Indeed, the litmus test of whether a company's code of ethics and statement of core values are cosmetic is the extent to which they are embraced in crafting strategy and in operating the business on a day-to-day basis. It is up to senior executives to walk the talk and make a point of considering two sets of questions whenever a new strategic initiative is under review:

- Is what we are proposing to do fully compliant with our code of ethical conduct? Is there anything here that could be considered ethically objectionable?
- Is it apparent that this proposed action is in harmony with our core values? Are any conflicts or concerns evident?

Unless questions of this nature are posed—either in open discussion or by force of habit in the minds of strategy makers, then there's room for strategic initiatives to become disconnected from the company's code of ethics and stated core values. If a company's executives are ethically principled and believe strongly in living up to the company's stated core values, there's a good chance they will pose these types of questions and reject strategic initiatives that don't measure up. There's also a good chance that strategic actions will be scrutinized for their compatibility with ethical standards and core values when the latter are so deeply ingrained in a company's culture and in the everyday conduct of company personnel that they are automatically taken into account in all that the company does. However, in companies with window-dressing ethics and core values or in companies headed by immoral or amoral managers, any strategy-ethics-values linkage stems mainly from a desire to avoid the risk of embarrassment, scandal, and possible disciplinary action should strategy-makers get called on the carpet and held accountable for approving an unethical strategic initiative.

core concept
More attention is paid to linking strategy with ethical principles and core values in companies headed by moral executives and in companies where ethical principles and core values are a way of life.

STRATEGY AND SOCIAL RESPONSIBILITY

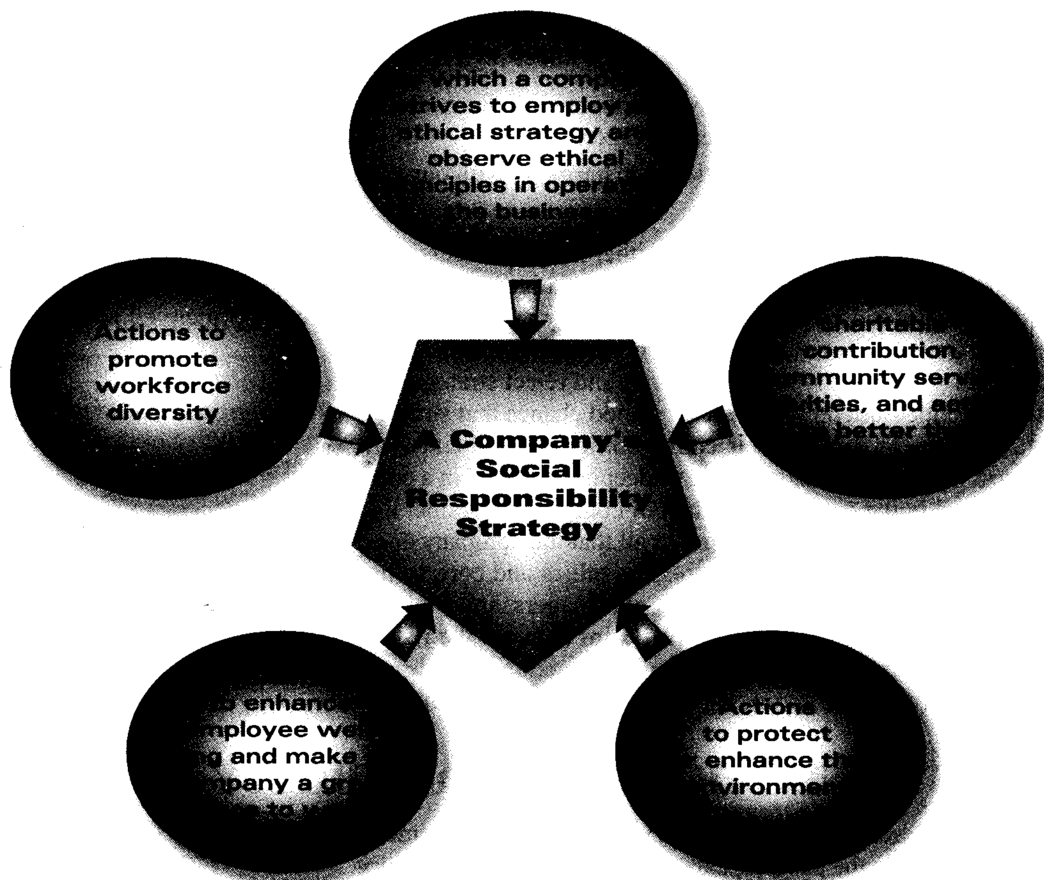
The idea that businesses have an obligation to foster social betterment, a much-debated topic in the past 40 years, took root in the 19th century when progressive companies in the aftermath of the industrial revolution began to provide workers with housing and other amenities. The notion that corporate executives should balance the interests of all stakeholders—shareholders, employees, customers, suppliers, the communities in which they operated, and society at large—began to blossom in the 1960s. A group of chief executives of America's 200 largest corporations, calling themselves the Business Roundtable, promoted the concept of corporate social responsibility. In 1981, the Roundtable's "Statement on Corporate Responsibility" said:[22]

core concept
The notion of *social responsibility* as it applies to businesses concerns a company's *duty* to operate by means that avoid harm to stakeholders and the environment and, further, to consider the overall betterment of society in its decisions and actions.

> Balancing the shareholder's expectations of maximum return against other priorities is one of the fundamental problems confronting corporate management. The shareholder must receive a good return but the legitimate concerns of other constituencies (customers, employees, communities, suppliers and society at large) also must have the appropriate attention . . . [Leading managers] believe that by giving enlightened consideration to balancing the legitimate claims of all its constituents, a corporation will best serve the interest of its shareholders.

Today, corporate social responsibility is a concept that resonates in Western Europe, the United States, Canada, and such developing nations as Brazil and India.

figure 10.1 **Categories of Socially Responsible Business Behavior**



Source: Adapted from material in Ronald Paul Hill, Debra Stephens, and Iain Smith, "Corporate Social Responsibility: An Examination of Individual Firm Behavior," *Business and Society Review* 108, no. 3 (September 2003), p. 348.

What Do We Mean by Social Responsibility?

The essence of socially responsible business behavior is that a company should strive to balance the benefits of strategic actions to benefit shareholders against any possible adverse impacts on other stakeholders (employees, suppliers, customers, local communities, and society at large) and, further, to proactively mitigate any harmful effects on the environment that its actions and business may have. Social responsibility includes corporate philanthropy and actions to earn the trust and respect of stakeholders for the firm's efforts to improve the general well-being of customers, employees, local communities, society at large, and the environment. As depicted in Figure 10.1, a company's menu for crafting its social responsibility strategy includes:

- *Efforts to employ an ethical strategy and observe ethical principles in operating the business*—A genuine commitment to observing ethical principles is necessary here simply because unethical strategies and conduct are incompatible with the concept of socially responsible business behavior.

- *Making charitable contributions, donating money and the time of company personnel to community service endeavors, supporting various worthy organizational causes, and reaching out to make a difference in the lives of the disadvantaged*—Some companies fulfill their corporate citizenship and community outreach obligations by spreading their efforts over a multitude of charitable and community activities; for instance, Microsoft and Johnson & Johnson support a broad variety of community art, social welfare, and environmental programs. Others prefer to focus their energies more narrowly. McDonald's, for example, concentrates on sponsoring the Ronald McDonald House program (which provides a home away from home for the families of seriously ill children receiving treatment at nearby hospitals), preventing child abuse and neglect, and participating in local community service activities; in 2003, there were 212 Ronald McDonald Houses in 20 countries and more than 5,000 bedrooms available nightly. British Telecom gives 1 percent of its profits directly to communities, largely for education—teacher training, in-school workshops, and digital technology. Leading prescription drug maker GlaxoSmithKline and other pharmaceutical companies either donate or heavily discount medicines for distribution in the least-developed nations. Numerous health-related businesses take a leading role in community activities that promote effective health care. Many companies work closely with community officials to minimize the impact of hiring large numbers of new employees (which could put a strain on local schools and utility services) and to provide outplacement services for laid-off workers. Companies frequently reinforce their philanthropic efforts by encouraging employees to support charitable causes and participate in community affairs, often through programs to match employee contributions.

> Business leaders who want their companies to be regarded as exemplary corporate citizens must not only see that their companies operate ethically but also display a social conscience in decisions that affect employees, the environment, the communities in which they operate, and society at large.

- *Actions to protect or enhance the environment and, in particular, to minimize or eliminate any adverse impact on the environment stemming from the company's own business activities*—Social responsibility as it applies to environmental protection means doing more than what is legally required. From a social responsibility perspective, companies have an obligation to be *stewards of the environment.* This means using the best available science and technology to achieve higher-than-required environmental standards. Even more ideally, it means putting time and money into improving the environment in ways that extend past a company's own industry boundaries—such as participating in recycling projects, adopting energy conservation practices, and supporting efforts to clean up local water supplies. Retailers such as Home Depot in the United States and B&Q in the United Kingdom have pressured their suppliers to adopt stronger environmental protection practices.[23]
- *Actions to create a work environment that enhances the quality of life for employees and makes the company a great place to work*—Numerous companies go beyond providing the ordinary kinds of compensation and exert extra efforts to enhance the quality of life for their employees, both at work and at home. This can include varied and engaging job assignments, career development programs and mentoring, rapid career advancement, appealing compensation incentives, ongoing training to ensure future employability, added decision-making authority, onsite day care, flexible work schedules for single parents, workplace exercise facilities, special leaves to care for sick family members, work-at-home opportunities, gender pay equity, showcase plants and offices, special safety programs, and the like.

- *Actions to build a workforce that is diverse with respect to gender, race, national origin, and perhaps other aspects that different people bring to the workplace*—Most large companies in the United States have established workforce diversity programs, and some go the extra mile to ensure that their workplaces are attractive to ethnic minorities and inclusive of all groups and perspectives. The pursuit of workforce diversity can be good business—Johnson & Johnson, Pfizer, and Coca-Cola believe that a reputation for workforce diversity makes recruiting employees easier (talented employees from diverse backgrounds often seek out such companies). And at Coca-Cola, where strategic success depends on getting people all over the world to become loyal consumers of the company's beverages, efforts to build a public persona of inclusiveness for people of all races, religions, nationalities, interests, and talents has considerable strategic value. Multinational companies are particularly inclined to make workforce diversity a visible strategic component; they recognize that respecting individual differences and promoting inclusiveness resonate well with people all around the world. At a few companies the diversity initiative extends to suppliers—sourcing items from small businesses owned by women or ethnic minorities.

Linking Strategy and Social Responsibility

While striving to be socially responsible entails choosing from the menu outlined in the preceding section, there can be no generic approach to linking a company's strategy and business conduct to social responsibility. It is logical for management to match the company's social responsibility strategy to its core values, business mission, and overall strategy. There's plenty of room for every company to make its own statement about what charitable contributions to make, what kinds of community service projects to emphasize, what environmental actions to support, how to make the company a good place to work, where and how workforce diversity fits into the picture, and what else it will do to support worthy causes and projects that benefit society. Thus, *the combination of socially responsible endeavors a company elects to pursue defines its social responsibility strategy.* However, unless a company's social responsibility initiatives become part of the way it operates its business every day, the initiatives are unlikely to catch fire and be fully effective. As an executive at Royal Dutch/Shell put it, corporate social responsibility "is not a cosmetic; it must be rooted in our values. It must make a difference to the way we do business."[24] Thus some companies are integrating social responsibility objectives into their missions and overall performance targets—they see social performance and environmental metrics as an essential component of judging the company's overall future performance.

core concept
A company's social responsibility strategy is defined by the specific combination of socially beneficial activities it opts to support with its contributions of time, money, and other resources.

