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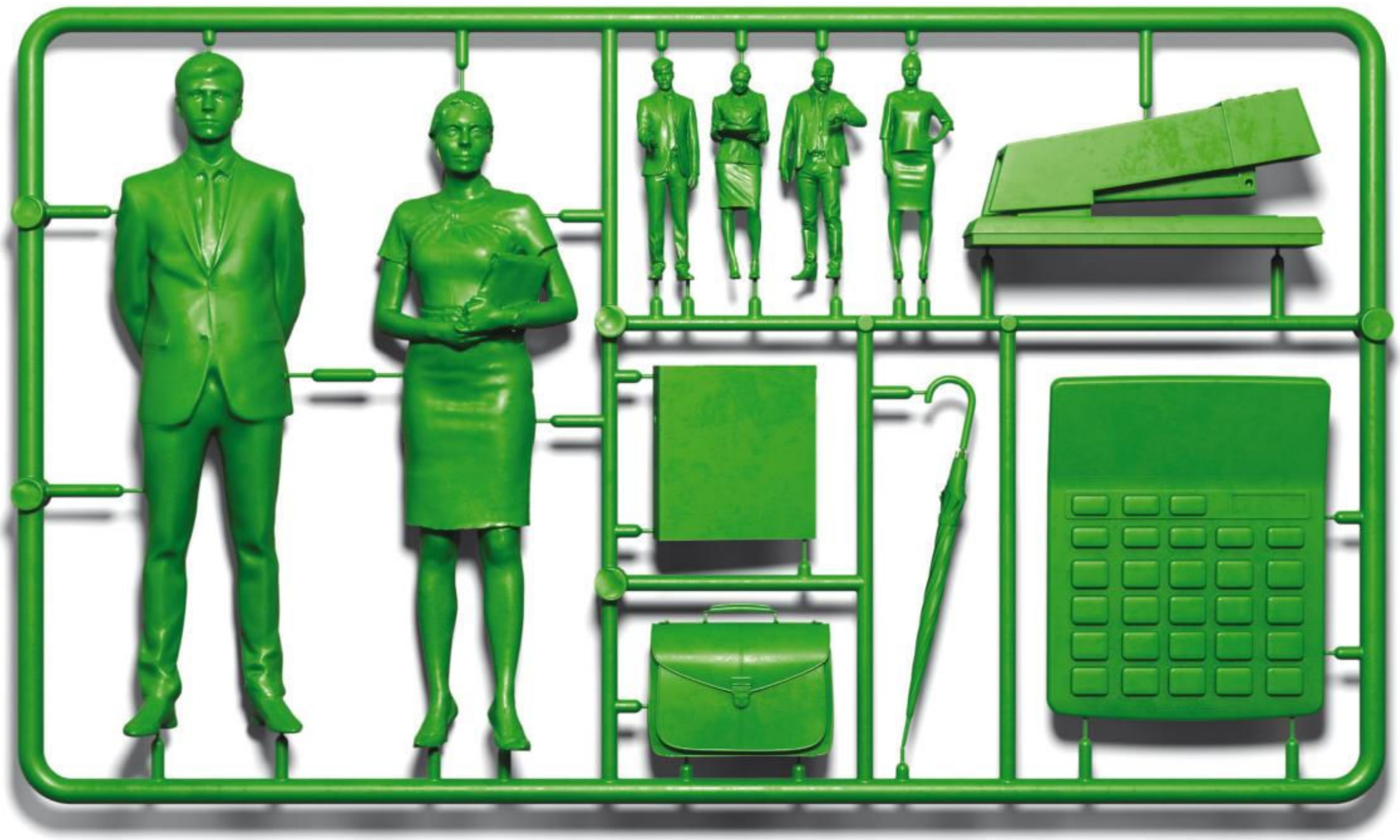

BUILDING A WORKFORCE FOR THE FUTURE

How to ensure that your team can handle any change PAGE 49


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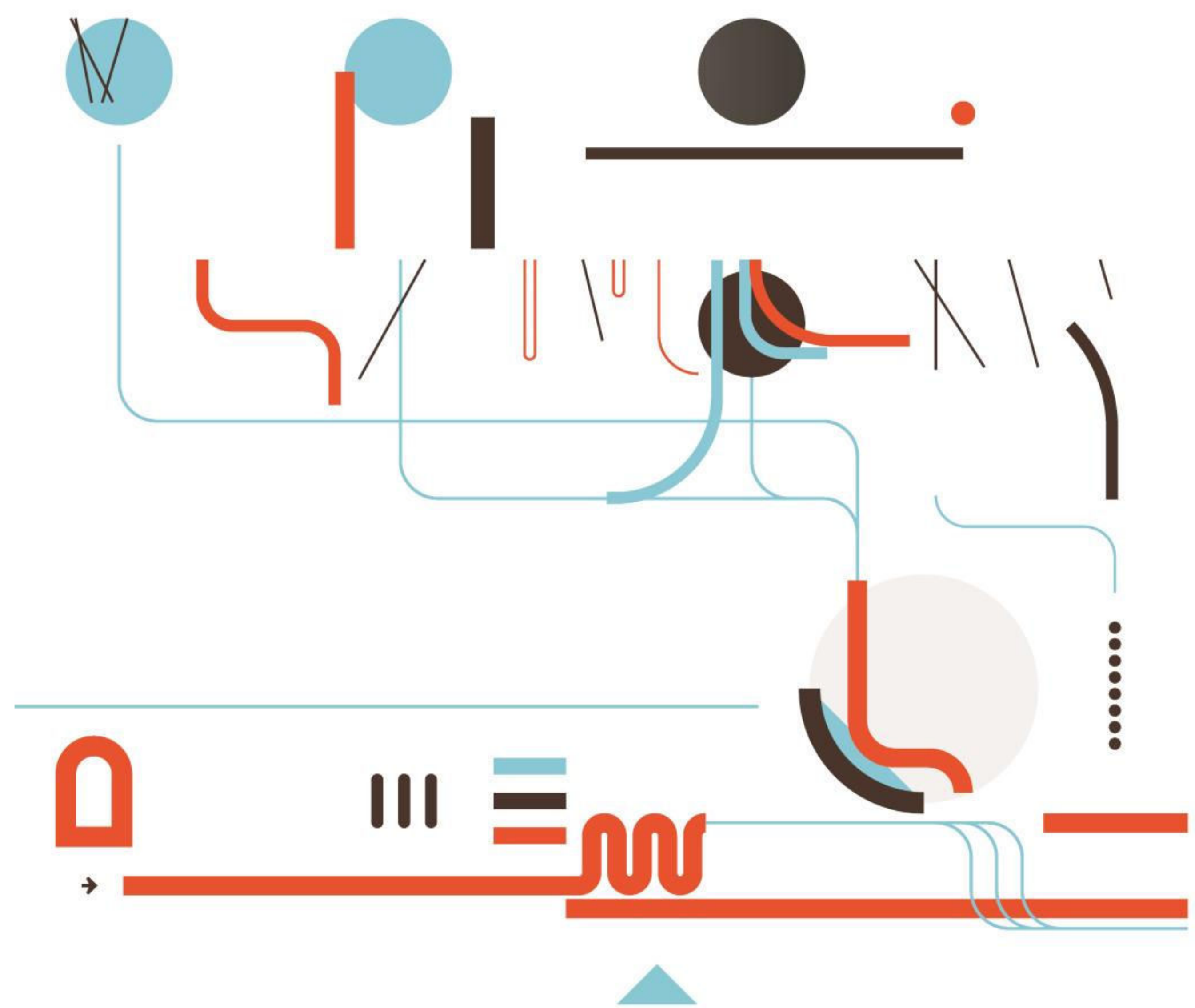

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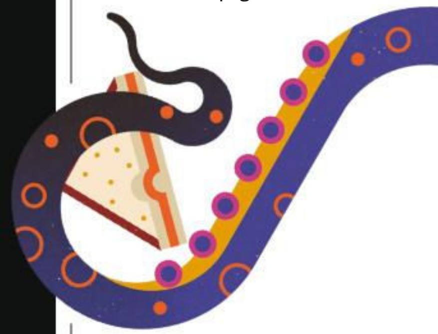
Powerful people are more likely to be rude, selfish, and unethical. page 112



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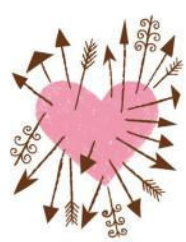

MICHAEL LEWIS; OWEN DAVEY; MELINDA BECK

From the Editor
Kahneman on "Noise"

Daniel Kahneman is surely one of the world's nimblest thinkers. In 2002 he shared the Nobel Prize in Economic Sciences, a neat trick for a psychologist who claims he never so much as sat in on an economics course. He has also made valuable contributions to the field of management, and I suspect he didn't do a lot of classwork in that area either. Kahneman has cowritten a couple of articles for *Harvard Business Review*—on how teams can make better decisions by identifying and reducing the biases that inevitably pop up in their thinking, and on how delusional optimism can lead executives to choose the wrong strategic path.

This month he's back with another compelling piece, coauthored with Andrew M. Rosenfield, Linnea Gandhi, and Tom Blaser, all of TGG Group, a Chicago-based consulting firm that Kahneman helped found.

The article demonstrates how inconsistent decision making can add up to a huge hidden cost for companies. Human judgments can be influenced by irrelevant factors such as mood and even the weather. The authors refer to this chance variability as "noise," and they call it an "invisible tax" on corporate bottom lines.

One solution: algorithms, which can replace human judgment far more often than one might expect. Although they sometimes sound dauntingly complex, algorithms don't always need a lot of outcome data to be valid, and they can be created from commonsense rules. The authors even describe how to build them.

The result, they promise, is less noise, more consistency, and a more effective company. You don't have to be an economist to see the value in that.

Adi Ignatius, Editor in Chief

JOHN VON PAMER

Contributors

As a young officer in the Israel Defense Forces, **Daniel Kahneman** developed a protocol for evaluating recruits that was designed to ensure that interviewers were consistent. Sixty years later, the Nobel laureate has returned to the study of "noise" in judgment. As he and his coauthors document on page 38, inconsistent decision making is an invisible tax on the bottom line of many organizations. "Where there is judgment, there is noise—and usually more of it than you think," they write.

Christoph Loch, a professor at and the director of Cambridge University's Judge School of Business, explores the factors that make technological innovations catch on. After working for five years on a variety of innovation projects, he came to understand the critical role business models play in linking technology changes to market needs and embarked on the research project presented with his coauthor on page 90.

Dacher Keltner, a professor of psychology at UC Berkeley, has spent decades studying how power corrupts. As his stature grew, he discovered that he himself was not immune to power's antisocial effects. "I've learned that when I'm feeling powerful, I'm more likely to interrupt, to say inappropriate things, to focus on myself rather than others, and worse," he says. He shares his insights about such behavior on page 112.

In 2014 **Cathy Benko,** vice chairman and managing principal at Deloitte LLP, had dinner with John Donovan, chief strategy officer and group president at AT&T. Donovan shared his company's plans to retrain hundreds of thousands of employees—an idea, he said, that had been shaped in part by Benko's writings on talent. She and Donovan describe AT&T's approach and progress on page 68.

The photo composites featured in this month's Spotlight section "capture the isolation of the human condition in transit," says **Ben Zank,** the New York artist behind them. "Some are in groups and families, while others drift past one another, disconnected from their reality in what seems like a vacuum of time and space."

VIVIAN SHIH


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Understanding Holacracy

HBR article by **Ethan Bernstein, John Bunch, Niko Canner,** and **Michael Lee,** July–August

The authors examine Zappos, Morning Star, and other companies to see why flat organizational structures evolved and how they work. Self-management models typically share three traits: (1) Teams *are* the structure, and individual "roles" are collectively defined and assigned; (2) teams design and govern themselves; (3) leadership is contextual and distributed among roles, not individuals, and responsibilities change as the work changes.

We have been self-managed for five years and implemented holacracy one and a half years ago, because we wanted clarity about who was doing what, and the team wanted more goal-oriented work. Holacracy achieves both aims, and our company gets through the build-measure-learn cycle much faster.
Mark Vletter, founder, Voys and Devhouse Spindle

When Tony Hsieh was inspired by Brian Robertson to implement holacracy at Zappos, a number of employees resigned either for economic reasons or because they were not connected with this kind of organizational structure. Holacracy is a culture thing, and not every organization is suited to it. In such cases it's good to review holacracy and cherry-pick certain parts to implement in the traditional organizational structure.
Arie Blokland, independent retail banking and mortgage consultant

The authors cite Frederick Taylor's early-1900s contribution to the literature but then they skip to the 1970s. In between, however, is the core of behavioral management. The six women in the classic late-1920s research proved that taking ownership of the workplace and hearing about their accomplishments of the prior workday are the secrets to what we now label empowerment.
Bruce Evans, professor of management, University of Dallas, College of Business

The authors respond: *Our exclusion of a reference to the 1920s Hawthorne studies was not meant to obscure its importance. But one might draw a distinction between empowered individuals and self-managing organizations. Morning Star explicitly distinguishes them: "We can talk about employee empowerment, and we'll be talking about something that's fundamental to self-management, but employee empowerment alone doesn't get you self-management." We agree: thus our focus on the historical development of self-management—through the social scientist Eric Trist and others—rather than on empowerment alone.*

Holacracy as an operating system can perhaps work best as an adjunct to a more traditional hierarchy that provides clarity of funding, authority, and structure. Looser, more fluid structures facilitate creativity and innovation that can then be supported by the resources of the organization.
Jill R. Robinson, senior manager for sustainability and natural resources, Phillips Exeter Academy

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BY SHAWN ACHOR AND MICHELLE GIELAN

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BY ANDREA S. KRAMER AND ALTON B. HARRIS

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BY SHERRY MOSS

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BY KASIA WEZOWSKI

Which MBAs Make More: Consultants or Small-Business Owners?
BY RICHARD S. RUBACK AND ROYCE YUDKOFF

How to Make the Most of Omnichannel Retailing

HBR article, July–August

For retailers that operate both stores and websites, the conventional "omnichannel" strategy is to encourage customers who shop only in stores to begin also buying online, and vice versa. In studying a Chinese department store's coupon strategy, researchers found that encouraging online customers to visit a store increased profits, but incentivizing in-store customers to shop online decreased them. Customers who shop in stores tend to buy more, are more willing to buy tactile, "experiential" goods such as apparel and makeup, and are less likely to compare prices.

Only slightly noted in this article is the fact that most shoppers are looking for the shopping "experience." A coupon may drive them to the store, but they won't necessarily use it. What they intend is to leisurely shop for items they want or need and have a fulfilling sensory experience in terms of store presentation, friendliness, and knowledgeability of the staff. Shoppers who know exactly what they want and have a coupon for it will head right for it (whether online or in person) and pat themselves on the back for getting a deal.

Kirsten Sandlin, owner, RFPrepared

This was a very valuable insight: The researchers say that shuttering stores more aggressively "assumes that the sales from a store that closes can be easily shifted online, but…in fact it is very difficult to win those sales back." Shutting down brick-and-mortar stores and focusing more on e-commerce assumes that the retailer can be as effective online as, say, Amazon, but that's almost never the case.

Bané Obrenovich, director of marketing, Controltek USA

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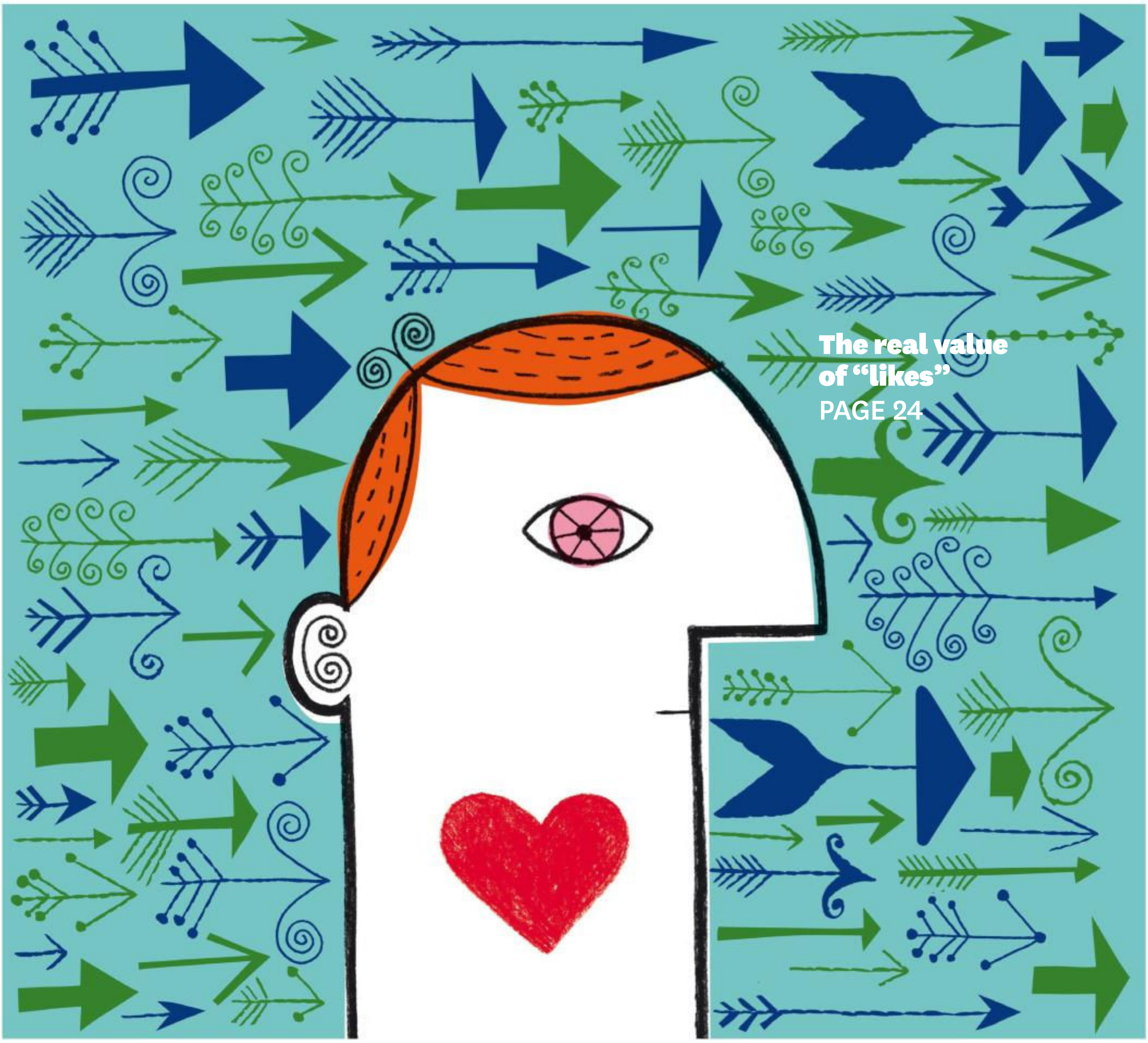

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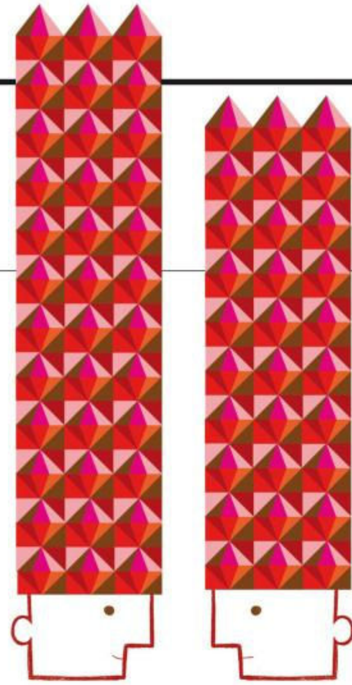


COMPENSATION

THE CASE AGAINST LONG-TERM INCENTIVE PLANS

Research shows four reasons why managers undervalue a key component of pay packages.

Alexander Pepper spent 27 years at a large accounting firm helping client companies devise ways to compensate CEOs and other senior executives. Starting in the early 1990s, pay packages have typically included long-term equity incentive plans aimed at aligning managers' and shareholders' interests. But over time Pepper grew disillusioned. "I began to realize that the people we were putting the packages in place for didn't necessarily like them very much, and the plans didn't do what they were intended to," he says. In the early 2000s Pepper went back to school, eventually earning a DBA; he teaches at the London School of Economics. Today he researches why pay-for-performance plans don't work. "I was part of the system that I've subsequently come to say is not very effective," he says.

Since 2013 Pepper has published four academic studies based on in-depth surveys with 756 senior executives across 40 countries. He sought to measure how well the executives understand and value the components of their pay plans and how their pay affects their behavior. Although compensation practices differ dramatically from country to country—CEOs in the U.S. earn far more than their counterparts elsewhere, for instance—Pepper finds that regardless of region, executives have the same general misperceptions about pay. He identifies four reasons why pay-for-performance incentives don't work as well as proponents expected.

Executives are more risk-averse than financial theory suggests. Would you rather have a 50% chance of getting a $90,000 bonus, or a guaranteed payout of $41,250? In theory, the rational choice is the risky payout, since its "expected value" is $45,000, but 63% of executives chose the sure thing—and when asked similar questions involving stock option payouts, they consistently showed a preference for less risky choices. Someone who's risk-averse assigns less value to dicey propositions, which suggests that executives see the at-risk portions of pay packages as less valuable than economic theory would predict. In interviews they attribute this attitude partly to how "extraordinarily complex" and even "arbitrary" equity plans are. Pepper says that if people view something as not worth very much, more of that thing is needed to make it meaningful—and this dynamic inflates the value of pay plans.

Executives discount heavily for time. Would you rather get a $1 payout today or a $2 payout in a year? The rational choice is to wait, because you'll earn a 100% return during the interval, but behavioral economists have found that many people choose the early payout—a phenomenon called "hyperbolic discounting." Pepper's studies show that it applies to executives' thinking about pay: A long-term incentive package that may be worth a lot in three or four years is valued very little today. (His data suggests that executives discount distant payouts at the remarkable rate of 30% a year—about five times the discount economic theory suggests.) One executive in the study summed up the situation this way: "Companies are paying people in a currency they don't value."

Executives care more about relative pay. Consider a simple question: Would you rather earn $50,000 or $100,000? Now consider the same question with some added context: Would you rather earn $50,000 in a society where the median income is $30,000, or $100,000 in a society where the median income is $125,000? Assuming that prices are the same in both settings, you should choose $100,000—it lets you buy more, regardless of whether it's more or less than what other people make. But economists have long known that people are highly sensitive to relative earnings and prefer to outearn others even if it means a lower absolute income. Pepper's research shows that this holds for executive compensation. The executives surveyed were less concerned with absolute earnings and more focused on (and motivated by) how they were paid in relation to their peers, both inside the company and at rival firms. Fully 46% indicated that they would prefer a lower pay package if it was higher than those of counterparts. One said, "The only way I really think about compensation is, 'Do I feel fairly compensated relative to my peers?'" If everyone asks that question, the resulting arms-race mentality drives pay packages higher.

Pay packages undervalue intrinsic motivation. People work for all sorts of reasons, but executive pay packages tend to discount nonmonetary motivations. Pepper's research shows that achievement, status, power, and teamwork are all important incentives; in answering survey questions, executives made it clear that extra-large pay packages don't necessarily create stronger

Non-CEO executives appointed to a corporate board are 44% likelier than other executives to gain a CEO position at an S&P 1500 firm.

"COME ABOARD! EXPLORING THE EFFECTS OF DIRECTORSHIPS IN THE EXECUTIVE LABOR MARKET," BY STEVEN BOIVIE, SCOTT D. GRAFFIN, ABBIE G. OLIVER, AND MICHAEL C. WITHERS

incentives. "I do not believe, nor have I ever observed, that $100 million motivates people more than $10 million or $1 million," said one company chairman. Executives said they would willingly reduce their pay packages by an average of 28% in exchange for a job that was better in other respects.

How should companies use these findings? Given that executives dramatically undervalue long-term incentive pay, Pepper believes that companies should eliminate that component and increase others. "My research suggests, somewhat perversely, that companies would be better off paying larger salaries and using annual cash bonuses to incentivize desired actions and behaviors," he says. Additionally, they should require leaders to invest those bonuses in company stock (or should pay the bonuses in the form of restricted stock) until a certain share of leaders' net worth, or some multiple of their annual salary, is invested. As long as executives hold substantial equity, Pepper says, their interests will be aligned with those of shareholders—and this arrangement would achieve that aim without the confusion and inefficiencies of long-term incentive plans. Some companies, including Berkshire Hathaway, already have plans structured along these lines.

Pepper and other observers recognize that companies looking to implement such changes will face headwinds. In the United States, for instance, salaries above $1 million are not tax deductible, and in most countries the notion of pay for performance is so ingrained that big salary increases could draw criticism. However, Pepper says that like fashion, executive pay tends to go through cycles, and he believes that the long-term incentives in vogue for the past quarter century may soon fall out of favor. "My argument is that pay for performance makes the problem worse, not better," he says. "You can pay executives considerably less in total—but do it in a different way."

HBR Reprint F1610A

ABOUT THE RESEARCH Pepper's studies, conducted with the University of Bath's Julie Gore, are described in his book *The Economic Psychology of Incentives: New Design Principles for Executive Pay* (Palgrave Macmillan, 2015).

MELINDA BECK

THE IDEA IN PRACTICE

"COMPANIES DON'T WANT TO RISK A PAY DISPUTE"

Tom Gosling is a partner at PwC and heads the firm's UK reward practice. He has spent 20 years advising boards on executive compensation, but he says the system is "broken." In a recent interview, he told HBR why. Edited excerpts follow.

Is it true that many executives don't understand their long-term incentive plans? Yes. It seems strange—these are very sophisticated people, and it's not that the plans are incomprehensible. It's that executives don't view them as relevant on a day-to-day basis. Also, they get a new plan every year with a three- or four-year term, so at any point they have three or four plans, all with different performance criteria. When I used to do financial planning work with CEOs, I'd be handed a box of award certificates—"I've got this stuff." The executive would have no idea what it was worth—and often it was millions of pounds. They're busy people, and they don't have time to go into the details.

Why do you think existing pay systems are flawed? If you look at the research, you'll find two main problems. First, so much emphasis on performance pay puts massive pressure on the target-setting process. That leads to unintended consequences—in particular, it leads people in senior positions to focus on targets to the exclusion of more-holistic performance goals. Second, the complexity of incentives means that executives discount them very heavily. That's another reason they rarely deliver the results you might hope for. People created these plans with good intentions, but I don't think the plans contribute to better performance.

If they're not working, why do they persist? The investor community and the proxy voting agencies, such as Institutional Shareholder Services, are still wedded to performance-pay models. There is quite a debate in the UK right now about executive pay, and there is increasing skepticism about the effectiveness of existing models. Personally, I favor simpler plans that replace long-term incentive pay with a requirement that executives own company stock and hold it for long periods of time. Many clients like that model but think it's too chancy to pursue. Most companies don't want to risk a pay dispute, so they stick with conventional models.

1987

FROM THE ARCHIVE

"Whether the Dow soars or plummets matters little to the companies that the shares represent. The stock market is irrelevant....And yet we continue to fret over it with great seriousness, as if it meant something real."

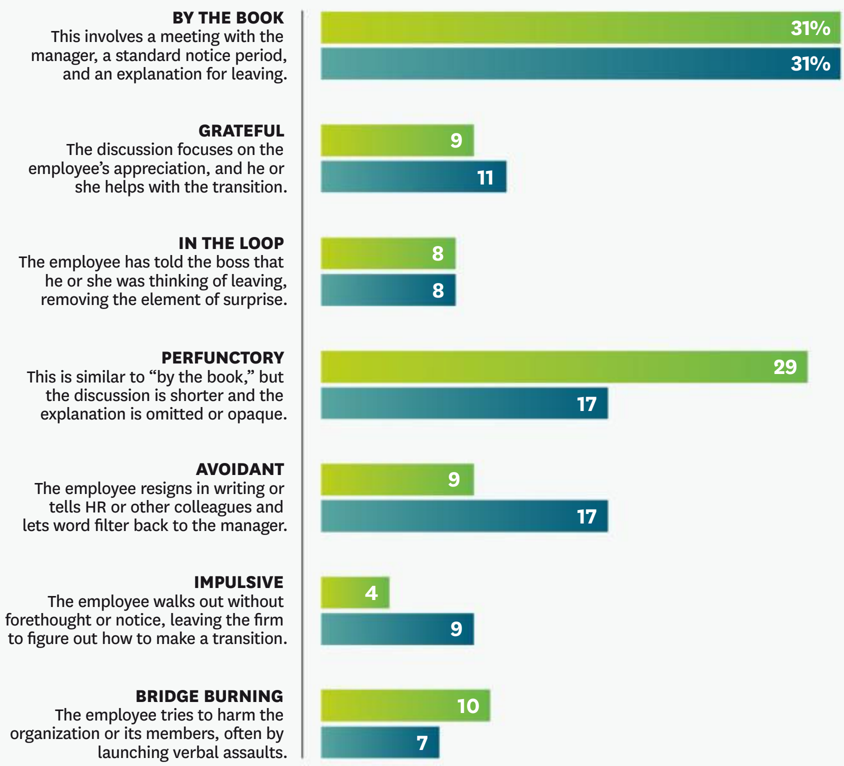
"THE MYSTERIOUS DISAPPEARANCE OF RETAINED EARNINGS," BY BEN C. BALL JR. (HBR, JULY–AUGUST 1987)

RESIGNATIONS
TAKE THIS JOB AND...

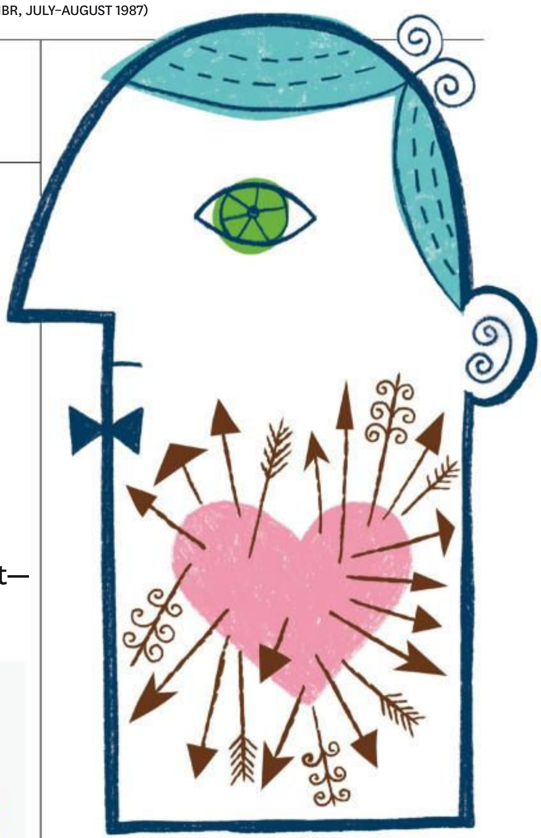
Ideally, every professional intending to leave a job would give notice during a respectful, candid meeting with the boss—followed by several weeks of continued effort until the departure day. But about half of all resignations play out differently, according to interviews with nearly 450 U.S. workers and managers conducted by researchers at Oregon State and the University of Oklahoma.

The biggest determinant of resignation style is whether the worker believes he or she was treated fairly. "Employees often view their resignation as the final chance to get even with their organization or manager," the researchers say. For companies, resignation styles can provide useful intelligence: If lots of workers are using the more negative ones, it probably signals dissatisfaction with their treatment—and may indicate managerial problems that should be addressed.

THE SEVEN RESIGNATION STYLES EMPLOYEES SAY THEY USE AND SUPERVISORS SAY THEY ENCOUNTER



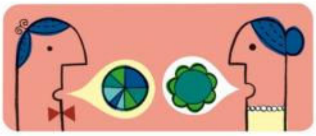
SOURCE "SAYING GOODBYE: THE NATURE, CAUSES, AND CONSEQUENCES OF EMPLOYEE RESIGNATION STYLES," BY ANTHONY C. KLOTZ AND MARK C. BOLINO (*JOURNAL OF APPLIED PSYCHOLOGY,* 2016)



MARKETING
BRAND "LIKES" MAY BE OVERRATED

For marketers, it's become a badge of success: How many people "like" the company's Facebook page? As the metric has taken hold, brands have begun spending millions of dollars to try to increase their social media following—and managers attempt to pin down something that's often elusive when it comes to marketing expenditures: What's the return on investment?

Over the past several years academics have used various methods to quantify the value of social media followers, without consistent results. In a new study, researchers at Harvard Business School conducted five experiments involving thousands of subjects to explore two questions: Does someone's liking a brand suggest that he or she is more likely to buy it? And do people's likes influence their friends?



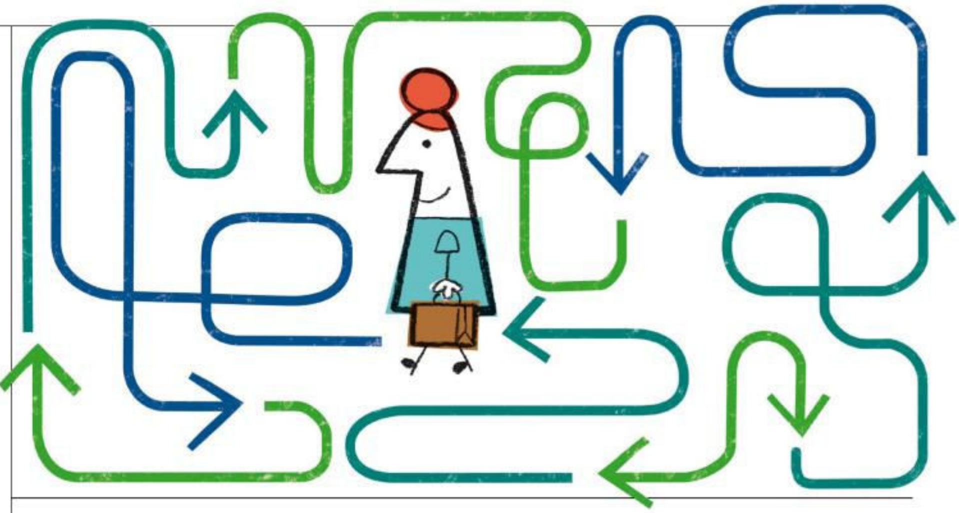
Female entrepreneurs do better than men on crowdfunding platforms; their use of emotional, inclusive language rather than business buzzwords provides an advantage in this arena, researchers say.

