TAKE AWAY?
We want students to understand the difference between boomerang employees, whom you'd welcome back, and "frenemy talent"—people you'd rehire despite reservations in order to keep them from going to a competitor. We also hope they learn to appreciate the need for a strong talent pipeline to fill the gaps when people in critical roles leave.

HBR's fictionalized case studies present problems faced by leaders in real companies and offer solutions from experts. This one is based on the HBS Case Study "The Indian Greenpreneur: Management of Frenemy Talent and Coopetition" (case no. W13372-PDF-ENG), by Jyotsna Bhatnagar, Neha Paliwal Sharma, and Nakul Gupta, which is available at **HBR.org**.

"I know, I know," Ram said. "He really let me—and the company—down. But he was a great employee—and a friend. I have to at least consider it."

"He stabbed you in the back," Shayam said. "He left you for more money, without thinking twice about Green Impact's mission or your friendship. You can't trust him. Besides, your business is doing great now. You don't need him anymore."

Indeed, after an extremely difficult year, Ram had been able to get Green Impact back on track. Two of the civil engineers that Hari had been managing—Preeti Das and Tuli Khanna—had stepped up. They were much less experienced than Hari, but after intensive training and coaching, Preeti and Tuli were able to fill the void that he'd left.



Recently, though, Ram had started to consider expansion, perhaps into the Middle East, where sustainable building wasn't such a hard sell. But he wasn't sure that his young team could keep the business thriving if he took his focus off day-to-day operations. With Hari back, maybe he could revive his dreams for the company. "Hari may be the only one who can help me take the business to the next level," he told Shayam.

His brother scoffed. "This city is full of talented, competent people. There is no way that that deserter is your only option."

What's Best for the Business

Three days later, Ram was back in the office. He'd returned Hari's call, and the two finally discussed what was on Hari's mind: He missed the tight-knit culture at Green Impact, and he was exhausted from the long hours at his new job. He had been wooed by a 75% salary increase and the opportunity to travel, he told Ram, but he wanted to feel as if he was helping to build something again, not just keep someone else's company running.

Ram had started to get excited about the possibility of working with his old employee. But now back at the office, surrounded by the team that had so capably risen to the challenge that Hari had created, he was less sure. He wondered about the disruption it would cause.

When Ram opened his e-mail, he saw a message from Preeti saying that she and Tuli were hoping to talk to him before they headed out to a project site for the day. "Sure," he replied, and moments later they were in his office. He could tell immediately by the uncomfortable looks on their faces that something was up.

Tuli, not one to mince words, blurted out: "We know about Hari." Ram tried not to react, but he could feel his eye twitching. It was amazing how quickly gossip traveled in their business. It probably didn't help that Shayam had been dating one of Ram's employees.

"I don't want to know how you know that. And I don't have any information to share at the moment," Ram said.

Tuli didn't pick up on his desire to end the conversation—or didn't care: "We just wanted to let you know that the staff is keen on the idea," she said.

"Which idea?" Ram asked.

"The idea that Hari might come back to work here," she said, and then quickly added: "It would make the Middle East a possibility."

Ram had talked with both women about his hopes to expand to a friendlier market like Dubai, and they'd been excited about the strategy and the opportunity. But he hadn't expected a welcome attitude toward Hari's potential return, especially not from Preeti, who was now in the role Hari had vacated.

"You're saying the staff has talked about this?" Ram asked.

"Most of us," Tuli said.

"And you're all in favor of rehiring Hari? Even though that would mean that we'd need to restructure your team and you'd likely have to give up some of your projects?"

"Things might be uncomfortable in the short term, but we think it would be best for the business. He was excellent at his job, and we don't want him working for another direct competitor, like Greenscapes or BRG. Yes, he left us, but think of the market intelligence he'd bring if he came back."

Ram nodded. The team was thinking strategically, which he appreciated. But then he realized something: Tuli had been doing all the talking.

"Are you on board with this, Preeti?" he asked.

"I want what's best for the business." She paused, glanced nervously at Tuli, and then continued. "Of course, I have some reservations. Yes, he left a big gap initially. But we've filled it, and we've been fine without him. In the past few months, we've been more than fine."

"And he could help us do even better," Tuli interjected.

"But I worry how coworkers will treat him," Preeti continued. "They mostly say they're fine with Hari's being part of the team again, but when he left, a lot of us said harsh things about him. Some people were—and may still be—very angry."

Preeti raised a good point. Could the team—could *he*—really welcome Hari back with no resentment? What message would that send to employees?

And could he really put his faith in someone who had left him in the lurch? Would he always be wondering whether Hari would jump ship again?

That's What We Do Here

"Of course you'll take him back. That's what we do here in India: We forgive. We give people second chances! I would take you back in a heartbeat."

Ram was having lunch with his mentor and friend, Mohan Chaudhary, who had hired Ram right out of university. Mohan had taken him under his wing, eventually encouraging him to leave and start his own company. Ram always sought Mohan's advice when he had work dilemmas.

"This is what the big companies do, too," Mohan continued. "Boomerang talent. Microsoft, McKinsey, they welcome people back after they've gone off and worked elsewhere, knowing that they bring with them new knowledge, expertise, even intelligence about competitors."

"So I should just give him his job again, no questions asked?" Ram asked.

"Well, not so fast. Why did he leave in the first place? He initially said personal reasons, right?"

"Yes, but he's being more honest with me now. He admitted they gave him a significant raise and promised lots of projects abroad."

"Right, and he probably experienced a significant increase in his workload, too. You know as well as I do that the same thing is happening all over India now. These big firms have deep pockets, but they also expect people to work 70 hours a week."

"He mentioned that," Ram said. "But he said he really misses the camaraderie and the start-up spirit."