At Starbucks, the commitment to social responsibility is linked to the company's strategy and operating practices via the tagline "Giving back to our communities is the way we do business"; top management makes the theme come alive via the company's extensive community building activities, efforts to protect the welfare of coffee growers and their families (in particular, making sure they receive a fair price), a variety of recycling and environmental conservation practices, and the financial support it provides to charities and the disadvantaged through the Starbucks Foundation. At Green Mountain Coffee Roasters, social responsibility includes fair dealing with suppliers and trying to do something about the poverty of small coffee growers; in its dealings with suppliers at small farmer cooperatives in Peru, Mexico, and Sumatra, Green Mountain pays "fair trade" prices for coffee beans (in 2002, the fair trade prices were a minimum of $1.26 per pound for conventional coffee and $1.41 for organically grown versus market prices of 24 to 50 cents per pound). Green Mountain also purchases about 25 percent of its

coffee direct from farmers so as to cut out intermediaries and see that farmers realize a higher price for their efforts—coffee is the world's second most heavily traded commodity after oil, requiring the labor of some 20 million people, most of whom live at the poverty level.[25] At Whole Foods Market, a $3 billion supermarket chain specializing in organic and natural foods, the social responsibility emphasis is on supporting organic farming and sustainable agriculture, recycling, sustainable seafood practices, giving employees paid time off to participate in worthy community service endeavors, and donating 5 percent of after-tax profits in cash or products to charitable causes. At General Mills the social responsibility focus is on service to the community and bettering the employment opportunities for minorities and women. Stonyfield Farm, a producer of yogurt and ice cream products, employs a social responsibility strategy focused on wellness, good nutrition, and "earth-friendly" actions (10 percent of profits are donated to help protect and restore the earth, and yogurt lids are used as mini-billboards to help educate people about environmental issues); in addition, it is stressing the development of an environmentally friendly supply chain, sourcing from farmers that grow organic products and refrain from using artificial hormones in milk production. Chick-Fil-A, an Atlanta-based fast-food chain with 1,000 outlets, has a charitable foundation, supports 12 foster homes and a summer camp (for some 1,500 campers from 22 states and several foreign countries), funds two scholarship programs (including one for employees that has awarded more than $17 million in scholarships), and a closed-on-Sunday policy to ensure that every Chick-Fil-A employee and restaurant operator has an opportunity to worship, spend time with family and friends, or just plain rest from the workweek.[26] Toys "R" Us supports initiatives addressing the issues of child labor and fair labor practices around the world. Community Pride Food Stores is assisting in revitalizing the inner city of Richmond, Virginia, where the company is based.

Each company's strategic efforts to operate in a socially responsible manner should be custom-tailored, matched to its core values and business mission, thereby representing its own statement about "how we do business and how we intend to fulfill our duties to all stakeholders and society at large."

It is common for companies engaged in natural resource extraction, electric power production, forestry and paper products, motor vehicles, and chemicals production to place more emphasis on addressing environmental concerns than, say, software and electronics firms or apparel manufacturers. Companies whose business success is heavily dependent on high employee morale or attracting and retaining the best and brightest employees are somewhat more prone to stress the well-being of their employees and foster a positive, high-energy workplace environment that elicits the dedication and enthusiastic commitment of employees, thus putting real meaning behind the claim "Our people are our greatest asset." Ernst & Young, one of the four largest global accounting firms, stresses its "People First" workforce diversity strategy that is all about respecting differences, fostering individuality, and promoting inclusiveness so that its 105,000 employees in 140 countries can feel valued, engaged, and empowered in developing creative ways to serve the firm's clients.

Thus, while the strategies and actions of all socially responsible companies have a sameness in the sense of drawing on the five categories of socially responsible behavior shown in Figure 10.1, each company's version of being socially responsible is unique.

The Moral Case for Corporate Social Responsibility

The moral case for why businesses should actively promote the betterment of society and act in a manner that benefits all of the company's stakeholders—not just the interests of shareholders—boils down to "It's the right thing to do." Ordinary decency, civic-mindedness, and concern for the well-being of society should be expected of any business. In today's social and political climate most business leaders can be expected to acknowledge that socially responsible actions are important and that businesses have

a duty to be good corporate citizens. But there is a complementary school of thought that business operates on the basis of an implied *social contract* with the members of society. According to this contract, society grants a business the right to conduct its business affairs and agrees not to unreasonably restrain its pursuit of a fair profit for the goods or services it sells; in return for this "license to operate," a business is obligated to act as a responsible citizen and do its fair share to promote the general welfare. Such a view clearly puts a moral burden on a company to take corporate citizenship into consideration and to act in the overall best interests of society as well as shareholders.

Every action a company takes can be interpreted as a statement of what the company stands for.

The Business Case for Socially Responsible Behavior

Whatever the merits of the moral case for socially responsible business behavior, it has long been recognized that it is in the enlightened self-interest of companies to be good citizens and devote some of their energies and resources to the betterment of such stakeholders as employees, the communities in which it operates, and society in general. In short, there are several reasons why the exercise of social responsibility is good business:

- *It generates internal benefits* (particularly as concerns employee recruiting, workforce retention, and training costs)—Companies with deservedly good reputations for contributing time and money to the betterment of society are better able to attract and retain employees compared to companies with tarnished reputations. Some employees just feel better about working for a company committed to improving society.[27] This can contribute to lower turnover and better worker productivity. Other direct and indirect economic benefits include lower costs for staff recruitment and training. For example, Starbucks is said to enjoy much lower rates of employee turnover because of its full benefits package for both full-time and part-time employees, management efforts to make Starbucks a great place to work, and the company's socially responsible practices. When a U.S. manufacturer of recycled paper, taking eco-efficiency to heart, discovered how to increase its fiber recovery rate, it saved the equivalent of 20,000 tons of waste paper—a factor that helped the company become the industry's lowest-cost producer.[28] Various benchmarking and measurement mechanisms have shown that workforce diversity initiatives promote the success of companies that stay behind them. Making a company a great place to work pays dividends in the form of higher worker productivity, more creativity and energy on the part of workers, and greater employee commitment to the company's business mission/vision and success in the marketplace.
- *It reduces the risk of reputation-damaging incidents and can lead to increased buyer patronage*—Firms may well be penalized by employees, consumers, and shareholders for actions that are not considered socially responsible. When a major oil company suffered damage to its reputation on environmental and social grounds, the CEO repeatedly said that the most negative impact the company suffered—and the one that made him fear for the future of the company—was that bright young graduates were no longer attracted to work for the company.[29] Consumer, environmental, and human rights activist groups are quick to criticize businesses whose behavior they consider to be out of line, and they are adept at getting their message into the media and onto the Internet. Pressure groups can generate widespread adverse publicity, promote boycotts, and influence like-minded or sympathetic buyers to avoid an offender's products. Research has shown that product boycott announcements are associated with a decline in a company's stock price.[30] Outspoken criticism of Royal Dutch/Shell by

environmental and human rights groups and associated boycotts were said to be major factors in the company's decision to tune in to its social responsibilities. For many years, Nike received stinging criticism for not policing sweatshop conditions in the Asian factories of its contractors, causing Nike CEO Phil Knight to observe that "Nike has become synonymous with slave wages, forced overtime, and arbitrary abuse."[31] In 1997, Nike began an extensive effort to monitor conditions in the 800 overseas factories from which it outsourced its shoes; Knight said, "Good shoes come from good factories and good factories have good labor relations." Nonetheless, Nike has continually been plagued by complaints from human rights activists that its monitoring procedures are flawed and that it is not doing enough to correct the plight of factory workers. In contrast, to the extent that a company's socially responsible behavior wins applause from consumers and fortifies its reputation, the company may win additional patronage; Ben & Jerry's, Whole Foods Market, Stonyfield Farm, and the Body Shop have definitely expanded their customer bases because of their visible and well-publicized activities as socially conscious companies. More and more companies are recognizing the strategic value of social responsibility strategies that reach out to people of all cultures and demographics—in the United States, women are said to having buying power of $3.7 trillion, retired and disabled people close to $4.1 trillion, Hispanics nearly $600 billion, African Americans some $500 billion, and Asian Americans about $255 billion.[32] So reaching out in ways that appeal to such groups can pay off at the cash register. Some observers and executives are convinced that a strong, visible social responsibility strategy gives a company an edge in differentiating itself from rivals and in appealing to those consumers who prefer to do business with companies that are solid corporate citizens. Yet there is only limited evidence that consumers go out of their way to patronize socially responsible companies if it means paying a higher price or purchasing an inferior product.[33]

> The higher the public profile of a company or brand, the greater the scrutiny of its activities and the higher the potential for it to become a target for pressure group action.

- *It is in the best interest of shareholders*—Well-conceived social responsibility strategies work to the advantage of shareholders in several ways. Socially responsible business behavior helps avoid or preempt legal and regulatory actions that could prove costly and otherwise burdensome. Increasing numbers of mutual funds and pension benefit managers are restricting their stock purchases to companies that meet social responsibility criteria. According to one survey, one out of every eight dollars under professional management in the United States involved socially responsible investing.[34] Moreover, the growth in socially responsible investing and identifying socially responsible companies has led to a substantial increase in the number of companies that publish formal reports on their social and environmental activities.[35] The stock prices of companies that rate high on social and environmental performance criteria have been found to perform 35 to 45 percent better than the average of the 2,500 companies comprising the Dow Jones Global Index.[36] A two-year study of leading companies found that improving environmental compliance and developing environmentally friendly products can enhance earnings per share, profitability, and the likelihood of winning contracts.[37] Nearly 100 studies have examined the relationship between corporate citizenship and corporate financial performance over the past 30 years; the majority point to a positive relationship. Of the 80 studies that examined whether a company's social performance is a good predictor of its financial performance, 42 concluded yes, 4 concluded no, and the remainder reported mixed or inconclusive findings.[38] To the extent that socially responsible behavior is good business, then, a social responsibility strategy

> There's little hard evidence indicating shareholders are disadvantaged in any meaningful or substantive way by a company's actions to be socially responsible.

that packs some punch and is more than rhetorical flourish turns out to be in the best interest of shareholders.

In sum, companies that take social responsibility seriously can improve their business reputations and operational efficiency while also reducing their risk exposure and encouraging loyalty and innovation. Overall, companies that take special pains to protect the environment (beyond what is required by law), are active in community affairs, and are generous supporters of charitable causes and projects that benefit society are more likely to be seen as good investments and as good companies to work for or do business with. Shareholders are likely to view the business case for social responsibility as a strong one, even though they certainly have a right to be concerned whether the time and money their company spends to carry out its social responsibility strategy outweighs the benefits and reduces the bottom line by an unjustified amount.

Companies are, of course, sometimes rewarded for bad behavior—a company that is able to shift environmental and other social costs associated with its activities onto society as a whole can reap large short-term profits. The major cigarette producers for many years were able to earn greatly inflated profits by shifting the health-related costs of smoking onto others and escaping any responsibility for the harm their products caused to consumers and the general public. But the profitability of shifting costs onto society is a risky practice because it attracts scrutiny from pressure groups, raises the threat of regulation and/or legislation to correct the inequity, and prompts socially conscious buyers to take their business elsewhere.

The Controversy over Do-Good Executives

While there is substantial agreement that businesses have stakeholder and societal obligations and that these must be incorporated into a company's overall strategy and into the conduct of its business operations, there is much less agreement about the extent to which "do-good" executives should pursue their personal vision of a better world using company funds. One view holds that any money executives authorize for so-called social responsibility initiatives is effectively theft from a company's shareholders who can, after all, decide for themselves what and how much to give to charity and other causes they deem worthy. A related school of thought says that companies should be wary of taking on an assortment of societal obligations because doing so diverts valuable resources and weakens a company's competitiveness. Many academics and businesspeople believe that businesses best satisfy their social responsibilities through conventional business activities, primarily producing needed goods and services at prices that people can afford. They further argue that spending shareholders' or customers' money for social causes not only muddies decision making by diluting the focus on the company's business mission but also thrusts business executives into the role of social engineers—a role more appropriately performed by charitable and nonprofit organizations and duly-elected government officials. Do we really want corporate executives deciding how to best balance the different interests of stakeholders and functioning as social engineers? Are they competent to make such judgments?

Take the case of Coca-Cola and Pepsi bottlers. Local bottlers of both brands have signed contracts with public school districts that provide millions of dollars of support for local schools in exchange for vending machine distribution rights in the schools.[39] While such contracts would seem to be a win–win proposition, protests from parents concerned about children's sugar-laden diets and commercialism in the schools make such contracts questionable. Opponents of these contracts claim that it is the role of government to provide adequate school funding and that the learning environment in local schools

should be free of commercialism and the self-serving efforts of businesses to hide behind providing support for education.