"THE NARRATIVE ADVANTAGE: GENDER AND THE LANGUAGE OF CROWDFUNDING," BY ANDREEA GORBATAI AND LAURA NELSON

The experiments, which used well-known brands such as Coca-Cola, Pepsi, and Burt's Bees, drew on several techniques to assess both attitudes and behaviors over short and long periods of time. Some were aimed at teasing out whether liking a brand was simply a signal of existing fondness (a lagging indicator) or meant that subsequent favorability and purchase proclivity were likely to increase. (Results point to the former.) In one experiment, for instance, ads for a brand created similarly favorable impressions among people who had accepted an invitation to like the brand and people who had received no such invitation. In another, people who had liked a brand supplied the names and e-mail addresses of three friends, who were told either that their friend "likes the brand" (no mention of social media) or that he or she "likes the brand on Facebook." The messages that didn't invoke Facebook led more people to claim a free product—a result suggesting that liking something on social media is seen as a token gesture and carries less weight than liking it in a more conventional sense.

Their findings don't mean that social media marketing *can't* yield returns, the researchers say, but additional steps may be needed to leverage a like into profitable behavior. (For instance, prior research has shown that people who post content on a brand's social network page often begin purchasing more.) "The act of liking a brand on Facebook—requiring mere seconds of attention and, by design, one click of a button—may simply induce too weak a signal of preference for consumers to infer increased liking for the brand," the researchers write. "Making joining [user] communities more difficult—for example, by requiring a series of actions such as a greater number of clicks to gain membership—might increase the impact of liking." And persuading consumers to communicate their preferences offline may drive better results.

ABOUT THE RESEARCH "Does 'Liking' Lead to Loving? The Impact of Joining a Brand's Social Network on Marketing Outcomes," by Leslie K. John, Oliver Emrich, Sunil Gupta, and Michael I. Norton (*Journal of Marketing Research*, forthcoming)



RETAIL
FINDING THE PERFECT RETURN POLICY

As retailers battle for market share, return policies constitute an important weapon. The theory is that flexible returns can sway consumers who are on the fence, because they reduce the risk of buying. But there's a downside: When too many shoppers back out of purchases, profitability plummets. So retailers look for the sweet spot—a policy that will increase sales without driving excessive returns.

To help them find it, researchers at the University of Texas conducted a metastudy of 21 journal articles about return policies. They identified five components of policies: *time leniency* (the period during which returns are accepted—say, 30 days), *monetary leniency* (whether the retailer refunds the entire purchase price or charges a restocking fee), *effort leniency* (the hassle involved, such as having to show an ID or fill out a form), *scope leniency* (is everything returnable, or are sale items or frequently returned products excluded?), and *exchange leniency* (does the return yield cash, store credit, or only an exchange of goods?).

The researchers also looked at other theories about ways in which return policies influence shoppers. For instance, a lenient policy might signal high quality, because it suggests the retailer is confident that buyers will be happy with their purchases.

The most important finding: Although a lenient policy increases both sales and returns, the jump in the former is significantly higher than the increase in the latter. So retailers generally benefit from flexible policies even after the costs of returns are factored in.

Tweaking the five components of return policies can considerably affect consumer behavior, the researchers found. Lenient monetary and effort policies tend to stimulate purchases, while limiting the scope of returns, granting longer return periods, and allowing leniency on exchanges can curb returns. "Careful thought should guide the choice of leniency factors, because they have differential effects on purchase and return," the researchers say. "Depending on their objectives, retailers may be better served by complex return policies that vary on multiple dimensions than by simple return policies that vary on just one or two dimensions."

ABOUT THE RESEARCH "The Effect of Return Policy Leniency on Consumer Purchase and Return Decisions: A Meta-analytic Review," by Narayan Janakiraman, Holly A. Syrdal, and Ryan Freling (*Journal of Retailing*, 2016)

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


WHERE EXPERIENCED EXECUTIVES
BECOME EXCEPTIONAL LEADERS

DEFEND YOUR RESEARCH

YOU'RE LIKELY TO LIVE LONGER IF YOU RETIRE AFTER 65

The research: Chenkai Wu, a PhD student in public health at Oregon State University, teamed up with OSU professors Robert Stawski and Michelle Odden and Colorado State's Gwenith Fisher to examine data from the Health and Retirement Study, a longitudinal survey of Americans age 50 and over. When they looked at the sample of 2,956 people who had begun participating in the study in 1992 and retired by 2010, the researchers found that the majority had retired around age 65. But a statistical analysis showed that when people retired at age 66 instead, their mortality rates dropped by 11%.

The challenge: Does work benefit us in unexpected ways? Is delayed retirement the secret to a longer life?
Mr. Wu, defend your research.

Wu: That's the conclusion we are leaning toward. What's interesting is that we didn't find any sociodemographic, lifestyle, or health factors that affected the relationship between delayed retirement and a lower risk of dying. When we looked at just the unhealthy retirees in the sample—who accounted for 1,022 of the 2,956 participants—we still found that retiring one year later was associated with a 9% lower mortality risk.

HBR: What were some of the other factors that you controlled for?
The typical variables—gender, ethnicity, age, education, marital status, and wealth. We also grouped people into three categories of occupations: white-collar jobs, service jobs, and blue-collar jobs. And we took into account more-detailed health- or lifestyle-related variables, like consumption of cigarettes and alcohol, exercise, body mass index, self-reported health ratings, and disabilities. Then we evaluated a number of chronic conditions, like diabetes, hypertension, and heart disease. We still found that retirement age was related to mortality, beyond all those variables.

How did you define retirement? We considered it to be the first year people responded to the survey saying they were "completely retired." For healthy people, the average age was right about 65, and the range was about age 53 to 78. For unhealthy people, the average age was only six months earlier, around age 64 and a half, and the range was about age 59 to 79.

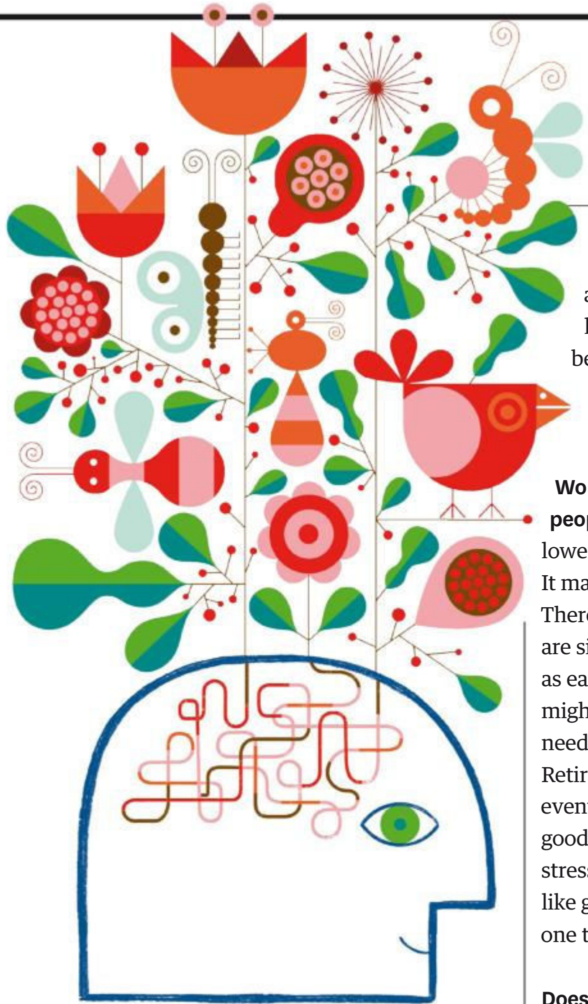
Correlation isn't causation. So you're not necessarily saying working longer means you'll live longer? Right. You'd have a long way to go to prove causation—and I'm not even sure that you could. To prove causation, the gold standard would be to do a randomized control trial, and it's probably unethical and unrealistic to randomly assign people different retirement ages.

But should everyone delay retirement in hopes of living longer? A lot of people have framed this as "Retire early, die early; or retire late, die late." But that's not actually the main message we want to convey. What we really want people to think about is "What does work represent?" There are a lot of social benefits related to working: You're more active, you're more engaged, you're talking with your peers, and so on. Losing those when you retire can be harsh.

Has anyone else looked at this phenomenon? The literature on the relationship between retirement age and longevity is still developing. The findings are mixed. Most research shows that delayed retirement helps reduce mortality. A couple of studies show no relationship, and still others show that delayed retirement is detrimental or that early retirement is beneficial. We extended the previous research by accounting for the healthy-worker bias and by looking at a more representative sample. Other studies had narrow samples, like German firefighters or U.S. petrochemical workers.

Has the trend shifted toward retiring later? Only very recently. Until the past couple of years, we actually saw a trend toward early retirement in the U.S.

The United States is a perfect place to study this because Americans have the flexibility of retiring at any age they want—if they've saved enough money. In contrast, many European countries have a mandatory retirement age. I initially got interested in this research because of the recent debate over China's mandatory retirement laws.



MELINDA BECK

The Chinese government is trying to raise the retirement age. I looked for data on the relationship between retirement age and health, but I couldn't find any.

Why would a later retirement affect longevity? Our theory is that a later retirement may actually delay when your physical and cognitive functioning starts to decline, because work keeps your mind and body active. If you stay active and socially engaged, it helps maintain your cognitive and physical abilities. It's definitely a future direction for this line of research. I'm interested in how people's physical and cognitive functions change over time. Older adults are a very heterogeneous group, so it would be interesting to see whether certain trajectories are beneficial or detrimental.

Another theory is that people's decisions about when to retire are shaped by many factors, including cultural and institutional norms. People will feel happier and more in control if they retire at an age consistent with what the culture of the country expects. In countries like the U.S., where work is highly valued and considered a necessary part of life, I think delayed retirement may be culturally desirable. Here, retiring "on time" might not be at 65; it may actually be a bit later.

Work can be stressful, though. Some people can't wait to retire. Well, the 11% lower death rate is the population average. It may not apply to any one individual. There are certain groups of people who are sick of work and just want to retire as early as possible. For them, doing so might be beneficial. But I think more work needs to be done to identify those groups. Retirement is often called a bittersweet event because it's a mix of bad things and good things. We believe that retirement is stressful, but that doesn't mean it's bad. It's like getting married—a happy event but one that can cause a lot of stress.

Does this possible benefit of delayed retirement help solve the problem of an aging workforce? Everyone tends to focus on whether delaying retirement is good for the economy or not. I think the lesson we want to convey is that we should also think about the health impact. Full-time work, which now means 40 hours a week or more, can be very stressful. But if people can have a slower transition into retirement, maybe working part-time or doing other activities, they'll stay active and socially engaged in a way that is beneficial to their health.

This sounds like good news for us Millennials, who often hear that we'll never get to retire. Cohorts are different. The people in the study were born between 1931 and 1941, so they're certainly different from Millennials. The takeaways are really not about the work or retirement age per se—they're about what those things mean. If you can find something that brings you the same benefits work does, that's what's important.

Interview by **Nicole Torres**
HBR Reprint F1610B

STRATEGIC HUMOR

To enter our caption contest, go to **HBR.org**.

CAPTION CONTEST

"Someday, and that day may never come, I'll call upon you to do a service for me. But until that day, accept this raise as a gift from the company."

This month's winning caption was submitted by **Greg Sandler,** of Northampton, Massachusetts.

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HOW I DID IT...

THE CEO OF POPEYES ON TREATING FRANCHISEES AS THE MOST IMPORTANT CUSTOMERS

by Cheryl Bachelder

GREGORY MILLER

The Idea

Behind the Popeyes turnaround was a conscious decision to treat leadership as stewardship—and to put the interests of franchisees above those of every other stakeholder group.

My first official day as CEO of Popeyes Louisiana Kitchen was November 1, 2007, but the company was holding a big franchisee meeting in Orlando a few days earlier. I wasn't technically an employee yet, but I decided to attend and make a presentation. My hope was to inspire the entrepreneurs who own and operate Popeyes restaurants about the bright future of the brand. In retrospect, I was naive and overly optimistic.

The company had gone through four CEOs in seven years, and sales had been choppy throughout that period. The meeting made it crystal clear that the relationship between Popeyes and its franchisees was strained. One conversation in particular stands out in my mind: A veteran franchisee, a 68-year-old man from Texas, said, "Miss Cheryl, don't expect us to trust you anytime soon. We're like abused foster children, and you're just a new foster parent." It was a humbling moment. I realized that until we demonstrated some value to our owners, it was unrealistic to expect their enthusiasm for the future.

Popeyes is the third food franchising company at which I've been a senior executive, and I've fallen in love with the business model. From a strategic point of view, it's asset-light, has a reliable cash flow, and expands a brand by leveraging entrepreneurs' capital and operating expertise. But what I really love is the opportunity to work with the passionate, talented entrepreneurs who own and operate the restaurants. They're buying into the brand in a way that traditional employees don't. They've made a huge investment of money and time. Being a franchisee isn't a job you can quit—it's your life.

At the same time, this business model often results in conflict between franchisees and the parent company, particularly if they aren't aligned on how to grow the business. To try to turn Popeyes around, my team and I decided to focus intently on the franchisees rather than other stakeholders. We decided to measure *our* success by *their* success. Nine years later, our results have improved dramatically—and while our relationship with them isn't perfect, it is remarkably better than at that 2007 meeting in Orlando.

From P&G to KFC

After graduating from Indiana University's MBA program in 1978, I started out in brand management at Procter & Gamble, moved to Gillette, and then joined Nabisco, where I managed snack and candy brands for seven years. My restaurant experience began in 1995, when Tom Monaghan, the founder of Domino's Pizza, hired me to run marketing and product development. I had no idea that Domino's was having problems with its franchisees, who filed a lawsuit against the company during my first week on the job. The owners claimed that Domino's was unfairly profiting from the dough and other supplies it sold to its franchisees. To settle the lawsuit, the management team created an audited, transparent system for the supply business and agreed to share any profits above a certain threshold with franchisees. Meanwhile, I set out to create an advisory group of owners who weren't involved in the lawsuit to find new ways to gain franchisee alignment and drive the growth of Domino's business. One of our biggest accomplishments was the launch of an innovation to keep pizzas hot during delivery: heated plates inside insulated bags, named Domino's HeatWave bags.

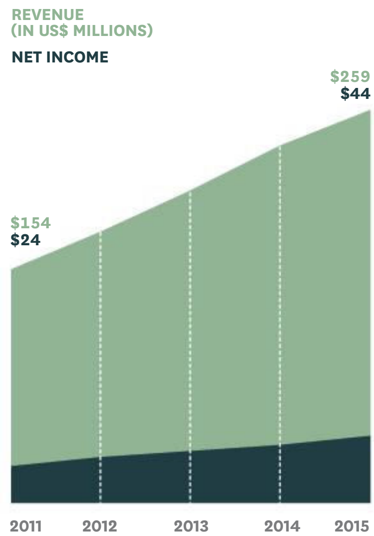
Shortly after Domino's was sold to Bain Capital, I was recruited to become president and chief concept officer at KFC, a division of Yum! Brands. KFC had been struggling, and its franchisees, too, were unhappy. Their contracts with KFC gave them much more power than in most franchise models; my assignment was to align the owners on a plan to grow the chicken business.

In my 30 months at KFC, we had 16 months of positive sales and 14 months of negative ones. We couldn't turn the corner fast enough to please the CEO, the board, or the shareholders, so I was fired in the fall of 2003. The most important lesson I took away from that experience is that you cannot serve the people or the enterprise well without delivering strong results.

When I left KFC, I decided to take a break. My children were then teenagers, and my husband was a management consultant who traveled frequently. After years of being a leader at the office, I decided our family needed my leadership skills at home. During

Popeyes Facts & Financials

FOUNDED 1972
HEADQUARTERS Atlanta, Georgia
LOCATIONS 2,569
FRANCHISEES 360
SYSTEMWIDE SALES (2015) $3.1B



that time I did some consulting and joined boards, including the hardware chain True Value's. Then, in 2006, I joined the board of Popeyes. I knew the company well, because I'd competed against it when I was at KFC. I had no idea I would someday become its CEO, but serving as a director turned out to be the perfect way to get a sense of the company's challenges and opportunities.

"Servant Leadership"

Popeyes was founded in 1972 in Baton Rouge, Louisiana, by Al Copeland, who was what we would now call a foodie. People tell stories about Al's passion for the recipes—how he'd stay up all night to perfect his mashed potatoes. Popeyes is called a fast-food restaurant, but it's known for slow-cooked foods and complex flavors. We use fresh bone-in chicken and marinate it for 12 hours before cooking. We've built a competitive advantage around the food. The company went public in 2001, and today we're in 48 states and 26 countries. We have 71 company-owned stores, but most of our 2,569 locations are owned by our 360 franchisees. The company receives a percentage of franchise sales, and it profits from development fees when new restaurants open.

In 2007 Popeyes was struggling for several reasons, including a lack of strategy and too much short-term thinking. Very little consideration had been given to new-product innovation. We had no arsenal of brand-building ideas. We also had no national advertising, so consumer awareness was low. Those problems, along with poor financial results, created an angry and frustrated group of franchisees. At one point some of them showed up uninvited to a Popeyes board meeting to demand changes. After the CEO resigned, I was asked to serve on the board search committee to hire a replacement. We offered the job to two candidates, but both turned it down. When the board asked me to step in as CEO, I knew it would be a difficult assignment. I also knew that it was in my sweet spot: a turnaround of a franchise-based enterprise.

After the contentious Orlando meeting, the leadership team convened in Atlanta to create a business plan. We also took a day to explore what kind of leaders we wanted to be. We made lists of our best bosses and worst bosses and described what made them good or bad. (The "worst" list was much longer.) The conversation led us to a model called servant leadership, in which leaders put the people of the enterprise above self-interest.

> Our franchisees have mortgaged their homes or taken out large loans to open restaurants. They have signed 20-year agreements. No one has more skin in the game.

Then we talked about the company's various stakeholders: guests, shareholders, franchisees, employees, directors, suppliers. The main question was, Which group would be our top priority? The CFO argued for shareholders, and he had a point—the stock had dropped from $34 to $14. We also discussed our guests. Many of us had worked for franchised food companies that prioritize guests first, and we'd seen how that can go wrong. Some chains try to legislate their way to better customer service by creating rules that *must* be followed. (For instance, the restrooms *must* be cleaned every 30 minutes.) But a number of intermediaries separate a chain's corporate headquarters from the customer in line at a quick-serve restaurant—the franchisee, the general manager, the shift supervisor, the restaurant team member. Unless all of them work together, the effort will certainly break down. At one point in my career, I was touring restaurants to talk to team members about the importance of serving guests well. I met a young man who was not excited about my "lesson." He asked who I was. "I'm Cheryl," I said. "Well, Cheryl," he said, "there's no place for me to hang up my coat in this restaurant, and until you think I'm important enough to have a hook where I can hang up my coat, I can't get excited about your new guest-experience program." It was a crucial reminder that we are in service to others—they are not in service to us.

The more my team and I talked about it, the more we saw the franchisees as our primary customers. They have mortgaged their homes or taken out large loans to open restaurants. They have signed 20-year agreements. No one has more skin in the game—they have no plan B. If we use our influence on the franchisee, he can bring his influence to bear on the restaurant manager and the frontline team members. To get a benchmark, we conducted our first franchisee satisfaction survey. We also began focusing on the metric that matters most to owners, which is restaurant-level profitability. Franchisees depend on those profits for their income and for the cash flow to open new locations. We hadn't even been measuring that number, but we began tracking it closely.

A Big Ask

Early on, we called a meeting of our vice presidents and directors and discussed a range of issues facing Popeyes, such as the speed of our drive-through windows (which was poor). We did that classic exercise in which everyone puts a Post-it note on the problem he or she thinks should be solved first. The most revealing moment came when someone named Sondra, who'd worked at Popeyes for more than 20 years, said, "We put these problems on the wall every year, but nothing ever changes." I was initially shocked, but I appreciated her candor. It was a reminder of the energy wasted in corporate America while people focus on work that isn't producing results. Even CEOs shy away from hard things—they worry about getting the board aligned, or finding the money to pay for a project. I told Sondra that we wanted to be the group that finally fixed problems—not all of them, but the few on which we could focus to make the most impact. We ended up listing seven priorities on our strategic road map, and in the end we accomplished only three of them—but we did them brilliantly.

The pivotal moment in the turnaround came when we tried to sell our business plan to the franchisees. We met 10 franchise leaders in a windowless hotel conference room in Chicago. At that time, all Popeyes advertising was controlled locally, and each franchisee contributed 3% of sales to pay for ads. Our plan called for increasing that number to 4% and creating a national ad campaign, to coordinate the brand message and drive awareness. We brought in an outside expert who described the chain as being at an inflection point: The time was right to make the move from local to national advertising. The franchisees asked us to sit in the hallway while they debated the idea. When we came back in, they said they'd agree—if the company would invest $6 million to increase the number of weeks of advertising. That was a big ask. It would require board approval and would lower our earnings, disappointing Wall Street. But it was essential to gaining systemwide franchise alignment. We committed the dollars and saw it through, even when the economy went into recession in the fall of 2008. National advertising was the first critical step in driving the Popeyes turnaround.

We made some missteps along the way. We introduced some value-oriented items, including a mini chicken tortilla wrap, and people traded down to the cheaper choices, lowering the average check. But we kept at it, we found some winning new products, and sales and profitability began to improve. We developed a cadence for new-product launches. We began using sophisticated software to help franchisees choose the best locations for new restaurants, dramatically increasing their success rates. Our market share grew from the teens to the mid-20s. We attracted franchisees who owned other fast-food restaurants and wanted to open a Popeyes. A third of our stores have been built in the past five years. We're opening more than 200 global locations a year, which puts us in the top tier of quick-service restaurants. We've had eight years of success—an unusual streak of steady growth in our industry.

> In franchising you're only as good as yesterday's results. There is no emotional bank account into which you can make deposits.

An Act of Stewardship

Although our numbers got better, the franchisees' trust in us didn't improve as much as I had hoped. Franchisees have elephants' memories. As the turnaround took hold, we had some meetings with owners that required outside facilitators to keep everyone calm; the two sides would be in opposite corners, as if in a boxing ring, with arms folded across their chests. In franchising you're only as good as yesterday's results—there is no emotional bank account into which you can make deposits. It feels unfair sometimes, but it's our job to keep modeling and earning trust.

Despite that complicated dynamic, I believe deeply in the franchise model. Starting a business from scratch is very risky, and franchising allows people to invest in a proven brand, reducing that risk. It lets them pursue the American dream: 40% of Popeyes franchisees in the U.S. are first-generation immigrants. Franchising is at the heart of a thriving economy, because it lowers risk for start-ups and creates a large number of entry-level and management jobs. One-quarter of Americans say their first job was in a restaurant—often a fast-food franchise.

The Popeyes turnaround has become a case study in what happens when leaders think about serving others—in this case, our franchisees. Leadership is an act of stewardship, not a practice that's solely for your personal benefit. The test of our leadership is simple: Are the people entrusted to our care better off? That lesson is not discussed much in business schools, and it's not the model that many leaders of my generation have demonstrated. In fact, a lot of Baby Boomers are too concerned about their own résumés, their wealth, and their next job. Instead, we need to be teaching young leaders how to *serve*—as a path to generating superior results. I'm excited about that opportunity. Today young leaders are more purposeful and intentional than my generation, and they're hungry for a new model of leadership that will make a positive difference in the world.

HBR Reprint R1610A

Daniel Kahneman is the Eugene Higgins Professor of Psychology Emeritus at Princeton University. He was awarded the Nobel Prize in Economic Sciences in 2002 for his work (with Amos Tversky) on cognitive biases. **Andrew M. Rosenfield** is the CEO and managing partner of The Greatest Good Group (TGG Group). **Linnea Gandhi** and **Tom Blaser** are managing directors at TGG Group.

INCONSISTENT DECISION MAKING IS A HUGE HIDDEN COST FOR MANY COMPANIES. HERE'S HOW TO OVERCOME WHAT WE CALL

ISE

BY DANIEL KAHNEMAN, ANDREW M. ROSENFIELD, LINNEA GANDHI, AND TOM BLASER

GONNY GONG

At a global financial services firm we worked with, a longtime customer accidentally submitted the same application file to two offices. Though the employees who reviewed the file were supposed to follow the same guidelines—and thus arrive at similar outcomes—the separate offices returned very different quotes. Taken aback, the customer gave the business to a competitor. From the point of view of the firm, employees in the same role should have been interchangeable, but in this case they were not. Unfortunately, this is a common problem.

Professionals in many organizations are assigned arbitrarily to cases: appraisers in credit-rating agencies, physicians in emergency rooms, underwriters of loans and insurance, and others. Organizations expect consistency from these professionals: Identical cases should be treated similarly, if not identically. The problem is that humans are unreliable decision makers; their judgments are strongly influenced by irrelevant factors, such as their current mood, the time since their last meal, and the weather. We call the chance variability of judgments *noise*. It is an invisible tax on the bottom line of many companies.

Some jobs are noise-free. Clerks at a bank or a post office perform complex tasks, but they must follow strict rules that limit subjective judgment and guarantee, by design, that identical cases will be treated identically. In contrast, medical professionals, loan officers, project managers, judges, and executives all make judgment calls, which are guided by informal experience and general principles rather than by rigid rules. And if they don't reach precisely the same answer that every other person in their role would, that's acceptable; this is what we mean when we say that a decision is "a matter of judgment." A firm whose employees exercise judgment does not expect decisions to be entirely free of noise. But often noise is *far above* the level that executives would consider tolerable—and they are completely unaware of it.

The prevalence of noise has been demonstrated in several studies. Academic researchers have repeatedly confirmed that professionals often contradict their own prior judgments when given the same data on different occasions. For instance, when software developers were asked on two separate days to estimate the completion time for a given task, the hours they projected differed by 71%, on average. When pathologists made two assessments of the severity of biopsy results, the correlation between their ratings was only .61 (out of a perfect 1.0), indicating that they made inconsistent diagnoses quite frequently. Judgments made by different people are even more likely to diverge. Research has confirmed that in many tasks, experts' decisions are highly variable: valuing stocks, appraising real estate, sentencing criminals, evaluating job performance, auditing financial statements, and more. The unavoidable conclusion is that professionals often make decisions that deviate significantly from those of their peers, from their own prior decisions, and from rules that they themselves claim to follow.

Noise is often insidious: It causes even successful companies to lose substantial amounts of money without realizing it. How substantial? To get an estimate, we asked executives in one of the organizations we studied the following: "Suppose the optimal assessment of a case is $100,000. What would be the cost to the organization if the professional in charge of the case assessed a value of $115,000? What would be the cost of assessing it at $85,000?" The cost estimates were high. Aggregated over the assessments made every year, the cost of noise was measured in billions—an unacceptable number even for a large global firm. The value of reducing noise even by a few percentage points would be in

Idea in Brief

THE PROBLEM
Many organizations expect consistency from their professional employees. However, human judgment is often influenced by such irrelevant factors as the weather and the last case seen. More important, decisions often vary from employee to employee. The chance variability of judgments is called *noise,* and it is surprisingly costly to companies.

THE STARTING POINT
Managers should perform a noise audit in which members of a unit, working independently, evaluate a common set of cases. The degree to which their decisions vary is the measure of noise. It will often be dramatically higher than executives anticipate.

THE SOLUTION
The most radical solution to a severe noise problem is to replace human judgment with algorithms. Algorithms are not difficult to construct—but often they're politically or operationally infeasible. In such instances, companies should establish procedures to help professionals achieve greater consistency.

the tens of millions. Remarkably, the organization had completely ignored the question of consistency until then.

It has long been known that predictions and decisions generated by simple statistical algorithms are often more accurate than those made by experts, even when the experts have access to more information than the formulas use. It is less well known that the key advantage of algorithms is that they are noise-free: Unlike humans, a formula will always return the same output for any given input. Superior consistency allows even simple and imperfect algorithms to achieve greater accuracy than human professionals. (Of course, there are times when algorithms will be operationally or politically infeasible, as we will discuss.)

In this article we explain the difference between noise and bias and look at how executives can audit the level and impact of noise in their organizations. We then describe an inexpensive, underused method for building algorithms that remediate noise, and we sketch out procedures that can promote consistency when algorithms are not an option.

Noise vs. Bias

When people consider errors in judgment and decision making, they most likely think of social biases like the stereotyping of minorities or of cognitive biases such as overconfidence and unfounded optimism. The useless variability that we call noise is a different type of error. To appreciate the distinction, think of your bathroom scale. We would say that the scale is *biased* if its readings are generally either too high or too low. If your weight appears to depend on where you happen to place your feet, the scale is *noisy.* A scale that consistently underestimates true weight by exactly four pounds is seriously biased but free of noise. A scale that gives two different readings when you step on it twice is noisy. Many errors of measurement arise from a combination of bias and noise. Most inexpensive bathroom scales are somewhat biased and quite noisy.

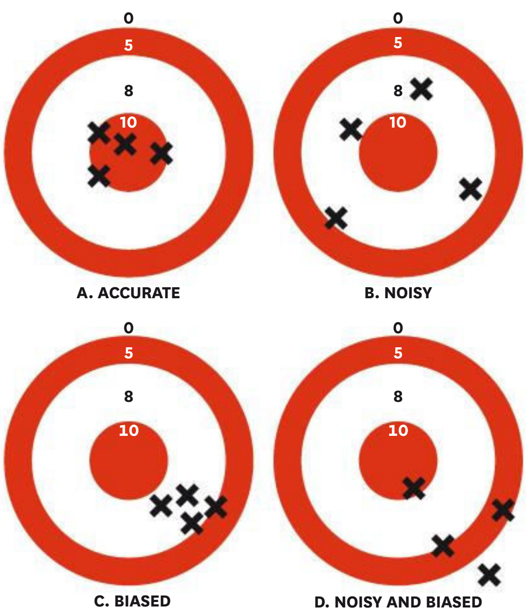
For a visual illustration of the distinction, consider the targets in the exhibit "How Noise and Bias Affect Accuracy." These show the results of target practice for four-person teams in which each individual shoots once.

- Team A is *accurate:* The shots of the teammates are on the bull's-eye and close to one another.

The other three teams are inaccurate but in distinctive ways:

- Team B is *noisy:* The shots of its members are centered around the bull's-eye but widely scattered.

HOW NOISE AND BIAS AFFECT ACCURACY



- Team C is *biased:* The shots all missed the bull's-eye but cluster together.
- Team D is both *noisy* and *biased*.

As a comparison of teams A and B illustrates, an increase in noise always impairs accuracy when there is no bias. When bias is present, increasing noise may actually cause a lucky hit, as happened for team D. Of course, no organization would put its trust in luck. Noise is always undesirable—and sometimes disastrous.

It is obviously useful to an organization to know about bias and noise in the decisions of its employees, but collecting that information isn't straightforward. Different issues arise in measuring these errors. A major problem is that the outcomes of decisions often aren't known until far in the future, if at all. Loan officers, for example, frequently must wait several years to see how loans they approved worked out, and they almost never know what happens to an applicant they reject.

Unlike bias, noise can be measured without knowing what an accurate response would be. To illustrate, imagine that the targets at which the shooters aimed were erased from the exhibit. You would know nothing about the teams' overall accuracy, but you could be certain that something was wrong with the scattered shots of teams B and D: Wherever the bull's-eye was, they did not all come close to hitting it. All that's required to measure noise in judgments is a simple experiment in which a few realistic cases are evaluated independently by several professionals. Here again, the scattering of judgments can be observed without knowing the correct answer. We call such experiments *noise audits*.

WHERE THERE IS JUDGMENT, THERE IS NOISE—AND USUALLY MORE OF IT THAN YOU THINK.

Performing a Noise Audit

The point of a noise audit is not to produce a report. The ultimate goal is to improve the quality of decisions, and an audit can be successful only if the leaders of the unit are prepared to accept unpleasant results and act on them. Such buy-in is easier to achieve if the executives view the study as their own creation. To that end, the cases should be compiled by respected team members and should cover the range of problems typically encountered. To make the results relevant to everyone, all unit members should participate in the audit. A social scientist with experience in conducting rigorous behavioral experiments should supervise the technical aspects of the audit, but the professional unit must own the process.

Recently, we helped two financial services organizations conduct noise audits. The duties and expertise of the two groups we studied were quite different, but both required the evaluation of moderately complex materials and often involved decisions about hundreds of thousands of dollars. We followed the same protocol in both organizations. First we asked managers of the professional teams involved to construct several realistic case files for evaluation. To prevent information about the experiment from leaking, the entire exercise was conducted on the same day. Employees were asked to spend about half the day analyzing two to four cases. They were to decide on a dollar amount for each, as in their normal routine. To avoid collusion, the participants were not told that the study was concerned with reliability. In one organization, for example, the goals were described as understanding the employees' professional thinking, increasing their tools' usefulness, and improving communication among colleagues. About 70 professionals in organization A participated, and about 50 in organization B.

We constructed a noise index for each case, which answered the following question: "By how much do the judgments of two randomly chosen employees differ?" We expressed this amount as a percentage of their average. Suppose the assessments of a case by two employees are \$600 and \$1,000. The average of their assessments is \$800, and the difference between them is \$400, so the noise index is 50% for this pair. We performed the same computation for all pairs of employees and then calculated an overall average noise index for each case.

Pre-audit interviews with executives in the two organizations indicated that they expected the differences between their professionals' decisions to range from 5% to 10%—a level they considered acceptable for "matters of judgment." The results came as a shock. The noise index ranged from 34% to 62% for the six cases in organization A, and the overall average was 48%. In the four cases in organization B, the noise index ranged from 46% to 70%, with an average of 60%. Perhaps most disappointing, experience on the job did not appear to reduce noise. Among professionals with five or more years on the job, average disagreement was 46% in organization A and 62% in organization B.

No one had seen this coming. But because they owned the study, the executives in both organizations accepted the conclusion that the judgments of their professionals were unreliable to an extent that could not be tolerated. All quickly agreed that something had to be done to control the problem.

Because the findings were consistent with prior research on the low reliability of professional judgment, they didn't surprise us. The major puzzle for us was the fact that neither organization had ever considered reliability to be an issue.

The problem of noise is effectively invisible in the business world; we have observed that audiences are quite surprised when the reliability of professional judgment is mentioned as an issue. What prevents companies from recognizing that the judgments of their employees are noisy? The answer lies in two familiar phenomena: Experienced professionals tend to have high confidence in the accuracy of their own judgments, and they also have high regard for their colleagues' intelligence. This combination inevitably leads to an overestimation of agreement. When asked about what their colleagues would say, professionals expect others' judgments to be much closer to their own than they actually are. Most of the time, of course, experienced professionals are completely unconcerned with what others might think and simply assume that theirs is the best answer. One reason the problem of noise is invisible is that people do not go through life imagining plausible alternatives to every judgment they make.