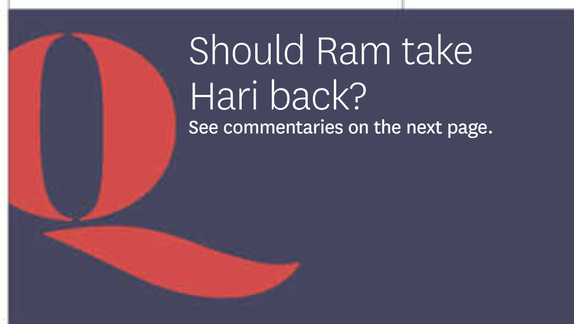
"I'm guessing it's more about the flexibility and work-life balance he'll have back with you. Or he's sick of being a cog in the consulting wheel, and he wants to lead a team again, calling the shots. Or maybe he just couldn't cut it at the other firm."

Ram had thought of that. Maybe Hari had been fired. Did Green Impact want another company's castoff? Was he really as good as Ram remembered?

"I do think having him back would be good for Green Impact, and for you," Mohan said. "But I also understand your worry. It sounds like you don't entirely trust him anymore. If you bring him back, you have to completely let go of your hurt and anger. Can you do that?"

"I thought I could," Ram said. "Now I'm not so sure."

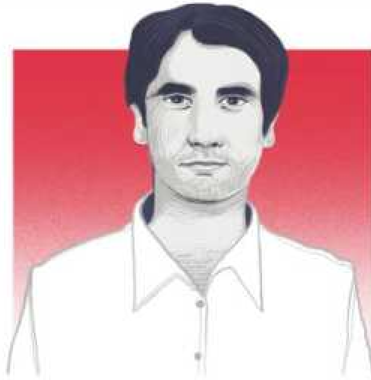
Tell us what you'd do in this situation. Go to **HBR.org**.



Should Ram take Hari back?

See commentaries on the next page.

The Experts Respond



Samdarsh Nayyar is the founder and managing partner of Green Horizon Consulting, in Gurgaon, India.

RAM SHOULD not take Hari back. The trust between them has been broken, and it will take more than a few phone calls to restore it.

Hari's motivation for returning is unclear at best and suspect at worst. He says he wants a better quality of life, but that doesn't ring true. I know very few young Indians who would give up a high-paying, fast-paced job for a relaxed, lower-paying one; most are looking to work hard and amass money early in their careers before they have families or other responsibilities. So it's quite likely that, as Ram's mentor suggested, Hari didn't quit his job; he was asked to leave.

Even if Hari is being honest about his reasons for wanting to return, how can Ram know those sentiments will last? The talent market in India is so fluid that a fickle player like Hari can easily switch companies every six months. Ram can't run the risk that Hari is going to use his company as a career stepping-stone again. That would do even more damage to the company and employee morale.

> Hari's motivation is unclear at best and suspect at worst.

I agree that Hari could bring in competitive intelligence, but that may not be 100% positive. His tales of what it's like to work at a larger, more prestigious firm could cause Ram's employees to rethink their options. And if Hari plans to leave again, he may try to take people with him.

Perhaps most important, Ram doesn't need Hari. Sure, he may have more experience than Preeti and Tuli, but he will also cost more, and there's no evidence he can outperform them. In fact, it sounds as if the two women are excelling in their current roles. If Ram is serious about growing, he's better off relying on team members who have proved they are trustworthy and can step up to a challenge. Ram should give them even more responsibility (compensating them accordingly), and if they prove themselves capable over the next three to six months, he should ramp up his expansion plans.

This case is loosely based on my experience with an employee who quit my firm and then asked to return three years later. I said no. I'm not against the idea of boomerang talent. But in my case, I was skeptical of my former employee's motivations, and I wasn't ready to take a chance, in large part because the company was doing well without him.

Since I made that decision three years ago, there has been some expected turnover at the lower and middle levels of my team, but for the most part it has been stable and tight-knit. Working together, we've increased our business volume by 300%. So I have no regrets about not taking the employee back, and neither should Ram. He should wish Hari the best and continue building his business with the trustworthy, reliable colleagues he has now.

Comments from the HBR.org community

Hang On to Great Talent
Hari was a high-performing employee before—and that doesn't change. He left for a better career, and while that move didn't work, at least he was forthcoming about learning from the mistake. He should be given another chance to prove himself.

Harish Agarwal, *vice president of corporate and marketing communications, Prudential Singapore*

Don't Reward Disloyalty
It's not about forgiveness or second chances. It's about the privilege of working for a company; you ask your company to put you first, and you put your company first. Fundamentally, rehiring Hari would reward an act of disloyalty. Do you want other employees to try the same?

Thomas Hill Jr., *technical director, Eriksson Engineering Associates*

Thwart Your Competitors
Tuli and Preeti stepped up and displayed their leadership abilities. Ram should reward them by assigning them to the Dubai project and working closely with them on it. He can then use Hari in the position he had before he left. Retaining him will make him

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unavailable to the company's competitors.

Animesh Dhagat, *student, Manipal Institute of Technology*

Negotiate New Terms

Ram should take Hari back, but not before having a serious heart-to-heart discussion about his reasons for leaving and conditions for rehire. Ram must make sure that Hari knows what will be expected of him in his new role and that things have changed since he left. In addition, milestones should be set for "compensation events" that allow Hari to prove his loyalty and value to the company.

Scott Sherman, *CFO, Pacific Southwest Container*

Diane Hoskins is the co-CEO of Gensler, a global design firm.

RAM SHOULD rehire Hari. Given Green Horizon's stage of growth, Ram is going to need additional strategic leadership, and it sounds like his former employee will be able to provide the right skills at this critical moment. Yes, Ram could recruit someone new. But Hari will have a shorter ramp-up time. He's familiar with the company, the people, and the culture, and his capabilities are well understood. Candidate vetting can only take you so far; until you work side by side with someone, you won't know if he or she can truly deliver.

At Gensler, we believe that once you're part of our family, you're always part of it. You shouldn't have to "forgive" people upon their return, as Ram's mentor suggests. This is about seeing each person's growth as a benefit to the team, even if some of that growth occurs outside your organization. We want our people to expand their skills and leadership capacity. We do our best to provide opportunities here, but we understand that employees will occasionally go elsewhere to get those needs met. So when people leave for any reason—even to go to a competitor—we wish them well and let them know that our door will be open when they're ready to come back.