In September 1997, the Business Roundtable changed its stance from one of support for social responsibility and balanced consideration of stakeholder interests to one of skepticism with regard to such actions:

> The notion that the board must somehow balance the interests of stockholders against the interests of other stakeholders fundamentally misconstrues the role of directors. It is, moreover, an unworkable notion because it would leave the board with no criteria for resolving conflicts between the interest of stockholders and of other stakeholders or among different groups of stakeholders.[40]

The new Business Roundtable view implied that the paramount duty of management and of boards of directors is to the corporation's stockholders. Customers may be "king," and employees may be the corporation's "greatest asset" (at least in the rhetoric), but the interests of shareholders rule.[41]

But there are real problems with disconnecting business behavior from the well-being of nonowner stakeholders and the well-being of society at large.[42] Isolating business from the rest of society when the two are inextricably intertwined and interdependent is unrealistic. Most business decisions spill over to impact nonowner stakeholders and society. Furthermore, the notion that businesses must be managed *solely* to serve the interests of shareholders is something of a stretch. Clearly, a business's first priority must be to deliver value to customers. Unless a company does a creditable job of satisfying buyer needs and expectations of reliable and attractively priced goods and services, it cannot survive. While shareholders provide capital and are certainly entitled to a return on their investment, fewer and fewer shareholders are truly committed to the companies whose stock they own. Shareholders can dispose of their holdings in a moment's whim or at the first sign of a downturn in the stock price. Mutual funds buy and sell shares daily, adding and dropping companies whenever they see fit. Day traders buy and sell within hours. Such buying and selling of shares is nothing more than a financial transaction and results in no capital being provided to the company to fund operations except when it entails the purchase of newly issued shares of stock. So why should shareholders—a group distant from the company's operations and adding little to its operations except when new shares of stock are purchased—lay such a large claim on how a company should be managed? Are most shareholders really interested in or knowledgeable about the companies they own? Or do they just own a stock for whatever financial returns it is expected to provide?

While there is legitimate concern about the use of company resources for do-good purposes and the motives and competencies of business executives in functioning as social engineers, it is tough to argue that businesses have *no obligations* to nonowner stakeholders or to society at large. If one looks at the category of activities that fall under the umbrella of socially responsible behavior (Figure 10.1), there's really very little for shareholders or others concerned about the do-good attempts of executives to object to in principle. Certainly, it is legitimate for companies to minimize or eliminate any adverse impacts of their operations on the environment. It is hard to argue against efforts to make the company a great place to work or to promote workforce diversity. And with regard to charitable contributions, community service projects, and the like, it would be hard to find a company where spending on such activities is so out of control that shareholders might rightfully complain or that the company's competitiveness is being eroded. What is likely to prove most objectionable in the social responsibility arena are the specific activities a company elects to engage in and/or the manner in which a company carries out its attempts to behave in a socially responsible manner.

How Much Attention to Social Responsibility Is Enough?

What is an appropriate balance between the imperative to create value for shareholders and the obligation to proactively contribute to the larger social good? What fraction of a company's resources ought to be aimed at addressing social concerns and bettering the well-being of society and the environment? A few companies have a policy of setting aside a specified percentage of their profits (typically 5 percent or maybe 10 percent) to fund their social responsibility strategy; they view such percentages as a fair amount to return to the community as a kind of thank-you or a tithe to the betterment of society. Other companies shy away from a specified percentage of profits or revenues because it entails upping the commitment in good times and cutting back on social responsibility initiatives in hard times (even cutting out social responsibility initiatives entirely if profits temporarily turn into losses). If social responsibility is an ongoing commitment rooted in the corporate culture and enlists broad participation on the part of company personnel, then a sizable portion of the funding for the company's social responsibility strategy has to be viewed as simply a regular and ongoing cost of doing business.

But judging how far a particular company should go in pursuing particular social causes is a tough issue. Consider, for example, Nike's commitment to monitoring the workplace conditions of its contract suppliers.[43] The scale of this monitoring task is significant: Nike has over 800 contract suppliers employing over 600,000 people in 50 countries. How frequently should sites be monitored? How should it respond to the use of underage labor? If only children above a set age are to be employed by suppliers, should suppliers still be required to provide schooling opportunities? At last count, Nike had some 80 people engaged in site monitoring. Should Nike's monitoring budget be $2 million, $5 million, $10 million, or whatever it takes?

Consider another example: If pharmaceutical manufacturers donate or discount their drugs for distribution to low-income people in less developed nations, what safeguards should they put in place to see that the drugs reach the intended recipients and are not diverted by corrupt local officials for reexport to markets in other countries? Should drug manufacturers also assist in drug distribution and administration in these less-developed countries? How much should a drug company invest in R&D to develop medicines for tropical diseases commonly occurring in less-developed countries when it is unlikely to recover its costs in the foreseeable future?

And how much should a company allocate to charitable contributions? Is it falling short of its responsibilities if its donations are less than 1 percent of profits? Is a company going too far if it allocates 5 percent or even 10 percent of its profits to worthy causes of one kind or another? The point here is that there is no simple or widely accepted standard for judging when a company has or has not gone far enough in fulfilling its citizenship responsibilities.

Linking Social Performance Targets to Executive Compensation

Perhaps the most surefire way to enlist a genuine commitment to corporate social responsibility initiatives is to link the achievement of social performance targets to executive compensation. If a company's board of directors is serious about corporate citizenship, then it will incorporate measures of the company's social and environmental performance into its evaluation of top executives, especially the CEO. And if the CEO uses compensation incentives to further enlist the support of down-the-line company

personnel in effectively crafting and executing a social responsibility strategy, the company will over time build a culture rooted in social responsible and ethical behavior. At Verizon Communications, 10 percent of the annual bonus of the company's top 2,500 managers is tied directly to the achievement of social responsibility targets; for the rest of the staff, there are corporate recognition awards in the form of cash for employees who have made big contributions towards social causes—Verizon paid out $1.24 million in such awards to its 227,000 employees in 2002.

According to one survey, 80 percent of surveyed CEOs believe that environmental and social performance metrics are a valid part of measuring a company's overall performance. To further heighten executive focus on the role and importance of socially responsible behavior, companies such as Safeway, Ford Motor, Sony, Vodaphone, DaimlerChrysler, and Prudential have begun issuing a special "corporate social responsibility report," much like an annual report, detailing their social responsibility initiatives and the results achieved.

key | points

Ethics involves concepts of right and wrong, fair and unfair, moral and immoral. Beliefs about what is ethical serve as a *moral compass* in guiding the actions and behaviors of individuals and organizations. Ethical principles in business are not materially different from ethical principles in general. Business actions are judged by the general ethical standards of society, not by a special set of standards that is either more permissive or less permissive.

Three categories of managers stand out as concerns their prevailing beliefs in and commitments to ethical and moral principles in business affairs: the moral manager; the immoral manager, and the amoral manager. By some accounts, the population of managers is said to be distributed among all three types in a bell-shaped curve, with immoral managers and moral managers occupying the two tails of the curve, and the amoral managers, especially the intentionally amoral managers, occupying the broad middle ground.

The apparently large numbers of immoral and amoral businesspeople are one obvious reason why some companies resort to unethical strategic behavior. Three other main drivers of unethical business behavior also stand out:

- Overzealous or obsessive pursuit of personal gain, wealth, and other selfish interests.
- Heavy pressures on company managers to meet or beat earnings targets.
- A company culture that puts the profitability and good business performance ahead of ethical behavior.

Ethical universalism holds that human nature is the same everywhere and thus that ethical rules are cross-cultural. *Ethical relativism* holds that different societal cultures and customs give rise to divergent values and ethical principles of right and wrong. *To some extent,* there is merit in the view that business ethics have to be viewed in the context of each country's local customs, religious traditions, and societal norms. A company has to be very cautious about exporting its home-country values and ethics to foreign countries where it operates—"photocopying" ethics is disrespectful of other countries' values and traditions. However, there are occasions when the rule of "When in Rome, do as the Romans do" is ethically and morally wrong irrespective of local customs, traditions and norms—one such case is the payment of bribes and kickbacks. Managers in multinational enterprises have to figure out how to navigate the gray zone that arises when operating in two cultures with two sets of ethics.

The stance a company takes in dealing with or managing ethical conduct at any given time can take any of four basic forms:

- The unconcerned or nonissue approach.
- The damage control approach.
- The compliance approach.
- The ethical culture approach.

The challenges that arise in each of the four approaches provide an explanation of why a company's executives may sense they have exhausted a particular mode's potential for managing ethics and that they need to move to a stronger, more forceful approach to ethics management.

There are two reasons why a company's strategy should be ethical: (1) because a strategy that is unethical in whole or in part is morally wrong and reflects badly on the character of the company personnel involved, and (2) because an ethical strategy is good business and in the self-interest of shareholders.

Corporate social responsibility is defined as a company's *duty* to operate its business by means that avoid harm to other stakeholders and the environment and, further, to consider the overall betterment of society in its decisions and actions. The essence of *socially responsible business behavior* is that a company should strive to *balance* the benefits of strategic actions to benefit shareholders against any possible adverse impacts on other stakeholders (employees, suppliers, customers, local communities, and society at large) and, further, to proactively mitigate any harmful effects on the environment that its actions and business may have. The menu of actions and behavior for demonstrating social responsibility includes:

- Employing an ethical strategy and observing ethical principles in operating the business.
- Making charitable contributions, donating money and the time of company personnel to community service endeavors, supporting various worthy organizational causes, and making a difference in the lives of the disadvantaged; corporate commitments are further reinforced by encouraging employees to support charitable and community activities.
- Protecting or enhancing the environment and, in particular, striving to minimize or eliminate any adverse impact on the environment stemming from the company's own business activities.
- Creating a work environment that makes the company a great place to work.
- Employing a workforce that is diverse with respect to gender, race, national origin, and perhaps other aspects that different people bring to the workplace.

While striving to be socially responsible entails selecting from the above menu, there can be no generic approach to linking a company's strategy and business conduct to social responsibility. Each company's social responsibility strategy should logically be matched to its core values and business mission and thus be somewhat different from the approaches to social responsibility taken by even other companies in the same industry.

The moral case for social responsibility boils down to a simple concept: It's the right thing to do. The business case for social responsibility holds that it is in the enlightened self-interest of companies to be good citizens and devote some of their energies and resources to the betterment of such stakeholders as employees, the communities in which it operates, and society in general. There are three reasons why the exercise of social responsibility is good business:

- It generates internal benefits (particularly as concerns employee recruiting, workforce retention, and training costs).
- It reduces the risk of reputation-damaging incidents and can lead to increased buyer patronage. The higher the public profile of a company or brand, the greater the scrutiny of its activities and the higher the potential for it to become a target for pressure group action.
- It is in the best interest of shareholders.

Companies that take social responsibility seriously can improve their business reputations and operational efficiency while also reducing their risk exposure and encouraging loyalty and innovation. Overall, they are more likely to be seen as a good investment and as a good company to work for or do business with.

However, there is a school of thought that says companies should be very cautious in their endeavors to better the overall well-being of society because it diverts valuable resources and weakens a company's competitiveness. According to this view, businesses best satisfy their social responsibilities through conventional business activities—producing needed goods and services at prices consistent with the lowest feasible costs. They further argue that spending shareholders' or customers' money for social causes not only muddies decision making by diluting the focus on the company's business mission but also thrusts business executives into the role of social engineers—a role more appropriately performed by charitable and nonprofit organizations and duly-elected government officials. Yet, it is tough to argue that businesses have *no obligations* to nonowner stakeholders or to society at large. If one looks at the category of activities that fall under the umbrella of socially responsible behavior (refer to Figure 10.1), there's really very little to object to in principle. The main problems come in judging the specifics of how well a company goes about the particular social betterment and corporate citizenship activities that it opts to pursue. Are the actions self-serving? Do the actions go far enough? Were the actions done in an appropriate fashion?

In sum, the case for ethical and socially responsible behavior are about attracting and retaining talented staff, about managing risk, and about assuring a company's reputation with customers, suppliers, local communities, and society.

| exercises

1. Consider the following portrayal of strategies employed by the major recording studios:[44]

> Some recording artists and the Recording Artists' Coalition claim that the world's five major music recording studios—Universal, Sony, Time Warner, EMI/Virgin, and Bertlesmann—deliberately employ strategies calculated to take advantage of musicians who record for them. One practice to which they strenuously object is that the major-label record companies frequently require artists to sign contracts committing them to do six to eight albums, an obligation that some artists say can entail an indefinite term of indentured servitude. Further, it is claimed that audits routinely detect unpaid royalties to musicians under contract; according to one music industry attorney, record companies misreport and underpay artist royalties by 10 to 40 percent and are "intentionally fraudulent." One music writer was recently quoted as saying the process was "an entrenched system whose prowess and conniving makes Enron look like amateur hour." Royalty calculations are based on complex formulas that are paid only after artists pay for recording costs and other expenses and after any advances are covered by royalty earnings.