The expectation that others will agree with you is sometimes justified, particularly where judgments are so skilled that they are intuitive. High-level chess and driving are standard examples of tasks that have been practiced to near perfection. Master players who look at a situation on a chessboard will all have very similar assessments of the state of the game—whether, say, the white queen is in danger or black's king-side defense is weak. The same is true of drivers. Negotiating traffic would be impossibly dangerous if we could not assume that the drivers around us share our understanding of priorities at intersections and roundabouts. There is little or no noise at high levels of skill.

Types of Noise and Bias

Bias and noise are distinct kinds of error. Each comes in different variants and requires different corrective actions.

TYPE OF BIAS	EXAMPLES	CORRECTIVE ACTIONS
GENERAL The average judgment is wrong.	• Planning fallacy: Forecasts of outcomes are mostly optimistic • Excessive risk aversion: A venture capital firm rejects too many promising but risky investments	• Continual monitoring of decisions • Guidelines and targets for the frequency of certain outcomes (such as loan approvals) • Eliminating incentives that favor biases
SOCIAL Discrimination occurs against—or for—certain categories of cases.	• Frequent denial of credit to qualified applicants from certain ethnic groups • Gender bias in assessments of job performance	• Monitoring statistics for different groups • Blinding of applications • Objective and quantifiable metrics • Open channels for complaints • Guidelines and training
COGNITIVE Decisions are strongly influenced by irrelevant factors or insensitive to relevant ones.	• Excessive effects of first impressions • Effects of anchors (such as an opening offer in negotiation) • Myopic neglect of future consequences	• Training employees to detect situations in which biases are likely to occur • Critiques of important decisions, focused on likely biases
TYPE OF NOISE	**EXAMPLES**	**CORRECTIVE ACTIONS**
VARIABILITY ACROSS OCCASIONS Decisions vary when the same case is presented more than once to the same individual.	• A hiring officer's judgments of a file are influenced by her mood or the quality of the previous applicant	• Algorithms to replace human judgment • Checklists that encourage a consistent approach to decisions
VARIABILITY ACROSS INDIVIDUALS Professionals in the same role make different decisions.	• Some individuals are generally more lenient than others • Some individuals are more cautious than others	• Algorithms to replace human judgment • Frequent monitoring of individuals' decisions • Roundtables at which differences are explored and resolved • Checklists that encourage a consistent approach to decisions

High skill develops in chess and driving through years of practice in a predictable environment, in which actions are followed by feedback that is both immediate and clear. Unfortunately, few professionals operate in such a world. In most jobs people learn to make judgments by hearing managers and colleagues explain and criticize—a much less reliable source of knowledge than learning from one's mistakes. Long experience on a job always increases people's confidence in their judgments, but in the absence of rapid feedback, confidence is no guarantee of either accuracy or consensus.

We offer this aphorism in summary: *Where there is judgment, there is noise—and usually more of it than you think.* As a rule, we believe that neither professionals nor their managers can make a good guess about the reliability of their judgments. The only way to get an accurate assessment is to conduct a noise audit. And at least in some cases, the problem will be severe enough to require action.

Dialing Down the Noise

The most radical solution to the noise problem is to replace human judgment with formal rules—known as algorithms—that use the data about a case to produce a prediction or a decision. People have competed against algorithms in several hundred contests of accuracy over the past 60 years, in tasks ranging from predicting the life expectancy of cancer patients to predicting the success of graduate students. Algorithms were more accurate than human professionals in about half the studies, and approximately tied with the humans in the others. The ties should also count as victories for the algorithms, which are more cost-effective.

In many situations, of course, algorithms will not be practical. The application of a rule may not be feasible when inputs are idiosyncratic or hard to code in a consistent format. Algorithms are also less likely to be useful for judgments or decisions that involve multiple dimensions or depend on negotiation with another party. Even when an algorithmic solution is available in principle, organizational considerations sometimes prevent implementation. The replacement of existing employees by software is a painful process that will encounter resistance unless it frees those employees up for more-enjoyable tasks.

But if the conditions are right, developing and implementing algorithms can be surprisingly easy. The common assumption is that algorithms require statistical analysis of large amounts of data. For example, most people we talk to believe that data on thousands of loan applications and their outcomes is needed to develop an equation that predicts commercial loan defaults. Very few know that adequate algorithms can be developed without any outcome data at all—and with input information on only a small number of cases. We call predictive formulas that are built without outcome data "reasoned rules," because they draw on commonsense reasoning.

STUDIES HAVE SHOWN THAT WHILE HUMANS CAN PROVIDE USEFUL INPUT, ALGORITHMS DO BETTER IN THE ROLE OF FINAL DECISION MAKER.

The construction of a reasoned rule starts with the selection of a few (perhaps six to eight) variables that are incontrovertibly related to the outcome being predicted. If the outcome is loan default, for example, assets and liabilities will surely be included in the list. The next step is to assign these variables equal weight in the prediction formula, setting their sign in the obvious direction (positive for assets, negative for liabilities). The rule can then be constructed by a few simple calculations. (For more details, see the sidebar "How to Build a Reasoned Rule.")

The surprising result of much research is that in many contexts reasoned rules are about as accurate as statistical models built with outcome data. Standard statistical models combine a set of predictive variables, which are assigned weights based on their relationship to the predicted outcomes and to one another. In many situations, however, these weights are both statistically unstable and practically unimportant. A simple rule that assigns equal weights to the selected variables is likely to be just as valid. Algorithms that weight variables equally and don't rely on outcome data have proved successful in personnel selection, election forecasting, predictions about football games, and other applications.

The bottom line here is that if you plan to use an algorithm to reduce noise, you need not wait for outcome data. You can reap most of the benefits by using common sense to select variables and the simplest possible rule to combine them.

Of course, no matter what type of algorithm is employed, people must retain ultimate control. Algorithms must be monitored and adjusted for occasional changes in the population of cases. Managers must also keep an eye on individual decisions and have the authority to override the algorithm in clear-cut cases. For example, a decision to approve a loan should be provisionally reversed if the firm discovers that the applicant has been arrested. Most important, executives should determine how to translate the algorithm's output into action. The algorithm can tell you which prospective loans are in the top 5% or in the bottom 10% of all applications, but someone must decide what to do with that information.

Algorithms are sometimes used as an intermediate source of information for professionals, who make the final decisions. One example is the Public Safety Assessment, a formula that was developed to help U.S. judges decide whether a defendant can be safely released pending trial. In its first six months of use in Kentucky, crime among defendants on pretrial release fell by about 15%, while the percentage of people released pretrial increased. It's obvious in

this case that human judges must retain the final authority for the decisions: The public would be shocked to see justice meted out by a formula.

Uncomfortable as people may be with the idea, studies have shown that while humans can provide useful input to formulas, algorithms do better in the role of final decision maker. If the avoidance of errors is the only criterion, managers should be strongly advised to overrule the algorithm only in exceptional circumstances.

Bringing Discipline to Judgment

Replacing human decisions with an algorithm should be considered whenever professional judgments are noisy, but in most cases this solution will be too radical or simply impractical. An alternative is to adopt procedures that promote consistency by ensuring that employees in the same role use similar methods to seek information, integrate it into a view of the case, and translate that view into a decision. A thorough examination of everything required to do that is beyond the scope of this article, but we can offer some basic advice, with the important caveat that instilling discipline in judgment is not at all easy.

Training is crucial, of course, but even professionals who were trained together tend to drift into their own way of doing things. Firms sometimes combat drift by organizing roundtables at which decision makers gather to review cases. Unfortunately, most roundtables are run in a way that makes it much too easy to achieve agreement, because participants quickly converge on the opinions stated first or most confidently. To prevent such spurious agreement, the individual participants in a roundtable should study the case independently, form opinions they're prepared to defend, and send those opinions to the group leader before the meeting. Such roundtables will effectively provide an audit of noise, with the added step of a group discussion in which differences of opinion are explored.

As an alternative or addition to roundtables, professionals should be offered user-friendly tools, such as checklists and carefully formulated questions, to guide them as they collect information about a case, make intermediate judgments, and formulate a final decision. Unwanted variability occurs at each of those stages, and firms can—and should—test how much such tools reduce it. Ideally, the people who use these tools will view them as aids that help them do their jobs effectively and economically.

How to Build a Reasoned Rule

You don't need outcome data to create useful predictive algorithms. For example, you can build a reasoned rule that predicts loan defaults quite effectively without knowing what happened to past loans; all you need is a small set of recent loan applications. Here are the next steps:

1 Select six to eight variables that are distinct and obviously related to the predicted outcome. Assets and revenues (weighted positively) and liabilities (weighted negatively) would surely be included, along with a few other features of loan applications.

2 Take the data from your set of cases (all the loan applications from the past year) and compute the mean and standard deviation of each variable in that set.

3 For every case in the set, compute a "standard score" for each variable: the difference between the value in the case and the mean of the whole set, divided by the standard deviation. With standard scores, all variables are expressed on the same scale and can be compared and averaged.

4 Compute a "summary score" for each case—the average of its variables' standard scores. This is the output of the reasoned rule. The same formula will be used for new cases, using the mean and standard deviation of the original set and updating periodically.

5 Order the cases in the set from high to low summary scores, and determine the appropriate actions for different ranges of scores. With loan applications, for instance, the actions might be "the top 10% of applicants will receive a discount" and "the bottom 30% will be turned down."

You are now ready to apply the rule to new cases. The algorithm will compute a summary score for each new case and generate a decision.

Unfortunately, our experience suggests that the task of constructing judgment tools that are both effective and user-friendly is more difficult than many executives think. Controlling noise is hard, but we expect that an organization that conducts an audit and evaluates the cost of noise in dollars will conclude that reducing random variability is worth the effort.

OUR MAIN GOAL in this article is to introduce managers to the concept of noise as a source of errors and explain how it is distinct from bias. The term "bias" has entered the public consciousness to the extent that the words "error" and "bias" are often used interchangeably. In fact, better decisions are not achieved merely by reducing general biases (such as optimism) or specific social and cognitive biases (such as discrimination against women or anchoring effects). Executives who are concerned with accuracy should also confront the prevalence of inconsistency in professional judgments. Noise is more difficult to appreciate than bias, but it is no less real or less costly.

HBR Reprint R1610B

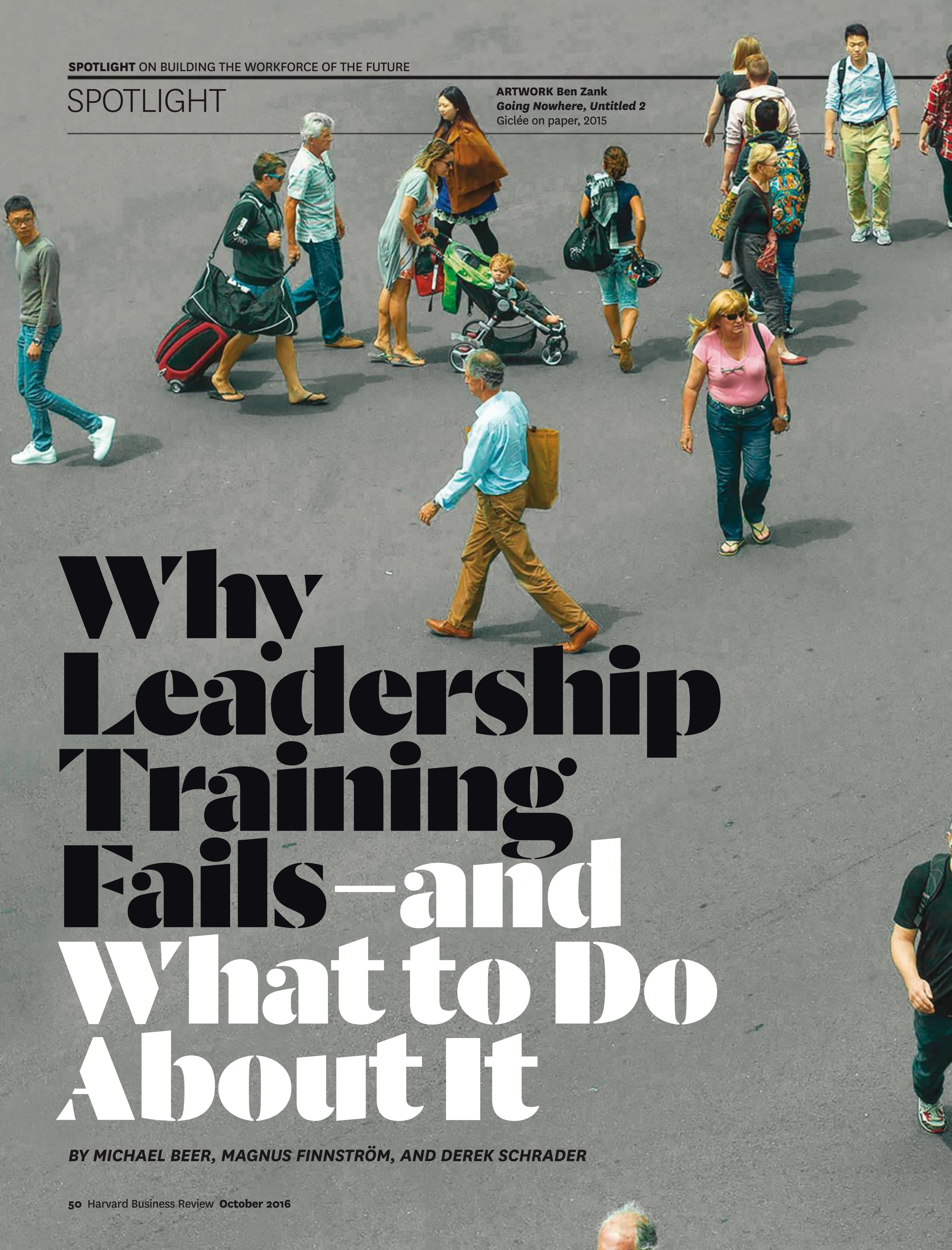
SPOTLIGHT

Building the Workforce of the Future

ARTWORK Ben Zank
Going Nowhere, Untitled 3 (detail)
Giclée on paper, 2015

SPOTLIGHT

ARTWORK Ben Zank
Going Nowhere, Untitled 2
Giclée on paper, 2015



Why Leadership Training Fails—and What to Do About It

BY MICHAEL BEER, MAGNUS FINNSTRÖM, AND DEREK SCHRADER

Corporations are victims of the great training robbery. American companies spend enormous amounts of money on employee training and education—$160 billion in the United States and close to $356 billion globally in 2015 alone—but they are not getting a good return on their investment. For the most part, the learning doesn't lead to better organizational performance, because people soon revert to their old ways of doing things.

Consider the micro-electronic products division (MEPD) at a company we'll call SMA, which one of us studied. SMA invested in a training program to improve leadership and organizational effectiveness. MEPD was one of the first business units to implement it, and virtually every salaried employee in the division attended.

Participants described the program as very powerful. For a whole week they engaged in numerous tasks that required teamwork, and they received real-time feedback on both individual and group behavior. The program ended with a plan for taking the learning back into the organization. Pre- and post-training surveys suggested that participants' attitudes had changed.

A couple of years later, when a new general manager came in to lead the division, he requested an assessment of the costly program. As it turned out, managers thought little had changed as a result of the training, even though it had been inspiring at the time. They found it impossible to apply what they had learned about teamwork and collaboration, because of a number of managerial and organizational barriers: a lack of strategic clarity, the previous GM's top-down style, a politically charged environment, and cross-functional conflict. "[The previous GM] had a significant impact on our organization, with all of us reflecting him in our managerial style," a member of the division's senior team explained during an interview. "We are all more authoritarian than before."

As a change strategy, training clearly had not worked. It rarely does, as we have found in our research and teaching and in the advising we've done at dozens of companies. One manufacturer, for instance, suffered multiple fatalities at its operating plants despite a $20 million investment in a state-of-the-art center for safety training. Participants in corporate education programs often tell us that the context in which they work makes it difficult for them to put what they're taught into practice.

Still, senior executives and their HR teams continue to pour money into training, year after year, in an effort to trigger organizational change. But what they actually need is a new way of thinking about learning and development. Context sets the stage for success or failure, so it's important to attend to organizational design and managerial processes first and *then* support them with individual development tools such as coaching and classroom or online education.

A Closer Look at What Goes Wrong

Education with the objective of individual growth is worthy in its own right, of course, and people are eager to acquire knowledge and skills that will help them advance in their careers. However, the primary reason senior executives and HR invest in management training is to make their leaders and organizations more effective, and results on that front have been disappointing. Three-quarters of the nearly 1,500 senior managers at 50 organizations interviewed in 2011 by the Corporate Leadership Council were dissatisfied with their companies' learning and development function. Only one in four reported that it was critical to achieving business outcomes. Decades' worth of studies show why it isn't working, but, sadly, that understanding has not made its way into most companies.

Researchers noted problems with training programs as early as the 1950s, during the seminal Ohio State leadership studies. They found that one program had succeeded in changing frontline supervisors' attitudes about how they should manage, but a follow-up study revealed that most supervisors had then regressed to their pre-training views. The only exceptions were those whose bosses practiced and

Only one in four senior managers report that their learning and development function was critical to achieving business outcomes.

Idea in Brief

THE PROBLEM
Companies are dumping billions of dollars into training and development programs—but their investments aren't paying off.

THE REASON
Six common managerial and organizational barriers prevent people from applying what they've learned, no matter how smart and motivated they are.

THE SOLUTION
To create a favorable context for learning and growth, senior executives must first attend to organizational design—both at the very top and unit by unit.

believed in the new leadership style the program was designed to teach.

Then, in the 1980s, one of us helped conduct a study showing that training programs did not facilitate organizational change: Companies that tried to launch major transformations by training hundreds or thousands of employees across many units to behave differently lagged the only company (in a sample of six) that didn't kick-start its transformation this way. The problem was that even well-trained and motivated employees could not apply their new knowledge and skills when they returned to their units, which were entrenched in established ways of doing things. In short, the individuals had less power to change the system surrounding them than that system had to shape them.

The idea that organizational systems—which define roles, responsibilities, and relationships—have a strong impact on individuals' mindsets and behavior is supported by a number of studies. For instance, research by Seymour Lieberman, of the Institute for Social Research at the University of Michigan, found that unionized frontline workers promoted to supervisory roles adopted pro-management attitudes, and managers forced by a recession to return to frontline jobs reverted to pro-union and antimanagement attitudes. Further reinforcing the idea, Harvard Business School professor Boris Groysberg found that "star" analysts on Wall Street, as rated by an independent agency, did not perform as well or maintain their star status after moving to another firm. In fact, most of them never regained that status during the five-year study. Those who did had taken their teams—the systems that had helped them succeed—with them when they changed companies.

Those findings dovetail with research—by Amy Edmondson, of HBS, and Anita Woolley, of Carnegie Mellon—showing that organizations need "fertile soil" in place before the "seeds" of training interventions can grow. When the researchers looked at a corporate training program aimed at improving problem solving and communication between managers and subordinates, they discovered that success varied across the company. Improvements were greater in units that had already developed a "psychologically safe" climate in which subordinates felt free to speak up.

From all these streams of research we've learned that education and training gain the most traction within highly visible organizational change and development efforts championed by senior leaders. That's because such efforts motivate people to learn and change; create the conditions for them to apply what they've studied; foster immediate improvements in individual and organizational effectiveness; and put in place systems that help sustain the learning.

A poor return on investment isn't the only bad outcome of failed training initiatives. Employees below the top become cynical. Corporate leaders may fool themselves into believing that they are implementing real change through corporate education, but others in the organization know better, as we saw in the MEPD example. Why don't leaders get this? For two reasons.

First, they implicitly view the organization as *an aggregation of individuals*. By that logic, people must be selected for and developed with the "right" knowledge, skills, and attitudes in order to improve the institution's effectiveness and performance. So HR defines the requisite individual competencies according to the company's strategy and then sells top management on training programs designed to develop those competencies, believing that organizational change will follow.

This widely embraced development model doesn't acknowledge that organizations are *systems of interacting elements*: Roles, responsibilities, and relationships are defined by organizational structure, processes, leadership styles, people's professional and cultural backgrounds, and HR policies and practices. And it doesn't recognize that all those elements together drive organizational behavior and performance. If the system does not change, it will not support and sustain individual behavior change—indeed, it will set people up to fail. (See the exhibit "Throwing Out Flawed Assumptions About Capability Development.")

Second, HR managers and others find it difficult or impossible to confront senior leaders and their teams with an uncomfortable truth: A failure to execute on strategy and change organizational behavior is rooted not in individuals' deficiencies but, rather, in the policies and practices created by top management. *Those* are the things to fix before training can succeed longer-term. It's much easier for HR to point to employees' competencies as the problem and to training as the clear solution. That's a message senior leaders are receptive to hearing.

Overcoming Barriers to Change

In our work helping managers have honest conversations about the effectiveness of their organizations, we hear about six common barriers. Companies consistently struggle with (1) unclear direction on strategy and values, which often leads to conflicting priorities; (2) senior executives who don't work as a team and haven't committed to a new direction or acknowledged necessary changes in their own behavior; (3) a top-down or laissez-faire style by the leader, which prevents honest conversation about problems; (4) a lack of coordination across businesses, functions, or regions due to poor organizational design; (5) inadequate leadership time and attention given to talent issues; and (6) employees' fear of telling the senior team about obstacles to the organization's effectiveness.

Because of that fear, we call these barriers "silent killers." They almost always appear together, and they block the systemic changes needed to make training and education programs effective. We saw firsthand how they initially thwarted leadership development at a UK medical technology company. The CEO, unsatisfied with his management bench, sought advice on building it out. Though his partners in HR recommended investments in training, he instead took a step back and asked us to help his senior team enable managers in the organization to speak truth to power about barriers to their development.

A task force empowered to conduct confidential interviews reported that lack of training was not the issue. Rather, the senior team had not articulated a clear strategy and corporate values, so managers did not understand what practices and behaviors were expected of them. Nor did the top team spend much time discussing talent and planning developmental assignments for high potentials. In fact, because senior management had not created an integrated corporation, leaders were hoarding the best talent and transferring the worst to enable their own business units to succeed. Clearly, the company had to tackle these systemic issues before it could implement a productive learning program for managers. Indeed, improving cross-unit integration would itself be a capability-development experience for the senior team and key managers that would lead to a better understanding of skills gaps that training and education might address.

This is the approach to talent development that we advocate, in six basic steps:

If the system does not change, it will not support and sustain individual behavior change— indeed, it will set people up to fail.

THROWING OUT FLAWED ASSUMPTIONS ABOUT CAPABILITY DEVELOPMENT

The usual logic:	**More effective:**
Problems of organizational behavior and performance stem from the deficiencies of individuals.	Problems of organizational behavior and performance stem from a poorly designed and ineffectively managed system.
Improving employees' knowledge, skills, and attitudes will strengthen organizational effectiveness and performance.	Changing that system to both support and demand new behaviors will enable learning and improve effectiveness and performance.
So...	**So...**
The target for change and development is the individual.	The primary target for change and development is the organization—followed by training for individuals.

1. The senior team clearly defines values and an inspiring strategic direction.
2. After gathering candid, anonymous observations and insights from managers and employees, the team diagnoses barriers to strategy execution and learning. It then redesigns the organization's roles, responsibilities, and relationships to overcome those barriers and motivate change.
3. Day-to-day coaching and process consultation help people become more effective in that new design.
4. The organization adds training where needed.
5. Success in changing behavior is gauged using new metrics for individual and organizational performance.
6. Systems for selecting, evaluating, developing, and promoting talent are adjusted to reflect and sustain the changes in organizational behavior.

Note that problems are diagnosed from the ground up. Those confidential employee interviews are critical for exposing the silent killers, including deficiencies in capabilities and talent management, because leaders often lack the objectivity to spot glitches in systems they have created. By addressing management practices and leadership behavior that shape the system before training individual employees, leaders create a favorable context for applying learning. The systemic changes encourage—even require—the desired behaviors.

In practice, these steps tend to overlap and are periodically recycled for continual improvement. We list them in sequence to emphasize the importance of placing individual development *after* organizational redesign. You also want leaders, their senior teams, and lower-level managers to develop on the job, as they learn individually and collectively to enact their redefined roles, responsibilities, and relationships. A consultant in HR can take advantage of real-time successes and failures to help managers reflect on the consequences of their actions and see alternatives. This "in vivo" approach also allows people to learn *how* to learn so that they can adapt to ever-changing circumstances—something that classroom training won't equip them to do. Just as important, learning and performance improvements occur simultaneously, enabling the business to recoup its investment immediately and more effectively.

To illustrate, let's return to the example at the beginning of this article. After SMA's micro-electronic products division found that its initial training hadn't changed ineffective patterns of behavior, it followed the six steps, with much better results. The new general manager asked organizational development specialists to interview key managers and professionals in every function and activity in MEPD's value chain. Their diagnosis revealed why and how interfunctional conflict, political behavior, and embedded managerial practices were undermining new-product development and employee commitment. The process exposed some barriers to effectiveness: unclear strategy and priorities, a senior team that was trying to manage new-product development initiatives from the top but lacked the necessary information, and a siloed organization that hindered coordination.

MEPD created cross-functional new-product development teams headed by leaders from marketing—a major departure from the structure that had blocked teamwork in the past. Roles and responsibilities were changed accordingly. For instance, senior management held the teams accountable through quarterly reviews at which they had to describe their progress in developing products and also report on their own effectiveness and any problems in collaboration among functional departments. This ongoing assessment helped sustain behavioral change.

Learning and development for both senior leaders and team members came in the form of hands-on coaching and process consultation. An internal organizational development consultant provided guidance as senior leaders conducted the reviews. When a few team leaders complained that senior management was getting too involved in the details, the consultant facilitated a conversation about how that behavior could undermine others' commitment to the new organization. Team members immediately embraced their new roles, which gave them a feeling of ownership and investment. Though early meetings were not very effective, because people weren't accustomed to collaborating so closely with colleagues from other functions, consultants from HR attended most meetings in the first year and helped the teams gel.

Within a few months, after analyzing shared information, three teams recommended that their projects be canceled because they realized the products could not succeed. This increased the senior team's confidence in the new organizational arrangements and reinforced the new pattern of management. Project team members said that they had learned a lot about how to work together and had come to appreciate the complexity of business problems and decision making in different functions. That motivated them to enroll in classroom training, where they learned how analytics could sharpen their approach to product planning and product management. Coming after their immersion in the revised way of working, the knowledge felt relevant and useful.

At the end of two years a rigorous evaluation showed a remarkable change in leadership and teamwork. Performance had improved as well. MEPD had developed nine new products in those two years, compared with five over the previous four years. Revenue and profits had increased significantly. The same organization that had not responded to a massive investment in individual training transformed itself by redesigning its roles, responsibilities, and relationships; learning how to live into them with the help of coaches and advisers; and *then* using targeted classroom training to pick up new methods and tools.

Developing the Organization Unit by Unit

Part of creating a favorable context for learning is making sure that *every area* of the business provides fertile ground. Soil conditions will inevitably vary within an organization, because each region, function, and operating group has its own needs and challenges. In our studies of corporate transformations and our work with clients, unit leaders have told us that their companies' education programs were not wrong in substance but failed to align with their local priorities and stage of business and organizational development. In other words, their groups were not ready for the training they got.

So companies should invest in capability development unit by unit. The corporate-level unit links everyone at the top—the CEO, her senior team, and key business unit, regional, and functional leaders and their key people. Individual units must consider their needs and capabilities in the context of their own strategy and goals.

Each unit's leadership team should periodically go through the six steps we've described to discover the silent killers that undermine real change, and each team should have a hand in setting its own change agenda (within the context of corporate strategy and values). Those who follow this approach will avoid the low return on investment that results from top-down programs. Common capability-development needs that emerge from unit-by-unit change can, of course, be addressed through a companywide program.

Cardo, a Swedish industrial company composed of two major independent divisions, provides a powerful example of why a unit-by-unit change strategy is important. To support its corporate transformation into an integrated global group, Cardo's CEO and his leadership team commissioned an education program to teach the top 80 managers how to lead change. The program, which integrated individual education and organizational development, featured four modules of classroom training. Between modules, participating managers were charged with implementing change and improving performance in their respective departments. They received consultation and coaching from program faculty members and peers and were invited to speak to the CEO during each module about organizational barriers to effectiveness and performance.

Evaluation of the program revealed significant behavioral changes in one of the divisions. Alignment between strategy and execution improved, as did teamwork across functions and borders, and management became more participative. The CEO estimated a tenfold return on the cost of the program by looking at the financial effect of the learning-intensive projects that managers led in their own departments and, when appropriate, in collaboration with peers in other parts of the division.

Part of creating a favorable context for learning is making sure that every area of the business provides fertile ground.

However, the other division did not experience comparable improvements. Its leaders, in contrast to those of the first group, failed to see the program's value—perhaps because they were not under the same pressure to change. Their short-term performance was good, after all. The CEO and his senior team had not assessed each division's receptiveness to the new vision and readiness to carry it out, nor had they made clear the type of organizational transformation they expected. As a result, the two divisions responded quite differently to the same program.

Contrast Cardo's experience with how ASDA, a grocery chain in the UK, approached its transformation in the 1990s. (One of us wrote a case study about the chain; it's an example worth revisiting here.) Archie Norman, the CEO at the time, led a turnaround of the company and its 200 stores by avoiding the fallacy of programmatic change—that is, the common impulse to roll out sweeping, companywide initiatives without gauging local readiness. ASDA began by creating a few model stores that demonstrated the leadership and organizational capabilities needed to build a more employee- and customer-centric culture. The company then devised a "driving test" to assess the remaining stores' capacity to implement what came to be known as the ASDA Way of Working. A store would receive corporate funds to invest in needed physical changes only if it passed the driving test. Stores that did not pass received consulting support from a corporate transformation team and then retook the test. If a store failed the test again, its manager was replaced.

At the time, ASDA's transformation was widely hailed as the most successful in the UK. In about a decade the company improved its market capitalization tenfold, thanks largely to its disciplined, unit-by-unit approach to change and development.

A New Capability Development Strategy

Even in companies with strong leaders and healthy cultures, discrete units require distinctive roles, responsibilities, and relationships—and distinctive capabilities to function in them. Moreover, each unit is probably at a different stage in its development. So CEOs and their HR chiefs must be sensitive to local variables when defining an integrated change agenda—one that simultaneously addresses performance improvement and capability development. To do that, they should answer the following questions, first at the top and then in each major unit:

- Is the leadership team aligned around a clear, inspiring strategy and set of values?
- Has the team collected unvarnished employee feedback about barriers to effectiveness and performance—including senior managers' own behavior?
- Has the team redesigned its organization, management systems, and practices to address the problems revealed by that diagnosis?
- Is HR offering consulting and coaching to help employees learn on the job so that they can practice the new attitudes and behaviors required of them?
- Do corporate training programs properly support the change agenda, and will each unit's leadership and culture provide fertile ground for it?

If your answer to any of those questions is no, your company is probably (with the best of intentions) overinvesting in training and education and failing to put talent development in its proper strategic change context.

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SPOTLIGHT

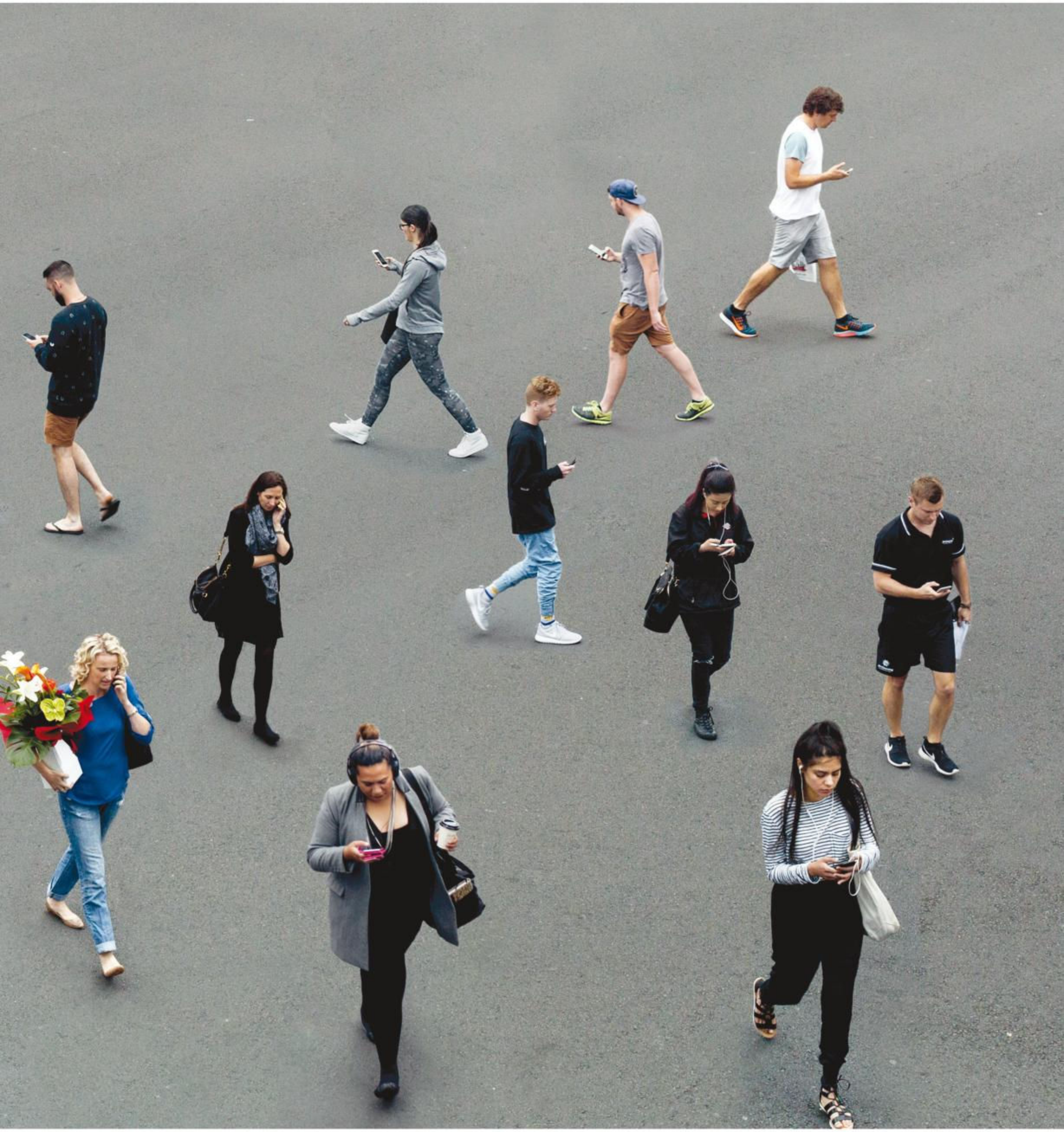
The Performance Management Revolution

The focus is shifting from accountability to learning.