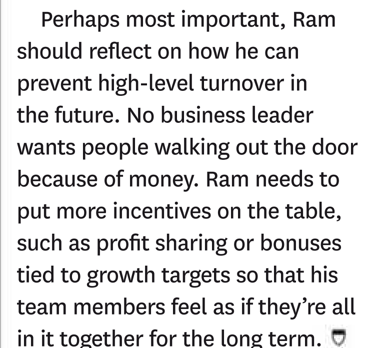
> This is about seeing each person's growth as a benefit to the team.

Gensler now has more than 5,000 employees, but even in the early years, when the company looked more like Green Impact, we were open to returning employees. In the 1960s, our founder, Art Gensler, rehired the late Walter Hunt, who had been lured away by a competitor. Hunt went on to be an important leader in transforming the firm from a small interiors practice into one of the largest architectural firms in the world. Walter also created our Boomerang program, which now counts 500 returning Gensler employees among its members.

Each December we have a ceremony at which we celebrate our staff, announce promotions, and give returning employees an engraved boomerang. I have one of them myself. I joined Gensler right out of school and worked at the company for three years before leaving to go to graduate school and then to work for a smaller competitor. When Gensler noticed my work and recruited me to return in a senior role, I couldn't have been happier.

All that said, Ram needs to be careful about how he brings Hari back. First, it should be a strategic decision, not an emotional one. He needs to put aside both his sentimentality and his resentment and really look at whether Hari can make a difference in the business.

He also needs to talk to Hari about why he left and what his role would be should he come back. Expectations must be crystal clear. Hari would need to respect the positions of those who advanced in his absence and understand exactly what his new role would entail. For example, international expansion might mean that he's again working long hours and traveling.



Perhaps most important, Ram should reflect on how he can prevent high-level turnover in the future. No business leader wants people walking out the door because of money. Ram needs to put more incentives on the table, such as profit sharing or bonuses tied to growth targets so that his team members feel as if they're all in it together for the long term.

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Reprint Case Only R1612X
Reprint Commentary Only R1612Z

JAMAICA

A Paradise at the Crossroads of Global Logistics

With a population roughly equivalent to that of Chicago, Jamaica enjoys a disproportionate cultural impact, punching above its weight on the global stage in the areas of sports, music, and the notoriety of its tourism spots.

In an effort to diversify its economy, Prime Minister Andrew Holness' administration intends to capitalize on one of Jamaica's key features: its geographic location, right outside the Panama Canal and at the center of the Caribbean.

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ANDREW HOLNESS
Prime Minister
@AndrewHolnessJM

> Jamaica can be a crossroads for the rest of Latin America, Central America, South America into North America

This Promotional Case Study was produced by **World Investment News** for December 2016/January 2017 edition of HBR. **Publisher**: Pascal Beldo; **Executive Director**: Stéphanie Huertas; **Project Associate**: Daria Skarzynska; **Special thanks to**: Honorable Andrew Holness - Prime Minister of Jamaica; Ms. Deborah A. Newland - Director of Cabinet; Honorable Audley Shaw - Minister of Finance and Public Service; Honorable Karl Samuda - Ministry of Industry, Commerce, Agriculture and Fisheries; Honorable Lester Michael Henry - Minister of Transport & Mining; Minister The Honorable Daryl Vaz - Minister without Portfolio in the Ministry of Economic Growth and Job Creation with responsibility for Land, Environment, Climate Change and Investments; Robert Nesta Morgan, Director of Communications and Public Affairs - OPM ; Honorable Michael Lee Chin, Chairman of Portland Holdings Inc. and NCB Jamaica Limited

PETROJAM

Stars Align for Petrojam Upgrade

HOWARD MOLLISON
General Manager

Jamaican oil refinery Petrojam believes their plant is ripe for a substantial upgrade in the next four years, growing its capacity by half, to the point where the refinery could start exporting fuel.

While the company has long been considering an upgrade, a clear timeframe for the project has emerged from the decision by Jamaica Public Service Company (JPS) to pivot to liquefied natural gas (LNG).

"That will impact our operations directly, because approximately 45% of our production is geared towards supplying the power companies," said Petrojam General Manager Howard Mollison. "Where does that leave us? With an opportunity to do a refinery upgrade, which we've been discussing for quite some time."

"The stars are now aligned for us to get that done," Mr. Mollison said, listing a number of other reasons for upgrading the plant in the near future for a more seamless transition into the new state of the Jamaican energy market.

"There is money out there, the price of steel is down by as much as 18%. Based on the amount of large projects that have been postponed, we have a lot of experienced EPC (Engineering Procurement and Construction) contractors out there doing good quality work that are available," he said.

Petrojam's capacity currently stands at 35,000 barrels per day, exporting only asphalt and jet fuel, the USD 900 million to 1.1 billion standalone project would raise that capacity to 50,000 barrels, or an export capability of 15,000 barrels a day.

A scenario without an upgrade could see the refinery's net income shrink as low as USD 4 million a year, from its current 21.9 million, while the upgrade would enable the income to grow to USD 94.8 million, enabling an internal rate of return for the project ranging from 12 to 16.7%.

> We are of the view that there really should be a diminished role for the government, and a higher role for private equity investment

At the moment, 51% of Petrojam owned by the government, and 49% by Venezuelan company Petroleos de Venezuela (PDV). However, the Jamaica Chamber of Commerce has recently called for the private sector to look into investing in the refinery.

While Petrojam has not yet established a clear policy on the issue, Mr. Mollison also favors private equity investment. "We are of the view that there really should be a diminished role for the government, and a higher role for private equity investment."

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University of the West Indies
Higher Education in the Time of Now

ARCHIBALD McDONALD
Principal

Thirsty for new ideas, the University of the West Indies (UWI) puts state of the art technology at the service of education to help the Caribbean reach its full potential.

As it rises to global recognition, UWI's priority is to drive Caribbean development by serving the people. "We are in the top 500 universities in the world, and we need to improve that ranking without changing our mandate. Our mandate is to serve the Caribbean people because they built this university with their tax dollars," says UWI Principal, Professor Archibald McDonald.