A *Baffler* magazine article outlined a hypothetical but typical record deal in which a promising young band is given a $250,000 royalty advance on a new album. The album subsequently sells 250,000 copies, earning $710,000 for the record company; but the band, after repaying the record company for $264,000 in expenses ranging from recording fees and video budgets to catering, wardrobe, and bus tour costs for promotional events related to the album, ends up $14,000 in the hole, owes the record company money, and is thus paid no royalties on any of the $710,000 in revenues the recording company receives from the sale of the band's music. It is also standard practice in the music industry for recording studios to sidestep payola laws by hiring independent promoters to lobby and compensate radio stations for playing certain records. Record companies are often entitled to damages for undelivered albums if an artist leaves a recording studio for another label after seven years. Record companies also retain the copyrights in perpetuity on all music recorded under contract, a practice that artists claim is unfair. The Dixie Chicks, after a year-long feud with Sony over contract terms, ended up refusing to do another album; Sony sued for breach of contract, prompting a countersuit by the Dixie Chicks charging "systematic thievery" to cheat them out of royalties. The suits were settled out of court. One artist said, "The record companies are like cartels."

Recording studios defend their strategic practices by pointing out that fewer than 5 percent of the signed artists ever deliver a hit and that they lose money on albums that sell poorly. According to one study, only 1 of 244 contracts signed during 1994–1996 was negotiated without the artists being represented by legal counsel, and virtually all contracts renegotiated after a hit album added terms more favorable to the artist.

a. If you were a recording artist, would you be happy with some of the strategic practices of the recording studios? Would you feel comfortable signing a recording contract with studios engaging in any of the practices? Which, if any, of their practices do you believe are unethical?

b. Would you want to be an employee of any of the companies described above? Would you be proud of the company you worked for if you were an employee?

2. Consider the following portrayal of the turnaround strategy employed by Fleming Companies, which at the time was the largest U.S. distributor of consumer packaged goods to retailers of all sizes and formats:[45]

Dozens of manufacturers that used Fleming as a channel for distributing their products to supermarkets and grocery retailers claimed that Fleming habitually deducted arbitrary sums (amounting to perhaps $100 million annually) from the billings they submitted. The practice was said to be a part of Fleming's turnaround strategy to boost its own margins and restore profitability after five money-losing years (1996–2000). According to a food industry consultant who once worked for Fleming, the company's practice was to "deduct and deduct until a vendor cuts them off, then they pay. Then they start deducting again."

Former high-level Fleming employees claimed that the company played games with slotting fees, sometimes taking slotting fee deductions from manufacturer billings for products it never stocked in its warehouse or put on retailers' shelves. Fleming's standing as the largest wholesale grocery products distributor, with some 50,000 retail customers (including Kmart), gave it powerful gatekeeper status because many grocery products manufacturers use a third-party distributor to access small independent grocery chains and because many small grocers get most of their merchandise through a grocery distributor (unlike Wal-Mart, Safeway, and many other large chains that buy directly from the manufacturers). Thus manufacturers that sold through Fleming were hesitant to cut off deliveries to Fleming or protest its deductions too vociferously because they didn't have effective alternatives to getting their products to Fleming's 50,000 customers.

Relationships with some of Fleming's retail customers, most notably Kmart (its biggest customer) and several small independent supermarkets, were also said to be strained because of recurring service and billing issues.

a. Is Fleming engaging in anything unethical here? If you were a Fleming executive, on what grounds would you defend the company's actions?

b. Is the company unfairly using its muscle of serving some 50,000 retail accounts to take advantage of its suppliers?

c. If you were a manufacturer that sold through Fleming, would you be looking for other distributors to handle your products?

d. If you were a Fleming shareholder, would you be pleased with the manner in which the company is being managed and the reputation that such practices are giving the company? Is what is going on here sufficient grounds for selling the shares you own?

(*Special note:* Shortly after Fleming's practices came to light in a front-page *Wall Street Journal* article on September 5, 2002, things at Fleming began to go downhill quickly. The company's profits on sales of $15.5 billion in 2002 were marginal, despite having acquired Target, Albertson's, and 100 other supermarkets as new customers. In February 2003, Kmart terminated its supply relationship with Fleming. In April 2003, Fleming filed for Chapter 11 bankruptcy protection and began a program to dispose of most all of its business assets to pay off creditors. By mid-2003, the company had sold all of its retail grocery operations and all of its wholesale grocery distribution business. Only two small divisions remained, and they were up for sale. The company was history.)

3. Log on to www.business-ethics.com. Review the companies listed as the 100 Best Corporate Citizens and criteria for earning a spot on this list. Do the criteria seem reasonable? Is there ample reason to believe that the 100 companies on this list pursue strategies that are ethical? Or do the criteria used to determine the 100 Best Corporate Citizens point more to companies that have some standout socially responsible practices?

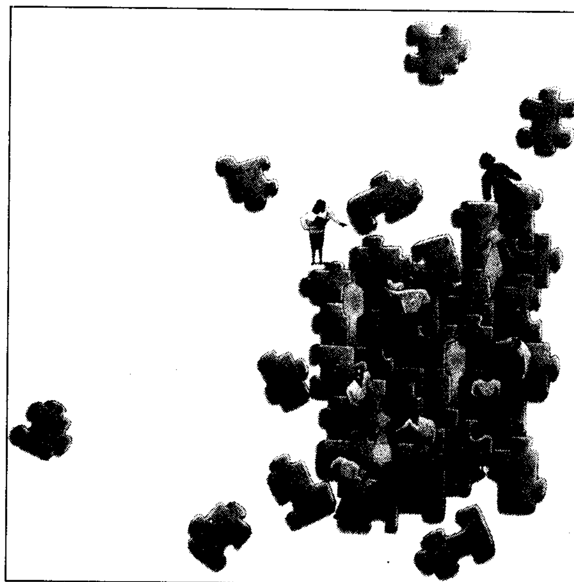
4. Recently, it came to light that three of the world's four biggest public accounting firms may have overbilled clients for travel-related expenses. PricewaterhouseCoopers, KPMG, and Ernst & Young were sued for systematically charging their clients full price for airline tickets, hotel rooms and car-rental expenses, even though they received volume discounts and rebates of up to 40 percent under their contracts with various travel companies. Large accounting firms, law firms and medical practices have in recent years used their size and purchasing volumes to negotiate sizable discounts and rebates on up-front travel costs; some of these contracts apparently required that the discounts not be disclosed to other parties, which seemingly included clients.

However, it has long been the custom for accounting and law firms to bill their clients for actual out-of-pocket expenses. The three accounting firms, so the lawsuit alleges, billed clients for the so-called full prices of the airline tickets, hotel rooms and car-rental expenses rather than for the out-of-pocket discounted amounts. They pocketed the differences to the tune of several million dollars annually in additional profits. Several clients, upon learning of the full-price billing practices, claimed fraud and sued.

Do you consider the accounting firms' billing practice to be unethical? Why or why not?

chapter | eleven 11

Building Resource Strengths and Organizational Capabilities



(©Images.com/CORBIS)

The best game plan in the world never blocked or tackled anybody.
—Vince Lombardi

Strategies most often fail because they aren't executed well.
—Larry Bossidy and Ram Charan
CEO Honeywell International; author and consultant

Organizing is what you do before you do something, so that when you do it, it is not all mixed up.
—A. A. Milne

Once managers have decided on a strategy, the emphasis turns to converting it into actions and good results. Putting the strategy into place and getting the organization to execute it well call for different sets of managerial skills. Whereas crafting strategy is largely a market-driven activity, executing strategy is primarily an operations-driven activity revolving around the management of people and business processes. Whereas successful strategy making depends on business vision, solid industry and competitive analysis, and shrewd market positioning, successful strategy execution depends on doing a good job of working with and through others, building and strengthening competitive capabilities, motivating and rewarding people in a strategy-supportive manner, and instilling a discipline of getting things done. Executing strategy is an action-oriented, make-things-happen task that tests a manager's ability to direct organizational change, achieve continuous improvement in operations and business processes, create and nurture a strategy-supportive culture, and consistently meet or beat performance targets.

Experienced managers are emphatic in declaring that it is a whole lot easier to develop a sound strategic plan than it is to execute the plan and achieve the desired outcomes. According to one executive, "It's been rather easy for us to decide where we wanted to go. The hard part is to get the organization to act on the new priorities."[1] What makes executing strategy a tougher, more time-consuming management challenge than crafting strategy is the wide array of managerial activities that have to be attended to, the many ways managers can proceed, the demanding people-management skills required, the perseverance necessary to get a variety of initiatives launched and moving, the number of bedeviling issues that must be worked out, the resistance to change that must be overcome, and the difficulties of integrating the efforts of many different work groups into a smoothly functioning whole.

Just because senior managers announce a new strategy doesn't mean that organizational members will agree with it or enthusiastically move forward in implementing it. Senior executives cannot simply tell their immediate subordinates to undertake new strategic initiatives and expect the needed actions and changes to occur rapidly and deliver the intended results. Skeptical managers and employees may see the strategy as contrary to the organization's best interests, unlikely to succeed, or threatening to

Companies don't implement and execute strategies; people do.

their departments or careers. Moreover, individual employees may have different ideas about what internal changes are needed to execute the strategy. Long-standing attitudes, vested interests, inertia, and ingrained organizational practices don't melt away when managers decide on a new strategy and begin efforts to implement it—especially when only comparatively few people have been involved in crafting the strategy and when the rationale for strategic change has to be sold to enough organizational members to root out the status quo. It takes adept managerial leadership to convincingly communicate the new strategy and the reasons for it, overcome pockets of doubt and disagreement, build consensus on all the hows of implementation and execution, secure the commitment and energetic cooperation of organizational units, and get all the pieces into place and working well. Depending on how much consensus building, motivating, and organizational change is involved, the process of implementing strategy changes can take several months to several years.

Like crafting strategy, executing strategy is a job for the whole management team, not just a few senior managers. While an organization's chief executive officer and the heads of major units (business divisions, functional departments, and key operating units) are ultimately responsible for seeing that strategy is executed successfully, the process typically affects every part of the firm, from the biggest operating unit to the smallest frontline work group. Top-level managers have to rely on the active support and cooperation of middle and lower managers to push strategy changes into functional areas and operating units and to see that the organization actually operates in accordance with the strategy on a daily basis. Middle and lower-level managers not only are responsible for initiating and supervising the execution process in their areas of authority but also are instrumental in getting subordinates to continuously improve on how strategy-critical value chain activities are being performed and in producing the operating results that allow company performance targets to be met—their role on the company's strategy execution team is by no means minimal. *Strategy execution thus requires every manager to think through the answer to "What does my area have to do to implement its part of the strategic plan, and what should I do to get these things accomplished effectively and efficiently?"*

core concept
All managers have strategy-executing responsibility in their areas of authority, and all employees are participants in the strategy execution process.

A FRAMEWORK FOR EXECUTING STRATEGY

Implementing and executing strategy entails figuring out all the hows—the specific techniques, actions, and behaviors that are needed for a smooth strategy-supportive operation—and then following through to get things done and deliver results. The idea is to make things happen and make them happen right. The first step in implementing strategic changes is for management to communicate the case for organizational change so clearly and persuasively to organizational members that a determined commitment takes hold throughout the ranks to find ways to put the strategy into place, make it work, and meet performance targets. The ideal condition is for managers to arouse enough enthusiasm for the strategy to turn the implementation process into a companywide crusade. *Management's handling of the strategy implementation process can be considered successful if and when the company achieves the targeted strategic and financial performance and shows good progress in making its strategic vision a reality.*

The specific hows of executing a strategy—the exact items that need to be placed on management's action agenda—always have to be customized to fit the particulars of a company's situation. Making

minor changes in an existing strategy differs from implementing radical strategy changes. The hot buttons for successfully executing a low-cost provider strategy are different from those in executing a high-end differentiation strategy. Implementing and executing a new strategy for a struggling company in the midst of a financial crisis is different from improving strategy execution in a company where the execution is already pretty good. Moreover, some managers are more adept than others at using this or that approach to achieving the desired kinds of organizational changes. Hence, there's no definitive 10-step checklist or managerial recipe for successful strategy execution. Strategy execution varies according to individual company situations and circumstances, the strategy implementer's best judgment, and the implementer's ability to use particular organizational change techniques effectively.

THE PRINCIPAL MANAGERIAL COMPONENTS OF THE STRATEGY EXECUTION PROCESS

While a company's strategy-executing approaches always have to be tailored to the company's situation, certain managerial bases have to be covered no matter what the circumstances. Eight managerial tasks crop up repeatedly in company efforts to execute strategy (see Figure 11.1):

1. Building an organization with the competencies, capabilities, and resource strengths to execute strategy successfully.
2. Marshaling resources behind the drive for good strategy execution and operating excellence.
3. Instituting policies and procedures that facilitate strategy execution.
4. Adopting best practices and striving for continuous improvement in how value chain activities are performed.
5. Installing information and operating systems that enable company personnel to carry out their strategic roles proficiently.
6. Tying rewards and incentives directly to the achievement of strategic and financial targets and to good strategy execution.
7. Shaping the work environment and corporate culture to fit the strategy.
8. Exerting the internal leadership needed to drive implementation forward and keep improving on how the strategy is being executed.