BY PETER CAPPELLI AND ANNA TAVIS

When Brian Jensen told his audience of HR executives that Colorcon wasn't bothering with annual reviews anymore, they were appalled. This was in 2002, during his tenure as the drugmaker's head of global human resources. In his presentation at the Wharton School, Jensen explained that Colorcon had found a more effective way of reinforcing desired behaviors and managing performance: Supervisors were giving people instant feedback, tying it to individuals' own goals, and handing out small weekly bonuses to employees they saw doing good things.

ARTWORK Ben Zank
Going Nowhere, Untitled 8
Giclée on paper, 2015



Back then the idea of abandoning the traditional appraisal process—and all that followed from it—seemed heretical. But now, by some estimates, more than one-third of U.S. companies are doing just that. From Silicon Valley to New York, and in offices across the world, firms are replacing annual reviews with frequent, informal check-ins between managers and employees.

As you might expect, technology companies such as Adobe, Juniper Systems, Dell, Microsoft, and IBM have led the way. Yet they've been joined by a number of professional services firms (Deloitte, Accenture, PwC), early adopters in other industries (Gap, Lear, OppenheimerFunds), and even General Electric, the longtime role model for traditional appraisals.

Without question, rethinking performance management is at the top of many executive teams' agendas, but what drove the change in this direction? Many factors. In a recent article for *People + Strategy,* a Deloitte manager referred to the review process as "an investment of 1.8 million hours across the firm that didn't fit our business needs anymore." One *Washington Post* business writer called it a "rite of corporate kabuki" that restricts creativity, generates mountains of paperwork, and serves no real purpose. Others have described annual reviews as a last-century practice and blamed them for a lack of collaboration and innovation. Employers are also finally acknowledging that both supervisors and subordinates despise the appraisal process—a perennial problem that feels more urgent now that the labor market is picking up and concerns about retention have returned.

But the biggest limitation of annual reviews—and, we have observed, the main reason more and more companies are dropping them—is this: With their heavy emphasis on financial rewards and punishments and their end-of-year structure, they hold people accountable for past behavior at the expense of improving current performance and grooming talent for the future, both of which are critical for organizations' long-term survival. In contrast, regular conversations about performance and development change the focus to building the workforce your organization needs to be competitive both today and years from now. Business researcher Josh Bersin estimates that about 70% of multinational companies are moving toward this model, even if they haven't arrived quite yet.

The tension between the traditional and newer approaches stems from a long-running dispute about managing people: Do you "get what you get" when you hire your employees? Should you focus mainly on motivating the strong ones with money and getting rid of the weak ones? Or are employees malleable? Can you change the way they perform through effective coaching and management and intrinsic rewards such as personal growth and a sense of progress on the job?

With traditional appraisals, the pendulum had swung too far toward the former, more transactional view of performance, which became hard to support in an era of low inflation and tiny merit-pay budgets. Those who still hold that view are railing against the recent emphasis on improvement and growth over accountability. But the new perspective is unlikely to be a flash in the pan because, as we will discuss, it is being driven by business needs, not imposed by HR.

First, though, let's consider how we got to this point—and how companies are faring with new approaches.

How We Got Here

Historical and economic context has played a large role in the evolution of performance management over the decades. When human capital was plentiful, the focus was on which people to let go, which to keep, and which to reward—and for those purposes, traditional appraisals (with their emphasis on individual accountability) worked pretty well. But when talent was in shorter supply, as it is now, developing people became a greater concern—and organizations had to find new ways of meeting that need.

From accountability to development. Appraisals can be traced back to the U.S. military's "merit rating" system, created during World War I to identify poor performers for discharge or transfer. After World War II, about 60% of U.S. companies were using them (by the 1960s, it was closer to 90%). Though seniority rules determined pay increases and promotions for unionized workers, strong merit scores meant good advancement prospects for managers. At least initially, *improving* performance was an afterthought.

And then a severe shortage of managerial talent caused a shift in organizational priorities: Companies began using appraisals to develop employees into supervisors, and especially managers into executives. In a famous 1957 HBR article, social

Idea in Brief

THE PROBLEM
By emphasizing individual accountability for past results, traditional appraisals give short shrift to improving current performance and developing talent for the future. That can hinder long-term competitiveness.

THE SOLUTION
To better support employee development, many organizations are dropping or radically changing their annual review systems in favor of giving people less formal, more frequent feedback that follows the natural cycle of work.

THE OUTLOOK
This shift isn't just a fad—real business needs are driving it. Support at the top is critical, though. Some firms that have struggled to go entirely without ratings are trying a "third way": assigning multiple ratings several times a year to encourage employees' growth.

psychologist Douglas McGregor argued that subordinates should, with feedback from the boss, help set their performance goals and assess themselves—a process that would build on their strengths and potential. This "Theory Y" approach to management—he coined the term later on—assumed that employees wanted to perform well and would do so if supported properly. ("Theory X" assumed you had to motivate people with material rewards and punishments.) McGregor noted one drawback to the approach he advocated: Doing it right would take managers several days per subordinate each year.

By the early 1960s, organizations had become so focused on developing future talent that many observers thought that tracking past performance had fallen by the wayside. Part of the problem was that supervisors were reluctant to distinguish good performers from bad. One study, for example, found that 98% of federal government employees received "satisfactory" ratings, while only 2% got either of the other two outcomes: "unsatisfactory" or "outstanding." After running a well-publicized experiment in 1964, General Electric concluded it was best to split the appraisal process into separate discussions about accountability and development, given the conflicts between them. Other companies followed suit.

Back to accountability. In the 1970s, however, a shift began. Inflation rates shot up, and merit-based pay took center stage in the appraisal process. During that period, annual wage increases really mattered. Supervisors often had discretion to give raises of 20% or more to strong performers, to distinguish them from the sea of employees receiving basic cost-of-living raises, and getting no increase represented a substantial pay cut. With the stakes so high—and with antidiscrimination laws so recently on the books—the pressure was on to award pay more objectively. As a result, accountability became a higher priority than development for many organizations.

Three other changes in the zeitgeist reinforced that shift:

First, Jack Welch became CEO of General Electric in 1981. To deal with the long-standing concern that supervisors failed to label real differences in performance, Welch championed the forced-ranking system—another military creation. Though the U.S. Army had devised it, just before entering World War II, to quickly identify a large number of officer candidates for the country's imminent military expansion, GE used it to shed people at the bottom. Equating performance with individuals' inherent capabilities (and largely ignoring their potential to grow), Welch divided his workforce into "A" players, who must be rewarded; "B" players, who should be accommodated; and "C" players, who should be dismissed. In that system, development was reserved for the "A" players—the high-potentials chosen to advance into senior positions.

Second, 1993 legislation limited the tax deductibility of executive salaries to $1 million but exempted performance-based pay. That led to a rise in outcome-based bonuses for corporate leaders—a change that trickled down to frontline managers and even hourly employees—and organizations relied even more on the appraisal process to assess merit.

Third, McKinsey's War for Talent research project in the late 1990s suggested that some employees were fundamentally more talented than others (you knew them when you saw them, the thinking went). Because such individuals were, by definition, in short supply, organizations felt they needed to take great care in tracking and rewarding them. Nothing in the McKinsey studies showed that fixed personality traits actually made certain people perform better, but that was the assumption.

So, by the early 2000s, organizations were using performance appraisals mainly to hold employees accountable and to allocate rewards. By some estimates, as many as one-third of U.S. corporations—and 60% of the *Fortune* 500—had adopted a forced-ranking system. At the same time, other changes in corporate life made it harder for the appraisal process to advance the time-consuming goals of improving individual performance and developing skills for future roles. Organizations got much flatter, which dramatically increased the number of subordinates that supervisors had to manage. The new norm was 15 to 25 direct reports (up from six before the 1960s). While overseeing more employees, supervisors were also expected to be individual contributors. So taking days to manage the performance issues of each employee, as Douglas McGregor had advocated, was impossible. Meanwhile, greater interest in lateral hiring reduced the need for internal development. Up to two-thirds of corporate jobs were filled from outside, compared with about 10% a generation earlier.

Back to development...again. Another major turning point came in 2005: A few years after Jack Welch left GE, the company quietly backed away from forced ranking because it fostered internal competition and undermined collaboration. Welch still defends the practice, but what he really supports is the general principle of letting people know how they are doing: "As a manager, you owe candor to your people," he wrote in the *Wall Street Journal* in 2013. "They must not be guessing about what the organization thinks of them." It's hard to argue against candor, of course. But more and more firms began questioning how useful it was to compare people with one another or even to rate them on a scale.

So the emphasis on accountability for past performance started to fade. That continued as jobs became more complex and rapidly changed shape—in that climate, it was difficult to set annual goals that would still be meaningful 12 months later. Plus, the move toward team-based work often conflicted with individual appraisals and rewards. And low inflation and small budgets for wage increases made appraisal-driven merit pay seem futile. What was the point of trying to draw performance distinctions when rewards were so trivial?

The whole appraisal process was loathed by employees anyway. Social science research showed that they hated numerical scores—they would rather be told they were "average" than given a 3 on a 5-point scale. They especially detested forced ranking. As Wharton's Iwan Barankay demonstrated in a field setting, performance actually declined when people were rated relative to others. Nor did the ratings seem accurate. As the accumulating research on appraisal scores showed, they had as much to do with who the rater was (people gave higher ratings to those who were like them) as they did with performance.

And managers hated *doing* reviews, as survey after survey made clear. Willis Towers Watson found that 45% did not see value in the systems they used. Deloitte reported that 58% of HR executives considered reviews an ineffective use of supervisors' time. In a study by the advisory service CEB, the average manager reported spending about 210 hours—close to five weeks—doing appraisals each year.

As dissatisfaction with the traditional process mounted, high-tech firms ushered in a new way of thinking about performance. The "Agile Manifesto," created by software developers in 2001, outlined several key values—favoring, for instance, "responding to change over following a plan." It emphasized principles such as collaboration, self-organization, self-direction, and regular reflection on how to work more effectively, with the aim of prototyping more quickly and responding in real time to customer feedback and changes in requirements. Although not directed at performance per se, these principles changed the definition of effectiveness on the job—and they were at odds with the usual practice of cascading goals from the top down and assessing people against them once a year.

So it makes sense that the first significant departure from traditional reviews happened at Adobe, in 2011. The company was already using the agile method, breaking down projects into "sprints" that were immediately followed by debriefing sessions. Adobe explicitly brought this notion of constant assessment and feedback into performance management, with frequent check-ins replacing annual appraisals. Juniper Systems, Dell, and Microsoft were prominent followers.

CEB estimated in 2014 that 12% of U.S. companies had dropped annual reviews altogether. Willis Towers Watson put the figure at 8% but added that 29% were considering eliminating them or planning to do so. Deloitte reported in 2015 that only 12% of the U.S. companies it surveyed were *not* planning to rethink their performance management systems.

CAN YOU TAKE COGNITIVE BIAS OUT OF ASSESSMENTS?

A classic study by Edward Jones and Victor Harris in the 1960s demonstrated that people tend to attribute others' behavior to character rather than circumstances.

When a car goes streaking past us, for instance, we think that the driver is a jerk and ignore the possibility that there might be an emergency. A good workplace example of this cognitive bias—known as the "fundamental attribution error"—is to assume that the lowest performers in any year will always be the worst performers and to fire them as a result. Such an assumption overlooks the impact of good or poor management, not to mention business conditions that are beyond employees' control.

Of course, this model is highly flattering to people who have advanced into executive roles—"A" players whose success is, by definition, credited to their superior abilities, not to good fortune. That may be partly why the model has persisted so long in the face of considerable evidence against it.

Even when "A" players seem to perform well in many contexts (and that's rarely measured), they may be coasting on the "halo effect"—another type of bias, akin to self-fulfilling prophecy. If these folks have already been successful, they receive more opportunities than others, and they're pushed harder, so naturally they do better.

Biases color individual performance ratings as well. Decision makers may give past behavior too much weight, for instance, or fall prey to stereotypes when they assign their ratings.

But when you get rid of forced ranking and appraisal scores, you don't eradicate bias. Discrimination and faulty assumptions still creep into qualitative assessments. In some ways the older, more cumbersome performance systems actually made it harder for managers to keep their blinders on. Formal feedback from various stakeholders provided some balance when supervisors were otherwise inclined to see only the good things their stars did and failed to recognize others' contributions.

Anytime you exercise judgment, whether or not you translate that to numerical ratings, intuition plays a part, and bias can rear its head.

This trend seems to be extending beyond the United States as well. PwC reports that two-thirds of large companies in the UK, for example, are in the process of changing their systems.

Three Business Reasons to Drop Appraisals

In light of that history, we see three clear business imperatives that are leading companies to abandon performance appraisals:

The return of people development. Companies are under competitive pressure to upgrade their talent management efforts. This is especially true at consulting and other professional services firms, where knowledge work is the offering—and where inexperienced college grads are turned into skilled advisers through structured training. Such firms are doubling down on development, often by putting their employees (who are deeply motivated by the potential for learning and advancement) in charge of their own growth. This approach requires rich feedback from supervisors—a need that's better met by frequent, informal check-ins than by annual reviews.

Now that the labor market has tightened and keeping good people is once again critical, such companies have been trying to eliminate "dissatisfiers" that drive employees away. Naturally, annual reviews are on that list, since the process is so widely reviled and the focus on numerical ratings interferes with the learning that people want and need to do. Replacing this system with feedback that's delivered right after client engagements helps managers do a better job of coaching and allows subordinates to process and apply the advice more effectively.

Kelly Services was the first big professional services firm to drop appraisals, in 2011. PwC tried it with a pilot group in 2013 and then discontinued annual reviews for all 200,000-plus employees. Deloitte followed in 2015, and Accenture and KPMG made similar announcements shortly thereafter. Given the sheer size of these firms, and the fact that they offer management advice to thousands of organizations, their choices are having an enormous impact on other companies. Firms that scrap appraisals are also rethinking employee management much more broadly. Accenture CEO Pierre Nanterme estimates that his firm is changing about 90% of its talent practices.

The need for agility. When rapid innovation is a source of competitive advantage, as it is now in many companies and industries, that means future needs are continually changing. Because organizations won't necessarily want employees to keep doing the same things, it doesn't make sense to hang on to a system that's built mainly to assess and hold people accountable for past or current practices. As Susan Peters, GE's head of human resources, has pointed out, businesses no longer have clear annual cycles. Projects are short-term and tend to change along the way, so employees' goals and tasks can't be plotted out a year in advance with much accuracy.

At GE a new business strategy based on innovation was the biggest reason the company recently began eliminating individual ratings and annual reviews. Its new approach to performance management is aligned with its FastWorks platform for creating products and bringing them to market, which borrows a lot from agile techniques. Supervisors still have an end-of-year summary discussion with subordinates, but the goal is to push frequent conversations with employees (GE calls them "touchpoints") and keep revisiting two basic questions: What am I doing that I should keep doing? And what am I doing that I should change? Annual goals have been replaced with shorter-term "priorities." As with many of the companies we see, GE first launched a pilot, with about 87,000 employees in 2015, before adopting the changes across the company.

The centrality of teamwork. Moving away from forced ranking and from appraisals' focus on individual accountability makes it easier to foster teamwork. This has become especially clear at retail companies like Sears and Gap—perhaps the most surprising early innovators in appraisals. Sophisticated customer service now requires front-line and back-office employees to work together to keep shelves stocked and manage customer flow, and traditional systems don't enhance performance at the team level or help track collaboration.

Gap supervisors still give workers end-of-year assessments, but only to summarize performance discussions that happen throughout the year and to set pay increases accordingly. Employees still have goals, but as at other companies, the goals are short-term (in this case, quarterly). Now two years into its new system, Gap reports far more satisfaction with its performance process and the best-ever completion of store-level goals. Nonetheless, Rob Ollander-Krane, Gap's senior director of organization performance effectiveness, says the company needs further improvement in setting stretch goals and focusing on team performance.

Implications. All three reasons for dropping annual appraisals argue for a system that more closely follows the natural cycle of work. Ideally, conversations between managers and employees occur when projects finish, milestones are reached, challenges pop up, and so forth—allowing people to solve problems in current performance while also developing skills for the future. At most companies, managers take the lead in setting near-term goals, and employees drive career conversations throughout the year. In the words of one Deloitte manager: "The conversations are more holistic. They're about goals and strengths, not just about past performance."

Perhaps most important, companies are overhauling performance management because their businesses require the change. That's true whether they're professional services firms that must develop people in order to compete, companies that need to deliver ongoing performance feedback to support rapid innovation, or retailers that need better coordination between the sales floor and the back office to serve their customers.

Of course, many HR managers worry: If we can't get supervisors to have good conversations with subordinates once a year, how can we expect them to do so more frequently, without the support of the usual appraisal process? It's a valid question—but we see reasons to be optimistic.

A TALENT MANAGEMENT TIMELINE

The tug-of-war between accountability and development over the decades

- Accountability focus
- Development focus
- A hybrid "third way"

WWI	WWII	1940s	1950s	1960s	1970s
The U.S. military created merit-rating system to flag and dismiss poor performers.	The Army devised forced ranking to identify enlisted soldiers with the potential to become officers.	About 60% of U.S. companies were using appraisals to document workers' performance and allocate rewards.	Social psychologist Douglas McGregor argued for engaging employees in assessments and goal setting.	Led by General Electric, companies began splitting appraisals into separate discussions about accountability and growth, to give development its due.	Inflation rates shot up, and organizations felt pressure to award merit pay more objectively, so accountability again became the priority in the appraisal process.

As GE found in 1964 and as research has documented since, it is extraordinarily difficult to have a serious, open discussion about problems while also dishing out consequences such as low merit pay. The end-of-year review was also an excuse for delaying feedback until then, at which point both the supervisor and the employee were likely to have forgotten what had happened months earlier. Both of those constraints disappear when you take away the annual review. Additionally, almost all companies that have dropped traditional appraisals have invested in training supervisors to talk more about development with their employees—and they are checking with subordinates to make sure that's happening.

Moving to an informal system requires a culture that will keep the continuous feedback going. As Megan Taylor, Adobe's director of business partnering, pointed out at a recent conference, it's difficult to sustain that if it's not happening organically. Adobe, which has gone totally numberless but still gives merit increases based on informal assessments, reports that regular conversations between managers and their employees are now occurring without HR's prompting. Deloitte, too, has found that its new model of frequent, informal check-ins has led to more meaningful discussions, deeper insights, and greater employee satisfaction. (For more details, see "Reinventing Performance Management," HBR, April 2015.) The firm started to go numberless like Adobe but then switched to assigning employees several numbers four times a year, to give them rolling feedback on different dimensions. Jeffrey Orlando, who heads up development and performance at Deloitte, says the company has been tracking the effects on business results, and they've been positive so far.

Challenges That Persist

The greatest resistance to abandoning appraisals, which is something of a revolution in human resources, comes from HR itself. The reason is simple: Many of the processes and systems that HR has built over the years revolve around those performance ratings. Experts in employment law had advised organizations to standardize practices, develop objective criteria to justify every employment decision, and document all relevant facts. Taking away appraisals flies in the face of that advice—and it doesn't necessarily solve every problem that they failed to address.

Here are some of the challenges that organizations still grapple with when they replace the old performance model with new approaches:

Aligning individual and company goals. In the traditional model, business objectives and strategies cascaded down the organization. All the units, and then all the individual employees, were supposed to establish their goals to reflect and reinforce the direction set at the top. But this approach works only when business goals are easy to articulate and held constant over the course of a year. As we've discussed, that's often not the case these days, and employee goals may be pegged to specific projects. So as projects unfold and tasks change, how do you coordinate individual priorities with the goals for the whole enterprise, especially when the business objectives are short-term and must rapidly adapt to

1980s

Jack Welch championed forced ranking at GE to reward top performers, accommodate those in the middle, and get rid of those at the bottom.

1990s

McKinsey's War for Talent study pointed to a shortage of capable executives and reinforced the emphasis on assessing and rewarding performance.

2000

Organizations got flatter, which dramatically increased the number of direct reports each manager had, making it harder to invest time in developing them.

2011

Kelly Services was the first big professional services firm to drop appraisals, and other major firms followed suit, emphasizing frequent, informal feedback.

Adobe ended annual performance reviews, in keeping with the famous "Agile Manifesto" and the notion that annual targets were irrelevant to the way its business operated.

2016

Deloitte, PwC, and others that tried going numberless are reinstating performance ratings but using more than one number and keeping the new emphasis on developmental feedback.

market shifts? It's a new kind of problem to solve, and the jury is still out on how to respond.

Rewarding performance. Appraisals gave managers a clear-cut way of tying rewards to individual contributions. Companies changing their systems are trying to figure out how their new practices will affect the pay-for-performance model, which none of them have explicitly abandoned.

They still differentiate rewards, usually relying on managers' qualitative judgments rather than numerical ratings. In pilot programs at Juniper Systems and Cargill, supervisors had no difficulty allocating merit-based pay without appraisal scores. In fact, both line managers and HR staff felt that paying closer attention to employee performance throughout the year was likely to make their merit-pay decisions more valid.

But it will be interesting to see whether most supervisors end up reviewing the feedback they've given each employee over the year before determining merit increases. (Deloitte's managers already do this.) If so, might they produce something *like* an annual appraisal score—even though it's more carefully considered? And could that subtly undermine development by shifting managers' focus back to accountability?

Identifying poor performers. Though managers may assume they need appraisals to determine which employees aren't doing their jobs well, the traditional process doesn't *really* help much with that. For starters, individuals' ratings jump around over time. Research shows that last year's performance score predicts only one-third of the variance in this year's score—so it's hard to say that someone simply isn't up to scratch. Plus, HR departments consistently complain that line managers don't use the appraisal process to document poor performers. Even when they do, waiting until the end of the year to flag struggling employees allows failure to go on for too long without intervention.

We've observed that companies that have dropped appraisals are requiring supervisors to immediately identify problem employees. Juniper Systems also formally asks supervisors each quarter to confirm that their subordinates are performing up to company standards. Only 3%, on average, are not, and HR is brought in to address them. Adobe reports that its new system has reduced dismissals, because struggling employees are monitored and coached much more closely.

Still, given how reluctant most managers are to single out failing employees, we can't assume that getting rid of appraisals will make those tough calls any easier. And all the companies we've observed still have "performance improvement plans" for employees identified as needing support. Such plans remain universally problematic, too, partly because many issues that cause poor performance can't be solved by management intervention.

Avoiding legal troubles. Employee relations managers within HR often worry that discrimination charges will spike if their companies stop basing pay increases and promotions on numerical ratings, which seem objective. But appraisals haven't prevented discriminatory practices. Though they force managers to systematically review people's contributions each year, a great deal of discretion (always subject to bias) is built into the process, and considerable evidence shows that supervisors discriminate against some employees by giving them undeservedly low ratings.

Leaders at Gap report that their new practices were driven partly by complaints and research showing that the appraisal process was often biased and ineffective. Frontline workers in retail (disproportionately women and minorities) are especially vulnerable to unfair treatment. Indeed, formal ratings may do more to *reveal* bias than to curb it. If a company has clear appraisal scores and merit-pay indexes, it is easy to see if women and minorities with the same scores as white men are getting fewer or lower pay increases.

All that said, it's not clear that new approaches to performance management will do much to mitigate discrimination either. (See the sidebar "Can You Take Cognitive Bias Out of Assessments?") Gap has found that getting rid of performance scores increased fairness in pay and other decisions, but judgments still have to be made—and there's the possibility of bias in every piece of qualitative information that decision makers consider.

Managing the feedback firehose. In recent years most HR information systems were built to move annual appraisals online and connect them to pay increases, succession planning, and so forth. They weren't designed to accommodate continuous feedback, which is one reason many employee check-ins consist of oral comments, with no documentation.

The tech world has responded with apps that enable supervisors to give feedback anytime and to record it if desired. At General Electric, the PD@GE app ("PD" stands for "performance development") allows managers to call up notes and materials from prior conversations and summarize that information. Employees can use the app to ask for direction when they need it. IBM has a similar app that adds another feature: It enables employees to give feedback to peers and choose whether the recipient's boss gets a copy. Amazon's Anytime Feedback tool does much the same thing. The great advantage of these apps is that supervisors can easily review all the discussion text when it is time to take actions such as award merit pay or consider promotions and job reassignments.

Of course, being on the receiving end of all that continual coaching could get overwhelming—it never lets up. And as for peer feedback, it isn't always useful, even if apps make it easier to deliver in real time. Typically, it's less objective than supervisor feedback, as anyone familiar with 360s knows. It can be also "gamed" by employees to help or hurt colleagues. (At Amazon, the cutthroat culture encourages employees to be critical of one another's performance, and forced ranking creates an incentive to push others to the bottom of the heap.) The more consequential the peer feedback, the more likely the problems.

NOT ALL EMPLOYERS face the same business pressures to change their performance processes. In some fields and industries (think sales and financial services), it still makes sense to emphasize accountability and financial rewards for individual performers. Organizations with a strong public mission may also be well served by traditional appraisals. But even government organizations like NASA and the FBI are rethinking their approach, having concluded that accountability should be collective and that supervisors need to do a better job of coaching and developing their subordinates.

Ideology at the top matters. Consider what happened at Intel. In a two-year pilot, employees got feedback but no formal appraisal scores. Though supervisors did not have difficulty differentiating performance or distributing performance-based pay without the ratings, company executives returned to using them, believing they created healthy competition and clear outcomes. At Sun Communities, a manufactured-home company, senior leaders also oppose eliminating appraisals because they think formal feedback is essential to accountability. And Medtronic, which gave up ratings several years ago, is resurrecting them now that it has acquired Ireland-based Covidien, which has a more traditional view of performance management.

Other firms aren't completely reverting to old approaches but instead seem to be seeking middle ground. As we've mentioned, Deloitte has backpedaled from giving no ratings at all to having project leads and managers assign them in four categories on a quarterly basis, to provide detailed "performance snapshots." PwC recently made a similar move in its client-services practices: Employees still don't receive a single rating each year, but they now get scores on five competencies, along with other development feedback. In PwC's case, the pushback against going numberless actually came from employees, especially those on a partner track, who wanted to know how they were doing.

At New York Life, after the company eliminated formal ratings, merit-pay increases were being shared internally and then interpreted as performance scores. These became known as "shadow ratings," and because they started to affect other talent management decisions, the company eventually went back to formal appraisals. But New York Life kept other changes it had made to its performance management system, such as quarterly conversations between managers and employees, to maintain its new commitment to development.

It will be interesting to see how well these "third way" approaches work. They, too, could fail if they aren't supported by senior leadership and reinforced by organizational culture. Still, in most cases, sticking with old systems seems like a bad option. Companies that don't think an overhaul makes sense for them should at least carefully consider whether their process is giving them what they need to solve current performance problems and develop future talent. Performance appraisals wouldn't be the least popular practice in business, as they're widely believed to be, if *something* weren't fundamentally wrong with them.

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SPOTLIGHT

ARTWORK Ben Zank
Going Nowhere, Untitled 6
Giclée on paper, 2015

John Donovan, chief strategy officer and group president at AT&T responsible for technology and operations, is based in Dallas.

Cathy Benko, a vice chairman and managing principal of Deloitte LLP and author of several best-selling books, is based in San Francisco.

AT&T's Talent Overhaul

Can the firm really retrain hundreds of thousands of employees?

BY JOHN DONOVAN AND CATHY BENKO

Having built the United States' telegraph and telephone infrastructure in the last century, AT&T could once claim to be the company "where the future was invented." But now the Dallas-based firm, like many in the technology sector, faces a future in which its legacy businesses are quickly becoming obsolete. With its industry moving from cables and hardware to the internet and the cloud, AT&T is in a sprint to reinvent itself.

The overhaul presents an enormous HR challenge. AT&T employs about 280,000 people, most of whom got their education and foundational job training in a different era. The average tenure at the company is 12 years—22 years if you don't count people working in call centers. But rather than hiring new talent wholesale, AT&T

has chosen to rapidly retrain its current employees while striving to engender a culture of perpetual learning. One of us (Donovan) is championing this effort at the company.

AT&T isn't alone in its need for new skills. In a recent Deloitte survey, 39% of large-company executives said they were either "barely able" or "unable" to find the talent their firms required. But AT&T's gambit to reeducate its enormous workforce is without precedent. Tens of thousands of jobs, billions of dollars in shareholder value, and the future of one of the most iconic brands in corporate history are at stake. If AT&T succeeds, it will provide a blueprint for how legacy technology companies can compete against younger, digitally native firms such as Google and Amazon. If it fails, it may deter other companies from attempting internal transformation, putting further pressure on the global labor market.

Rapidly Shifting Technical Demands

For the past three years, AT&T's CEO, Randall Stephenson, has been making large strategic bets on a diverse range of wireless technologies—most recently the $63 billion acquisition of satellite television company DirecTV. Asked about the decision to venture into new businesses, John Stankey, the head of AT&T's Entertainment Group, says, "We have no choice." Customers are demanding constant connectivity; from 2007 to 2015, for example, data traffic on AT&T's wireless network grew by more than 150,000%. The company forecasts that by 2020, 75% of its network will be controlled by software-defined architecture. That percentage was virtually zero in 2000. This means, says Stankey, that most of AT&T's global employees "signed up for a deal that is entirely different from the environment in which their business operates today."

The new landscape requires skills in cloud-based computing, coding, data science, and other technical capabilities. Many of these fields are advancing so quickly that traditional methods of training and development cannot keep up. As Scott Smith, AT&T's senior vice president of human resources operations, puts it, "You can go out to the street and hire for the skills, but we all know that the supply of technical talent is limited, and everybody is going after it. Or you can do your best to step up and reskill your existing workforce to fill the gap."

In 2013, when the initiative began, AT&T increased its annual budget for employee learning and professional development by 25%. Since then, it has spent $250 million on employee education and professional development programs and more than $30 million on tuition assistance. All told, 140,000 employees are actively engaged in acquiring skills for newly created roles. (And the expectation is that every four years they'll change roles again.) Employees who'd been retrained filled half of all technology jobs at the company in 2015 and received 47% of promotions in the technology organization.

It's too soon to measure the full results, but one encouraging sign has been an increase in speed and efficiency. In the past 18 months AT&T has reduced its product-development cycle time by 40% and accelerated time to revenue by 32%. Recently, when the company decided to develop an "on demand" capacity that let large business customers expand their bandwidth in real time, it took only six months to scale it up from an idea to a service with more than 450 customers in over 175 markets. Prior to 2014, developing and rolling out that kind of offering would have taken at least a year.

A Long View on Talent Management

The first task of AT&T's program—dubbed Workforce 2020 (or W2020)—was to identify the skills the firm would need and create a blueprint for sourcing them internally. Managers documented existing gaps and formulated "future role profiles" for themselves and their teams. Every individual in AT&T's network and technology strategy organization, which constitutes roughly half the firm's total workforce, was assigned a new role and expected to get the training or credentials to fill it.

W2020 consolidated 250 roles across the company into 80. The goal was to radically simplify and standardize role structures, in order to increase job mobility and foster the development of interchangeable skills. In information technology, for instance, 17 existing roles spanning design, development, and testing evolved into the job of "software engineer." Nine other roles, such as team lead and tech director, became "people leader." No longer do programmers focus solely on writing code. Now they write test scripts as well and test their own code. Reliability engineers, who previously only tested equipment, write software that keeps systems operational. This

Idea in Brief

THE PROBLEM
AT&T, the original architect of the United States' communication infrastructure, now faces a future in which its legacy businesses will become obsolete. It's racing to reinvent itself for the digital marketplace, and to do that, it needs people skilled in new technologies.

THE SOLUTION
Rather than hiring new talent wholesale, AT&T has chosen to rapidly retrain its current workforce of 280,000 employees.

THE PROGRAM
Workforce 2020 consolidates roles, simplifies performance metrics, de-emphasizes seniority, and gives workers tools for career development. A partnership with Udacity and Georgia Tech allows employees to fill skill gaps through education. Every employee is encouraged to seek out new capabilities, roles, and experiences.

broadening of roles makes AT&T's resources more flexible and the company more agile.

To manage the new realignment of skills, the company redesigned its talent practices in three ways:

1. Performance metrics were simplified to focus more directly on how individuals contributed to business goals and to better recognize the market value of jobs. This has increased the financial rewards for individuals with skills in high demand, including cybersecurity, computer science, data science, IT networking, and software-defined networking.
2. Performance expectations were raised. In AT&T's Technology and Operations unit, for example, the number of people receiving the two highest performance ratings on a five-point scale declined by 5%, while the bottom two ratings increased by 37%.
3. Redesigned compensation plans de-emphasized seniority, added more variable compensation to motivate high performers, and gave weight to the in-demand skills.

From the outset, AT&T was clear that employees would be required to use their own time for—and in some cases invest their own money in—their re-education. A central challenge early on was how to motivate the company's professional-level employees to embrace doing this. That cohort includes the country's largest full-time union workforce, which represents about half of AT&T's employees. To encourage union members to update their skills, union contracts outline training and development program specifics. Like most employees, the union supports the company's retraining efforts, understanding their necessity and the perils that the alternative holds for the workforce.

Consider network support specialist Jacobie Davis. He's been with AT&T for 19 years in a number of capacities, including sales, software support, provisioning, and even 911-line maintenance. Given the transition to voice-over IP-based technology and the software focus at AT&T, he is repositioning his skills in hopes of earning a spot as a data scientist. "It's really hard to describe the vast difference between the things we're moving toward and the types of legacy technology I've been working on. It's like night and day," he notes.

Davis says that many of his colleagues have been at AT&T for over a quarter century, supporting technologies that will soon be obsolete. "The question for all of us becomes, Do I make this pivot or do I retire when the company retires the technology that I'm an expert on?"

Nevertheless, many employees express apprehension about W2020. Glenn Lurie, CEO of AT&T Mobility, a subsidiary that provides wireless services, acknowledges that even with a process in place, uncertainty—about jobs, skills, and future qualifications—can worry and distract people who have held the same position for many years and been rewarded well for their efforts.

One principle of AT&T's program is to give every employee who wants it the chance to change with the organization in order to minimize the number of people who leave or lose their jobs. Reductions in staffing are inevitable, though the company believes they can be handled in large part through attrition. But people who are unwilling to shift gears will eventually need to move on, if only because their future opportunities will be extremely limited as older technologies become obsolete.

Tools for Change

To help employees with the transition, in January 2014 human resources launched an online self-service platform, which provides a host of tools and processes for performance management, career development, and talent planning. It also offers workshops on a wide range of topics, such as virtualization and cloud computing, "technologies in motion," and "the communication transformation." So far the platform has gained good traction with workers, who accessed it 6 million times last year alone.