For Jamaica to reach its full potential, says Prof. McDonald, Jamaicans need the ability to make their ideas come alive.

"If you go from the leadership of our government, to the man in the street, to the academic institutions, there is no shortage of ideas in our country," says Prof. McDonald. "We made a commitment three years ago to change the way we do business and have a positive impact. We teach entrepreneurship on campus and we have a business incubator, which takes ideas and converts them into businesses."
Established in Kingston in 1948, the university is now present in 18 countries. All four campuses – one in Trinidad and another in Barbados – have programs in all disciplines, while its virtual campus specializes in online programs.

Using the latest technologies, the University Hospital is transitioning to a digital management system and is implementing a telemedicine program so the region's top doctors can collaborate. Similar technology also helps the university improve education across the country, thanks to its research and education network CARIBNET.

At the forefront of innovation to bring out the best in its graduates, UWI's senior management team is growing ever younger and richer with new ideas. As the principal says, "We are living in the time of now."

www.uwi.edu

Delta Supply Company Ltd:
A Customer-Centric, Information-Driven Business

GEORGE SWIRE, Managing Director at Delta Supply Company Ltd (centre), **JONATHAN SWIRE**, General Manager at Delta Supply Company Ltd (right) & **LEROY MORRIS**, Managing Director at ELARC Welding Products Ltd (left).

Since it was founded in 1972, Delta Supply Company Ltd has established itself as one of the leading industrial equipment distributors in Jamaica and through its sister company, ELARC Welding Products Ltd, has developed a successful, locally-manufactured line of welding consumables and accessories. Although initially focused on the Jamaican bauxite industry, Delta has since expanded its core business and today, the organization boasts a diverse portfolio ranging from cleaning solutions to construction equipment to agriculture, landscaping and irrigation supplies.

Delta's conception began in earnest 44 years ago when the organization's Managing Director, George Swire, was presented with an opportunity to purchase a contractor's excess stock of equipment. Risking his entire life savings, Mr Swire acquired the inventory and eventually sold off JMD$250,000 worth of materials over a ten year period. Crediting his ability to connect with people and his extensive product knowledge as key factors for his early entrepreneurial success, Mr Swire continues to instill a customer-centric, information-driven approach at Delta Supply.

"Product knowledge is incredibly important to our business: it empowers our staff, enlightens our customers and differentiates our organization from its competitors," shares Jonathan Swire, General Manager at Delta Supply. "Improving our brand expertise is an ongoing objective as we strive to ensure every team member has a complete understanding of the features and benefits of our company's product line," he explains.

Delta encourages its employees to recognize their work goes far beyond the transaction business and is essentially a consultancy. When a customer comes through its doors, the organization aims to offer a holistic, educational experience. This tactic is highly beneficial as it allows the company to sow the seeds of a long-term relationship with its client base, from providing useful insight for the initial purchase to offering technical support during the maintenance phase.

> Product knowledge is incredibly important to our business: it empowers our staff, enlightens our customers and differentiates our organization from its competitors

Delta Supply has proved to be a formidable agent and is widely recognized as the dealer of choice for several premium brands, including Hilti, Rainbird, Atlas Copco, Karcher, Wacker Neuson and Stihl. In the years since the company acquired the Stihl distributorship for the Jamaican market, for example, it has embarked on a targeted strategy to market the chainsaws and brushcutters to small entrepreneurs, and increase brand awareness amongst students at technical schools across the country. As a direct result of this measured approach, today, Stihl commands a staggering 90% of the chainsaw market, and 70% of the brushcutter market in the island.

Always aiming to add value to its customers' operations, Delta Supply Company Ltd emphasizes the importance of the customer and customer applications. With this outlook, the organization is able to truly understand its clients' needs and effectively seek solutions for any challenges they might face.

JAMAICA TOURIST BOARD

Delivering on the Jamaican promise

EDMUND BARTLETT
Minister of Tourism

If there were a way to measure a country's worldwide cultural impact relative to its size, Jamaica would dominate the field the same way Usain Bolt toys with his fellow athletes. In what other country with a population under three million can you name figures whose impact has been as profound, lasting and widespread as Bob Marley, Shaggy, the world's fastest man and woman, Mr. Bolt and Shelly-Ann Fraser-Pryce, not to mention the myriad stars, athletes and world leaders of Jamaican descent.

Resort cities like Montego Bay and Ocho Rios are but a fraction of what the island has to offer. In a country where driving north coast to south coast will take you under and hour – thanks to its brand new highway system – you will find UNESCO world heritage sites such as the Blue and John Crow Mountains, the former "wickedest city on earth," Port Royal, which was featured in Pirates of the Caribbean, the estate of James Bond creator Ian Fleming, GoldenEye, which, despite lending its name to the seventeenth entry in the Bond franchise, does not feature a secret satellite dish intended for world domination.

Yet, according to Minister of Tourism Edmund Bartlett, the main reason to visit Jamaica lies not in its topographical features, historical sites, or resorts, but elsewhere entirely. Everywhere, in fact. "I think our first comparative advantage is our iconic attraction called our people," he says.

Yet, the country's human capital is only one of the five pillars Mr. Bartlett is counting on to further develop Jamaica's tourism industry, a critical platform for the economic growth of the country.

First among them is attracting new markets. While North Americans currently represent the largest portion of visitors, this may be in large part due to a combination of Jamaica's geographical location and its infrastructure; none of the island's three international airports can support mega-sized aircraft used for ultra long-haul flights, forcing visitors from other continents – including markets with large potential such as China and India – to make an extra stop.

> "The people of Jamaica, born out of this confluence of cultures and ethnicities, provides a mosaic that is a reflection of the world. Our people have a natural inclination to hospitality. We are a very warm, friendly and happy people, and we transmit that to our visitors when they come."
>
> Edmund Bartlett, Minister of Tourism

Second is the development of new products. Between its beautiful beaches and some of the Caribbean most varied geography, Jamaica has much to offer in way of resorts and eco-tourism. Yet, under the surface lies a wealth of culture and history; opportunities more than ripe for the development of new experiences. "We want to build out more experiences," says the Minister. "Shopping is a huge area that we think is needed. And then food and gastronomy. We're going to be building out those too."