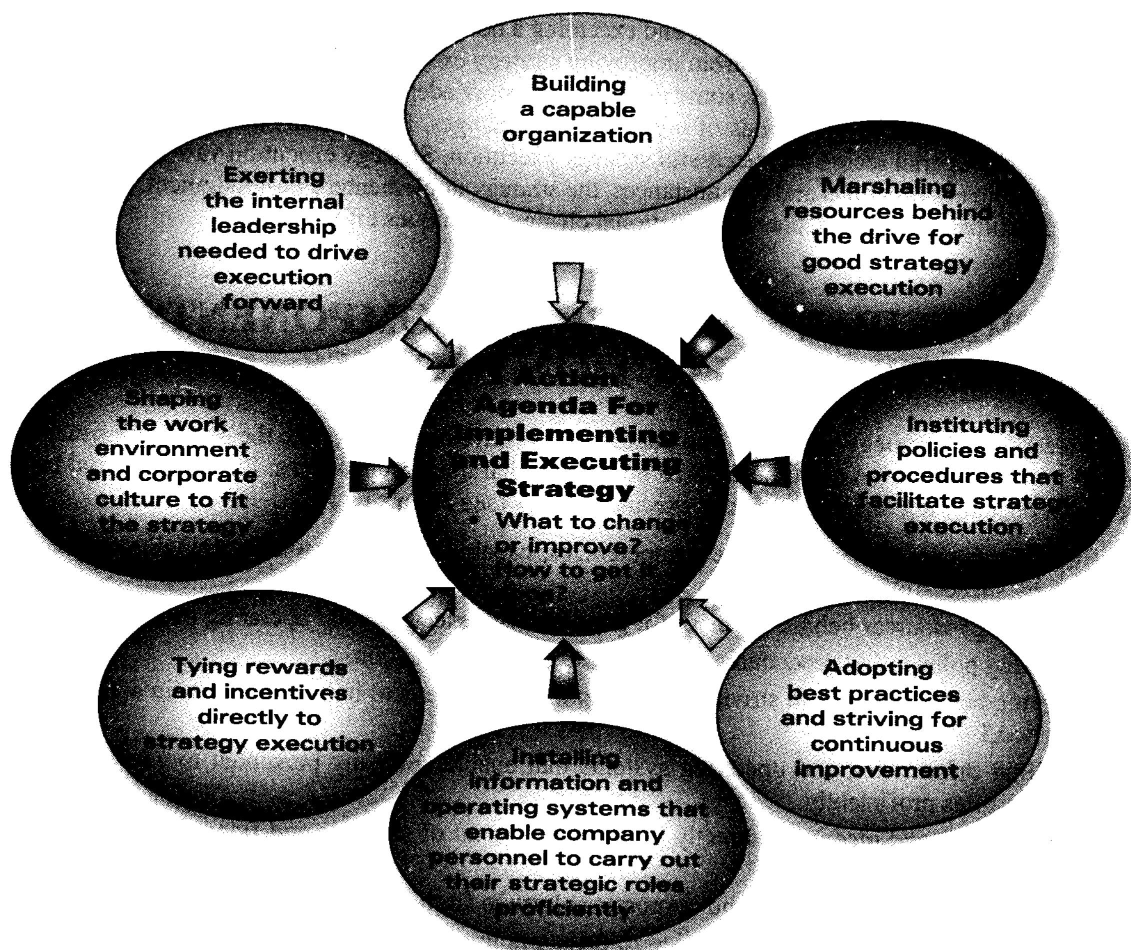
How well managers perform these eight tasks has a decisive impact on whether the outcome is a spectacular success, a colossal failure, or something in between.

When strategies fail, it is often because of poor execution—things that were supposed to get done slip through the cracks.

In devising an action agenda for implementing and executing strategy, the place for managers to start is with *a probing assessment of what the organization must do differently and better to carry out the strategy successfully.* They should then consider *precisely how to make the necessary internal changes as rapidly as possible.* Successful strategy implementers have a knack for diagnosing what their organizations need to do to execute the chosen strategy well and figuring out how to get things done—they are masters in promoting results-oriented behaviors on the part of company personnel and following through on making the right things happen.[2]

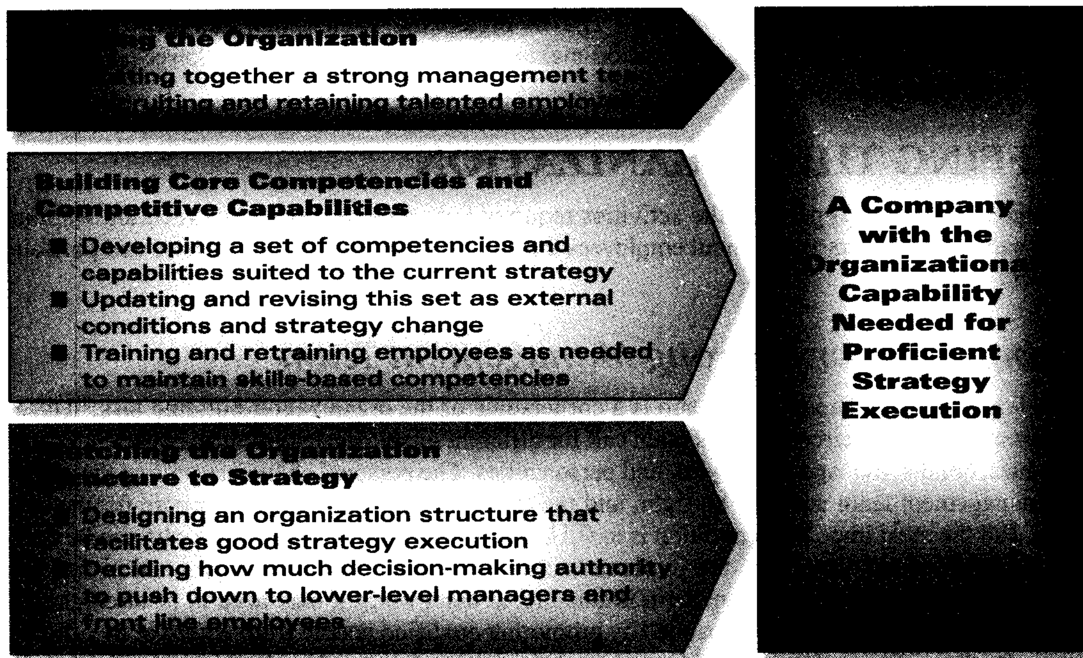
The bigger the organization, the more that successful strategy execution depends on the cooperation and implementing skills of operating managers who can push needed changes at the lowest

figure 11.1 **The Eight Components of the Strategy Execution Process**



organizational levels and deliver results. In a company with geographically scattered operating units, the action agenda of senior executives mostly involves communicating the case for change to others, building consensus for how to proceed, installing strong allies in positions where they can push implementation along in key organizational units, urging and empowering subordinates to keep the process moving, establishing measures of progress and deadlines, recognizing and rewarding those who achieve implementation milestones, directing resources to the right places, and personally leading the strategic change process. In small organizations, by contrast, top managers can deal directly with frontline managers and employees, personally orchestrating the action steps and implementation sequence, observing firsthand how implementation is progressing, and deciding how hard and how fast to push the process along. Regardless of the organization's size and the scope of the changes, the most important leadership trait is a strong, confident sense of what to do and how to do it. Such confidence comes from understanding the circumstances of the organization and the requirements for effective strategy execution. It then remains

figure 11.2 **The Three Components of Building a Capable Organization**



for those managers and company personnel in strategy-critical areas to step up to the plate and produce the desired results.

Managing the Strategy Execution Process: What's Covered in Chapters 11, 12, and 13 In the remainder of this chapter and the next two chapters, we will discuss what is involved in managing the process of implementing and executing strategy. The discussion of executing strategy in Chapters 11, 12, and 13 is framed around the eight managerial tasks shown in Figure 11.1 and the most common issues associated with each. This chapter explores the task of building strategy-supportive competencies, capabilities, and resource strengths. Chapter 12 looks at allocating sufficient money and people to the performance of strategy-critical activities, establishing strategy-facilitating policies and procedures, instituting best practices, installing operating systems, and tying rewards to the achievement of good results. Chapter 13 deals with creating a strategy-supportive corporate culture and exercising appropriate strategic leadership.

BUILDING A CAPABLE ORGANIZATION

Proficient strategy execution depends heavily on competent personnel, better-than-adequate competitive capabilities, and effective internal organization. Building a capable organization is thus always a top priority in strategy execution. As shown in Figure 11.2, three types of organization-building actions are paramount:

1. *Staffing the organization*—putting together a strong management team and recruiting and retaining employees with the needed experience, technical skills, and intellectual capital.

2. *Building core competencies and competitive capabilities*—developing a set of abilities that will enable good strategy execution and updating them as strategy and external conditions change.
3. *Structuring the organization and work effort*—organizing value chain activities and business processes and deciding how much decision-making authority to push down to lower-level managers and frontline employees.

STAFFING THE ORGANIZATION

No company can hope to perform the activities required for successful strategy execution without attracting capable managers and without employees that give it a suitable knowledge base and portfolio of *intellectual capital.*

Putting Together a Strong Management Team

Assembling a capable management team is a cornerstone of the organization-building task.[3] Different strategies and company circumstances often call for different mixes of backgrounds, experiences, know-how, values, beliefs, management styles, and personalities. The personal chemistry among the members of the management team needs to be right, and the talent base needs to be appropriate for the chosen strategy. But the most important condition is to fill key managerial slots with people who can be counted on to get things done; otherwise the implementation-execution process can't proceed at full speed. Sometimes the existing management team is suitable; at other times it may need to be strengthened or expanded by promoting qualified people from within or by bringing in outsiders whose experience, skills, and leadership styles better suit the situation. In turnaround and rapid-growth situations, and in instances when a company doesn't have insiders with the requisite experience or know-how, filling key management slots from the outside is a fairly standard organization-building approach. Illustration Capsule 11.1 describes General Electric's widely acclaimed approach to developing a high-caliber management team.

core concept
Putting together a talented management team with the right mix of skills and experiences is one of the first strategy-implementing steps.

Recruiting and Retaining Capable Employees

Assembling a capable management team is not enough. Staffing the organization with the right kinds of people must go much deeper than managerial jobs in order to build an organization capable of effective strategy execution. Companies like Electronic Data Systems (EDS), McKinsey & Company, Cisco Systems, Southwest Airlines, Procter & Gamble, PepsiCo, Nike, Microsoft, and Intel make a concerted effort to recruit the best and brightest people they can find and then retain them with excellent compensation packages, opportunities for rapid advancement and professional growth, and challenging and interesting assignments. Having a cadre of people with strong skill sets and budding management potential is essential to their business. EDS requires college graduates to have at least a 3.5 grade point average (on a 4.0 scale) just to qualify for an interview, believing that having a high-caliber pool of employees is crucial to operating the information technology systems of its customers. Microsoft makes a point of hiring the very brightest and most talented programmers it can find and motivating them with both good monetary incentives and the challenge of working on cutting-edge software design projects. McKinsey & Company, one of the world's premier management consulting companies, recruits only cream-of-the-crop master's degree candidates at the nation's top 10 business schools; such talent is essential to McKinsey's strategy

illustration capsule 11.1

How General Electric Develops a Talented and Deep Management Team

General Electric (GE) is widely considered to be one of the best-managed companies in the world, partly because of its concerted effort to develop outstanding managers. For starters, GE strives to hire talented people with high potential for executive leadership; it then goes to great lengths to expand the leadership, business, and decision-making capabilities of all its managers. Four key elements underpin GE's efforts to build a talent-rich stable of managers:

1. GE makes a practice of transferring managers across divisional, business, or functional lines for sustained periods of time. Such transfers allow managers to develop relationships with colleagues in other parts of the company, help break down insular thinking in business "silos," and promote the sharing of cross-business ideas and best practices. There is an enormous emphasis at GE on transferring ideas and best practices from business to business and making GE a "boundaryless" company.
2. In selecting executives for key positions, GE is strongly disposed to candidates who exhibit what are called the four E's—enormous personal *energy*, the ability to motivate and *energize* others, *edge* (a GE code word for instinctive competitiveness and the ability to make tough decisions in a timely fashion, saying yes or no instead of maybe), and *execution* (the ability to carry things through to fruition).
3. All managers are expected to be proficient at what GE calls *workout*—a process in which managers and employees come together to confront issues as soon as they come up, pinpoint the root cause of the issues, and bring about quick resolutions so the business can move forward. Workout is GE's way of training its managers to diagnose what to do and how to do it.
4. Each year GE sends about 10,000 newly hired and longtime managers to its Leadership Development Center (generally regarded as one of the best corporate training centers in the world) for a three-week course on the company's Six Sigma quality initiative. More than 5,000 "master black belt" and "black belt" Six Sigma experts have graduated from the program to drive forward thousands of quality initiatives throughout GE. Six Sigma training is an ironclad requirement for promotion to any professional and managerial position and any stock option award. GE's Leadership Development Center also offers advanced courses for senior managers that may focus on a single management topic for a month. All classes involve managers from different GE businesses and different parts of the world. Some of the most valuable learning comes in between formal class sessions when GE managers from different businesses trade ideas about how to improve processes and better serve the customer. This knowledge sharing not only spreads best practices throughout the organization but also improves each GE manager's knowledge.