Some of the more popular tools on the platform include:

A *career profile tool* for assessing competencies, business experience, and credentials. It quantifies each person's skills and generates a single talent-and-development profile that the employee can compare with new-job requirements to identify skills to acquire. The tool also helps workers find open positions across business units and links them to resources for developing proficiency in required competencies. A "click-through" feature allows people to instantly connect to a nearby employee in a similar role.

A *career intelligence tool* for making informed career decisions by analyzing hiring trends within the company and profiles of different jobs (with target salary range and number of incumbents). Employees interested in a U.S.-based network services job, for example, could see that in 2015 AT&T offered nearly twice as many such positions as it had in 2012. Conversely, information technology roles trended down by more than 200 jobs during the same period. This tool also provides links to skills training.

A *job simulation tool* that presents realistic job-related situations and rates how people respond to them to assess their suitability for various jobs.

Once employees have identified skill gaps through the self-service platform and in conversations with their managers, they take it upon themselves to fill them through online courses, certifications, and degree programs developed through a partnership between AT&T, Udacity, and Georgia Tech. Most employees spend five to 10 hours a week on retraining. The options fan out in a number of ways:

Individual courses. Through May 2016, employees had taken more than 1.8 million emerging-technology courses. The majority of these were online. The cost to students is $200 a month for unlimited courses with no deadlines for completion. AT&T refunds half the tuition when a course is successfully finished. People also earn a badge—essentially a digital certificate of achievement—for completing certain tutorials and assessments. By the end of 2015, the company had handed out 117,000 badges to 53,000 employees.

Nanodegrees. Curated course bundles created by Udacity, "nanodegree" programs deliver training and certification in high-demand technical specialties, such as software engineering, coding, and web development. Transforming a programmer into a software engineer, for example, typically involves 25 courses. Preparing that same programmer for IP networking takes eight courses, and for a security specialty, three courses. Nanodegrees usually take six to 12 months to earn.

Online master's degrees. Georgia Tech, Udacity, and AT&T teamed up to offer a fully accredited online master's degree in computer science—the first of its kind delivered through a MOOC platform. The cost is $6,600, versus $45,000 for an equivalent campus-based program.

The company offers up to $8,000 in annual tuition aid per employee for degrees and nanodegrees, with a lifetime cap of $25,000 for undergrad degrees and $30,000 for graduate degrees. At the beginning of 2016, 323 employees had enrolled in the online master's program, and another 1,101 were in the process of earning nanodegrees. AT&T has also opened the courses designed with Udacity and Georgia Tech to individuals outside the company, in an effort to seed the talent market with external candidates who will be qualified to fill future roles.

AT&T is working to instill a mindset in which each individual becomes CEO of his or her own career.

A New Model for Agility

Training is only a part of AT&T's initiative. There has also been a shift from corporate-ladder to corporate-lattice thinking—a new model explored by one of us (Cathy) in the book *The Corporate Lattice: Achieving High Performance in the Changing World of Work*. (Neither she nor her firm, Deloitte, is formally engaged in AT&T's program.) In the industrial era the corporate ladder was the standard metaphor for talent development and career paths. Its one-size-fits-all, only-way-is-up rules were clear, and incentives uniformly supported them. The lattice, in contrast, represents career paths that change continually and adaptively through multidirectional, zigzag movements.

A lattice approach supports lateral, diagonal, and both ascending and descending career moves. It encompasses apprentice opportunities and job sharing for the purpose of training, legitimizing arrangements seldom suited to corporate ladders. Although lattices vary from company to company, they create a range of options for growth and development and foster a more inclusive workplace that makes learning opportunities available and relevant.

Essential to lattice thinking is the principle that individuals actively own their development, which fundamentally changes the social contract between employer and employee. AT&T is working to instill a mindset in which each individual becomes CEO of his or her own career, empowered to seek out new skills, roles, and experiences. The company feels this is in line with the demands of the wider economy—where job tenure today averages just 4.6 years, according to the U.S. Bureau of Labor—and will arm its employees for success even if they leave AT&T. "We're moving from being a company where you learn a technology, become a subject-matter expert, and then you're done," Davis says, "to one where we're going to be learning something new all the time."

What all this means is that AT&T—one of America's largest companies—is attempting to become much more nimble and take advantage of approaches common in start-ups. The firm is already organizing, motivating, and developing people through such techniques as crowdsourcing, marathon process cycles, and small, temporary process teams. Brooks McCorcle, the president of AT&T Partner Solutions, believes that the ingenuity of start-ups will emerge more readily as the company continues to break down old boundaries that prevented collaboration.

HOW AT&T TRACKS PROGRESS

Measuring results is a critical component of AT&T's Workforce 2020 retraining effort. The company examines them in four categories—activity, hydraulics, business outcomes, and sentiment—to gain insight into the integrity and momentum of the program.

Activity refers to the development and implementation of initiatives that increase skills the company will need in the future. These include the identification of gaps between current and future competencies and culture; the creation of performance metrics and systems that shift the focus from rewarding seniority to recognizing results and the relative value of roles; the resetting of expectations for roles and responsibilities; and use of the career tool kit by employees. Activity also includes course registrations, course completions, certifications, and degree progress. Through May 2016, for instance, employees had completed some 1.8 million courses.

Hydraulics facilitate employees' movements up, down, laterally, and diagonally across the organization. Success in this category is linked to the number of people taking on new roles. Here a variety of results, such as the robustness of the internal pipeline, are tracked. Internal sourcing of STEM jobs, which increased more than 20% from 2012 to 2015, is a particularly important measure, as are the time taken to fill open jobs and recruiting costs.

Business outcomes include increases in efficiency, the retention of employees with deep institutional knowledge and relationships, and product development cycle times. For example, the time required to take new offerings from idea to customer implementation on a major global scale has been cut in half since 2014.

Sentiment is the internal and external perception of AT&T's reputation. Metrics here include willingness to recommend AT&T as an employer. Media and industry analyst mentions are another barometer for tracking how perceptions are changing. For example, 21% of the 1,600 articles written on the topic of software for applied networking in 2015 featured AT&T as the world leader—twice as many as featured the next closest telecom competitor.

"In time, you won't necessarily have a marketing floor or a finance floor. Instead you'll have marketing and finance and product development working in small project teams," she says. "These joint experiences expose people to different parts of the organization and differing roles that people may want to pivot toward as their careers unfold."

This may be the most ambitious element of AT&T's bid to reinvent itself—its aspiration to create a culture in which newly empowered employees can thrive. AT&T wants to invest in, rather than leave behind, those who helped build its position in the marketplace. But to remain profitable in the future, it has to move beyond the skills that once made it great. As Stephenson recently told the *New York Times,* the company has to look forward and transform; if it doesn't succeed at retraining and reinvention, he said, "mark my words, in three years we'll be managing decline."

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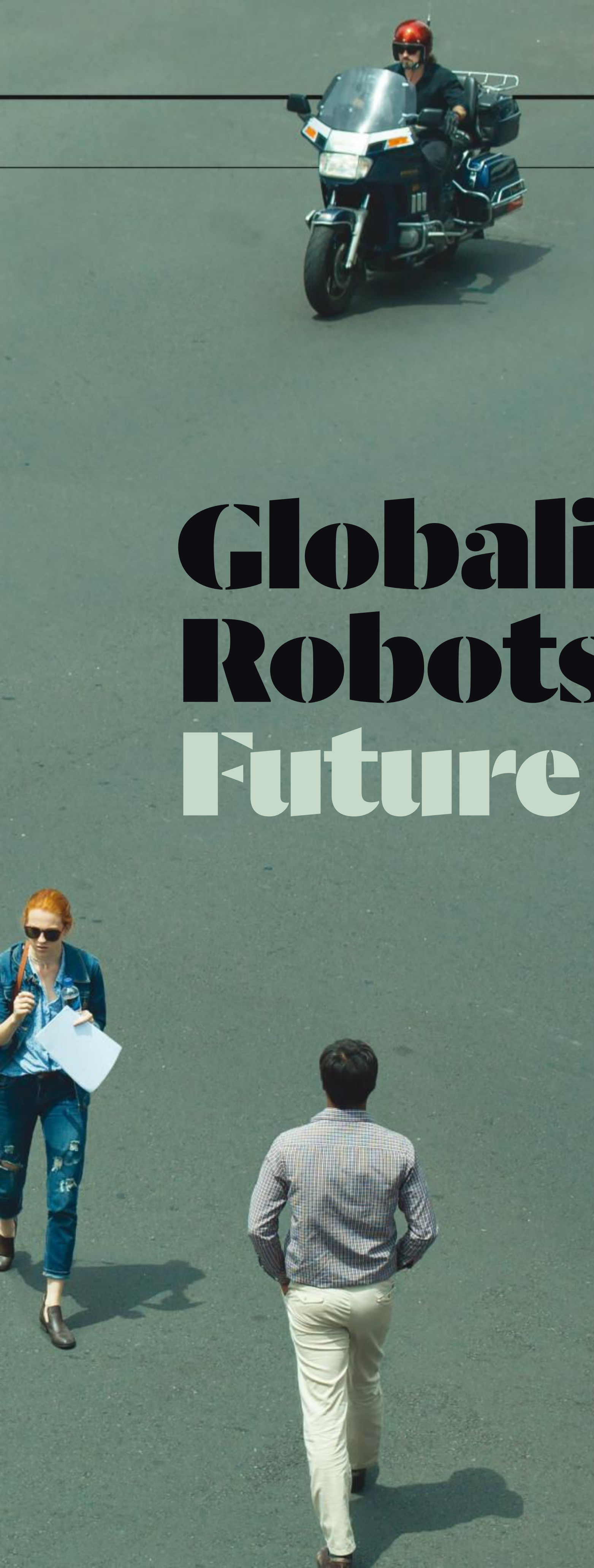
SPOTLIGHT

ARTWORK Ben Zank
Going Nowhere, Untitled 1
Giclée on paper, 2015



Globalization, Robots, and the Future of Work

An interview with Jeffrey Joerres, former CEO and chairman of ManpowerGroup

WHEN JEFFREY JOERRES first joined Manpower, in 1993, the labor market was relatively stable and the company was still largely focused on traditional office, clerical, and industrial staffing. But since then, the employment landscape has been dramatically reshaped by globalization and rapid advances in technology. Joerres, who led ManpowerGroup for 15 years before stepping down in 2015, responded to the shifts in kind, expanding the company's international operations and moving into the increasingly competitive market for IT, finance, and engineering professionals. Joerres, now 56 and a private investor based in Milwaukee, talked with HBR's editor, Amy Bernstein, about the transformation of work and how to manage it.

HBR: What trends do you see shaping the workforce?
JOERRES: The obvious one—the one that has shaken up the market most—is globalization. In the 1990s, if you didn't have a China strategy, you were missing out and putting your company at a competitive disadvantage. These days, companies need a global strategy for finding a highly skilled, cost-effective labor force.

Lately we've seen the emergence of micromarket analysis that reveals geolocated pools of skills. So companies are tapping specific areas for specific skills. They may put their call center in Manila and a transaction processing center in Bratislava. But after the initial move to take advantage of available skills and labor arbitrage, the location matures quickly and those benefits dry up.

Let's say you find a previously undiscovered workforce of multilingual IT professionals in Bratislava, and you set up a processing center. Pretty soon your competitors are going to follow you there, deplete the skills pool, and drive up wages. In other words, the greenfield you originally had all to yourself has become a battlefield. And now it's not just the decreasing value of labor arb, it's also a shortage of the most competitive skills. You're once again fighting for talent, you're investing more in training, and you're back to the micromarket mining of these labor skills.

How is micromarket mining different from traditional skills sourcing? Companies are doing more "micro footprinting," and that takes a nomadic mentality: You're ready to pick up and move when required. Large footprinting, on the other hand, means you're committed to a community for better or worse. More and more, companies will need to take a dual approach, establishing large locations and more-temporary, smaller operations at the same time.

The location of talent pools isn't constant either. Now we're seeing in-demand skills pop up in different areas of a country or the world. For a few years the best place to find IT developers was Kraków; then it shifted to Kiev, because Kraków became saturated. It's kind of like Whac-A-Mole: You're confronting this perpetual, fast-moving skills dodge, and it's only going to get worse.

At this point most of the greenfields have been developed; very few remain. Clearly Central Africa is the next greenfield for skills, but you have to have a lot of courage to get in there right now. As soon as that region has matured enough from a labor law perspective, and the problems with bribery and the black market have been addressed, it too will get soaked up. We are not going back to the days of finding a little gold vein of labor of your very own.

ROBOTS AND JOBS

Are robots really as much of a threat as some people say? Artificial intelligence and robotics are affecting the labor market, but they're not yet in broad use. As soon as you can get a robot for $5,000 instead of $100,000, as soon as you can get AI with better voice recognition, and as soon as you can get full contextual AI that can anticipate and answer questions without human intervention—that's going to throw the labor markets into a tizzy.

How's that going to play out? The conventional wisdom is that increased productivity helps labor markets—it creates a temporary disconnect while workers scramble to acquire new skills to tackle new jobs, but they catch up relatively quickly. In today's context I don't buy that. The disconnect is happening a lot faster than in the past, and as a result there are more displaced and discouraged workers than ever before.

In many ways, what we have now in the U.S. is similar to the early 19th century, when the Luddites first worried that machines were going to steal their jobs. We must deal with the reality that when full-scale robotics and AI arrive in a broad-based, affordable, easily justifiable way, we'll see enormous waves of workers put out of work and ill prepared to take on very different jobs. This is going to create challenges that our institutions are not ready for.

BUILDING AND LEADING YOUR FUTURE WORKFORCE

How can organizations ensure that they have the right skills for the future when they don't even know what they're going to need? Most companies have to operate in a legacy world, meaning that they have to be able to keep doing the nuts-and-bolts work at the core of their business. But they also have to be ready to compete in a fast-changing environment, one that's really hard to predict. We know that the skills needed in the future will be durable and broad—like problem solving and the ability to work on fluid teams—but they're hard to

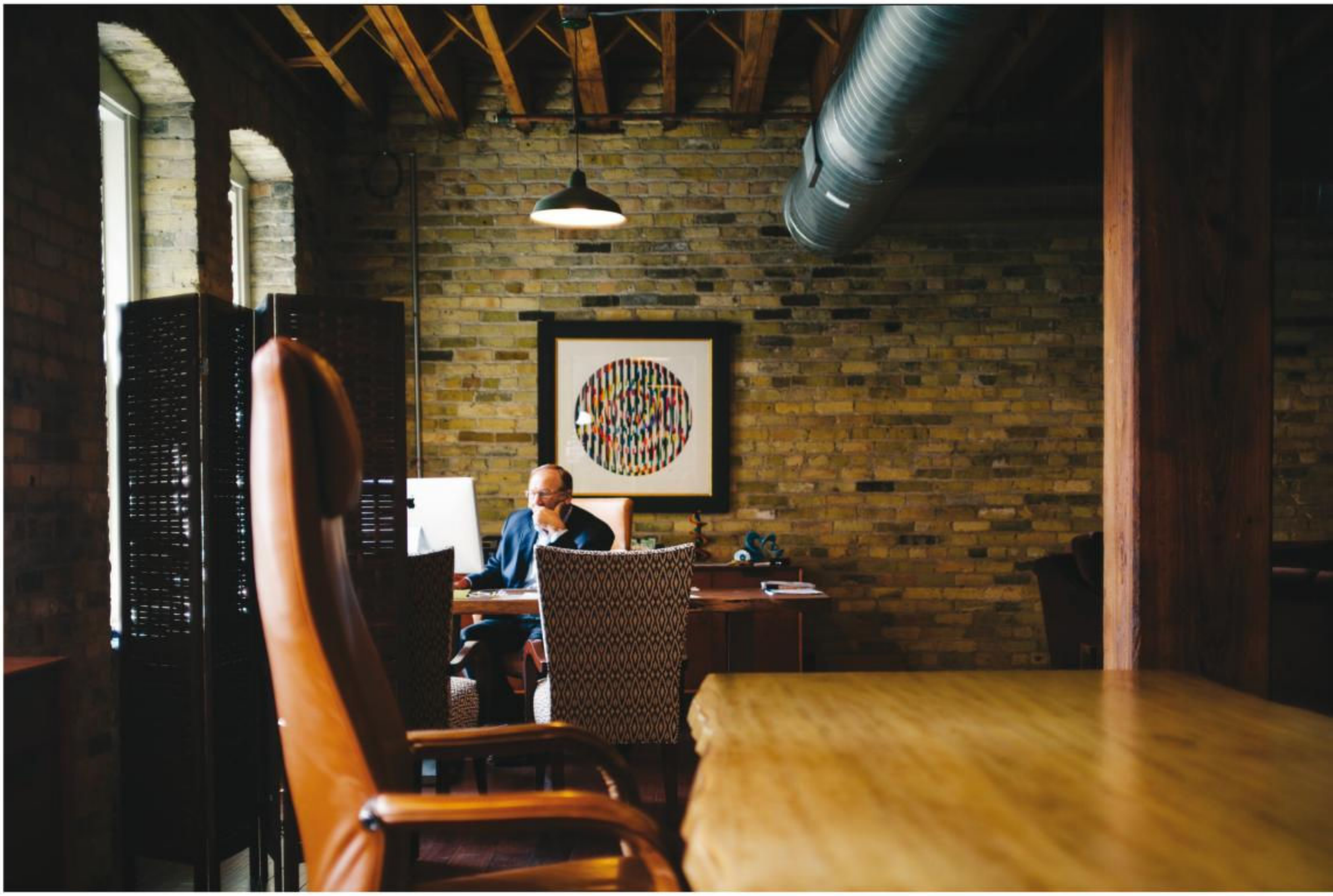
PETER HAUCK

Investors don't ask for your workforce strategy, they ask for your business strategy.

put your finger on. If I can develop that sort of agility in my organization to tackle the leading-edge stuff, I can then bring on the more discrete, recognizable skills as they're required. But no one knows what all those specific skills are going to be.

Nevertheless, companies routinely fail to put in place a workforce strategy that supports their business strategy. Most have done a pretty good job of looking out three years, maybe five, but they don't then marry that up with the skills they're going to need. They don't deal with how their strategy is going to change their sales force, or their engineering core, or their logistics management. This is partly because the investor community doesn't ask for your workforce strategy; it only asks for your business strategy. The really good companies, particularly the large ones that have been burned—the Accentures and IBMs of the world—are pretty good at it, because they've learned to live in multiple worlds and continually look for ways to better serve their customers. The customers themselves are often less good at it.

What's your advice to companies that want to develop a workforce strategy? For most companies today, business takes place on multiple fronts at multiple speeds. It's mandatory to put in place multiple work models and truly practice them. I'm talking about putting in crowdsourcing as one element, distant manufacturing or technology or transaction processing as another,



Our systems look broken because they're trying to fit the way the labor markets worked in the past.

contract-temporary-moving-to-full-time as yet another. My point is that you don't know what you're going to need three to five years from now, but if you have your skills sharpened in multiple work models, you can turn the volume up in one and down in another, minimizing the latency time to get what you need. And that's going to be the difference between success and failure.

In many ways, the labor market is like a product life cycle—in fact, the two are now locked together in many instances. Think of mobile phones: They're a high-demand, low-margin business, and their product life cycles are really short. That has worked its way down into the labor market. You don't have a couple of years to develop the workforce you need. If you wait that long, you're going to have your head in your hand.

Keeping up with workforce shifts isn't easy, particularly for big, traditional companies. The problem is that they're trapped by their own history. So many times I see big companies try to move more nimbly, but their stumbling blocks are their own culture and middle managers who are not fully committed to multiple work models and see them as a threat to their span of control.

Clearly you can't just blow your culture up. You have to figure out how to modify it so that people are able to learn and adapt. It's doable, but you have to continually break down behaviors that once worked but now get in the way. Command-and-control behaviors, for example, don't foster agility. Fifteen years ago, managers held the knowledge; now the systems do. It's hard to make that shift.

How do we train people to manage this workforce that you're describing? As we look to the future, role modeling of behaviors is going to be more important than training. You'll still have some form of leadership training, but it'll evolve. When I went through my first training class, the whole first week was on performance appraisals and salary administration—you know, the rule book. Well, managers don't need that now.

It really comes down to this: You need to be vigilant and make sure that your organization is intolerant of the behaviors that dampen flexibility and agility and learning and adaptation. As a leader, you're a parent in the best sense. You can't just say, "Here are my rules—now follow them." You have to role model all the time, you have to demonstrate accountability all the time—it's never-ending. This kind of leadership is exhausting work.

But the rewards are enduring competitive advantage, right? Absolutely. The rewards are great, but they're not binary. In other words, a switch doesn't go on and you suddenly get all the benefits. The flywheel just goes faster, and you need to go faster too. You can never be satisfied, and that's where you get frustration. When are we done with this efficiency thing? The answer is never.

People are still saying we're in recovery from the last recession. I get that from an economic viewpoint, but that's not good language inside a company. Better to say, "This is it, guys. It's not going to get any better, so let's enjoy what we're doing here. Let's have some fun. Let's win at this." Because that is the secret sauce. It may mean that the flywheel has to turn faster, so a company must parse work differently to keep up. Parsing of work is not new—think of outsourcing call centers, tagging photos, or using contractors. However, dynamic parsing *is* new and will become mandatory. The ability to rapidly shift the location of the work according to skill availability and criticality will be the competitive advantage.

This makes the job of communicating strategy and motivating workers much more difficult and much more critical. Because there's an emotional toll to all this: Employees can easily feel as if they're getting jerked around, especially if the communication from management is not consistent and authentic.

INSTITUTIONS MUST CATCH UP

You're describing a working environment that's very different from the one many of us first entered. Is the world ready for that? Our institutions are inadequate. Look at unemployment compensation, welfare, Social Security—these were all put in place in the middle of the past century. And they were based on certain assumptions: that when you lost your job, you would go through a process and on the other side find a job that you'd then have for a long time. Today that's not going to happen. Look at the gig economy, look at parsed work—all these models just allow us to move faster. My dad had a second job. He went to a gas station after he got home from his first job, and he ate his dinner in between. Well, second jobs look different now. Uber is a second job. So what do you do when someone is collecting unemployment and takes a job with Uber to moonlight while he's in training for a new full-time job? Should he lose food stamps or health care because he's earning a little extra money to get by? Our systems look broken because they're trying to fit things into the way the labor markets worked in the past.

The same goes for broad-access universities. They're built on the old labor models. They're not turning out graduates with the skills companies need. So we have to refashion these institutions that are so important to our society.

What's your solution? I think we need an iterative model. Why does it have to be all in or all out? Why can't someone be on partial welfare? Or on partial unemployment compensation? If a worker loses her job that paid $50,000 a year but can only find a new job for $40,000, her unemployment compensation goes away, but she has lost $10,000. Why don't we make up the difference for her for another six months because she had what it took to go out and find a job? Some people might see that as a giveaway. It's not. It's a small price to pay to encourage that worker to get back into the market. I'd rather pay someone to be in the market than out of the market.

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JAMIE CHUNG

THE ECOSYSTEM OF SHARED VALUE

Companies must sometimes team up with governments, NGOs, and even rivals to capture the economic benefits of social progress.

BY MARK R. KRAMER AND MARC W. PFITZER

In the past, companies rarely perceived themselves as agents of social change. Yet the connection between social progress and business success is increasingly clear. Consider these examples: The first large-scale program to diagnose and treat HIV/AIDS in South Africa was introduced by the global mining company Anglo American to protect its workforce and reduce absenteeism. The €76 billion Italian energy company Enel now generates 45% of its power from renewable and carbon-neutral energy sources, preventing 92 million tons of CO_2 emissions annually.

And MasterCard has brought mobile-banking technology to more than 200 million people in developing countries who previously lacked access to financial services.

If business could stimulate social progress in every region of the globe, poverty, pollution, and disease would decline and corporate profits would rise. Indeed, in recent years *creating shared value*—pursuing financial success in a way that also yields societal benefits—has become an imperative for corporations, for two reasons. The legitimacy of business has been sharply called into question, with companies seen as prospering at the expense of the broader community. At the same time, many of the world's problems, from income inequality to climate change, are so far-reaching that solutions require the expertise and scalable business models of the private sector. Even corporations once known for a hard-nosed approach have embarked on significant shared value initiatives.

But as they pursue shared value strategies, businesses inevitably face barriers at many turns. No company operates in isolation; each exists in an ecosystem where societal conditions may curtail its markets and restrict the productivity of its suppliers and distributors. Government policies present their own limitations, and cultural norms also influence demand.

These conditions are beyond the control of any company—or of any single actor. To advance shared value efforts, therefore, businesses must foster and participate in multisector coalitions—and for that they need a new framework. Governments, NGOs, companies, and community members all have essential roles to play, yet they work more often in opposition than in alignment. A movement known as *collective impact* (introduced in 2011 by John Kania and Mark Kramer in the *Stanford Social Innovation Review*) has facilitated successful collaborations in the social sector, and it can guide companies' efforts to bring together the various actors in their ecosystems to catalyze change.

Companies that turn to collective impact will not only advance social progress but also find economic opportunities that their competitors miss. In this article we'll examine the principles of collective impact and explore its basic elements one by one. But first we'll take a broad look at how two very different companies—the Norway-based manufacturer Yara and the retail giant Walmart—have used collective-impact principles to improve their ecosystems for all concerned.

Reshaping the Ecosystem

Yara, a global leader in fertilizer sales, faced numerous obstacles in its effort to reach African smallholder farmers from its port of entry in Tanzania. Fertilizer had the potential to increase crop yields in the famine-afflicted country. But corruption in the government-controlled port delayed the unloading of shipments for many months. Roads were inadequate for conveying fertilizer to farms and produce back to the port; a third of the harvest was typically left to rot for lack of refrigerated transport. Farmers were poor, often illiterate, and unaccustomed to using fertilizer; they also lacked access to credit. A government ban on the export of key crops, meant to protect local consumption, had the unintended consequence of shrinking the market and curbing capital investment.

All this added up to a classic market failure that perpetuated famine and poverty and also curtailed Yara's growth. The problem was deeply entrenched:

Idea in Brief

THE IMPERATIVE
Creating shared value—pursuing financial success in a way that also benefits society—has become increasingly important to companies as they look for new economic opportunities and seek to regain the public's trust.

THE BARRIERS
Companies don't operate in isolation. Each exists within an ecosystem where societal conditions may curtail markets and restrict productivity. Government policies and cultural norms present further limitations.

THE WAY FORWARD
Businesses must initiate "collective impact" efforts that involve all the players in their ecosystems. Five elements are needed: a common agenda, a shared measurement system, mutually reinforcing activities, constant communication, and dedicated "backbone" support from one or more independent organizations.

The farmers had little power to influence government policy, and they were suspicious of any changes to their traditional methods. International aid temporarily alleviated hunger but left the underlying issues untouched. No single intervention could prevail; success required that all the interrelated obstacles be addressed at once.

Starting in October 2009, Yara worked to bring together 68 organizations, including multinational companies, civil society groups, international aid agencies, and the Tanzanian government, in a partnership known as the Southern Agricultural Growth Corridor of Tanzania (SAGCOT), which was initiated at the World Economic Forum Africa summit in 2010. The mission was to build a $3.4 billion fully developed agricultural corridor from the Indian Ocean to the country's western border, covering an area the size of Italy. It has involved, among other things, investing in infrastructure, including the port, a fertilizer terminal, roads, rail, and electricity; fostering better-managed farmer cooperatives; bringing in agro dealers and financial services providers; and supporting agro-processing facilities and transport services. Public sources have provided one-third of SAGCOT's funding; the rest comes from the participating private enterprises. Although originally envisioned as a 20-year project, the corridor was well established within three years and has already bolstered the incomes of hundreds of thousands of farmers. Yara was decisive in launching the effort but did not lead or control it. Nor was the company's investment—$60 million—a major part of the funding. Yet the project has boosted Yara's sales in the region by 50% and increased the company's EBITDA by 42%.

Societal constraints are not limited to emerging markets, of course. In 2012, as Walmart was working to eliminate 20 million tons of greenhouse gas emissions from its supply chain and reduce its packaging costs, it encountered an unexpected roadblock: Its suppliers could not source enough recycled plastic to use in their packaging. It turned out that 45% of the U.S. population lived in cities that were still dumping trash in landfills. Even though recycling would have yielded significant new revenues and savings, cash-strapped municipalities could not afford the up-front investment required for collection and sorting equipment and for campaigns to change consumer behavior. So in April 2013 Walmart, like Yara, convened a cross-sector coalition of NGOs, city managers, recyclers, major consumer brand companies (including direct competitors such as Unilever and P&G), and financing experts from Goldman Sachs. Many of the participants had spent years trying to launch their own recycling programs; by the time they met, all recognized that the problem could be solved only by collectively addressing the challenge of financing municipal curbside recycling.

Together, 10 companies invested in the $100 million Closed Loop Fund, whose purpose is to catalyze investments in recycling infrastructure across the United States. It is governed by an independent committee of experts in finance, the environment, recycling, supply chain, and municipal management. Although it lends to municipalities and private companies at below-market interest rates, it insists that every proposal demonstrate the potential for commercially viable returns so that the model can eventually be scaled up through conventional capital markets.

To date the fund has financed 10 projects with a total of $80 million: $20 million of its own capital and $60 million from co-investors. As the result of one project, every household in Memphis, Tennessee—a city that had no curbside recycling whatsoever—now has access to convenient recycling carts. These 10 projects alone are expected to reduce annual waste to landfill by more than 800,000 tons and cut greenhouse gas emissions by more than 250,000 tons while creating hundreds of jobs. And the benefits to Walmart are considerable: The increased availability of recycled materials strengthens its supply chain and reduces the cost of packaging. Again like Yara, Walmart neither led nor controlled its cross-sector effort—but it provided the necessary impetus.

What Is Collective Impact?

Collective impact is based on the idea that social problems arise from and persist because of a complex combination of actions and omissions by players in all sectors—and therefore can be solved only by the coordinated efforts of those players, from businesses to government agencies, charitable organizations, and members of affected populations. What's needed is nothing less than changing how the system functions. Collective-impact efforts have made significant progress on issues as diverse as education, homelessness, juvenile justice, substance abuse, childhood obesity, job creation, and pollution.

Before engaging in a collective-impact effort, each participant has typically viewed the problem at hand solely from its own perspective. By bringing together all the relevant parties and ensuring rigorous data collection and careful facilitation, collective-impact initiatives foster a shared understanding of the problem—the first step toward solving it. If an initiative is to succeed, each entity must be represented by senior leaders with the authority to execute change within their organizations. Local communities affected by the problem must be included and empowered, and any data analysis or proposed actions must account for their perspectives.

Businesses bring essential assets to collective-impact efforts. They know how to define and achieve objectives within a limited time and budget. They understand change management and the art of negotiation. And corporate pragmatism, accountability, and data-driven decision making can cut through the red tape and ideological disagreements that often stymie governments and NGOs.

In addition to these considerable assets, businesses whose growth and resilience are constrained by societal problems have a powerful motive to kick-start social change. Conventional wisdom holds that governments and NGOs are the strongest catalysts of social progress, but that is not always true. Governments typically respond only to the most influential interests and may be paralyzed by partisan divides. Few NGOs have the resources and the clout to command attention from governments and global corporations, whose involvement is essential. But that doesn't mean that companies should try to lead or control an effort; it does mean they can be instrumental in getting it off the ground. Because collective impact mobilizes resources from many entities, businesses do not have to shoulder the massive costs of social transformation alone. And they can win big when new economic opportunities arise from social progress.

The Elements of Collective Impact

Five elements must be in place for a collective-impact effort to achieve its aim of large-scale social change: a common agenda, a shared measurement system, mutually reinforcing activities, constant communication, and dedicated "backbone" support from one or more independent organizations. Let's examine them in turn.

A common agenda. Participants must reach a shared vision for change and a joint approach to a solution. This not only helps align their efforts but also defines each organization's commitment and determines how data will be shared within and outside the group. The agenda must take each participant's perspective and interests into consideration. Not surprisingly, reaching agreement among numerous diverse stakeholders can be extremely challenging and may require six to 12 months or more of intensive work.

Just as companies should not lead or control a collective-impact effort, they should not try to impose an agenda. But they can initiate the process of reaching one, using their relationships to assemble key participants. The Closed Loop Fund, for example, emerged from a lengthy campaign—including an

COMPANIES THAT TURN TO COLLECTIVE IMPACT WILL BOTH ADVANCE SOCIAL PROGRESS AND FIND ECONOMIC OPPORTUNITIES THAT THEIR COMPETITORS MISS.

initial gathering of 30 consumer goods companies—to align numerous parties around a shared understanding of the problem and its solution. The idea of a social-impact fund using capital from participating companies arose in the very first meeting; however, developing the business case took eight months of work. Walmart CEO Doug McMillon played an instrumental role in the fund's launch: He asked his counterparts in major companies, including Procter & Gamble, PepsiCo, Unilever, Johnson & Johnson, Keurig Green Mountain, and Coca-Cola, to publicly commit to involvement. Another eight months of legal work ironed out the model—a limited-partnership structure with a fund management team in charge of reviewing and advising on city applications and an independent investment committee responsible for funding decisions. In October 2014, 18 months after the initial impetus, the fund closed its first round of financing and began issuing requests for proposals.

A shared measurement system. Participants must agree on a single short list of indicators that determine how success will be measured and reported. This helps formalize the common agenda, establishes a basis for understanding as a group what is or isn't working as each organization implements its activities, and sets the stage for ongoing course adjustments.

CocoaAction, a coalition similar to SAGCOT, brings together nine chocolate companies and numerous partner organizations to increase agricultural productivity and support communities in Côte d'Ivoire and Ghana. It spent two years establishing its agenda, goals, and measurements. The first step, as for SAGCOT, was recognizing the systemic challenges faced by farmers who operate at subsistence levels and were unable to invest in yield-enhancing innovations or in the community health and education practices needed for successful farming. Once the coalition had agreed on the imperative to address both farm productivity and community gaps, it could build consensus on performance measures. In May 2016 it released its guide to measurement and evaluation, which includes metrics for capturing farmers' adoption of recommended agricultural practices, soil fertility practices, and planting material; assessing the number of boys and girls in school; and gauging the number of women participating in income-generating activities.

Mutually reinforcing activities. Collective impact does not, of course, require that all participants do the same things. Instead, diverse stakeholders engage in mutually reinforcing activities. Each organization focuses on what it can do best. Typically, initiatives form multiple working groups, each addressing a different aspect of the problem.

Through their supply and distribution chains, businesses are deeply practiced in coordinating hundreds of organizations with different specialties. They can clearly evaluate participants' strengths and weaknesses while offering their own functional expertise.