Not only will the country expand its range of products, it will also establish a destination assurance – a guarantee of quality, if you will – to ensure visitors get what they came for. "We want to guarantee destination assurance, so that we can always deliver on the promise of Jamaica," says Jamaica Tourist Board Director Paul Pennicook.

Of course, investment is critical. "We have to go after stronger foreign direct investments (FDI), plus local investments. We have to encourage local entrepreneurship in tourism," says Mr. Bartlett.

But this administration is far from thinking only in local terms. "We're thinking about multi-destination marketing in this new shared economy," says the Minister, painting a dream of tourism partnerships between Caribbean destinations.

The sun is shining on the future of Jamaican tourism. With positive vibrations in abundance and its iconic relaxed image and culture, the Caribbean nation will continue to be known as the Home of All Right.

A burning desire to chill, up in the hills overlooking the sea, relishing the sound of reggae music and the smell of jerk chicken. That's all right.

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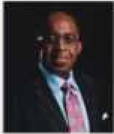
JAMAICA HOME OF ALL RIGHT

NCB
Digitising for Success



PATRICK HYLTON
Managing Director

The banking and finance landscape in the Caribbean has changed in keeping with international trends. How should financial institutions compete for top stakes in the market while operating in a digitally evolving world? Recognizing that emerging millennial customers are unlikely to wait for retail banks to catch up, the National Commercial Bank Jamaica Limited (NCB), Jamaica's largest bank, has embraced digitisation as the core of its strategy to drive business model transformation.

"NCB has a solid record of innovation throughout its decades of operation," says Group Managing Director, Patrick Hylton. "We have long embraced the fact that we must constantly pioneer the way in which we serve and operate within our market; recognizing pretty early that transformation is a key enabler for growth. The simple reality is that digital technology has changed the competitive and consumer dynamics for all industries. We now have a mandate to optimize our core business model and then take it a step further by generating new revenue opportunities."

A leading local player with pan Caribbean aspirations, NCB has carefully designed its Digital Transformation programme with three core objectives in mind: 1) re-imagining the approach to service delivery to significantly improve the experience while lowering distribution costs. 2) To enhance the work experience, resources and environment of its employees. The Bank's focus is on building a distinct employee culture of innovation, while building the right skill sets and capabilities. 3) Working towards greater efficiencies in its core business operations. To deliver on its convenience promise, it inroduced initiatives such as Online Account Opening and Cross-Bank Transfer that provide much more ease in doing banking.

Disrupting its own business model, rather than waiting to be disrupted is the mantra for NCB's digitization thrust. To this end, there are ongoing initiatives to build our innovation pipeline, including an Innovation Lab established to create a safe, collaborative space for NCB employees to develop ideas on how to diversify its product, as well as an Innovation Internship Programme through which university-level millennials are engaged in discussions and workshops to generate out of the box ideas to help in the transformation towards value-added digital service options.

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Investing in the Future

In addition to the recently opened highways connecting the island's north and south coasts – a major improvement for trade, logistics and tourism – Transport Minister Michael Henry is spearheading the ambitious Vernamfield airport redevelopment project, a multi-modal transport hub connecting rail, road, sea and air transportation.

Jamaica is also in the midst of an energy revolution, with major investments in natural gas, solar and offshore wind energy to reduce dependence on imported oil.

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Jamaica Social Investment Fund

Investing in the Jamaican Community

OMAR SWEENEY
Managing Director

The Jamaica Social Investment Fund for the past 20 years has been pivotal in assisting Jamaica's development through a model that prioritizes access to opportunities via effective community participation and empowerment, partnerships and sustainability. Established in Jamaica in 1996 the JSIF is financed by international agencies and partners such as the World Bank, the European Union and the Jamaican government.

> "It's a success in the sense that we are recognized as an efficient government agency, and it is a success in how the public perceives us; that we are not, in any way, biased, or not delivering on our commitments"

JSIF empowers vulnerable communities, through social, infrastructural and economic projects that enhance access to education, employment, and other basic services. The entity supports inclusive governance through facilitating communities to directly play a part in their own development.

The projects JSIF manage are integral in improving Jamaica's standards in education, healthcare, clean water and crime prevention, among others. The fund not only facilitates infrastructural development but also aids in social development through skills training and equipping individuals with the tools to elevate them out of poverty. Over 1500 projects have been implemented, benefitting almost 2 million persons, nearly 2/3 of the population in the major sectors of education, health, security & justice, transport, water, tourism, agriculture.

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SAM CHIVERS

Synthesis
The Philanthropist's Burden

by Tim Sullivan

If you think making money is hard, just try giving it away.

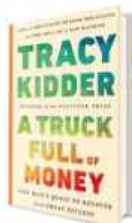
That's one lesson evident in *A Truck Full of Money,* Tracy Kidder's new book about Paul English, the now millionaire cofounder of the travel website Kayak.com. Kidder, having chronicled the hardware revolution in his 1981 book *The Soul of a New Machine,* wanted to return to the topic of computing. He set his sights on English, a coding prodigy who was in the midst of selling his remarkably successful travel-booking site for billions of dollars. English is an interesting character—possibly bipolar, certainly driven—who succeeded beyond his wildest dreams. You see, he never aimed to become a millionaire. He just wanted a site that worked well, a happy user base that kept coming back, and a team that hummed and thrummed and had fun. The money was a by-product.

But after the sale of Kayak, English did in fact have great wealth—he'd been, in the words of one of his colleagues, hit by that "truck full of money" (a memorable phrase that became the title of Kidder's book). How, though, to recover? What does one do for a second act?