Each of GE's 85,000 managers and professionals is graded in an annual process that divides them into five tiers: the top 10 percent, the next 15 percent, the middle 50 percent, the next 15 percent, and the bottom 10 percent. Everyone in the top tier gets stock awards, nobody in the fourth tier gets shares of stock, and most of those in the fifth tier become candidates for being weeded out. Business heads are pressured to wean out "C" players. GE's CEO personally reviews the performance of the top 3,000 managers. Senior executive compensation is heavily weighted toward Six Sigma commitment and producing successful business results.

According to Jack Welch, GE's CEO from 1980 to 2001, "The reality is, we simply cannot afford to field anything but teams of 'A' players."

Sources: 1998 annual report; www.ge.com; John A. Byrne, "How Jack Welch Runs GE," *Business Week,* June 8, 1998, p. 90; Miriam Leuchter, "Management Farm Teams," *Journal of Business Strategy,* May 1998, pp. 29–32; and "The House That Jack Built, *The Economist,* September 18, 1999.

of performing high-level consulting for the world's top corporations. The leading global accounting firms screen candidates not only on the basis of their accounting expertise but also on whether they possess the people skills needed to relate well with clients and colleagues. Southwest Airlines goes to considerable lengths to hire people who can have fun on the job; it uses special interviewing and screening methods to gauge whether applicants for customer-contact jobs have outgoing personality traits that match its

strategy of creating a high-spirited, fun-loving, in-flight atmosphere for passengers; it is so selective that only about 3 percent of the people who apply are offered jobs.

In high-tech companies, the challenge is to staff work groups with gifted, imaginative, and energetic people who can bring life to new ideas quickly and inject into the organization what one Dell Computer executive called "hum."[4] The saying "People are our most important asset" may seem hollow, but it fits high-technology companies dead-on. Besides checking closely for functional and technical skills, Dell Computer tests applicants for their tolerance of ambiguity and change, their capacity to work in teams, and their ability to learn on the fly. Companies like Amazon.com and Cisco Systems have broken new ground in recruiting, hiring, cultivating, developing, and retaining talented employees—most all of whom are in their 20s and 30s. Cisco goes after the top 10 percent, raiding other companies and endeavoring to retain key people at the companies it acquires so as to maintain a cadre of star engineers, programmers, managers, salespeople, and support personnel in executing its strategy to remain the world's leading provider of Internet infrastructure products and technology.

core concept
In many industries adding to a company's talent base and building intellectual capital is more important to strategy execution than additional investments in plants, equipment, and other hard assets.

Where intellectual capital is crucial in building a strategy-capable organization, companies have instituted a number of practices in staffing their organizations and developing a strong knowledge base:

1. Spending considerable effort in screening and evaluating job applicants, selecting only those with suitable skill sets, energy, initiative, judgment, and aptitudes for learning and adaptability to the company's work environment and culture.
2. Putting employees through training programs that continue throughout their careers.
3. Providing promising employees with challenging, interesting, and skill-stretching assignments.
4. Rotating people through jobs that not only have great content but also span functional and geographic boundaries. Providing people with opportunities to gain experience in a variety of international settings is increasingly considered an essential part of career development in multinational or global companies.
5. Encouraging employees to be creative and innovative, to challenge existing ways of doing things and offer better ways, and to submit ideas for new products or businesses. Progressive companies work hard at creating an environment in which ideas and suggestions bubble up from below rather than proceed from the top down. Employees are made to feel that their opinions count.
6. Fostering a stimulating and engaging work environment such that employees will consider the company a great place to work.
7. Exerting efforts to retain high-potential, high-performing employees with salary increases, performance bonuses, stock awards and equity ownership, and other long-term incentives.
8. Coaching average performers to improve their skills and capabilities, while weeding out underperformers and benchwarmers.

BUILDING CORE COMPETENCIES AND COMPETITIVE CAPABILITIES

A top organization-building priority in the strategy implementing/executing process is the need to build and strengthen competitively valuable core competencies and organizational capabilities. Whereas

managers identify the desired competencies and capabilities in the course of crafting strategy, good strategy execution requires putting the desired competencies and capabilities in place, upgrading them as needed, and then modifying them as market conditions evolve. Sometimes a company already has the needed competencies and capabilities, in which case managers can concentrate on nurturing them to promote better strategy execution. More often, however, company managers have to add new competencies and capabilities to implement strategic initiatives and promote proficient strategy execution.

A number of prominent companies have succeeded in establishing core competencies and capabilities that have been instrumental in making them winners in the marketplace. Honda's core competence is its depth of expertise in gasoline engine technology and small engine design. Intel's is in the design of complex chips for personal computers and servers. Procter & Gamble's core competencies reside in its superb marketing/distribution skills and its R&D capabilities in five core technologies—fats, oils, skin chemistry, surfactants, and emulsifiers. Sony's core competencies are its expertise in electronic technology and its ability to translate that expertise into innovative products (cutting-edge video game hardware, miniaturized radios and video cameras, TVs and DVDs with unique features, attractively designed PCs). Dell Computer can deliver state-of-the-art products to its customers within days of next-generation components becoming available—and at attractively low costs (it has leveraged its collection of competencies and capabilities into being the global low-cost leader in PCs).

The Three-Stage Process of Developing and Strengthening Competencies and Capabilities

Building core competencies and competitive capabilities is a time-consuming, managerially challenging exercise. While some organization-building assist can be gotten from discovering how best-in-industry or best-in-world companies perform a particular activity, trying to replicate and then improve on those competencies and capabilities of others is, however, much easier said than done—for the same reasons that one cannot become a good golfer just by watching Tiger Woods. Putting a new capability in place is more complicated than just forming a new team or department and charging it with becoming highly competent in performing the desired activity, using whatever it can learn from other companies having similar competencies or capabilities. Rather, it takes a series of deliberate and well-orchestrated organizational steps to achieve mounting proficiency in performing an activity. The capability-building process has three stages:

Stage 1—First, the organization must develop the *ability* to do something, however imperfectly or inefficiently. This entails selecting people with the requisite skills and experience, upgrading or expanding individual abilities as needed, and then molding the efforts and work products of individuals into a collaborative effort to create organizational ability.

Stage 2—As experience grows and company personnel learn how to perform the activity *consistently well and at an acceptable cost,* the ability evolves into a tried-and-true *competence or capability.*

Stage 3—Should the organization continue to polish and refine its know-how and otherwise sharpen its performance such that it becomes *better than rivals* at performing the activity, the core competence rises to the rank of a *distinctive competence* (or the capability becomes a competitively superior capability), thus providing a path to competitive advantage.

Many companies manage to get through stages 1 and 2 in performing a strategy-critical activity, but comparatively few achieve sufficient proficiency in performing strategy-critical activities to qualify for the third stage.

Managing the Process Four traits concerning core competencies and competitive capabilities are important in successfully managing the organization-building process:[5]

1. *Core competencies and competitive capabilities are bundles of skills and know-how that most often grow out of the combined efforts of cross-functional work groups and departments performing complementary activities at different locations in the firm's value chain.* Rarely does a core competence or capability consist of narrow skills attached to the work efforts of a single department. For instance, a core competence in speeding new products to market involves the collaborative efforts of personnel in R&D, engineering and design, purchasing, production, marketing, and distribution. Similarly, the capability to provide superior customer service is a team effort among people in customer call centers (where orders are taken and inquiries are answered), shipping and delivery, billing and accounts receivable, and after-sale support. Complex activities (like designing and manufacturing a sport-utility vehicle or creating the capability for secure credit card transactions over the Internet) usually involve a number of component skills, technological disciplines, competencies, and capabilities—some performed in-house and some provided by suppliers/allies. An important part of the organization-building function is to think about which activities of which groups need to be linked and made mutually reinforcing and then to forge the necessary collaboration both internally and with outside resource providers.
2. *Normally, a core competence or capability emerges incrementally out of company efforts either to bolster skills that contributed to earlier successes or to respond to customer problems, new technological and market opportunities, and the competitive maneuverings of rivals.* Migrating from the one-time ability to do something up the ladder to a core competence or competitively valuable capability is usually an organization-building process that takes months and often years to accomplish—it is definitely not an overnight event.
3. *The key to leveraging a core competence into a distinctive competence (or a capability into a competitively superior capability) is concentrating more effort and more talent than rivals on deepening and strengthening the competence or capability, so as to achieve the dominance needed for competitive advantage.* This does not necessarily mean spending more money on such activities than competitors, but it does mean consciously focusing more talent on them and striving for best-in-industry, if not best-in-world, status. To achieve dominance on lean financial resources, companies like Cray in large computers and Honda in gasoline engines have leveraged the expertise of their talent pool by frequently re-forming high-intensity teams and reusing key people on special projects. The experiences of these and other companies indicate that the usual keys to successfully building core competencies and valuable capabilities are superior employee selection, thorough training and retraining, powerful cultural influences, effective cross-functional collaboration, empowerment, motivating incentives, short deadlines, and good databases—not big operating budgets.
4. *Evolving changes in customers' needs and competitive conditions often require tweaking and adjusting a company's portfolio of competencies and intellectual capital to keep its capabilities freshly honed and on the cutting edge.* This is particularly important in high-tech industries and fast-paced markets where important developments occur weekly. As a consequence, wise company managers work at anticipating changes in customer-market requirements and staying ahead of the

curve in proactively building a package of competencies and capabilities that can win out over rivals.

Managerial actions to develop core competencies and competitive capabilities generally take one of two forms: either strengthening the company's base of skills, knowledge, and intellect, or coordinating and networking the efforts of the various work groups and departments. Actions of the first sort can be undertaken at all managerial levels, but actions of the second sort are best orchestrated by senior managers who not only appreciate the strategy-executing significance of strong competencies/capabilities but also have the clout to enforce the necessary networking and cooperation among individuals, groups, departments, and external allies.

One organization-building question is whether to develop the desired competencies and capabilities internally or to outsource them by partnering with key suppliers or forming strategic alliances. The answer depends on what can be safely delegated to outside suppliers or allies versus what internal capabilities are key to the company's long-term success. Either way, though, calls for action. Outsourcing means launching initiatives to identify the most attractive providers and to establish collaborative relationships. Developing the capabilities in-house means marshaling personnel with relevant skills and experience, networking the individual skills and related cross-functional activities to form organizational capability, and building the desired levels of proficiency through repetition (practice makes perfect).[6]

Sometimes the tediousness of internal organization building can be shortcut by buying a company that has the requisite capability and integrating its competencies into the firm's value chain. Indeed, a pressing need to acquire certain capabilities quickly is one reason to acquire another company—an acquisition aimed at building greater capability can be every bit as competitively valuable as an acquisition aimed at adding new products or services to the company's business lineup. Capabilities-motivated acquisitions are essential (1) when a market opportunity can slip by faster than a needed capability can be created internally, and (2) when industry conditions, technology, or competitors are moving at such a rapid clip that time is of the essence. But usually there's no good substitute for ongoing internal efforts to build and strengthen the company's competencies and capabilities in performing strategy-critical value chain activities.

Updating and Reshaping Competencies and Capabilities as External Conditions and Company Strategy Change Even after core competencies and competitive capabilities are in place and functioning, company managers can't relax. Competencies and capabilities that grow stale can impair competitiveness unless they are refreshed, modified, or even replaced in response to ongoing market changes and shifts in company strategy. Indeed, the buildup of knowledge and experience over time, coupled with the imperatives of keeping capabilities in step with ongoing strategy and market changes, makes it appropriate to view a company as *a bundle of evolving competencies and capabilities.* Management's organization-building challenge is one of deciding when and how to recalibrate existing competencies and capabilities, and when and how to develop new ones. Although the task is formidable, ideally it produces a dynamic organization.