At SAGCOT, the long-term vision determined the sequence of investments and activities, starting with broad infrastructure improvements. Better roads and a more efficient port had to precede investments in refrigerated transport and increased yields. The Tanzanian government ended its export ban, waived taxes on irrigation equipment, eliminated a crop tax, generated new land-use plans, and spent $211 million modernizing the port. Aid agencies financed roadwork and facilitated farmer co-ops. Yara focused its direct investment on port infrastructure and agro-dealer networks—areas in which it had extensive knowledge from its activities in other parts of the world. To help coordinate the initiative, it drew on its experience with global agricultural markets and its work in Tanzania and other African countries in conjunction with the UN Millennium Project's Hunger Task Force and the Tanzanian Agricultural Partnership.

For the Closed Loop Fund, gaps in the recycling value chain of cities have determined the projects undertaken. These range from curbside collection supervised by municipalities to materials processing and manufacturing by private operators. And for CocoaAction, the national governments approve and help finance specific interventions; Mars, Nestlé, and other chocolate manufacturers are leveraging decades' worth of research on plant science and dissemination; Cargill, Olam, Barry Callebaut, and other cocoa processors and exporters are building the capacity of cooperatives; and the International Cocoa Initiative, CARE, and other NGOs are tackling child-labor monitoring systems.

Constant communication. All players must engage in frequent and structured communication to build trust and coordinate mutual objectives. Building trust among NGOs, governments, and competing businesses is not easy; however, constant communication and consistent follow-through on commitments can overcome even long-standing suspicions. Communication also fosters legitimacy, momentum, and learning.

Companies bring expertise in effective messaging for diverse audiences and have sophisticated in-house communication teams. SAGCOT, the Closed Loop Fund, and CocoaAction have all benefited from high-profile events set up by champion companies.

IN COLLECTIVE-IMPACT EFFORTS, DIVERSE STAKEHOLDERS ENGAGE IN MUTUALLY REINFORCING ACTIVITIES, AND EACH ONE FOCUSES ON WHAT IT CAN DO BEST.

CREATING SHARED VALUE

In the 2011 HBR article "Creating Shared Value," Michael Porter and Mark Kramer argued that companies can move beyond corporate social responsibility and gain competitive advantage by including social and environmental considerations in their strategies. Treating societal challenges as business opportunities, they suggested, is the most important new dimension of corporate strategy and the most powerful path to social progress.

Shared value results from policies and practices that contribute to competitive advantage while strengthening the communities in which a company operates. Companies can create shared value in three ways: by reconceiving products and markets, redefining productivity in the value chain, and strengthening local clusters. All three require a sufficiently robust market ecosystem. A collective-impact approach may not always be needed for the first two activities, but it is always necessary at the cluster level.

SAGCOT, a member of the World Economic Forum, gains exposure and commitment at the forum's yearly conference in Davos, Switzerland. Walmart used the CEO's bully pulpit at its 2014 Sustainable Product Expo in Bentonville, Arkansas, to enlist its suppliers in the Closed Loop Fund. And CocoaAction has used Barry Callebaut's annual Chocovision conference to mobilize partners and heighten the urgency for change.

At the operational level, each coalition issues regular updates and schedules meetings for its working groups and investors. SAGCOT holds an annual partnership forum and more-frequent regional-cluster meetings, while the Closed Loop Fund and CocoaAction convene each quarter. The fund's communications often draw on the technical expertise of businesses. For example, as investments make possible the processing of new streams of recycled packaging material, the participating companies discuss how to foster markets that can get the material into packaging supply chains—which requires a sophisticated understanding of quality and quantity specifications and of geographic and transportation constraints.

Dedicated "backbone" support. A separate, independently funded staff dedicated to the initiative—the "backbone" of the project—is needed to guide vision and strategy, support activities, establish shared measurement practices, build public will, advance policy, and mobilize resources. These activities can be managed by a single organization or divided among several with differing competencies. The backbone function ensures that all the working groups remain aligned and informed. Companies cannot be the backbone—they are not neutral players. They can, however, provide funding to launch it, technology support for online communication, and mentoring or coaching, in some cases introducing Six Sigma and other continuous improvement processes.

Although Yara initiated Tanzania's agricultural corridor, it was careful to avoid taking ownership or branding the effort as its own. The backbone is an independent secretariat—the SAGCOT Centre—whose initial CEO was a former head of the Tanzania National Business Council and whose deputy CEO was an associate director of the World Economic Forum. The Closed Loop Fund was likewise independently incorporated and staffed; its recycling experts have a deep understanding of the relevant technologies and economics. CocoaAction has entrusted its backbone to the World Cocoa Foundation, whose staff members are widely experienced in agricultural development and policy; the lead companies maintain strategic oversight through membership on the foundation's board.

Together these five elements—simple to describe, immensely challenging to implement—can ensure that the hundreds of organizations spanning the populations affected by a given social issue work together constructively despite vastly different perspectives, cultures, and ideologies. To realize that potential, collective impact requires a new kind of leadership, sometimes called *system leadership.* There is never just one system leader; multiple individuals, representing different constituencies, lead together.

System leaders must frame their own intentions and the overall situation in a way that motivates and builds trust among all participants. Even as they are accountable to their own organizations and keep their priorities in mind, they must help others in the coalition understand how the health of the whole system benefits each party. System leadership requires persistence and the ability to listen deeply and see reality through the eyes of other stakeholders.

Consider Ron Gonen and Rob Kaplan, cofounders of the Closed Loop Fund. Gonen led New York City's recycling program; prior to that, he started Recyclebank, a company that has promoted recycling in more than 4 million U.S. households. Kaplan spearheaded Walmart's efforts to reduce greenhouse gas emissions throughout its supply chain and was responsible for packaging sustainability. Together the two are experienced in all aspects of recycling and product supply chains—from municipal collection to retail procurement, and across business, nonprofits, and politics—giving them the credibility and insight to engage all parties. Such cross-sector experience is essential among system leaders and enables them to speak the language and appreciate the motivations of each sector.

A company's choice of the right internal champion for system leadership is critical both to bringing the company to action and to keeping the other partners focused on the common agenda. For example, Kaplan first helped Walmart appreciate the link between its emissions and broader recycling-system failures and then raised awareness among the company's product purchasers, helping them "see" the hidden savings that could be obtained by using recycled materials. And he was instrumental in helping McMillon secure public commitments from the CEOs and presidents of other corporations.

Why Business Misses the Opportunity

Despite their powerful incentives and unique capacity to support large-scale social change, companies rarely step up. Our research suggests that they encounter three obstacles.

Questions of legitimacy. Trust is a precondition for successful collaboration. And although companies are often respected, they are more likely to be feared than trusted. After all, they're in the self-interested pursuit of profit. So they may be viewed as not having the legitimacy to initiate social progress.

However, companies that pursue shared value and engage in collective-impact efforts recognize that their long-term profitability depends on a healthy society. They aim their strategies at achieving social outcomes that mesh with public priorities, such as the UN's Sustainable Development Goals. And, as we have said, they do not lead in any conventional sense; the participants collectively determine the agenda and the actions to be taken.

Competitive free riders. When one company improves the market ecosystem, it almost always improves conditions for its competitors. Nestlé spent 40 years working to raise the productivity of dairy farmers in Moga, India—efforts that not only strengthened its own business but also produced a cluster of thriving local competitors. Many companies are understandably reluctant to bear the costs when rivals will share the benefits.

But despite the free-ride opportunity, companies that create shared value often enjoy a sustained advantage. Take Novo Nordisk, the world's leading provider of insulin to manage diabetes. In the 1980s diabetes was virtually undiagnosed, and thus untreated, in China, even though nearly 10 million people there suffered from the disease. In 2002 the company established the World Diabetes Foundation and worked with the Chinese Ministry of Health, the Chinese Academy of Sciences, and others to train more than 200,000 health providers and educate more than 2 million patients. It funded medical research and a widespread media campaign to combat the social stigma associated with the disease. These efforts have saved some 500,000 "disability-adjusted life-years."

Novo Nordisk's actions unquestionably improved conditions in China for any insulin supplier; yet in initiating the change and building close relationships with suppliers, distributors, the government, and others, the company established a $1.3 billion market for itself and gained a commanding advantage that later entrants have been unable to weaken. It currently has a 59% market share in China; its larger global competitors, Eli Lilly and Sanofi, have Chinese market shares of just 15% and 5%, respectively. Similarly, although Yara's participation in SAGCOT improved conditions for any fertilizer company operating in Tanzania, the company saw its market share there rise from 35% to 52%.

Investment justification. Most companies relegate social issues to their philanthropy, citizenship, or CSR departments, thus perpetuating the separation of social problems from core operations and strategy. They rarely examine changing ecosystem conditions through the rigorous business lens that would reveal their significance to a company's financial prospects. Shared value

BARRIERS IN THE ECOSYSTEM

Companies are accustomed to thinking of strategy in terms of the activities under their direct control. They recognize the importance of a broader market ecosystem, but research has focused on the ecosystem of competition or of "coopetition" among related companies rather than on the social factors that affect markets. Yet every company that pursues shared value in the face of inhospitable market conditions will encounter barriers in its ecosystem. Private- or public-sector intermediaries may be incapable of supplying basic infrastructure and services to end users—or those intermediaries may not even exist. Misaligned government policies or informal rules often perpetuate existing deficits, and ingrained behaviors and cultural norms may prevent the adoption of new solutions. The further a company looks beyond its own value chain to the causes of market failure—situations in which socioeconomic conditions prevent conventional business models from succeeding—the less control and perceived legitimacy it has, and the greater the cost, complexity, and time frame of change. These factors keep many companies from even contemplating an effort to alter the external context.

creation is a strategy that requires expertise in both societal *and* business issues; projects must be subject to the same analysis as any other capital investment. If companies do not accurately assess the business case for such projects, they will miss the justification for investing the required funding and management attention, which may greatly exceed those of normal philanthropic or CSR projects. If shared value projects are successful, however, the returns from ecosystem change may dwarf those from equivalent investments that companies would not hesitate to make in R&D or marketing.

Collective impact also requires a long-term vision and a commitment of resources that are insulated from quarterly or even annual review. Interim budget fluctuations can undermine the steady progress and trust necessary for collective-impact efforts. Although the total project costs may be large, they are borne by many participants, so they generally won't show up as a significant factor in any major company's financial statements and should not affect the short-term performance for which shareholders rigidly hold companies accountable. However, companies must tailor their investments to the nature and timing of the changes pursued. If they seek long-term results, for instance, then separate, special-purpose funds (Danone's Ecosystem Fund is one example) may be the most appropriate channel for investment.

SIMPLE PROBLEMS should be amenable to simple solutions. Binary partnerships with other companies, government agencies, or NGOs can often overcome one or a few obstacles in the local ecosystem. However, leading companies have begun to realize that addressing the complex social problems at the root of market failures is often the only way to achieve their ambitious shared value strategies. In such situations, the ability to understand and catalyze collective impact is essential.

The greatest impediments to this promise of social and economic progress are the internal barriers that prevent companies from taking action. Cost should not be a problem if the business case is well understood: In all the examples mentioned here, the initiating company garnered substantial economic returns and saw significant benefits to society from relatively modest capital investments. But corporate executives often lack the courage and the vision to wade into the social sector, engage openly with civil society, understand the business case, and pursue a longer-term strategy in cooperation with others.

Leading social change in the service of shareholder value is immensely challenging. The problems will take years to solve, and the results won't show up in the quarterly performance targets at which managers typically aim. Governments and NGOs won't always welcome corporate leadership. Yet businesses are essential players, able to unlock possibilities for change on issues that have long been impervious to intervention. Without their participation, we will neither meet shareholders' growth expectations nor remedy the world's most urgent social failures.

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THE TRANSFORMATIVE BUSINESS MODEL

How to tell if you have one

BY STELIOS KAVADIAS, KOSTAS LADAS, AND CHRISTOPH LOCH

LEANDRO CASTELAO

We usually associate an industry's transformation with the adoption of a new technology. But although new technologies are often major factors, they have never transformed an industry on their own. What does achieve such a transformation is a business model that can link a new technology to an emerging market need.

MP3 technology is a classic case in point. Early MP3 devices represented an order-of-magnitude increase in capacity over magnetic tapes and CDs: Users could carry thousands of songs on a small device. But MP3 players revolutionized the audio devices market only after Apple coupled the iPod with iTunes in a new business model, swiftly moving music-recording sales from the physical to the virtual world.

What, exactly, enables a business model to deliver on a technology's potential? To answer that question, we embarked on an in-depth analysis of 40 companies that had launched new business models in a variety of industries. Some succeeded in radically altering their industries; others looked promising but ultimately did not succeed. In this article we present the key takeaways from our research and suggest how they can help innovators transform industries.

How Business Models Work

Definitions of "business model" vary, but most people would agree that it describes how a company creates and captures value. The features of the model define the customer value proposition and the pricing mechanism, indicate how the company will organize itself and whom it will partner with to produce value, and specify how it will structure its supply chain. Basically, a business model is a system whose various features interact, often in complex ways, to determine the company's success.

In any given industry, a dominant business model tends to emerge over time. In the absence of market distortions, the model will reflect the most efficient way to allocate and organize resources. Most attempts to introduce a new model fail—but occasionally one succeeds in overturning the dominant model, usually by leveraging a new technology. If new entrants use the model to displace incumbents,

Idea in Brief

THE QUESTION
No new technology can transform an industry unless a business model can link it to an emerging market need. How can you tell whether a model will succeed in doing that?

THE RESEARCH
The authors undertook an in-depth analysis of 40 companies that launched new business models in a variety of industries. Some had transformed their industries; others looked promising but ultimately didn't succeed.

THE FINDINGS
Transformative business models tend to include three or more of these features: (1) personalization, (2) a closed-loop process, (3) asset sharing, (4) usage-based pricing, (5) a collaborative ecosystem, and (6) an agile and adaptive organization.

or if competitors adopt it, then the industry has been transformed.

Consider Airbnb, which upended the hotel industry. Founded in 2008, the company has experienced phenomenal growth: It now has more rooms than either InterContinental Hotels or Hilton Worldwide. As of this writing, Airbnb represents 19.5% of the hotel room supply in New York and operates in 192 countries, in which it accounts for 5.4% of room supply (up from 3.6% in 2015).

The founders of Airbnb realized that platform technology made it feasible to craft an entirely new business model that would challenge the traditional economics of the hotel business. Unlike conventional hotel chains, Airbnb does not own or manage property—it allows users to rent any livable space (from a sofa to a mansion) through an online platform that matches individuals looking for accommodations with home owners willing to share a room or a house. Airbnb manages the platform and takes a percentage of the rent.

Because its income does not depend on owning or managing physical assets, Airbnb needs no large investments to scale up and thus can charge lower prices (usually 30% lower than hotels charge). Moreover, since the home owners are responsible for managing and maintaining the property and any services they may offer, Airbnb's risks (not to mention operational costs) are much lower than those of traditional hotels. On the customer side, Airbnb's model redefines the value proposition by offering a more personal service—and a cheaper one.

Before platform technology existed, there was no reason to change the hotel business in any meaningful way. But after its introduction, the dominant business model became vulnerable to attack from anyone who could leverage that technology to create a more compelling value proposition for customers. The new business model serves as the interface between *what technology enables* and *what the marketplace wants*.

Let's look now at what features make a business model transformative.

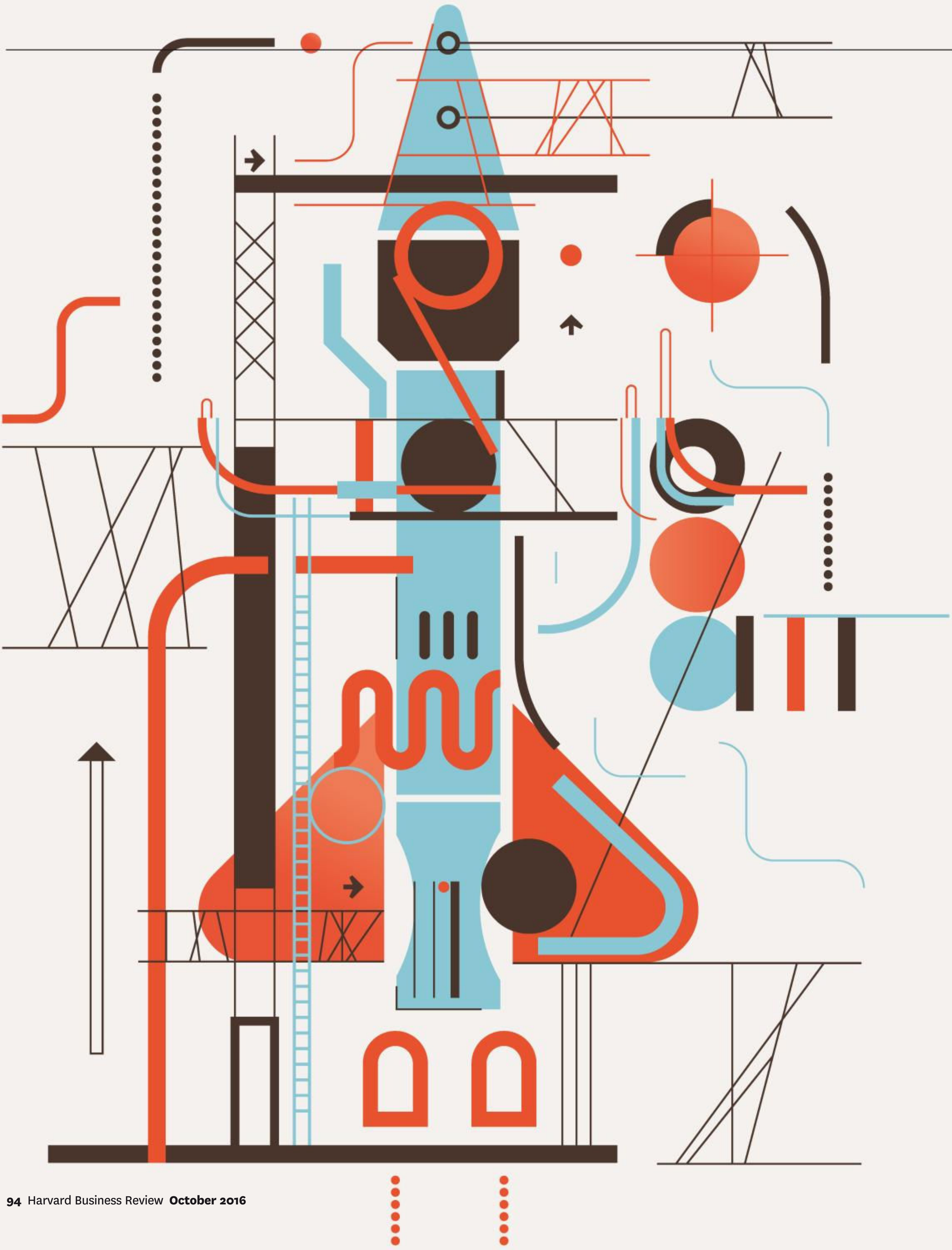
The Six Keys to Success

We selected the 40 new business models we analyzed on the basis of how many mentions they received in the high-quality, high-circulation business press. All of them seemed to have the *potential* to transform their industries, but only a subset had succeeded in doing so. We looked for recurring features in the models and found six. No company displayed all of them, but as we shall see, a higher number of these features usually correlated with a higher chance of success at transformation.

1 **A more personalized product or service.**
Many new models offer products or services that are better tailored than the dominant models to customers' individual and immediate needs. Companies often leverage technology to achieve this at competitive prices.

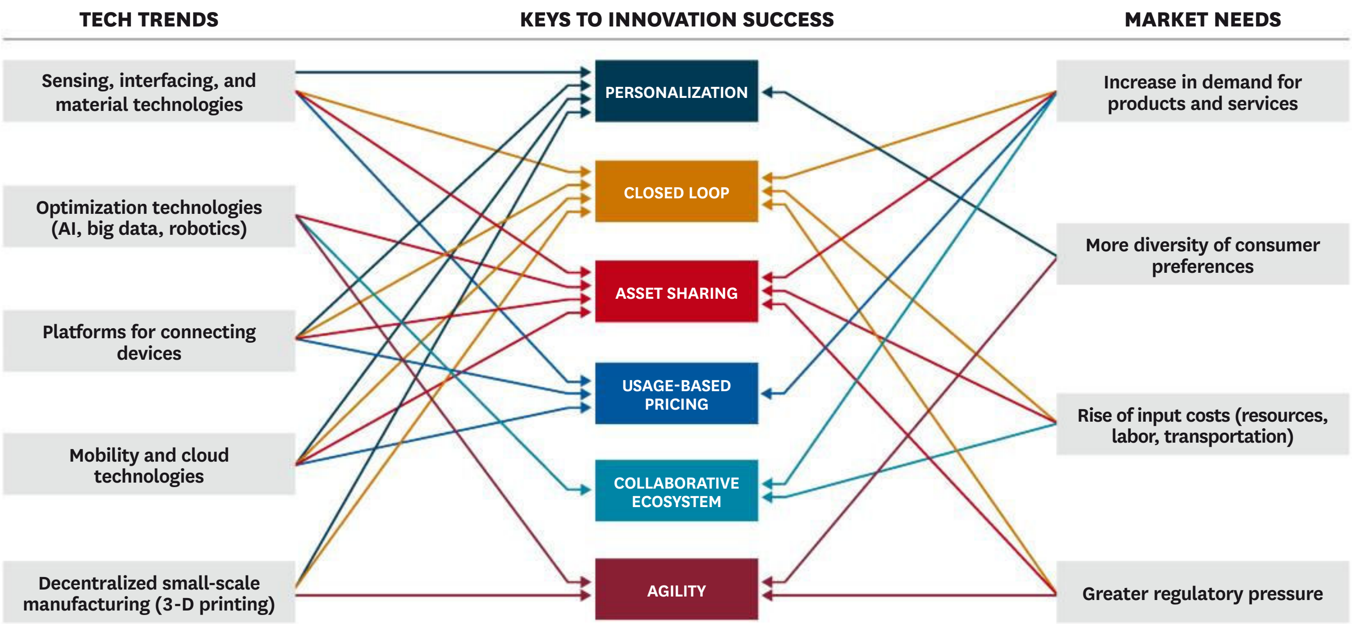
2 **A closed-loop process.**
Many models replace a linear consumption process (in which products are made, used, and then disposed of) with a closed loop, in which used products are recycled. This shift reduces overall resource costs.

3 **Asset sharing.**
Some innovations succeed because they enable the sharing of costly assets—Airbnb allows home owners to share them with travelers, and Uber shares assets with car owners. Sometimes assets may be shared across a supply chain. The sharing typically happens by means of two-sided online marketplaces that unlock value for both sides: I get money from renting my spare room, and you get a cheaper and perhaps nicer place



Linking Technology and the Market

The six features that characterize successful innovation all link a recognized technology trend and a recognized market need. Trends were identified by an analysis of regularly published industry reports from think tanks and consulting companies such as the McKinsey Global Institute, PwC, and the Economist Intelligence Unit.



to stay. Sharing also reduces entry barriers to many industries, because an entrant need not own the assets in question; it can merely act as an intermediary.

4 **Usage-based pricing.**
Some models charge customers when they use the product or service, rather than requiring them to buy something outright. The customers benefit because they incur costs only as offerings generate value; the company benefits because the number of customers is likely to grow.

5 **A more collaborative ecosystem.**
Some innovations are successful because a new technology improves collaboration with supply chain partners and helps allocate business risks more appropriately, making cost reductions possible.

6 **An agile and adaptive organization.**
Innovators sometimes use technology to move away from traditional hierarchical models of decision making in order to make decisions that better reflect market needs and allow real-time adaptation to changes in those needs. The result is often greater value for the customer at less cost to the company.

Each feature on this list is tied to long-term trends in both technology and demand. (See the exhibit "Linking Technology and the Market.") On the tech side, one trend is the development of sensors that allow cheaper and broader data capture. Another is that big data, artificial intelligence, and machine learning are enabling companies to turn enormous amounts of unstructured data into rules and decisions. A third is that connected devices (the internet of things) and cloud technology are permitting decentralized and widespread data manipulation and analysis. And a fourth is that developments in manufacturing (think nanotechnology and 3-D printing) are creating more possibilities for distributed and small-scale production.

On the market side, although the steady progress of developing countries has led to a stable increase in demand worldwide, it is complicated by a greater diversity in customer preferences (both across and within countries). Higher factor prices (despite the commodity price reductions of 2015) and heightened regulation (notably on environmental effects and business conduct) further increase the challenges for companies looking to gain market share.

All six features represent potential solutions for linking market demand and technological capability. For example, greater personalization in the value proposition responds to the fragmentation of consumer preferences and the resultant demand for more-diverse offerings. That personalization has been made possible by sensors that collect data from connected devices via the cloud; the data is analyzed by big data solutions and turned into services—such as recommendations and alerts—that are different for each user.

From Innovation to Transformation

In theory, the more of the six features a new business model has, the greater its potential to transform a given industry should be. We tested that hypothesis by analyzing how many features each of the 40 new models displayed and comparing the results with its actual performance.

We gave each model one point for each feature on which it outperformed the incumbent business model. We then assessed its transformative success according to the degree to which the model had attracted market share (displacing incumbents) and the extent to which other companies had copied it.

Uber can claim five of the six key features of a potentially transformative business model.

Our results strongly suggest (that's the best one can get from statistical analyses) that business models with transformative potential tend to have three or more of the six features. (See the exhibit "How Many Boxes Should a Model Tick?")

The taxi service company Uber ticks no fewer than five boxes. Its business model is built on *asset sharing*—the drivers use their own cars. Uber has developed a *collaborative ecosystem* in which the driver assumes the risk of winning rides, while the platform helps minimize that risk through the application of big data. The platform also creates *agility* through an internal decision-making system that responds to market changes in real time. This lets Uber apply *usage-based pricing* and direct drivers to locations where the probability of finding a fare is high.

Finally, Uber uses a scheme whereby customers rate drivers. Via the big data platform, a would-be customer can see on his or her mobile device the closest drivers and their ratings. The rating system pushes drivers to offer clean cars and quality service, and it also provides at least a bit of *personalization*. Allowing the customer to decide between the closest car and the one (maybe a bit farther out) with the highest rating may not sound like much, but it is still far ahead of traditional taxi services.

The implication of our finding is straightforward: If you are thinking about changing your business model or entering an industry with a new model, you can rate yourself on how well your model performs on the six features. If you don't beat the competition on any of them, your chances of success are low. But if your model significantly outdoes the current model on three or more features, you are well positioned to succeed.

To rate yourself on a feature, you must first define what it actually means in your industry. For example, in financial services *personalization* may mean tailored loan terms (including interest rates, monthly payments, and loan duration), whereas in retail it may mean customized T-shirt designs or one-off dresses. In education it may mean that the support provided to students changes according to their individual strengths and weaknesses, and in health care it may mean data-enabled, targeted medicine. Only when performance is expressed in such industry-specific ways can a company develop metrics to evaluate and compare its model on the key features and begin to think about how to differentiate itself by using new technologies.

Healx: A Case Study

Informed by our business model framework, we advised (and Cambridge Judge Business School's business accelerator supported) the tech venture Healx, which focuses on the treatment of patients with rare diseases in the emerging field of personalized medicine. A big challenge for pharmaceutical companies in this domain is that rare-disease markets are very small, so companies usually have to charge astronomical prices. (One drug, Soliris, used in the treatment of paroxysmal nocturnal hemoglobinuria, costs about $500,000 per patient-year.) Some potential treatments are, however, being used for more-common diseases with large patient markets. They could be repurposed

How Many Boxes Should a Model Tick?

Our research suggests that to transform an industry, a business model must display at least three of the six key features. Here's how the 40 new models we examined stacked up.

	BUSINESS	INDUSTRY	PERSONALIZATION	CLOSED LOOP	ASSET SHARING	USAGE-BASED PRICING	COLLABORATIVE ECOSYSTEM	AGILITY	SCORE
1	AIRBNB	REAL ESTATE	X		X		X	X	**4**
2	ALIBABA	RETAIL	X			X	X		**3**
3	AMAZON	RETAIL	X			X	X	X	**4**
4	APPEAR HERE	REAL ESTATE RENTALS			X		X		**2**
5	APPLE IPOD	ELECTRONICS	X			X	X		**3**
6	ARM	ELECTRONICS	X				X	X	**3**
7	CANON	ELECTRONICS/COPIERS		X		X	X		**3**
8	COURSERA	EDUCATION	X				X		**2**
9	DELL	ELECTRONICS	X			X	X	X	**4**
10	EDX	EDUCATION	X				X		**2**
11	ETSY	RETAIL	X						**1**
12	GOOGLE ADWORDS	ADVERTISING	X			X	X	X	**4**
13	HANDY	HOME SERVICES				X	X		**2**
14	IKEA	RETAIL	X	X			X	X	**4**
15	INTERFACE	CARPETING		X		X			**2**
16	JUSTPARK	REAL ESTATE	X		X	X			**3**
17	LEGO FACTORY	TOYS	X			X	X	X	**4**
18	LENDING CLUB	BANKING				X		X	**2**
19	LIVEOPS	CALL CENTERS			X		X	X	**3**
20	LYFT	TAXI OPERATION	X		X	X	X		**4**
21	M-PESA	BANKING	X		X		X		**3**
22	MEDICAST	HEALTH CARE	X		X		X		**3**
23	NATURA	COSMETICS		X			X		**2**
24	NIKE ID	FOOTWEAR	X					X	**2**
25	PHILIPS PAY PER LUX	LIGHTING		X	X	X	X		**4**
26	RICOH PAY PER PAGE	ELECTRONICS		X		X	X		**3**
27	ROLLS-ROYCE POWER-BY-THE-HOUR	ENGINES		X		X	X	X	**4**
28	RYANAIR	TRANSPORTATION				X	X	X	**3**
29	SALESFORCE.COM	SOFTWARE	X		X	X			**3**
30	SHYP	TRANSPORT & LOGISTICS	X	X			X		**3**
31	TASKRABBIT	HOME SERVICES			X	X			**2**
32	TENCENT QQ	SOFTWARE	X			X	X		**3**
33	UBER	TAXI OPERATION	X		X	X	X	X	**5**
34	UDACITY	EDUCATION	X				X		**2**
35	WASHIO	DRY CLEANING	X		X	X			**3**
36	WAYFAIR	HOME GOODS		X			X	X	**3**
37	XEROX	ELECTRONICS				X		X	**2**
38	ZARA	APPAREL	X				X	X	**3**
39	ZIPCAR	TRANSPORTATION	X		X	X		X	**4**
40	ZOPA	BANKING	X		X	X		X	**4**

to suit the needs of rare-disease sufferers, but they typically work only for people with specific genetic profiles.

Enter Healx, with a platform that leverages big data technology and analytics across multiple databases owned by various organizations within global life sciences and health care to efficiently match treatments to rare-disease patients. Its initial business model hit three of our six key features. First, Healx's value proposition was about *asset sharing* (for example, making available clinical-trial databases that record the effectiveness of most drugs across therapeutic areas and diseases, including rare ones). Second, the business promised more *personalization* by revealing drugs with high potential for treating the rare diseases covered. Finally, Healx's model would, in theory, create a *collaborative ecosystem* by bringing together big pharma (which has the treatment and trial data) and health care providers (which have data about effectiveness and incompatibility reactions and also personal genome descriptions).

How did we measure performance along those features? To assess *personalization,* we compared the amount of drug data currently provided to sufferers of rare diseases with the amount that Healx could provide, which initially covered 1,000 of the 7,000 rare diseases that have formal advocacy groups worldwide. These groups represent some 350 million people, 95% of whom currently get no even reasonably relevant drug recommendations. We measured *asset sharing* by looking at the proportion of known data on rare-disease-relevant drugs that Healx could access—about 20% in its start-up phase. Finally, we assessed its *collaborative ecosystem* by looking at how many of the main data-holding institutions participated—about a quarter.

The latest version of Healx's business model brings *personalization* to the maximum possible level.

At first Healx struggled to get pharma companies to join the platform; they were concerned that their treatment data would leak to competitors. But the Healx team spotted an opportunity to give companies an incentive. In 2014 the United Kingdom's National Health Service introduced a new rule for pharmaceutical companies: If an expensive treatment doesn't work for a patient, the company responsible can be forced to reimburse NHS providers for its cost. The reimbursement amounts were disease-specific and counted in the thousands of British pounds.

Treatment failure is often caused by specificities in individual genomes, and Healx's managers realized that their technology could help companies predict such failures with high accuracy, potentially saving millions of pounds a year.

More recently, Healx has developed a machine-learning algorithm that can use a patient's biological information not only to match drugs to disease symptoms but also to predict exactly which drug will achieve what level of effectiveness for that particular patient. The latest version of its business model brings *personalization* to the maximum possible level and adds *agility,* because the treating clinician—armed with the biological data and the algorithm—can make better treatment decisions directly with the patient and doesn't have to rely on fixed rules of thumb about which of the few available off-label drugs to use. In this way, Healx is able to support decentralized, real-time, accurate decision making.

This version of the Healx model has even more transformation potential—it exhibits four of the six features; it has already generated revenue from customers; and in the long term it could empower patients by giving them much more information before they consult a medical practitioner. Although it is still too early to tell whether that potential will be realized, Healx is clearly a venture to watch. It has earned a number of prizes (including the 2015 Life Science Business of the Year and the 2016 Graduate Business of the Year in the Cambridge cluster) and sizable investments from several global funds.

YOU CANNOT guarantee the success of an innovation (unless you choose a market niche so small as to be insignificant). But you can load the dice by ensuring that your business model links market needs with emerging technologies. The more such links you can make, the more likely you are to transform your industry.

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RENAULT-NISSAN ALLIANCE CEO CARLOS GHOSN

IRWIN WONG

“Making the Car a Mobile, Connected Workspace”

THERE’S A REVOLUTION UNDER WAY IN THE AUTOMOTIVE INDUSTRY, AND CARLOS GHOSN WANTS TO MAKE SURE HE’S AMONG THE WINNERS.

CARLOS GHOSN has made a career out of handling crises. In the 1990s the celebrated car executive essentially saved first Renault and then Nissan, and for the past 11 years he's served as CEO of both. A Brazilian-born Lebanese-Frenchman—the very embodiment of globalization—he somehow manages to be a hands-on executive on two continents.

He is also among the most recognizable figures in the industry. By restructuring Renault and restoring it to profitability, he earned the nickname "Le Cost Killer." For his success in overhauling Nissan, which formed an alliance with Renault in 1999, Ghosn won the sobriquet "Mr. Fix-It." And he is famously portrayed as a superhero in a Japanese comic-book series.