English is hardly alone. Once today's millionaires and billionaires hit it big, they're chased by the expectation that they, like the philanthropists of the past—the Carnegies and Rockefellers, who endowed some of the United States' great universities and other public institutions—will give away at least some of their fortune to make the world a better place. Bill Gates, for instance, established a foundation for that purpose. But other efforts, like Mark Zuckerberg's attempts to reform the Newark, New Jersey, school system, have

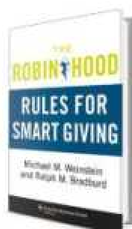
TOMMY HILFIGER: WHAT I'M READING
Life, by Keith Richards with James Fox (Little, Brown, 2010)
"Music and musicians have been a driving force in my work, inspiring many of my clothing designs. The energy, influence, and drama of the Rolling Stones, one of my favorite groups, made reading *Life* even more alluring."

Tommy Hilfiger is the principal designer at Tommy Hilfiger Group and the author, with Peter Knobler, of *American Dreamer: My Life in Fashion & Business* (Ballantine Books, 2016).



A Truck Full of Money: One Man's Quest to Recover from Great Success
Tracy Kidder
Random House, 2016

Poverty, Inc.
Acton Institute, 2014



The Robin Hood Rules for Smart Giving
Michael M. Weinstein and Ralph M. Bradburd
Columbia University Press, 2013

failed miserably—although the Facebook founder and his wife, Priscilla Chan, are trying to bounce back with the Chan Zuckerberg Initiative, an organization that recently announced that it will give away $3 billion to "cure, prevent, or manage" all disease by the end of this century.

For his part, English set out to follow the example of his friend and quasi mentor, Thomas J. White, another accidental millionaire who donated most of his fortune to Partners in Health (PIH), a nonprofit that supports health missions in Haiti, Mexico, Russia, and other countries around the world. (PIH was cofounded by Paul Farmer, the subject of another Kidder book, *Mountains Beyond Mountains.*) In the end, however, despite an exploratory visit to a homeless community in his hometown of Boston, the Kayak founder had less interest in doling out dollars than in creating another venture-backed tech start-up—not for the money, necessarily, but for the action. Philanthropy didn't have nearly the same luster as building something from scratch, so his nascent charitable efforts soon faded.

English did have other options. He could have decided to donate a significant sum to some well-established charity organization, one that appears to be doing God's work in eradicating global poverty. But even in that direction lie hidden dangers, exposed by a 2014 documentary, *Poverty, Inc.,* that explores the equilibrium that the international aid community and social entrepreneurship have created in the developing world. Director Michael Matheson Miller reviews the situation in Haiti in particular and in some sub-Saharan African countries, and finds that the perfectly legitimate desire to help, which often manifests itself in the form of cash and in-kind donations, keeps the developing world in its developing state. Gifts from individual philanthropists, nonprofits, governments, and socially conscious businesses have created a state of dependence. When a country is awash in free money, free clothes, and free food from the developed world, it's nearly impossible for local farmers and entrepreneurs, even formerly successful ones, to compete. Industry dries up, but the residents can't always rely on specific kinds of aid, since it's inconsistently delivered.

> "The performance of U.S. philanthropies is, as a matter of law, accountable to no outside force."
> Michael M. Weinstein and Ralph M. Bradburd, *The Robin Hood Rules for Smart Giving*

That's not to condemn any person or organization with good intentions—the filmmakers are very careful on this point. No one is ungracious about the aid offered. But the single most important message to come out of *Poverty, Inc.* is from aid recipients themselves: *Stop.* Stop giving us free stuff and help us figure out how to build sustainable businesses that will have positive and long-lasting impact on our communities. The free shoes sure were nice for a while, but we'd really like to build our own shoe factories instead.

So what's a modern philanthropist to do, especially one not grand enough to endow a foundation or initiative in the style of Gates and Zuckerberg? One option—turn to *The Robin Hood Rules for Smart Giving,* by Michael M. Weinstein and Ralph M. Bradburd. Based on the methods developed by Weinstein and others at the Robin Hood Foundation, the book bills itself as a guide "for making choices among philanthropic options when resources are limited"—which they always are, even for billionaires. The foundation, established in 1988, calls its methodology "relentless monetization," a formula that allows the donor to evaluate different choices using the same criteria—a kind of fancy-pants cost-benefit analysis. The method is simple on its face: Adopt a mission statement, translate that mission into well-defined goals, identify a specific intervention to try along with the relevant outcomes, and then analyze and score the results. Repeat. Simple, perhaps, but not easy, which is why the authors provide detailed guidance on how to make choices that have real, positive impact in the world.

Whatever one's approach—whether Robin Hood's quant-driven methodology or Tom White's all-in style—it's clear that giving away money must be as disciplined a process as making it in the first place. One cannot simply donate millions willy-nilly and expect to change the state of the world for the better. If philanthropy worked that way, we'd be done by now.

Tim Sullivan is the editorial director of HBR Press and the coauthor, with Ray Fisman, of *The Inner Lives of Markets.*

EXECUTIVE SUMMARIES DECEMBER 2016

SPOTLIGHT ON SETTING CEOS UP TO WIN

Replacing the chief executive is one of the most crucial turning points in an organization's life. This month we explore how firms should tackle the process.

LEADERSHIP

The Secrets of Great CEO Selection

Ram Charan | page 52

When it comes to selecting a new CEO, judgment really matters. The choice may devastate a company or create enormous value. In his work advising companies, Charan has observed that some board members are especially great at succession decisions. In this article he describes how they go about picking the right candidate.

Directors who excel at selection zero in on the two or three distinct capabilities that a CEO will need to thrive at the firm in question. (Charan calls this the "pivot" because the succession decision turns on it.) For example, when IBM was conducting a CEO search in 1993, many thought it should hire a technologist, but two directors saw that what the company really needed was an executive with business acumen, a customer orientation, and execution skills. At their urging, the board brought in Lou Gerstner, who quickly turned IBM's $8 billion loss into a $3 billion profit.