From Competencies and Capabilities to Competitive Advantage

While strong core competencies and competitive capabilities are a major assist in executing strategy, they are an equally important avenue for securing a competitive edge over rivals in situations where it is

core concept
Building competencies and capabilities has a huge payoff—improved strategy execution and a potential for competitive advantage.

relatively easy for rivals to copy smart strategies. Any time rivals can readily duplicate successful strategy features, making it difficult or impossible to beat rivals in the marketplace with a superior strategy, the chief way to achieve lasting competitive advantage is to beat them by performing certain value chain activities in superior fashion. Building core competencies, resource strengths, and organizational capabilities that rivals can't match is thus one of the best and most reliable ways to beat them. Moreover, cutting-edge core competencies and organizational capabilities are not easily duplicated by rival firms; thus, any competitive edge they produce is likely to be sustainable, paving the way for above-average organizational performance.

The Strategic Role of Employee Training

Training and retraining are important when a company shifts to a strategy requiring different skills, competitive capabilities, managerial approaches, and operating methods. Training is also strategically important in organizational efforts to build skills-based competencies. And it is a key activity in businesses where technical know-how is changing so rapidly that a company loses its ability to compete unless its skilled people have cutting-edge knowledge and expertise. Successful strategy implementers see to it that the training function is both adequately funded and effective. If the chosen strategy calls for new skills, deeper technological capability, or building and using new capabilities, training should be placed near the top of the action agenda.

The strategic importance of training has not gone unnoticed. Over 600 companies have established internal "universities" to lead the training effort, facilitate continuous organizational learning, and help upgrade company competencies and capabilities. Many companies conduct orientation sessions for new employees, fund an assortment of competence-building training programs, and reimburse employees for tuition and other expenses associated with obtaining additional college education, attending professional development courses, and earning professional certification of one kind or another. A number of companies offer online, just-in-time training courses to employees around the clock. Increasingly, employees at all levels are expected to take an active role in their own professional development, assuming responsibility for keeping their skills and expertise up-to-date and in sync with the company's needs.

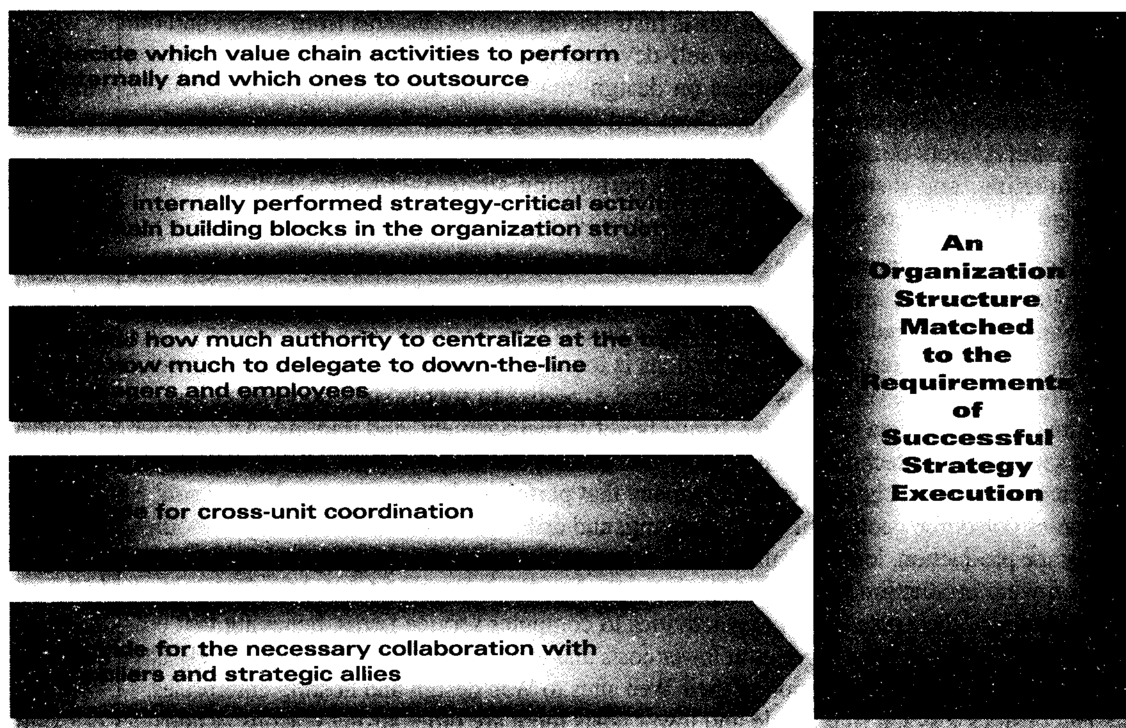
MATCHING ORGANIZATION STRUCTURE TO STRATEGY

There are few hard-and-fast rules for organizing the work effort to support strategy. Every firm's organization chart is partly a product of its particular situation, reflecting prior organizational patterns, varying internal circumstances, executive judgments about reporting relationships, and the politics of who gets which assignments. Moreover, every strategy is grounded in its own set of key success factors and value chain activities. But some considerations are common to all companies. These are summarized in Figure 11.3 and discussed in turn in the following sections.

Deciding Which Value Chain Activities to Perform Internally and Which to Outsource

In any business, some activities in the value chain are always more critical to strategic success and competitive advantage than others. Among the primary value chain activities are certain crucial business

figure 11.3 **Structuring the Work Effort to Promote Successful Strategy Execution**



processes that have to be performed either exceedingly well or in closely coordinated fashion for the organization to deliver on the capabilities needed for strategic success. For instance, hotel/motel enterprises have to be good at fast check-in/check-out, room maintenance, food service, and creating a pleasant ambience. For a manufacturer of chocolate bars, buying quality cocoa beans at low prices is vital and reducing production costs by a fraction of a cent per bar can mean a seven-figure improvement in the bottom line. In discount stock brokerage, the strategy-critical activities are fast access to information, accurate order execution, efficient record keeping, and good customer service. In specialty chemicals, the critical activities are R&D, product innovation, getting new products onto the market quickly, effective marketing, and expertise in assisting customers. In consumer electronics, where advancing technology drives new product innovation, rapidly getting cutting-edge, next-generation products to market is a critical organizational capability.

As a general rule, strategy-critical activities need to be performed internally so that management can directly control their performance. Less important activities—like routine administrative housekeeping (doing the payroll, administering employee benefit programs, providing corporate security, managing stockholder relations, maintaining fleet vehicles) and some support functions (information technology and data processing, training, public relations, market research, legal and legislative affairs)—may be strong candidates for outsourcing. Two questions help pinpoint an organization's strategy-critical activities: "What functions or business processes have to be performed extra well or in timely fashion to achieve sustainable competitive advantage?" and "In what value chain activities would poor execution seriously impair strategic success?"[7]

However, a number of companies have found ways to successfully rely on outside components suppliers, product designers, distribution channels, advertising agencies, and financial services firms to perform strategically significant value chain activities.[8] For years Polaroid Corporation bought its film from Eastman Kodak, its electronics from Texas Instruments, and its cameras from Timex and others, while it concentrated on producing its unique self-developing film packets and designing its next-generation cameras and films. Nike concentrates on design, marketing, and distribution to retailers, while outsourcing virtually all production of its shoes and sporting apparel. Likewise, a number of personal computer manufacturers outsource assembly, concentrating their energies instead on product design, sales and marketing, and distribution. So while performing strategy-critical activities in-house normally makes good sense, there can be times when outsourcing some of them works to good advantage.

The Merits of Outsourcing Noncritical Value Chain Activities Managers too often spend inordinate amounts of time, mental energy, and financial resources wrestling with functional support groups and other internal bureaucracies, which diverts their attention from the company's strategy-critical activities. One way to reduce such distractions is to cut the number of internal staff-support activities and instead rely on outside vendors with specialized expertise to supply such noncritical support services as Web site operations, data processing, fringe benefits management, and training. An outsider, by concentrating specialists and technology in its area of expertise, can frequently perform certain services as well or better, and often more cheaply, than a company that performs these services only for itself. Many mining companies outsource geological work, assaying, and drilling. E. & J. Gallo Winery outsources 95 percent of its grape production, letting farmers take on the weather and other grape-growing risks while it concentrates on wine production and sales.[9] Eastman Kodak, Ford, Exxon Mobil, Merrill Lynch, and Chevron have outsourced their data processing activities to computer service firms, believing that outside specialists can perform the needed services at lower costs and equal or better quality. A relatively large number of companies outsource the operation of their Web sites to Web design and hosting enterprises.

But besides less internal hassle and lower costs there are other strong reasons to consider outsourcing. Approached from a strategic point of view, outsourcing noncrucial support activities can decrease internal bureaucracies, flatten the organization structure, speed decision making, heighten the company's strategic focus, improve its innovative capacity (through interaction with best-in-world suppliers), and increase competitive responsiveness.[10] Outsourcing has considerable merit when it allows a company to concentrate its own energies and resources on those value chain activities for which it can create unique value and thus become best in the industry (or, better still, best in the world). It also has merit when the company needs strategic control to build core competencies, achieve competitive advantage, and manage key customer/supplier/distributor relationships.

core concept
Outsourcing has many strategy-executing advantages—lower costs, less internal bureaucracy, speedier decision-making, and heightened strategic focus.

The Merits of Partnering with Others to Gain Added Competitive Capabilities

There is another equally important reason to look outside for resources to compete effectively aside from just the cost savings and agility that outsourcing can permit. *Partnerships can add to a company's arsenal of capabilities and contribute to better strategy execution.* By building, continually improving, and then leveraging partnerships, a company enhances its overall organizational capabilities and builds resource strengths—strengths that deliver value to customers and consequently pave the way for competitive success.

Automobile manufacturers, for example, work closely with their suppliers to advance the design and functioning of engine cooling systems, transmission systems, electrical systems, and so on—all of which helps shorten the cycle time for new models, improve the quality and performance of those models, and lower overall production costs. Prior to merging with Germany's Daimler-Benz, Chrysler transformed itself from a high-cost producer into a low-cost producer by abandoning internal production of many parts and components and instead outsourcing them from more efficient parts/components suppliers; greater reliance on outsourcing enabled Chrysler to shorten its design-to-market cycle for new models and drive down its production costs. Soft-drink and beer manufacturers all cultivate their relationships with their bottlers and distributors to strengthen access to local markets and build the loyalty, support, and commitment for corporate marketing programs, without which their own sales and growth are weakened. Similarly, fast-food enterprises like McDonald's and Taco Bell find it essential to work hand-in-hand with franchisees on outlet cleanliness, consistency of product quality, in-store ambience, courtesy and friendliness of store personnel, and other aspects of store operations. Unless franchisees continuously deliver sufficient customer satisfaction to attract repeat business, a fast-food chain's sales and competitive standing will suffer quickly. Companies like Ford, Boeing, Aerospatiale, AT&T, BMW, and Dell Computer have learned that their central R&D groups cannot begin to match the innovative capabilities of a well-managed network of supply chain partners having the ability to advance the technology, lead the development of next-generation parts and components, and supply them at a relatively low price.[11]

core concept
Strategic partnerships, alliances, and close collaboration with suppliers, distributors, makers of complementary products, and even competitors all make good strategic sense whenever the result is to enhance organizational resources and capabilities.

The Dangers of Excessive Outsourcing Critics contend that *a company that goes overboard on outsourcing can hollow out its knowledge base and capabilities, putting itself at the mercy of outside suppliers and leaving it short of the resource strengths to be master of its own destiny.*[12] The point is well taken. Outsourcing strategy-critical activities must be done judiciously and with safeguards against losing control over the performance of key value chain activities and becoming overly dependent on outsiders. Thus, many companies refuse to source key components from a single supplier, opting to use two or three suppliers as a way to avoid becoming overly dependent on any one supplier and giving any one supplier too much bargaining power. Moreover, they regularly evaluate their suppliers, looking not only at the supplier's overall performance but also at whether they should switch to another supplier or even bring the activity back in-house. To avoid loss of control, companies typically work closely with key suppliers, endeavoring to make sure that suppliers' activities are closely integrated with their own requirements and expectations. Most companies appear alert to the primary danger of excessive outsourcing: being caught without the internal strengths and capabilities needed to protect their well-being in the marketplace.