But technology can humble even the most successful executives, and Ghosn these days is focused on trying to remain an innovator. Dramatic advances—electric cars, vehicles that operate with significant autonomy, fully self-driving cars—threaten to shake up the industry. Upstarts like Tesla and even Google are now in the automotive business. The transformation is sure to crown new market leaders and ding some incumbents. "We expect major disruptions in technology," says Ghosn, "which will change the product mix."

The challenge seems to have energized the 62-year-old leader. He has invested billions in electric-vehicle development at both Renault and Nissan. He took a big gamble with the Nissan Leaf back in 2010. But although the Leaf is the industry's top-selling all-electric car, with more than 200,000 units on the road, its overall sales are at least four years behind initial expectations. The problem, Ghosn says, isn't with the product but with the slow development of the supporting infrastructure. But it's a problem nonetheless.

And so Ghosn is scrambling to find ways to maintain his track record: tapping into synergies within the alliance, cutting costs, being the public cheerleader for his companies. In May he concluded another big deal, as Nissan invested $2.2 billion for a controlling 34% stake in troubled Mitsubishi Motors. The now-triple alliance presents Ghosn with further opportunities for cost savings—through shared work in engineering, production, and other areas.

It's a complex managerial challenge, and investors have wondered aloud if anyone other than Ghosn could handle it. Renault and Nissan's combined worldwide car sales last year totaled 8.5 million units. Add in the 1 million that Mitsubishi sold, and Ghosn's companies are approaching sales of 10 million cars a year—making the alliance the world's fourth-largest carmaker, after Toyota, Volkswagen, and General Motors.

Ghosn took a break from it all recently in New York City to talk with HBR's editor in chief, Adi Ignatius, about the future of the auto industry.

HBR: A lot of the innovation in cars these days is coming from Google and others in Silicon Valley. Is that worrisome for the auto industry?

Ghosn: I'm not worried. Sure, it's interesting to talk about Apple or Google making cars. But we have a long tradition of taking technology from the outside and putting it into our products. Automakers are architects. We assemble parts. We assemble technologies. We assemble know-how—all to make a product and bring it to the consumer. Our big challenge is, How do you put new technologies into a car while continuing to deliver on classic expectations?

Do you fear the rise of new manufacturers?

If a tech company wants to become a car manufacturer, it will buy an existing automaker and transform it according to its own criteria. But I don't think that's what tech firms are looking to do. The fact that new players are developing technologies to help make cars more attractive is good for us, because we never want to become a "commodity." We want the car to continue to be a high-tech, exciting product that people desire. Today that comes from design, driving performance, and the quality of the materials.

Going forward, we want to add more connectivity, along with more autonomous-driving functions.

What's your vision for autonomous drive? We're introducing sophisticated functions to empower the driver, who can decide when to drive and when not to. And if he or she decides not to drive, we'll have the technology to ensure that it's in a safe and low-stress environment where the driver can be doing something else.

What does "empower" mean? It means giving you options. I don't hear anyone say, "I love driving in traffic jams," or even on highways with miles and miles of road ahead. But people love driving in the countryside, where they can enjoy the car's performance. In the future, when you're bored, you can give up the driving. And when you are excited about being behind the wheel, you can take back control. We know that consumers want that.

What are some of the most promising of these self-driving features? We already have single-lane autopilot. When your car deviates from the lane, the system brings it back. We have an autonomous braking system. If you get too close to the car in front of you, the car brakes without your intervening. The car is making decisions, for safety reasons, without you. And there's autoparking. Cars will be able to park themselves. The ultimate step is for cars to be able to handle city driving.

How close is the industry to producing these kinds of advanced autonomous vehicles? It's coming in waves. Cars today already have a lot of autonomous functions. People will really notice it when these functions combine to offer drivers the full possibility of giving up driving. We plan to bring such a car to market in 2020.

Will competitors beat you to it? According to their statements, yes. But the reality? We don't know. We've heard a lot of claims. Some carmakers said they'd be mass-marketing fuel-cell cars this year. Come on! Selling 500 cars is not mass-marketing.

I assume these innovations will create tricky new liability issues. Not with autonomous cars. Because at the end of the day, the driver is responsible for the vehicle, even as he or she has more ability to give up the driving. There is a robust and important dialogue taking place about this, but ultimately drivers must understand their legal responsibilities while behind the wheel. At the same time, automakers must take steps to educate customers about how much control they can cede to the vehicle. The manufacturer is responsible if the car malfunctions. The confusion starts with driverless cars, like Google's, where you have no one inside calling the shots.

Hardware and Software

It seems that you now have to manage a couple of cycles: the car-design cycle and the technology cycle, which I presume turns over more quickly. Yes, but it's manageable. It's like the smartphone. You have hardware, which can last for a while, and software, which adjusts all the time. The car is going to last five or six years, while the software inside can be updated far more rapidly and from a distance.

> You can't afford people who are doing just OK. You need high performers.

Does that suggest there will be a convergence whereby competing auto manufacturers all use the same operating systems within their cars? I'm not sure about that. At this point we want to figure out how we can get the most up-to-date technology without losing control of the content within our systems. If we lose that, the car becomes just hardware, and somebody else is going to develop all the apps. So we need to be very prudent and make sure that no matter what gets put into the car, we maintain control of our product.

So you view the interior electronics as an enduring competitive advantage. Sure we do.

Getting Beyond Oil

How does the low cost of oil affect the pace of innovation in your business? It's good for the industry overall. We've had low interest rates, cheap oil, cheap raw materials—and it's all been favorable. Last year was great for the industry as a whole, and I think 2016 overall will be the same. Of course, there is a downside. Fuel efficiency is less of a concern for consumers, because at these prices it's not economically penalizing to have an inefficient car. But I don't think the pace of innovation has slowed. For one thing, nobody believes the price of oil will stay low forever. For another, people are concerned not just about fuel efficiency, but also about emissions. That picture is getting better thanks to regulations on CO_2 and other emissions.

The best response to a problem is to be transparent.

As a manufacturer, do you welcome governments' setting industry standards on emissions? Does that level the playing field in a good way, or does it take away competitive advantage? Consumers care about emissions. They worry about global warming and about which technologies are sustainable and which aren't. This is where you need governments, because they have the authority and credibility to say, "This is the level that we consider acceptable." So it's very important to have regulations.

Let's talk about your top electric model, the Nissan Leaf. What have you learned about the electric-car market so far? In terms of the technology, the Leaf has been a big success. People worried that it wouldn't be reliable, that the batteries wouldn't work. But it's a great car. In our customer surveys, Leaf owners report the highest levels of satisfaction. We've sold more than 200,000 units. The problem is that sales are below what we thought we could achieve. The reasons are becoming clear. People complain about the recharging infrastructure and the range. The Leaf can go 100 miles on battery power, but that's not enough for many people. They want 200 or 400 miles. And this complaint is linked to the still small number of charging stations, which makes drivers anxious.

Had you expected that this market would develop more quickly? Yes. The recharging infrastructure is developing very slowly, and that's keeping a lot of people from buying an electric car. We're working, among other things, on enhancing the battery to extend the car's range, but the problem won't be solved until there is a larger network of charging stations. Nissan is focused on this as well and is working closely with public- and private-sector partners to further develop the global recharging infrastructure.

The Leaf is at the low end of this market. When you look at Tesla, do you think about getting into the high end? We are about mass-marketing electric cars. If you want to make a difference for the environment, you need to produce a lot of these cars. Putting out 100,000 electric cars frankly isn't going to make a big difference. You have to have millions of electric cars on the roads, which means you have to invest in the mass market. We won't enter the premium space until we have a full range of cars for the mass market.

What will the auto industry look like in five years? We expect major disruptions in technology, which will change the product mix. You'll see more electric cars, more autonomous drive, and more connectivity. But it's hard to speculate, because much of the change will depend on governments' willingness to legislate on emissions and put in basic recharging infrastructure.

Who should build that infrastructure? You? Governments? Entrepreneurs who see an opportunity? It's up to governments to create the conditions in which somebody can make a business out of it. It's like gasoline stations in the old days. The government didn't build them, but it created an environment in which it made sense for people to make them a business.

Capitalizing on Digital Innovation

Connectivity could make converts out of folks who are not car people and create a way for them to love their cars. Oh, yeah. I see a lot of advantages—for improving quality of life and productivity—that will come from making the car a mobile, connected workspace.

But you'll need to ensure that when people buy a new car, just as when they get a new phone, all their personal data is easily transferable. Exactly. We're at the very beginning of connectivity. But we're excited about it, because it's going to make the car an indispensable personal space. A bit like your house or your office.

Speaking of digital innovation, are we at the beginning of the post-dealership era in car sales? I don't buy that. People get a lot of information from the net, but they always complete the deal with a dealer. They want to see the real product. They want to touch it. They want to feel it. And they want to negotiate the price and conclude the deal.

Are you worried that Uber and other car-sharing apps will cut into new car sales? I'm not worried. By our estimates, the industry sold 85 million cars worldwide in 2015 and is moving toward 87 million this year—both industry records. And we still have a reservoir of growth in emerging markets.

One CEO, Two Companies

Shifting gears, I want to ask how you have been able to run two companies. I mean, literally, how do you do it? About half of my time is predetermined, with board meetings, executive committee meetings, product meetings, design meetings, and so on—for two separate companies. One week a month all of the key Nissan people are with me in Tokyo. We compress everything into that week and make most of the big decisions. And then our top managers are free the rest of the month to be out with their teams. I do the same thing with the Renault team for one week a month in Paris.

What do you do with your unscheduled time? That's when I'm in operations, visiting specific markets, researching the latest technologies, spending time with suppliers and buyers. That is my time to look for the next opportunity, the next frontier.

Have you developed a philosophy on what makes a great CEO? In my case, heading two companies, I realize more than most that you have to empower the people around you. And that also means strict organization and accountability for everyone's performance. You can't afford to have somebody who's doing just OK. You need high performers.

As CEO, what do you need to concentrate on most? The most important thing is selecting the right people. And that includes preparing the younger generation, who will eventually take on key roles. If you miss on that, it's a pain. Having the wrong guy at the top is like shutting down an engine on your airplane. The other crucial thing is strategy. What products are priorities? What technology will we introduce? Where will we invest? What are we going to do? What are we not going to do?

How important is it for a CEO to be out there in front of the public? I'm not the only one who needs to be out there. The people heading our country operations are also out there a lot. But if we're doing something like launching a global car, the CEO needs to be visible, because then the media will think it's important. But I don't do a lot of that. I prefer to concentrate on strategic matters.

You've been at Nissan for 17 years. What are the pluses and minuses of such a long tenure in the CEO slot? It depends on the industry and the CEO, but the ultimate questions will always be,

Is the company growing? Is it profitable? And is the shareholder return growing? If not, no one is going to stay in a job like this. If so, it's probably better to keep the devil you know than try the one you don't.

How would you describe the contrasting culture of the CEO in Japan, Western Europe, and the U.S.? It's hard to generalize about Europe because things vary so much from country to country. But I can talk about Japan and the U.S. In Japan the president is the equivalent of the CEO and the guardian of the integrity and sustainability of the company. The president is the face of the company but not always the most competent and active person in the organization. He or she needs to be the most reassuring person, the one who is entrusted to preserve the company and its values.

What about in the U.S.? In the U.S. you have to perform—or that's it. There's more focus on short-term financial results. You are worth as much as your last quarter or your last year. It's transactional: You deliver, you get paid. If you're looking for recognition, buy yourself a dog.

Have the problems at Volkswagen and Takata affected the auto industry broadly? Sure. Every time you have such a situation, there is suspicion: Is it a wider issue? Is it an industry problem? The best response is to be transparent, to get out there as soon as possible to reestablish trust. That's why you see so many recalls these days. It's not because there are more problems but because carmakers understand that it's better to act before the issue gets bigger.

What do you still hope to accomplish in your roles? I want to make sure the Nissan-Renault Alliance continues to be solid, with good performance and good governance. I don't want people to say, "Oh, it's working only because Carlos Ghosn is there."

Is that viewpoint fair? I don't think so. But I hope the next two to three years will show that more clearly, with strong growth and profit for Renault that matches Nissan's.

You've had great nicknames in the past—"Le Cost Killer," "The Icebreaker," "Mr. Fix-It." What should we call you now? I don't know. I don't make these names up; I just read them in the newspaper. You should come up with one for me.

I'll work on it and run it by you. You shouldn't be the last to know. OK!

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Developing Risk Management for the Future

ZURICH®

Globalization, new technologies, changing demographics and a rapid-cycle economy are all having an impact on the insurance industry. Today, insurance companies must rethink human capital strategies to ensure they have the talent that can meet customer needs for risk management services in a new era. *Harvard Business Review* recently talked with Don Pickens, Chief Underwriting Officer, Zurich Global Corporate in North America, about Zurich's approach to recruiting and developing its global workforce.

How are shifts in demographics, as well as the economy, challenging insurance companies in meeting their talent needs?

There is a sizable group of insurance professionals with a high degree of knowledge and experience who are approaching retirement age. The industry employs about 2.5 million people. Over the next five years or so, we may have to replace as many as 25 percent of the people in our workforce. So we must figure out how to get the right degree of institutional knowledge transferred, and provide the mentoring and development to a new group of professionals to keep them engaged and energized so they can build a sustainable business and risk platform for the industry.

There is a lot of competition for top young talent. How can insurance companies compete when so many other options are available? Does insurance have an "image problem"?

The insurance industry does have a bit of an image problem. The industry has been around for centuries because the concept of sharing the risks of the few among the many is crucial for society. By some estimates, about 7 percent of the GDP flows through the insurance industry for all the products in use. That is a remarkable number: We don't do enough to celebrate the value that we bring. Insurance puts families and businesses back together when something happens. Insurance allows businesses to take calculated risks, develop new products, and transform services and lifestyles. It's a very noble profession, filled with smart, passionate people. With our data, analysis and tools, we're part of managing risk in almost every area of life. That's exciting, but maybe we're too far removed for people to see the "glamour."

What kinds of programs do you use to attract and enhance the skills of the underwriting professionals working for Zurich?

We're a truly global company, so we offer people an opportunity to train and work in different disciplines and geographies. Underwriters must understand multiple risk dimensions to make thoughtful financial and strategic decisions about risk. That's why we expose people to different roles and experiences throughout the company. We have a variety of foundational and ongoing training programs, including our Zurich Experts Underwriting program, to bring in new talent to the organization and blend very specific training with on-the-job learning.

What is Zurich doing to develop the new talent base you will need in the future?

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OWEN DAVEY

Why power corrupts
PAGE 112

Managing Yourself

Don't Let Power Corrupt You

How to rise to the top without losing the virtues that got you there *by Dacher Keltner*

In the behavioral research I've conducted over the past 20 years, I've uncovered a disturbing pattern: While people usually gain power through traits and actions that advance the interests of others, such as empathy, collaboration, openness, fairness, and sharing; when they start to feel powerful or enjoy a position of privilege, those qualities begin to fade. The powerful are more likely than other people to engage in rude, selfish, and unethical behavior. The 19th-century historian and politician Lord Acton got it right: Power *does* tend to corrupt.

I call this phenomenon "the power paradox," and I've studied it in numerous settings: colleges, the U.S. Senate, pro sports teams, and a variety of other professional workplaces. In each I've observed that people rise on the basis of their

OWEN DAVEY

A study of two call centers in China found that **workers are 6% more productive** on low-pollution days than they are on high-pollution ones.

"THE EFFECT OF POLLUTION ON WORKER PRODUCTIVITY: EVIDENCE FROM CALL-CENTER WORKERS IN CHINA," BY TOM CHANG, JOSHUA GRAFF ZIVIN, TAL GROSS, AND MATTHEW NEIDELL

good qualities, but their behavior grows increasingly worse as they move up the ladder. This shift can happen surprisingly quickly. In one of my experiments, known as "the cookie monster" study, I brought people into a lab in groups of three, randomly assigned one to a position of leadership, and then gave them a group writing task. A half hour into their work, I placed a plate of freshly baked cookies—one for each team member, plus an extra—in front of everyone. In all groups each person took one and, out of politeness, left the extra cookie. The question was: Who would take a second treat, knowing that it would deprive others of the same? It was nearly always the person who'd been named the leader. In addition, the leaders were more likely to eat with their mouths open, lips smacking, and crumbs falling onto their clothes.

Studies show that wealth and credentials can have a similar effect. In another experiment, Paul Piff of UC Irvine and I found that whereas drivers of the least expensive vehicles—Dodge Colts, Plymouth Satellites—*always* ceded the right-of-way to pedestrians in a crosswalk, people driving luxury cars such as BMWs and Mercedes yielded only 54% of the time; nearly half the time they ignored the pedestrian and the law. Surveys of employees in 27 countries have revealed that wealthy individuals are more likely to say it's acceptable to engage in unethical behavior, such as taking bribes or cheating on taxes. And recent research led by Danny Miller at HEC Montréal demonstrated that CEOs with MBAs are more likely than those without MBAs to engage in self-serving behavior that increases their personal compensation but causes their companies' value to decline.

These findings suggest that iconic abuses of power—Jeffrey Skilling's fraudulent accounting at Enron, Tyco CEO Dennis Kozlowski's illegal bonuses, Silvio Berlusconi's bunga bunga parties, Leona Helmsley's tax evasion—are extreme examples of the kinds of misbehavior to which all leaders, at any level, are susceptible. Studies show that people in positions of corporate power are three times as likely as those at the lower rungs of the ladder to interrupt coworkers, multitask during meetings, raise their voices, and say insulting things at the office. And people who've just moved into senior roles are particularly vulnerable to losing their virtues, my research and other studies indicate.

The consequences can be far-reaching. The abuse of power ultimately tarnishes the reputations of executives, undermining their opportunities for influence. It also creates stress and anxiety among their colleagues, diminishing rigor and creativity in the group and dragging down team members' engagement and performance. In a recent poll of 800 managers and employees in 17 industries, about half the respondents who reported being treated rudely at work said they deliberately decreased their effort or lowered the quality of their work in response.

Studies show that people in positions of corporate power are three times as likely as other employees to interrupt coworkers, raise their voices, and say insulting things at the office.

So how can you avoid succumbing to the power paradox? Through awareness and action.

A Need for Reflection

A first step is developing greater self-awareness. When you take on a senior role, you need to be attentive to the feelings that accompany your newfound power and to any changes in your behavior. My research has shown that power puts us in something like a manic state—making us feel expansive, energized, omnipotent, hungry for rewards, and immune to risk—which opens us up to rash, rude, and unethical actions. But new studies in neuroscience find that by simply reflecting on those thoughts and emotions—"Hey, I'm feeling as if I should rule the world right now"—we can engage regions of our frontal lobes that help us keep our worst impulses in check. When we recognize and label feelings of joy and confidence, we're less likely to make irrational decisions inspired by them. When we acknowledge feelings of frustration (perhaps because subordinates aren't behaving the way we want), we're less likely to respond in adversarial or confrontational ways.

You can build this kind of self-awareness through everyday mindfulness practices. One approach starts with sitting in a comfortable and quiet place, breathing deeply, and concentrating on the feeling of inhaling and exhaling, physical sensations, or sounds or sights in your environment. Studies show that spending just a few minutes a day on such exercises gives people greater focus and calm, and for that reason techniques for them are now taught in training programs at companies like Google, Facebook, Aetna, General Mills, Ford, and Goldman Sachs.

It's also important to reflect on your demeanor and actions. Are you interrupting people? Do you check your phone when others are talking? Have you told a joke or story that embarrassed or humiliated someone else? Do you swear at the office? Have you ever taken sole credit for a group effort? Do you forget colleagues' names? Are you spending a lot more money than in the past or taking unusual physical risks?

If you answered yes to at least a few of these questions, take it as an early warning sign that you're being tempted into problematic, arrogant displays of power. What may seem innocuous to you probably doesn't to your subordinates. Consider a story I recently heard about a needlessly hierarchical lunch-delivery protocol on a cable-television writing team. Each day when the team's sandwiches arrived, they were doled out to the writers in order of seniority. In failing to correct this behavior, the group's leaders were almost certainly diminishing its collaborative and creative potential. For a contrast, consider U.S. military mess halls, where the practice is the reverse, as the ethnographer and author Simon Sinek notes in the title of his most recent book, *Leaders Eat Last*. Officers adhere to the policy not to cede authority but to show respect for their troops.

Practicing Graciousness

Whether you've already begun to succumb to the power paradox or not, you must work to remember and repeat the virtuous behaviors that helped you rise in the first place. When teaching executives and others in positions of power, I focus on three essential practices—empathy, gratitude, and generosity—that have

been shown to sustain benevolent leadership, even in the most cutthroat environments.

For example, Leanne ten Brinke, Chris Liu, Sameer Srivastava, and I found that U.S. senators who used empathetic facial expressions and tones of voice when speaking to the floor got more bills passed than those who used domineering, threatening gestures and tones in their speeches. Research by Anita Woolley of Carnegie Mellon and Thomas Malone of MIT has likewise shown that when teammates subtly signal understanding, engagement, interest, and concern for one another, the team is more effective at tackling hard analytical problems.

Small expressions of gratitude also yield positive results. Studies show that romantic partners who acknowledge each other's value in casual conversation are less likely to break up, that students who receive a pat on the back from their teachers are more likely to take on difficult problems, and that people who express appreciation to others in a newly formed group feel stronger ties to the group months later. Adam Grant of Wharton has found that when managers take the time to thank their employees, those workers are more engaged and productive. And my own research on NBA teams with Michael Kraus of Yale University shows that players who physically display their appreciation—through head raps, bear hugs, and hip and chest bumps—inspire their teammates to play better and win nearly two more games per season (which is both statistically significant and often the difference between making the play-offs and not).

Simple acts of generosity can be equally powerful. Studies show that individuals who share with others in a group—for example, by contributing new ideas or directly assisting on projects not their own—are deemed more worthy of respect and influence and more suitable for leadership. Mike Norton at Harvard Business School has found that when organizations provide an opportunity to donate to charities at work, employees feel more satisfied and productive.

It might seem difficult to constantly follow the ethics of "good power" when you're the boss and responsible for making sure things get done. Not so. Your capacity for empathy, gratitude, and generosity can be cultivated by engaging in simple social behaviors whenever the opportunity presents itself: a team meeting, a client pitch or negotiation, a 360-degree feedback session. Here are a few suggestions.

To practice empathy:

- **Ask a great question or two in every interaction, and paraphrase important points that others make.**
- **Listen with gusto. Orient your body and eyes toward the person speaking and convey interest and engagement vocally.**
- **When someone comes to you with a problem, signal concern with phrases such as "I'm sorry" and "That's really tough." Avoid rushing to judgment and advice.**
- **Before meetings, take a moment to think about the person you'll be with and what is happening in his or her life.**

Arturo Bejar, Facebook's director of engineering, is one executive I've seen make empathy a priority as he guides his teams of designers, coders, data specialists, and writers. Watching him at work, I've noticed that his meetings all tend to be structured around a cascade of open-ended questions and that he never fails to listen thoughtfully. He leans toward whoever is speaking and carefully writes down everyone's ideas on a notepad. These small expressions of empathy signal to his team that he understands their concerns and wants them to succeed together.

To practice gratitude:

- **Make thoughtful thank-yous a part of how you communicate with others.**
- **Send colleagues specific and timely e-mails or notes of appreciation for jobs done well.**
- **Publicly acknowledge the value that each person contributes to your team, including the support staff.**
- **Use the right kind of touch—pats on the back, fist bumps, or high fives—to celebrate successes.**

When Douglas Conant was CEO of the Campbell Soup Company, he emphasized a culture of gratitude across the organization. Each day he and his executive assistants would spend up to an hour scanning his e-mail and the company intranet for news of employees who were "making a difference." Conant would then personally thank them—everyone from senior executives to maintenance people—for their contributions, usually with handwritten notes. He estimates that he wrote at least 10 a day, for a total of about 30,000 during his decade-long tenure, and says he would often find them pinned up in employees' workspaces. Leaders I've taught have shared other tactics: giving small gifts to employees, taking them out to nice lunches or dinners, hosting employee-of-the-month celebrations, and setting up real or virtual "gratitude walls," on which coworkers can thank one another for specific contributions.

> Campbell Soup CEO Douglas Conant handwrote at least 10 thank-you notes to his employees each day.

To practice generosity:

- **Seek opportunities to spend a little one-on-one time with the people you lead.**
- **Delegate some important and high-profile responsibilities.**
- **Give praise generously.**
- **Share the limelight. Give credit to all who contribute to the success of your team and your organization.**

Pixar director Pete Docter is a master of this last practice. When I first started working with him on the movie *Inside Out,* I was curious about a cinematic marvel he'd created five years before: the montage at the start of the film *Up,* which shows the protagonist, Carl, meeting and falling in love with a girl, Ellie; enjoying a long married life with her; and then watching her succumb to illness. When I asked how he'd accomplished it, his answer was an exhaustive list of the 250 writers, animators, actors, story artists, designers, sculptors, editors, programmers, and computer modelers who had worked on it with him. When people ask about the box-office success of *Inside Out,* he gives a similar response. Another Facebook executive I've worked with, product manager Kelly Winters, shares credit in a similar way. When she does PowerPoint presentations or talks to reporters about the success of her Compassion team, she always lists or talks about the data analysts, engineers, and content specialists who made it happen.

YOU CAN OUTSMART the power paradox by practicing the ethics of empathy, gratitude, and generosity. It will bring out the best work and collaborative spirit of those around you. And you, too, will benefit, with a burnished reputation, long-lasting leadership, and the dopamine-rich delights of advancing the interests of others.

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Dacher Keltner is a professor of psychology at University of California, Berkeley, and the faculty director of the Greater Good Science Center.

Case Study
Competing with a Goliath

A Peruvian apparel company struggles to position itself against a global brand. *by Jill Avery*

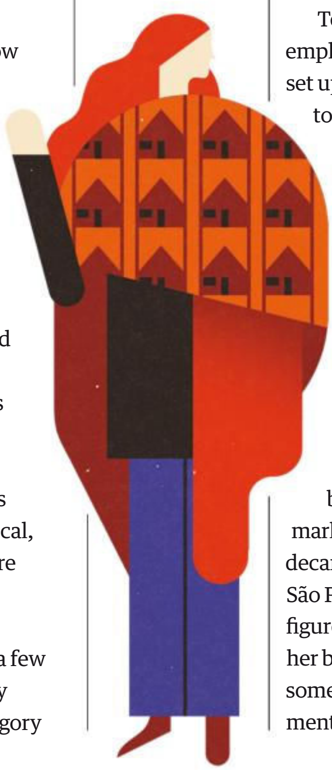
"IT FEELS WEIRD eavesdropping like this," Alejandra Chirinos told Ricardo Rodriguez, her marketing VP, and Miguel Martinez, her head of sales. They were in a conference room in Lima watching a focus group in Surrey, England, via Skype as the group discussed the fashion ponchos designed and manufactured by Alejandra's five-year-old company, Tela.

Ricardo chuckled. "They know they're being watched," he said.

Soledad Orellana, the market research consultant who'd arranged the session, concurred. "There are cameras everywhere in that room."

This was Alejandra's first focus group. She'd agreed to it because Soledad and Ricardo had convinced her that Tela needed to up its marketing game if it was to compete on an international stage against the U.S.-based poncho maker Saira. While Tela's ponchos were made in Peru of local, sustainable materials, Saira's were made in Bangladesh of cheaper materials and labeled "Peruvian design." But Saira had launched a few years before Tela and had quickly captured a 60% share of the category across markets in western Europe and North and South America—in fact, in every South American country except Peru. This was mostly due to its smart and heavily marketed "buy one, give one" business model: Like TOMS with shoes and Warby Parker with eyeglasses, Saira donated a poncho to a person in need for each one a customer purchased.

Jill Avery is a senior lecturer in the marketing unit at Harvard Business School.



CHRISTOPHER DELORENZO

Tela had a social mission too. It employed traditional weavers and set up programs to teach weaving to underprivileged women. And not only were its ponchos authentically Peruvian, but they retailed for $40 to $70, whereas Saira charged $60 to $100. But Tela hadn't been able to get those messages across outside its home market, and Peru was too small to provide a platform for continued growth.

Ricardo, a Lima native who'd been working as Saira's head of marketing for South America, had decamped from the U.S. company's São Paulo office to help Alejandra figure out how to better position her brand. She was thrilled to find someone with his experience, not to mention a shared love of the product and Peru. Together they'd decided to invest a sizable portion of their meager marketing budget to partner with Soledad on developing and testing several marketing messages in key expansion markets, such as the UK.

On-screen, a British facilitator stood facing 10 compatriots. "If you had to use one word to describe the ponchos in your hands, what would it be?" she asked.

"Soft," replied a woman with dyed red hair.

An older lady spoke next: "Peru."

"Real," said a man with a nose ring.

"I know this isn't one word, but I have to ask a question," said a guy in the back. "This is the same poncho as Saira's, right? With a different label?"

Ricardo winced. "Ouch, that stings," he said. He had come to believe that Saira's charitable giving was just a marketing ploy designed to cover the fact that the quality of the products didn't warrant their high prices.

"It's not a bad thing," Miguel countered. "If customers see no difference between our products and Saira's but ours cost less, it will be easy to take some of its market share."

This was an ongoing debate between the two men: Should Tela emphasize the quality and authenticity of its products, or their affordable prices? Alejandra had always argued that the company should promote its social mission. It sometimes infuriated her that Saira had claimed the crown of "do good" poncho company before Tela had had a chance to make a mark. But her colleagues and Soledad agreed that the company needed one simple story to sell to customers around the world. Saira had "buy one, give one." What did Tela's brand stand for?

Alejandra held up a hand. "We're not here to rehash old arguments," she said. She looked at the screen. "Let's listen to what they have to say."

Case Study Teaching Notes

Jill Avery teaches the case on which this one is based in her branding course.

WHAT DREW YOU TO THIS STORY?
I've been researching how underdog brands can position themselves as passionate and determined by calling attention to their disadvantaged status. While in Buenos Aires I visited Paez and found that it was experimenting with several value propositions to compete against TOMS but hadn't yet given thought to labeling itself an underdog.

HOW DO STUDENTS TYPICALLY REACT?
They are often reluctant to make hard choices about the positioning options and want to combine all the messages into one.

WHAT LESSONS DOES THE CASE OFFER?
Strong, compelling value propositions are relevant to consumers and durable against the competition. This case provides an opportunity to analyze some of the most common positioning options companies are using today—price, social mission branding, authenticity, and lifestyle.

The Social Mission

Soledad and Ricardo had come up with four concepts to test. The first emphasized Tela's support of local entrepreneurs and workers; the second its made-in-Peru bona fides; the third its price point. The fourth was a combination of the other three.

As the facilitator read the taglines for the first concept—"Tela isn't just about style; it's about livelihood" and "Our ponchos keep you warm and keep women entrepreneurs in business"—there was lots of nodding in the focus group.

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

The red-haired woman said she tried to buy "socially responsible" products, and a young man agreed it was important to "give back to a cause."

Alejandra smiled. "See, I told you mission matters," she said, forgetting the directive she'd given moments before. "Maybe we've found a winner."

"Not so fast," Soledad warned. "That was just the first one."

Ricardo was only too happy to jump back into the conversation. "Unfortunately, Saira has already staked out that territory," he said.

"Yes, but it's our territory too," Alejandra replied. "I founded this company to give Peruvians stable, well-paying jobs and to help develop a new class of entrepreneurs."

"You don't have to convince me that what we do is more effective and important than what Saira does," Ricardo said. "They hand out donations; we create employment and develop economies. But they sold their social mission first and better. We can't compete. We'd look like copycats—ones with a much more complicated message."

"You could ride in their marketing tailwind," said Soledad. "A lot of small companies have grown by attaching their sails to the biggest ship."

As if on cue, the man who had mentioned their rival did so again. "I'd bet doing good is why Saira has become so big in the UK," he said. "When you buy a poncho for yourself, you're helping someone else. It's easy to understand. I guess I care about helping weavers and Peru's economy. But putting warm clothes on a child's back? That just feels good."

Ricardo gave Alejandra an "I told you so" look.

Authenticity

The facilitator turned to the next concept, the one positioning Tela as a maker of "authentic Peruvian ponchos" with an emphasis on tradition and back-to-the-land craftsmanship.

When she finished reading the taglines, a young woman spoke up. "I don't understand the distinction. I know the knockoffs in Tesco aren't made in Peru. But Saira's are, right?"

"Wrong!" Ricardo shouted.

The facilitator explained the differences between the two companies' supply chains, and Ricardo got excited. "I'm telling you, this is Saira's Achilles' heel," he said. "The people buying these ponchos want to know they're getting the real thing, and my old colleagues are shaking in their boots, worried that someone will expose their product as the fraud it is."

Miguel shook his head. "You really think they spend time worrying about us? They're too focused on world domination. And what are you suggesting—that we go on the attack? Accuse Saira of cultural misappropriation? Not only would that diminish our brand, it would be like a flea kicking an elephant's toe!"

Alejandra shushed them. The Saira fan was talking again; she was beginning to think he worked for the company. "Does it really matter where they're made as long as the quality is good and you know you're helping someone?" he asked.

"It matters to me," said the man with the nose ring.

"Yes!" Ricardo shouted, pumping his fist as if he were watching a soccer match, not a focus group.

"I disagree," the redhead said. "And Saira's not lying. It's a design from Peru that's made in Bangladesh—where they need jobs too, by the way."

Several in the focus group murmured in agreement. Ricardo groaned.

Affordability

The facilitator turned to the third set of taglines: "Fashion at the right price" and "A poncho for real people."

Miguel leaned forward. "If Saira has an Achilles' heel, *this* is it," he said to Ricardo. "Customers might say they care about social mission or authenticity, but all they really want is a nice poncho for a good price."

"This is where Saira's size helps you," Soledad said. "They've built up demand, and you can swoop in and win over the more price-sensitive consumers without spending a lot."

"And I don't need to tell you how little we have to spend," Miguel said.

"But will a $20 price difference matter that much?" Ricardo asked.

"Let's find out," said Soledad, pointing to the screen.

The man with the nose ring was speaking. "Wait a minute," he said. "How can Tela provide the same quality as Saira at a lower price? If it's selling its ponchos so cheaply, are the weavers even making any money?"

"Because we're not ridiculously marking them up," Miguel muttered.

"It's like people don't understand that the buy one, give one model means consumers are essentially paying for two ponchos!" Ricardo said. On this, he and Miguel saw eye to eye.

The older woman was saying she liked this concept best. "Saira is for young people. I'm on a pensioner's income, and I want to know I'm getting the best deal out there."

After a pause, the nose-ring guy spoke again. "Still doesn't make sense to me. Something's fishy."