Astute directors also keep an open mind about where the best candidate will come from; they shed assumptions about insiders and outsiders and may even consider a leader a few levels below the CEO. They go deep to understand which person is the best fit with the pivot, doing their own due diligence. Finally, they allow for the imperfections in the chosen candidate, figuring out which gaps can be filled by other executives or corrected with coaching. **HBR Reprint** R1612C

MANAGING ORGANIZATIONS

After the Handshake

Dan Ciampa | page 60

A startling percentage of new CEOs fail within their first 18 months, according to many estimates—whether they come from outside or are promoted from within. Sometimes the new leader makes poor strategic moves, and sometimes the board makes an imperfect choice, overestimating a candidate's abilities or hiring someone whose skill set doesn't fit the context. But when succession fails, the responsibility is almost always shared.

New leaders may be unable to read the political situation clearly or achieve the cultural changes their strategic and operational agendas require. Boards and key executives may not grasp the complex nature of CEO succession or consider the likely political and cultural challenges the new leader will face. A CEO transition is not the same as onboarding, which is a formal, short-term, agenda-driven orientation program of briefings and meetings. It is a longer process of interactions both formal and informal, planned and impromptu; it should begin when the board's choice accepts the position and last for months after he or she arrives. The outgoing CEO, the chief human resources officer, and the board all have key roles to play in the process, writes the author, who describes best practices for each.

The article includes an interview with Mark Thompson, CEO of The New York Times Company, about his own succession process in 2012. **HBR Reprint** R1612D

GOVERNANCE

Succession Planning: What the Research Says

Eben Harrell | page 70

While every organization inevitably must replace its CEO, most firms are ill-prepared for succession. In this article, HBR senior editor Eben Harrell reviews the most salient studies of succession planning and offers context from the experts. Some key takeaways:

- Though turnover among CEOs is rising, only 54% of boards are grooming a specific successor, and 39% have no viable internal candidate. The consequences of poor planning are serious: Companies that scramble to find replacements forgo an average of $1.8 billion in shareholder value.
- Grooming leaders takes years but pays off: Chief executives who have gone through executive development at "CEO factories" like GE deliver superior operating performance. But directors need to get more involved. The majority don't understand the capabilities of the executives below the CEO, and only about a quarter participate in their evaluations.
- The trend toward external hires is growing, and outsiders command higher median pay. But studies suggest that on the whole, insider CEOs deliver better returns.
- More researchers are studying the traits of the ideal CEO. So far they're finding that younger CEOs outperform, that execution matters more than interpersonal strengths, and that a military background makes leaders more honest, but this line of inquiry is in its early days, and the jury is still out. **HBR Reprint** R1612E

The Big Idea

GLOBALIZATION

Mapping Frontier Economies

Aldo Musacchio and Eric Werker | page 40

Global players in search of double-digit growth are running out of opportunities. Emerging-market giants such as Brazil, Russia, and China are experiencing an economic slowdown. They are increasingly expensive as a base for operations, and it's harder to export to and import from these countries than it used to be.

As a result, multinationals are paying more attention to low-income, high-risk countries both as new markets for selling goods and services and as platforms from which to export them elsewhere. Even in industries where competition is skewed by government manipulation, foreign players that target the right sectors with the right strategies can prosper.

The first step in identifying opportunities in a frontier economy is to assess the competitive environment of its industries along two dimensions: (1) the degree to which profitability is determined by competition between firms and not by government policies and actions and (2) whether the industry is focused primarily on domestic sales or on exports. Industries will fall into one of four categories.

Each category is associated with a distinct strategy, ranging from the conventional (leverage existing capabilities, adapt to local tastes) to the unfamiliar (make yourself indispensable to powerful local players).

In this article, the authors offer companies a framework to help figure out whether and where to play and how to win in the spaces in which they choose to compete.

HBR Reprint R1612B

Feature

HEALTH CARE

Health Care Needs Real Competition

Leemore S. Dafny and Thomas H. Lee | page 76

Competition improves quality and efficiency, spurs innovation, and drives down costs in many sectors. Health care should be no exception.

The U.S. health care system is inefficient, unreliable, and crushingly expensive. There is no shortage of proposed solutions, but central to the best of them is the idea that health care needs more competition. In other sectors, competition improves quality and efficiency, spurs innovation, and drives down costs. Health care should be no exception.

Yet providers and payers continue to try to stymie competition. Many are actively pursuing consolidation, buying up market share and increasing their bargaining power.

In this article, the authors argue that health care payers and providers must stop fighting the emergence of a competitive health care marketplace and make competing on value central to their strategy.

All stakeholders in the health care industry—regulators, providers, insurers, employers, and patients themselves—have roles to play in creating real competition and positive change. In particular, five catalysts will accelerate progress: Put patients at the center of care, create choice, stop rewarding volume, standardize value-based methods of payment, and make data on outcomes transparent.

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Edward Crowley, GENERAL MANAGER

Feature

MANAGING TECHNOLOGY

Fixing Discrimination in Online Marketplaces

Ray Fisman and Michael Luca | page 88

Online marketplaces such as eBay, Uber, and Airbnb have the potential to reduce racial, gender, and other forms of bias that affect the off-line world. And in the early days of internet commerce, the relative anonymity of transactions did make it harder for participants to discriminate. But as listings began to include photos, names, and other means of identification, bias emerged in areas ranging from labor markets to credit applications to housing—sometimes made worse by a lack of regulation, the absence of in-person interactions, and the use of automation and big data. How can companies reverse the tide?

The key lies in more-intentional platform design, say the authors, who offer a framework for creating a thriving marketplace while minimizing the risk of discrimination. For starters, they say, companies must track and report on potential problems and carefully test choices that may influence the extent of discrimination. And they should thoroughly examine four design decisions, asking themselves:

- *Are we providing too much information?* In many cases, the simplest, most effective change a platform can make is to withhold information such as race and gender until after a transaction has been agreed to.
- *Could we further automate the process?* Features such as "instant book," allowing a buyer to sign up for a rental, say, without the seller's prior approval, can reduce discrimination while increasing convenience.
- *Can we make discrimination policies more top-of-mind?* Presenting them during the actual transaction process, rather than burying them in fine print, makes them less likely to be broken.
- *Should we make our algorithms discrimination-aware?* To ensure fairness, designers need to track how race or gender affects the user experience and set explicit objectives.