Miguel put his head in his hands.

"This is one of the risks of a fast-follower strategy," Soledad said. "Consumers assume the lower-priced product is lower quality."

"So we should emphasize authenticity," Ricardo replied. "Let people know our product is the real deal."

"We're not done yet," Soledad said.

A Combination?

"I'm not sure why we're even testing this batch," Miguel said as the facilitator turned to the last concept, the taglines that combined all the other positions.

Alejandra knew they were doing it only to placate her, but she couldn't help feeling that the more complex message was the most accurate one. Tela didn't offer just authentic ponchos made in Peru, or ones that helped women and families, or ones people could afford. It offered *all* those things, and she wanted consumers to understand that.

The facilitator read the taglines: "Locally sourced and mission driven, without passing the cost on to you." "The real thing at an affordable price." "Buy Peru, build Peru."

A long silence hung over both rooms.

"I'm sorry to say it, Jandra, but they look awfully confused," Ricardo said.

It was another few seconds before the man with the nose ring said, "I don't get it. What's the brand?"

The redhead chimed in: "Is this supposed to be all the messages mixed together?"

Alejandra sighed. It looked as if Soledad and the others were right.

The facilitator wrapped up the session, and the participants shuffled out, most giving a small wave to the cameras. After the screen went black, Soledad was the first to speak.

"As I've said all along, the decision isn't solely up to customers. Sure, the participants were leaning toward the social mission, but I have hesitations about that direction. Branding is like trying to buy real estate in the consumer's mind, and I'm not sure you want to spend time and resources fighting for space Saira already has. You might be better off finding an empty lot elsewhere. And at the end of the day, you need a message that feels comfortable for Tela."

Alejandra had to laugh. "None of this is particularly comfortable," she said.

She was joking, but she didn't know how they were going to resolve this. Ricardo had deep industry experience, but she couldn't tell if his judgment was clouded by a personal desire to undermine his old employer. Miguel had been with Tela since the beginning but was acting the way any salesperson would. Her own instinct was to promote the mission even if it meant an uphill battle.

"It's not easy," Soledad said with a sympathetic smile. "You're figuring out what the soul of your company is."

"Or at least what we're going to tell the world our soul is," Alejandra replied. "I don't want to hide who we really are behind a message that's easier to explain."

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 "Paez" (case no. 316085-PDF-ENG), by Jill Avery, Maria Fernanda Miguel, and Laura Urdapilleta, which is available at **HBR.org**.

Q

Which positioning should Tela use?

See commentaries on the next page.

The Experts Respond

Consumers are capable of appreciating layered messages.

Mark Rampolla is a partner at Powerplant Ventures, a fund focused on remaking the global food system. He was previously the founder and CEO of Zico, a maker of coconut water.

ALEJANDRA HAS been given a false choice. Yes, finding the right positioning is critical, especially for a small company facing serious competition. Yes, it's important to develop a clear, simple message. And yes, you have only one chance to own a piece of consumers' minds. But like life and careers, brands don't fit into neat boxes. The business is always going to be deeper and wider than a one-sentence tagline. Instead of picking a statement that she's not comfortable with, Alejandra needs to find the mission she wants to champion.

Unfortunately, the process Tela is using won't yield that. The group needs to back up a bit. Alejandra should spend the little money she has on internal research first. Instead of asking how consumers view the brand, the company should ask questions like: Who is Alejandra? Why did she start this business? What are her values and personal interests? What is she trying to achieve with Tela? Market share is relevant, but it's not a destination in itself. Is Tela about livable wages? The number of women empowered? These questions can help the company get to the core of who Alejandra is, what Tela stands for, and how it ultimately defines success.

Once the group has done that deep internal research, it can look outside the firm—not just to consumers but also to retailers, suppliers, and the weavers themselves to find out what those stakeholders think.

During the nine years when I ran Zico, we had three or four distinct positioning statements, but they all came back to our social mission. This was our touchstone: We wanted to see people drinking something more healthful, especially in a world of sugar-laden beverages. We initially positioned Zico as a postworkout replenishment for yogis. It was a very narrow choice, but we were able to reach a broader audience through that community. We eventually expanded to include endurance athletes and others. But we always came back to the mission of promoting healthful living—for our customers, our team, and the people in the communities where we sourced our coconut water.

Tela should expect that its message will similarly morph over time, but it should always return to the soul of the company: having a deep, sustainable impact on Peru and its people. It's possible to convey that while also signaling that the product is affordable and authentic.

Soledad should give consumers more credit. They are capable of comprehending and appreciating layered messages; the days of having to be authentic *or* affordable *or* socially responsible are gone. It's hard to come up with an elegant multifaceted message, but it's not impossible. That's what the group should aim to do: find a positioning that encompasses all the things Alejandra and her team care about. It might try something like: "Tela is the fabric of life. Fabric that warms us, protects us, connects us, inspires us, and benefits all of us." That would feel more like a mission and would attract investors, retailers, and consumers. People don't want a tagline; they want something to believe in.

Alejandra needs to focus less on Saira and more on Tela. You can't fly blind in the face of a large competitor, but it's far more important to know what *you* stand for. If the message is not true to her, it won't be true to anyone else.

Comments from the HBR.org community

Move Upmarket

Tela should position itself as an authentic luxury brand and raise its prices above Saira's. This would play to its strengths as a provider of quality ponchos and expose Saira's weaknesses without a smear campaign. The company could also continue its social mission of building the Peruvian economy.

Raymond J. Cohen, *corporate lending analyst, Israel Discount Bank of New York*

Tap the Power of Storytelling
Tela should use storytelling to highlight both its authenticity and its social cause. It could show a traditional poncho craftswoman earning her daily bread, sending her children to school, and otherwise bettering her life as a result of her work with the company. All it would take is one well-scripted commercial.
Sethu Sankar, *student, SCMS Cochin School of Business*

Forget the Focus Group
I'm skeptical of focus groups, as I believe people find it very difficult to accurately describe why they buy. A more effective test would be to try various marketing approaches in a few different stores and compare actual sales data.
Robert Mendenhall, *director of sales and business development, Guernsey Coating Laboratories*

Tomás Pando is a cofounder and the president of Paez, an Argentine footwear company.

SOLEDAD IS right that you can't be all things to all people, and it would be a big mistake for Tela to try.

> It's important to put a stake in the ground with a clear, consistent message.

One of the major problems brands face today is dilution: too many messages aimed at too many target groups. This may work in the short term, but eventually sales and performance will suffer, because nobody knows what your brand stands for. Alejandra can avoid this by picking one direction for her company's marketing—not a combination—and sticking with it for at least a few years.

This case is loosely based on our experience at Paez, a maker of traditional Argentine *alpargatas*. Several years ago we took stock of our brand position and realized we had been confusing consumers. One year we'd talk about our social mission of building meaningful manufacturing; the next year it was our heritage. Like Alejandra, my cofounder and I were passionate about everything we were doing, so we wanted to promote it all. But the result was confusion. In Argentina consumers said Paez was about design. In Asia they said it was about being yourself. An added complication was the fact that TOMS, a clear leader in the alpargata and now the casual-shoe industry, had beaten us to the social mission message and was doing a great job with it. So we admitted we had made a mistake and froze everything until we could figure out one strong message.

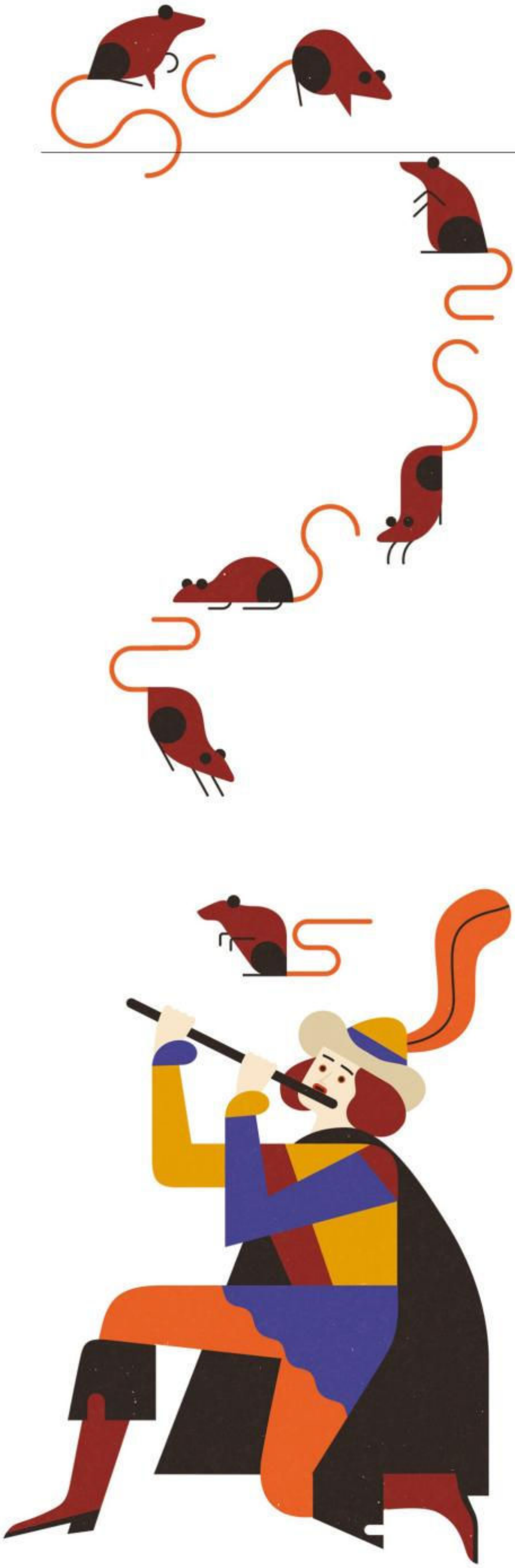
Through internal discussions and consultations with agencies and mentors, we landed on a lifestyle message—Paez is about "enjoying the ride"—and we've stopped talking about other aspects of our company and product, at least for now. We want our brand to inspire consumers to be more independent, appreciate the journey they're on, and not take life too seriously. Once they understand that this is what we represent, we can add other important messages. We still plan to talk about our social mission and the authenticity of our product, but when we do, it will be under the umbrella of our lifestyle brand.

Tela needs to find its focus too. The positioning I find most compelling for it is authenticity. This is a Peruvian company founded and owned by someone giving back to the country she loves. If Tela can communicate those values in a creative way, it will have a leg up on the competition.

It shouldn't obsess about Saira. When you're David to a Goliath, it's tempting to try to exploit your competitor's weaknesses, but that's not enough to build a brand around. To feel fresh to consumers, you have to find your own niche, story, and products.

Alejandra seems very hesitant, almost afraid, to make a choice, but she shouldn't be. It's better to choose a position than to be in the middle of nowhere. If that position doesn't work, or if (and likely when) the competitive landscape, consumer preferences and values, or the company itself changes, you can always add to or adjust it. But it's important to put a stake in the ground now with a clear, consistent message.

HBR Reprint R1610L
Reprint Case Only R1610X
Reprint Commentary Only R1610Z



Synthesis

Resisting the Hard Sell

Learn to distinguish between spin and substance.
by Kevin Evers

The nefarious side of persuasion has been a subject of philosophical inquiry since Aristotle, who warned his fellow Greeks about the dangers of being blinded by a person's charisma and character. He implored his listeners to focus solely on the facts of an argument to avoid being emotionally manipulated.

More than 2,000 years later, that advice is still sound. But let's be honest: We're terrible pupils. No matter how hard we try to remain objective, we get seduced by clever advertising campaigns, flashy presentations, high-powered promises, and gregarious sales reps, colleagues, partners, and job candidates who make bad ideas sound great.

There is hope, however. Although most books and research on persuasion are geared toward helping people become better advocates, they can also serve the reverse purpose: teaching readers how to avoid being manipulated. If we take the time to understand the tricks of the trade and why we're so susceptible to them, we can learn to better protect ourselves.

The first step is to admit our weaknesses, which is easier said than done. Jonah Berger, a marketing professor at Wharton and the author of *Invisible Influence,* a popular business read this past summer, claims that most of us are in denial about our own shortcomings, particularly when it comes to social influence. We're keenly aware when our colleagues and friends are led by others, but we still believe that we're shepherds in crowds of sheep.

This is due to what Berger calls the illusion of difference. We don't see that we're wearing the same Brooks Brothers button-down as a coworker because the shirts are different colors. We don't recognize that we're following our boss's lead because our ideas seem slightly more nuanced. In other words, minor differences can blind us to glaring similarities and lead us to think that our ideas are wholly our own when they're not.

Berger offers advice on avoiding the groupthink that plagues so many organizations. Individuals should speak up with challenges and questions—and, we can infer, managers should be open to such pushback. Better yet, he suggests collecting employee input via secret ballot since we can't be influenced by things that we can't see or hear.

CHRISTOPHER DELORENZO

ROBERT GOTTLIEB: WHAT I'M READING
Oblomov, by Ivan Goncharov
"This is the famous Russian novel about a man who prefers not getting out of bed. Tolstoy loved it, Chekhov loved it, and I love it."

Robert Gottlieb is a former editor-in-chief of Simon & Schuster, a former editor of the *New Yorker,* and the author of a new memoir, *Avid Reader* (Farrar, Straus and Giroux, 2016).

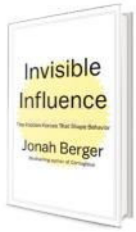
Although most of his ideas and examples aren't revelatory, his book is an entertaining reminder that the fight against bad persuasion must start from within.

Literary theorist Stanley Fish takes a similar stance in his recent book, *Winning Arguments.* He concedes that none of us will ever become completely rational beings, free of weaknesses and biases. And the world will always be full of skilled persuaders who use their talents for less than honorable purposes. (The stories he cites range from the fall of Adam and Eve to the rise of Donald Trump.) Yet he also seems to suggest that more humility might help us more readily recognize when we're being sheep.

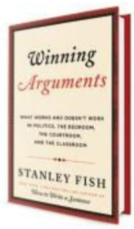
The next step, of course, is to learn how the other side operates. Robert Cialdini is perhaps the foremost expert on effective persuasion, and the advice outlined in his 2001 HBR article, "Harnessing the Science of Persuasion"—which called on readers to boost their influence by employing the principles of liking, reciprocity, social proof, consistency, authority, and scarcity—has become foundational in the field.

Cialdini's latest book, *Pre-Suasion,* builds on that work, arguing that the best persuaders aren't merely eloquent charmers with well-crafted, finely tuned arguments; they're also creative preparers who focus on finding the best ways to launch their offers and ideas. He calls this pre-suasion: the ability to convince us of the importance and desirability of something before we even hear the facts.

The book provides a vast catalogue of research and techniques, many of them marketing related: Hearing German music can make us more apt to buy expensive German wine; being asked if we're adventurous can increase our willingness to try new soft drinks; seeing an embedded photo of clouds can persuade us to prefer "softness" and "comfort" over price when browsing a website for high-end furniture.



Invisible Influence: The Hidden Forces That Shape Behavior
Jonah Berger
Simon & Schuster, 2016



Winning Arguments: What Works and Doesn't Work in Politics, the Bedroom, the Courtroom, and the Classroom
Stanley Fish
HarperCollins, 2016

Pre-Suasion: A Revolutionary Way to Influence and Persuade
Robert Cialdini
Simon & Schuster, 2016

Those examples may make pre-suasion seem a bit like hypnosis. But again, awareness is key. If we recognize the mind games being used to ensnare us, perhaps we can avoid the trap. And there's something to be learned from the more granular examples. For instance, Cialdini recalls a story about a consultant who was having a tough time persuading clients to agree to his prices. In the past, he had tried to explain the cost of each line item during negotiations, but that never worked. Then during one presentation, he decided to try a new approach. Right before mentioning his $75,000 fee, he joked, "As you can tell, I'm not going to be able to charge you a million dollars for this." Everyone in the room laughed. But no one pushed back on his actual offer. Why? He had conditioned his audience to believe that his services weren't exorbitantly priced by taking advantage of what psychologists call the focusing illusion—our habit of concentrating on a single aspect of an argument or experience (in this case, the million dollars). Smarter clients would have seen through the trick and followed up with their normal price-negotiation process.

More generally, Cialdini warns that when confronted with any persuasive argument—even one with which we instinctively agree—we must spend as much time considering the possibility of failure as we do dreaming of the odds for success.

He also sounds a reassuring note when he acknowledges that persuasion is more art than science. We're not likely to be conned by someone who tries to follow a manual or a list of bullet points.

> "Bad persuasion is an instrument of power; participants make their points with the twin intentions of leaving the opponent with nothing to say and capturing the sympathy, not the rational agreement, of the audience."
> Stanley Fish, *Winning Arguments*

In fact, he says, we can usually spot peddlers of bad ideas who use pre-suasive techniques because they draw outsize attention to their weaknesses.

Of course, there's no fail-safe way to prevent ourselves from getting duped, manipulated, and persuaded to do things that we later regret; on that, all three authors agree. But if we remind ourselves of how flawed and fallible we are as thinkers, while also better attuning ourselves to the artful techniques used by master manipulators, then we have a chance of increasing our good-decision percentage (if only by a few points) without closing ourselves off to new ideas and views.

Kevin Evers is an assistant editor at *Harvard Business Review.*

EXECUTIVE SUMMARIES OCTOBER 2016

SPOTLIGHT ON BUILDING THE WORKFORCE OF THE FUTURE

Speedy technological advances and expanding globalization have created a powerful challenge to workers and their managers alike. This month we look at new and adaptive approaches to employee training and education, performance appraisals, and talent acquisition.

MANAGING ORGANIZATIONS

Why Leadership Training Fails—and What to Do About It

Michael Beer, Magnus Finnström, and Derek Schrader | page 50

U.S. corporations spend enormous amounts of money—some $356 billion globally in 2015 alone—on employee training and education, but they aren't getting a good return on their investment. People soon revert to old ways of doing things, and company performance doesn't improve. To fix these problems, senior executives and their HR departments should change the way they think about learning and development: Because context is crucial, needed fixes in organizational design and managerial processes must come first.

The authors have identified six common barriers to change: (1) unclear direction on strategy and values, which often leads to conflicting priorities; (2) senior executives who don't work as a team and haven't committed to a new direction or acknowledged necessary changes in their own behavior; (3) a top-down or laissez-faire style by the leader, which prevents honest conversation about problems; (4) a lack of coordination across businesses, functions, or regions due to poor organizational design; (5) inadequate leadership time and attention given to talent issues; and (6) employees' fears of telling the senior team about obstacles to the organization's effectiveness. They advocate six basic steps to overcoming these barriers and achieving greater success in talent development.

HBR Reprint R1610C

ASSESSING PERFORMANCE

The Performance Management Revolution

Peter Cappelli and Anna Tavis
page 58

Hated by bosses and subordinates alike, traditional performance appraisals have been abandoned by more than a third of U.S. companies. The annual review's biggest limitation, the authors argue, is its emphasis on holding employees accountable for what they did last year, at the expense of improving performance now and in the future. That's why many organizations are moving to more-frequent, development-focused conversations between managers and employees.

The authors explain how performance management has evolved over the decades and why current thinking has shifted: (1) Today's tight labor market creates pressure to keep employees happy and groom them for advancement. (2) The rapidly changing business environment requires agility, which argues for regular check-ins with employees. (3) Prioritizing improvement over accountability promotes teamwork.

Some companies worry that going numberless may make it harder to align individual and organizational goals, award merit raises, identify poor performers, and counter claims of discrimination—though traditional appraisals haven't solved those problems, either. Other firms are trying hybrid approaches—for example, giving employees performance ratings on multiple dimensions, coupled with regular development feedback.

HBR Reprint R1610D

MANAGING PEOPLE

AT&T's Talent Overhaul

John Donovan and Cathy Benko
page 68

AT&T, which built the U.S. communications infrastructure in the past century, could once claim to be the company "where the future was invented." But now its legacy businesses are becoming obsolete. With its industry moving from cables to the cloud, AT&T is in a race to reinvent itself. As part of that transformation, it has initiated a massive effort to help its workers acquire new digital skills.

In this article Cathy Benko, vice chairman of Deloitte, and John Donovan, AT&T's chief strategy officer, offer a look inside the company's ambitious program, dubbed Workforce 2020. The challenges are sizable: The firm employs 280,000 workers, and their average tenure is 22 years (not counting people in call centers). At least half the workforce has been assigned a new role and is expected to get the credentials or training to fill it.

To manage the talent overhaul, the company has revised its performance metrics, raised performance expectations, and redesigned compensation plans. It is also providing workers with a host of tools for training and development through an online self-service platform, courses in new technologies, tuition reimbursement, and even online master's degrees in computer science, developed with Georgia Tech and Udacity.

HBR Reprint R1610E

THE FUTURE

Globalization, Robots, and the Future of Work

Former CEO of ManpowerGroup Jeffrey Joerres, interviewed by Amy Bernstein | page 74

When Jeffrey Joerres first joined Manpower, in 1993, the labor market was relatively stable and the company still focused largely on traditional office, clerical, and industrial staffing. But since then globalization and rapid advances in technology have dramatically reshaped the employment landscape. During his 15 years as CEO, Joerres expanded the company's international operations and moved into the increasingly competitive market for IT, finance, and engineering professionals.

In this interview with HBR's editor, he describes how micromarket analysis reveals "geolocated pools of skills" that businesses can tap—until competitors muscle in, deplete the skills pool, and drive up wages. So companies must acquire a "nomadic mentality" that will allow them to establish more-temporary, smaller operations as well as large ones. He acknowledges that "when full-scale robotics and artificial intelligence arrive in a broad-based, affordable, easily justifiable way," hordes of workers will be displaced, with little or no preparation for very different jobs. Joerres advises companies that want to develop a workforce strategy to put multiple work models in place—crowdsourcing, distant manufacturing, temporary contractors moving to full-time—and truly practice them. "When are we done with this efficiency thing?" he says. "The answer is never."

HBR Reprint R1610F

Features

THE BIG IDEA

DECISION MAKING

Noise

Daniel Kahneman, Andrew M. Rosenfield, Linnea Gandhi, and Tom Blaser | page 38

Organizations expect to see consistency in the decisions of their employees, but humans are unreliable. 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. And irrelevant factors, such as mood and the weather, can change one person's decisions from occasion to occasion. This chance variability of decisions is called *noise*, and it is surprisingly costly to companies, which are usually completely unaware of it.

Nobel laureate Daniel Kahneman, a professor of psychology at Princeton, and Andrew M. Rosenfield, Linnea Gandhi, and Tom Blaser of TGG Group explain how organizations can perform a *noise audit* by having members of a professional unit evaluate a common set of cases. The degree to which their assessments vary provides the measure of noise. If the problem is severe, firms can pursue a number of remedies. The most radical is to replace human judgment with algorithms. Unlike people, algorithms always return the same output for any given input, and research shows that their predictions and decisions are often more accurate than those made by experts.

Although algorithms may seem daunting to construct, the authors describe how to build them with input data on a small number of cases and some simple commonsense rules. But if applying formulas is politically or operationally infeasible, companies can still set up procedures and practices that will guide employees to make more-consistent decisions.

HBR Reprint R1610B

STRATEGY

The Ecosystem of Shared Value

Mark R. Kramer and Marc W. Pfitzer | page 80

Businesses can help solve major social problems by engaging in "collective impact" efforts.

Governments, NGOs, companies, and community members must all be involved in programs to create shared value, yet they work more often in opposition than in alignment. A movement known as *collective impact* has facilitated successful collaborations in the social sector, and it can guide businesses in bringing together the various actors in their ecosystems to help remedy some of the world's most urgent problems. In the process, companies will find economic opportunities that their competitors miss.

Five elements must be in place for a collective-impact effort to achieve its aims: (1) a common agenda, which helps align the players' efforts and defines their commitment; (2) a shared measurement system; (3) mutually reinforcing activities; (4) constant communication, which builds trust and ensures mutual objectives; and (5) dedicated "backbone" support, delivered by a separate, independently funded staff, which builds public will, advances policy, and mobilizes resources.

HBR Reprint R1610G

STRATEGY

The Transformative Business Model

Stelios Kavadias, Kostas Ladas, and Christoph Loch | page 90

A business model that can link a new technology to an emerging market need is the key to industry transformation. When Apple coupled the iPod with iTunes, it revolutionized the audio devices market. But most attempts to introduce a new model fail. The authors did an in-depth analysis of 40 companies that had launched new business models in a variety of industries, and here they present the key takeaways from their research.

They looked for recurring features in the models and found six: personalization, a closed-loop process, asset sharing, usage-based pricing, a collaborative ecosystem, and an agile and adaptive organization. No model displayed all of them, but having a higher number of features usually correlated with a greater chance of success at transformation. (The taxi service Uber can claim five of the six.)

Companies that are thinking about changing their business model or entering an industry with a new model can rate themselves on the six features to assess the likelihood that they'll be transformative.

HBR Reprint R1610H

THE HBR INTERVIEW

LEADERSHIP

"Making the Car a Mobile, Connected Workspace"

Carlos Ghosn, interviewed by Adi Ignatius | page 100

Carlos Ghosn's official title is CEO and chairman of the Renault-Nissan Alliance, but he's more colorfully known as "Le Cost Killer" and "Mr. Fix-It." He earned those nicknames by rescuing first Renault and then Nissan back in the 1990s. Now he's hoping for yet another turnaround—at struggling Mitsubishi, where Nissan recently acquired a controlling share.

A Brazilian-born Lebanese-Frenchman, Ghosn deftly handles the challenges of managing companies on two continents. In this interview, he describes how he does it—meeting with his teams in Tokyo and Paris for a week each month and spending the rest of his time in operations, talking to suppliers and buyers, and looking for new opportunities.

In the next five years, he says, "you'll see more electric cars, more autonomous drive, and more connectivity." He's excited about using technology "to make the car an indispensable personal space" and developing a fully self-driving vehicle by 2020. And he's not worried about competition in the electric-car market from companies like Apple or Google: "We have a long tradition of taking technology from the outside and putting it into our products."

Ghosn believes the role of a CEO is to be "the guardian of the integrity and sustainability of the company." He sees his most important tasks as selecting the right people and directing strategy. "I want to make sure the Nissan-Renault Alliance continues to be solid," he says, "with good performance and good governance."

HBR Reprint R1610J

How I Did It

STRATEGY

The CEO of Popeyes on Treating Franchisees as the Most Important Customers

Cheryl Bachelder | page 33

During her career, Cheryl Bachelder had been a senior executive at two other food franchising companies, Domino's and KFC, and she'd learned to love the model. But when she took office at Popeyes, in 2007, which was struggling from a lack of strategy and too much short-term thinking, she found that the company's relationship with its franchisees was severely strained. As she and her team worked to turn Popeyes around, they would have to both regain the owners' trust and fire up their enthusiasm for the future. They would also have to create an arsenal of brand-building ideas and a national advertising campaign to build consumer awareness.

In talks about how they should lead and which stakeholders should be their primary focus, the team members settled on a model called "servant leadership," in which the people of an enterprise come before self-interest. And they agreed that Popeyes franchisees should be their most important customers: "No one," Bachelder writes, "has more skin in the game." The company conducted its first in a series of franchisee satisfaction surveys and began measuring what matters most to owners, namely restaurant-level profitability. It launched a number of winning new products and acquired sophisticated software to help franchisees choose the best locations for new restaurants. The result has been eight years of steady growth. **HBR Reprint** R1610A

Managing Yourself

Don't Let Power Corrupt You

Dacher Keltner | page 112

A paradox of power is that people gain it through virtuous behaviors such as collaboration, openness, fairness, and sharing, but once they enjoy a position of privilege, those finer qualities start to fade. Research shows that the powerful are more likely to engage in rude, selfish, and unethical behavior. This tarnishes their reputations, undermining their influence, and creates stress and anxiety among their colleagues, dragging down their teams' engagement and performance.

Dacher Keltner, a psychology professor who has studied this phenomenon in a variety of professional settings, describes how executives can avoid succumbing to this syndrome. The first step is developing awareness: being attentive to the feelings that accompany a rise to leadership, practicing mindfulness, and looking for warning signals in your behavior. The second is to remember and try to practice the three ethics of good power—empathy, gratitude, and generosity—in your interactions, meetings, and communications every day. **HBR Reprint** R1610K

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Life's Work

Penn Jillette is one-half of the magic duo Penn & Teller, who launched their act to great acclaim in the 1980s but have never stopped changing it. A performer on stage and screen for more than 40 years, he recently lost 100+ pounds, an experience chronicled in his new book, *Presto!* ***Interviewed by Alison Beard***

HBR: How do you and Teller develop your act?
Jillette: Every Tuesday we get together, usually at a coffee shop, sit with our computers, and knock around ideas. We are not in any way supportive. As soon as the germ of an idea comes up, the other person tries to crush it, because if there's something bad about it, we want to find out as soon as we can. We never compromise, because that can only lead to mediocrity. If one of us doesn't like something, we try to come up with another idea we do both like. We almost always start with a pretentious intellectual thought—for example, what do we have to say about the TSA and freedom? Then we add a trick, and the last thing we add is jokes.

Has your relationship changed over the years? Some people you have natural affection for. With others, your relationship is completely intellectual. I have that with Teller. We became partners because we respected each other and felt we did better work together than separately. Many performing groups are almost romantic—Lennon and McCartney, Lewis and Martin. But those things blow up. Respect is more durable. And there's no better partner than Teller. He never makes mistakes. He's always on time. He doesn't drink or do drugs; neither of us does. So all our attention can go toward doing the best art we can.

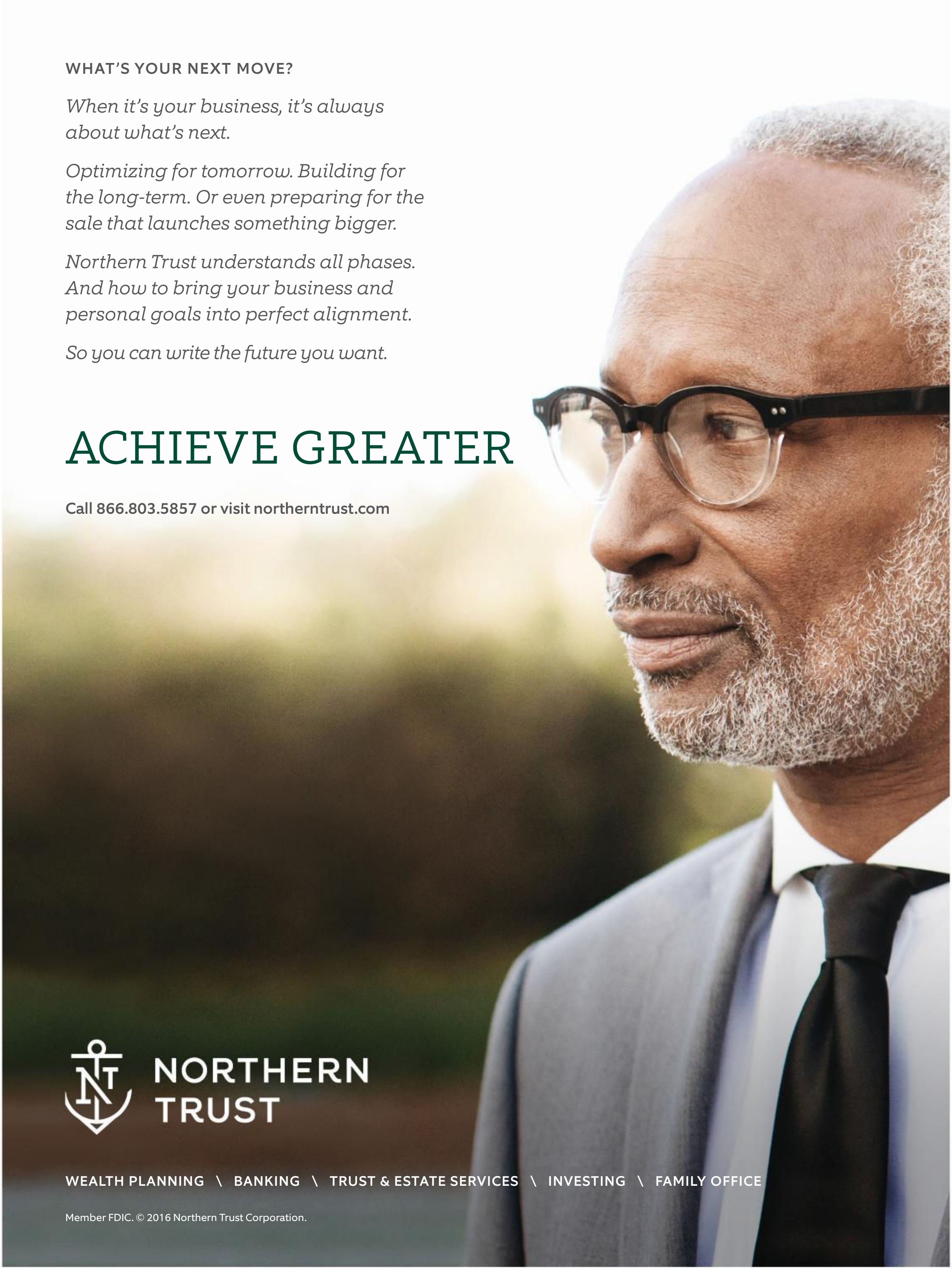
Early on, you rejected the label "magician" and did unorthodox things like revealing how tricks were done. How do you fit into the industry now? When we hit the scene, a magician was a greasy guy in a tux with birds, torturing women. We wanted a different audience, so we avoided that word. Of course, we then won every award in the community. Hack magicians hated us, because they said we were giving away secrets. One guy came up to us, very angry, and said, "Whose side are you on?"—implying that there's some battle line between magician and audience. But that kind of thinking is toxic and anti-art. Can you imagine Keith Richards saying to Eddie Van Halen, "Why are you on the audience's side? What's wrong with you?" Or Ginsberg saying to Kerouac, "What—you're writing for the people?" Once we were known, we could embrace being magicians. There's a lot to be said for sniffing around to find something different and then going back to your roots.

What's the secret to connecting with an audience? If someone is talking about their passion—whether it's horizontal oil drilling, Spanish nurse porn, or stamp collecting—I get sucked in. People say, "How can I make this particular idea play?" But if they're phrasing it that way, they haven't got a chance. It has to be "I have something I desperately want to say. How do I say it?" Then it comes down to mechanics: Are your sentences clear? Are you making eye contact? One teacher, one time, told me a valuable thing: "No one cares about what you say. They're looking for any excuse to not listen. So make sure they don't have one." And boy, that applies to everything. When you go out on stage, you've got two minutes to get the audience thinking "This is important" or "This is grabbing my heart."

HBR Reprint R1610M

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

MICHAEL LEWIS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