Seemingly small design features can have an outsize impact on discriminatory behavior. Smart choices and transparent experimentation can create markets that are both more efficient and more inclusive.

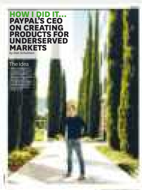
HBR Reprint R1612G

How I Did It

STRATEGY

PayPal's CEO on Creating Products for Underserved Markets

Dan Schulman | page 35



Back when the author was the CEO of Virgin Mobile, he accepted a challenge to live like a homeless person for 24 hours in New York City—with no money or credit card, no cell phone, just the clothes on his back. A few years later, when he was head of a division at American Express, he joined his leadership team in a variation on that experiment: They would spend an entire day trying to pay bills and transfer money the way people without bank accounts or credit cards have to. Those experiences increased his empathy for less-affluent people and his awareness of how difficult it is for them to manage and move money—and energized PayPal's new strategy after Schulman joined the company as CEO, in 2014.

That strategy was to be a "customer champion" company and reorganize into just two groups: merchants and consumers. For merchants, PayPal would evolve its technology platform to enable more-intimate relationships with customers using mobile and software. For consumers, it would empower underserved citizens throughout the world to make more-secure, faster, easier, and less-expensive financial transactions. Within those two segments, the company has created or acquired a suite of products that target different markets, including Venmo for Millennials, Xoom for international digital payments, and PayPal Working Capital, which lends money to small businesses.

HBR Reprint R1612A

Managing Yourself

Do You Hate Your Boss?

Manfred F.R. Kets de Vries | page 98

At least half of all employees have quit a job at some point because of their supervisor. People complain of bosses who bully them, micromanage, steal credit, hoard information, and otherwise make them unhappy—which threatens their productivity and the organization's success.

But don't despair if you don't get along with your boss. This article lays out steps you can take to improve the situation:

Practice empathy. Behavioral research and neuroscience suggest that being mindful of the pressures on your boss and responding empathetically can trigger reciprocal support.

Examine your role. Consider how you might be contributing to a negative dynamic, and seek training or advice to help you change your behavior.

Talk to your boss. Start by asking how you can improve your performance and the relationship. If that isn't fruitful, launch a frank conversation about the dysfunction in your interactions.

Go to HR. As a last resort—and only if you have evidence to show that your boss is unfit—file a formal complaint.

Leave. If you see no potential for change, it's probably time to start job hunting.

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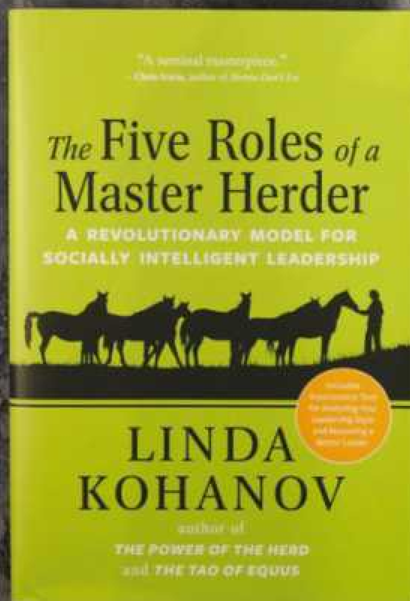
Create the Balance



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Life's Work

Brian Wilson overcame partial deafness, stage fright, mental illness, and drug addiction to write, produce, and perform some of the most influential music of the 1960s—first as a member of the Beach Boys, later as a solo artist. Famously reticent, he has a new autobiography out now. ***Interviewed by Alison Beard***

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

HBR: Your songs have been called groundbreaking. Where did the innovation start?

Wilson: I first got inspiration from artists on the radio: Chuck Berry, Rosemary Clooney, the Four Freshmen. Producers like Phil Spector inspired me to want to make creative records. So did bands like the Beatles; they weren't really rivalries, just mutual-admiration trips. I wanted to grow musically, so I experimented. I wasn't the type to sit around and be satisfied, especially not in the studio. And I had ideas coming into my head all the time. Many had to do with using instruments as voices and voices as instruments. I would put sounds together to create something new. Some ideas didn't work, because they were too difficult to achieve at the time. But most did. And then I immediately moved to the next thing.

How did that drive affect your relationship with your bandmates? They believed in me, my process, and what I was trying to achieve. They didn't know how to produce, so I took charge. I was a real perfectionist. But we always mixed in some humor to lighten the load.

What makes a group work well together? Bands are relationships, and relationships change over time. Some people are leaders, and everyone contributes in different ways. The Beach Boys were a family—three brothers, a cousin, and a friend—which gave us a cohesiveness. But I think the key to our success was respecting one another's ideas and opinions. Also a lot of practice, and everyone pitching in. Each guy had his own part to sing.

You've been diagnosed with schizoaffective disorder. How did you work through that to achieve so much? I've dealt with my mental condition differently in different parts of my life. I gained a little bit from drugs, but then they started to become a hazard—something that didn't work. So I had to unlearn taking them. Then I saw a psychiatrist, Dr. Landy, who overmedicated me to the point where I could be completely controlled, and I felt powerless to do anything about it. Thankfully, Melinda, who is now my wife, gave me love and support and rescued me. When I finally had my freedom back from Dr. Landy, I started dealing with my condition by talking to my friends—I like to be around creative people—doing a lot of thinking, and playing the piano.

And how have you overcome your stage fright? By just keeping at it, one concert at a time. It usually starts a few hours before a performance, so I just sit in a big comfortable chair on the side of the stage and meditate or contemplate how the show will go. I know that once I walk out and hear that first note, all the anxiety will go away. It always does.

What do you consider to be your greatest accomplishment? *Pet Sounds,* because it's timeless. Fifty years later, I'm doing a world tour, playing it live, and seeing and hearing the audience respond. It brought and continues to bring love to the world, which was my intent when I wrote the music. Also "Good Vibrations." It's my single-song production masterpiece.

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