Making Strategy-Critical Activities the Main Building Blocks of the Organization Structure

The rationale for making strategy-critical activities the main building blocks in structuring a business is compelling: If activities crucial to strategic success are to have the resources, decision-making influence, and organizational impact they need, they have to be centerpieces in the organizational scheme. Plainly, implementing a new or changed strategy is likely to entail new or different key activities, competencies, or capabilities and therefore to require new or different organizational arrangements. If workable

core concept
Just as a company's strategy evolves to stay in tune with changing external circumstances, so must an organization's structure evolve to fit shifting requirements for proficient strategy execution.

organizational adjustments are not forthcoming, the resulting mismatch between strategy and structure can open the door to execution and performance problems.[13] Hence, attempting to carry out a new strategy with an old organizational structure is usually unwise.

Although the stress here is on designing the organization structure around the needs of effective strategy execution, it is worth noting that structure can and does influence the choice of strategy. A good strategy must be doable. When an organization's present structure is so far out of line with the requirements of a particular strategy that the organization would have to be turned upside down to implement it, the strategy may not be doable and should not be given further consideration. In such cases, structure shapes the choice of strategy. The thing to remember, however, is that *once a strategy is chosen, structure must be modified to fit the strategy if, in fact, an approximate fit does not already exist.* Any influences of structure on strategy should, logically, come before the point of strategy selection rather than after it.

The Primary Building Blocks of the Organization Structure The primary organizational building blocks within a business are usually *traditional functional departments* (R&D, engineering and design, production and operations, sales and marketing, information technology, finance and accounting, and human resources) and *process-complete departments* (supply chain management, filling customer orders, customer service, quality control, direct sales via the company's Web site).[14] In enterprises with operations in various countries around the world (or with geographically scattered organizational units within a country), the basic building blocks may also include *geographic organizational units,* each of which has profit/loss responsibility for its assigned geographic area. In vertically integrated firms, the major building blocks are *divisional units performing one or more of the major processing steps along the value chain* (raw materials production, components manufacture, assembly, wholesale distribution, retail store operations); each division in the value chain may operate as a profit center for performance measurement purposes.

The typical building blocks of a diversified company are its *individual businesses,* with each business unit usually operating as an independent profit center and with corporate headquarters performing assorted support functions for all of its business units.

Why Functional Organization Structures Often Impede Strategy Execution A big weakness of traditional functionally organized structures is that pieces of strategically relevant activities and capabilities often end up scattered across many departments, with the result that no one group or manager is accountable. Consider, for example, how a functional structure results in fragmented performance of the following strategy-critical activities:

- *Filling customer orders accurately and promptly*—a process that cuts across sales (which wins the order); finance (which may have to check credit terms or approve special financing); production (which must produce the goods and replenish warehouse inventories as needed); warehousing (which has to verify whether the items are in stock, pick the order from the warehouse, and package it for shipping); and shipping (which has to choose a carrier to deliver the goods and release the goods to the carrier).[15]
- *Speeding new products to market*—a cross-functional process involving personnel in R&D, design and engineering, purchasing, manufacturing, and sales and marketing.

- *Improving product quality*—a process that often involves the collaboration of personnel in R&D, engineering and design, components purchasing from suppliers, in-house components production, manufacturing, and assembly.
- *Supply chain management*—a collaborative process that cuts across such functional areas as purchasing, engineering and design, components purchasing, inventory management, manufacturing and assembly, and warehousing and shipping.
- *Building the capability to conduct business via the Internet*—a process that involves personnel in information technology, supply chain management, production, sales and marketing, warehousing and shipping, customer service, finance, and accounting.
- *Obtaining feedback from customers and making product modifications to meet their needs*—a process that involves personnel in customer service and after-sale support, R&D, engineering and design, components purchasing, manufacturing and assembly, and marketing research.

Handoffs from one department to another lengthen completion time and frequently drive up administrative costs, since coordinating the fragmented pieces can soak up hours of effort on the parts of many people.[16] This is not a fatal flaw of functional organization—organizing around specific functions has worked to good advantage in support activities like finance and accounting, human resource management, and engineering, and in such primary activities as R&D, manufacturing, and marketing. But fragmentation is an important weakness of functional organization, accounting for why we indicated that a company's competencies and capabilities are usually cross-functional and don't reside in the activities of a single functional department.

Increasingly during the past decade, companies have found that rather than continuing to scatter related pieces of a strategy-critical business process across several functional departments and scrambling to integrate their efforts, it is better to reengineer the work effort and create *process departments.* This is done by pulling the people who performed the pieces in functional departments into a group that works together to perform the whole process. Pulling the pieces of strategy-critical processes out of the functional silos and creating process departments or cross-functional work groups charged with performing all the steps needed to produce a strategy-critical result has been termed **business process reengineering.**

core concept
Business process reengineering involves pulling the pieces of a strategy-critical process out of various functional departments and integrating them into a streamlined, cohesive series of work steps performed within a single work unit.

In the electronics industry, where product life cycles run only three to six months due to the speed of advancing technology, companies have formed process departments charged with cutting the time it takes to bring new technologies and products to commercial fruition. Northwest Water, a British utility, used business process reengineering to eliminate 45 work depots that served as home bases to crews who installed and repaired water and sewage lines and equipment. Now crews work directly from their vehicles, receiving assignments and reporting work completion from computer terminals in their trucks. Crew members are no longer employees but contractors to Northwest Water. These reengineering efforts not only eliminated the need for the work depots but also allowed Northwest Water to eliminate a big percentage of the bureaucratic personnel and supervisory organization that managed the crews.[17] At acute care hospitals such as Lee Memorial in Fort Myers, Florida, and St. Vincent's in Melbourne, Australia, medical care has been reengineered so that it is delivered by interdisciplinary teams of health care professionals organized around the needs of the patients and their families rather than around functional departments within the hospital. Both hospitals created treatment-specific wards within the hospital to handle most of a patient's needs, from admission to discharge. Patients are no longer wheeled from

department to department for procedures and tests; instead, teams have the equipment and resources within each focused care unit to provide total care for the patient. While the hospitals had some concern about functional inefficiency in the use of some facilities, process organization has resulted in substantially lower operating costs, faster patient recovery, and greater satisfaction on the part of patients and caregivers.

Reengineering strategy-critical business processes to reduce fragmentation across traditional departmental lines and cut bureaucratic overhead has proved to be a legitimate organization design tool, not a passing fad. Process organization is every bit as valid an organizing principle as functional specialization. Strategy execution is improved when the pieces of strategy-critical activities and core business processes performed by different departments are properly integrated and coordinated.

Companies that have reengineered some of their business processes have ended up compressing formerly separate steps and tasks into jobs performed by a single person and integrating jobs into team activities. Reorganization then follows as a natural consequence of task synthesis and job redesign. When done properly, reengineering can produce dramatic gains in productivity and organizational capability. In the order-processing section of General Electric's circuit breaker division, elapsed time from order receipt to delivery was cut from three weeks to three days by consolidating six production units into one, reducing a variety of former inventory and handling steps, automating the design system to replace a human custom-design process, and cutting the organizational layers between managers and workers from three to one. Productivity rose 20 percent in one year, and unit manufacturing costs dropped 30 percent.[18]

Determining the Degree of Authority and Independence to Give Each Unit and Each Employee

In executing strategy and conducting daily operations, companies must decide how much authority to delegate to the managers of each organization unit—especially the heads of business subsidiaries; functional and process departments; and plants, sales offices, distribution centers; and other operating units—and how much decision-making latitude to give individual employees in performing their jobs. The two extremes are to *centralize decision making* at the top (the CEO and a few close lieutenants) or to *decentralize decision making* by giving managers and employees considerable decision-making latitude in their areas of responsibility. As shown in Table 11.1, the two approaches are based on sharply different underlying principles and beliefs, with each having its pros and cons.

Centralized Decision-Making *In a highly centralized organization structure, top executives retain authority for most strategic and operating decisions and keep a tight rein on business-unit heads, department heads, and the managers of key operating units; comparatively little discretionary authority is granted to frontline supervisors and rank-and-file employees.* The command-and-control paradigm of centralized structures is based on the underlying assumption that frontline personnel have neither the time nor the inclination to direct and properly control the work they are performing, and that they lack the knowledge and judgment to make wise decisions about how best to do it—hence the need for managerially prescribed policies and procedures, close supervision, and tight control. The thesis underlying authoritarian structures is that strict enforcement of detailed procedures backed by rigorous managerial oversight is the most reliable way to keep the daily execution of strategy on track.

There are disadvantages to having a small number of top-level managers micromanage the business by personally making decisions or by requiring they approve the recommendations of lower-level subordinates before actions can be taken.

table 11.1 **Advantages and Disadvantages of Centralized versus Decentralized Decision-Making**

Centralized Organizational Structures	Decentralized Organizational Structures
Basic Tenets • Decisions on most matters of importance should be pushed to managers up the line who have the experience, expertise, and judgment to decide what is the wisest or best course of action. • Frontline supervisors and rank-and-file employees can't be relied on to make the right decisions because they seldom know what is best for the organization and because they do not have the time or the inclination to properly manage the tasks they are performing.	**Basic Tenets** • Decision-making authority should be put in the hands of the people closest to and most familiar with the situation and these people should be trained to exercise good judgment. • A company that draws on the combined intellectual capital of all its employees can outperform a command-and-control company.
Chief Advantage • Tight control from the top allows for accountability.	**Chief Advantages** • Encourages lower-level managers and rank-and-file employees to exercise initiative and act responsibly. • Promotes greater motivation and involvement in the business on the part of more company personnel. • Spurs new ideas and creative thinking. • Allows fast response times. • Reduces layers of management.
Primary Disadvantages • Lengthens response times because management bureaucracy must decide on a course of action. • Does not encourage responsibility among lower-level managers and rank-and-file employees. • Discourages lower-level managers and rank-and-file employees from exercising any initiative—they are expected to wait to be told what to do.	**Primary Disadvantages** • Puts the organization at risk if many bad decisions are made at lower levels. • Impedes cross-unit coordination and capture of strategic fits.

The big advantage of an authoritarian structure is tight control by the manager in charge—it is easy to know who is accountable when things do not go well. But there are some serious disadvantages. Hierarchical command-and-control structures make an organization sluggish in responding to changing conditions because of the time it takes for the review/approval process to run up all the layers of the management bureaucracy. Furthermore, to work well, centralized decision making requires top-level managers to gather and process whatever information is relevant to the decision. When the relevant knowledge resides at lower organizational levels (or is technical, detailed, or hard to express in words), it is difficult and time-consuming to get all of the facts and nuances in front of a high-level executive located far from the scene of the action—full understanding of the situation cannot be readily copied from one mind to another. Hence, centralized decision making is often impractical—the larger the company and the more scattered its operations, the more that decision-making authority has to be delegated to managers closer to the scene of the action.

Decentralized Decision-Making *In a highly decentralized organization, decision-making authority is pushed down to the lowest organizational level capable of making timely, informed, competent decisions.* The objective is to put adequate decision-making authority in the hands of the people closest to and most familiar with the situation and train them to weigh all the factors and exercise good judgment. The case for empowering down-the-line managers and employees to make decisions related to daily operations and executing the strategy is based on the belief that a company that draws on the combined

> **The ultimate goal of decentralized decision making is not to push decisions down to lower levels but to put decision-making authority in the hands of those persons or teams closest to and most knowledgeable about the situation.**

intellectual capital of all its employees can outperform a command-and-control company. Decentralized decision making means, for example, that in a diversified company the various business-unit heads have broad authority to execute the agreed-on business strategy with comparatively little interference from corporate headquarters; moreover, the business-unit heads delegate considerable decision-making latitude to functional and process department heads and the heads of the various operating units (plants, distribution centers, sales offices) in implementing and executing their pieces of the strategy. In turn, work teams may be empowered to manage and improve their assigned value chain activity, and employees with customer contact may be empowered to do what it takes to please customers. At Starbucks, for example, employees are encouraged to exercise initiative in promoting customer satisfaction—there's the story of a store employee who, when the computerized cash register system went offline, enthusiastically offered free coffee to waiting customers.[19] With decentralized decision making, top management maintains control by limiting empowered managers' and employees' discretionary authority and holding people accountable for the decisions they make.

Decentralized organization structures have much to recommend them. Delegating greater authority to subordinate managers and employees creates a more horizontal organization structure with fewer management layers. Whereas in a centralized vertical structure managers and workers have to go up the ladder of authority for an answer, in a decentralized horizontal structure they develop their own answers and action plans—making decisions in their areas of responsibility and being accountable for results is an integral part of their job. Pushing decision-making authority down to middle and lower-level managers and then further on to work teams and individual employees shortens organizational response times and spurs new ideas, creative thinking, innovation, and greater involvement on the part of subordinate managers and employees. In worker-empowered structures, jobs can be defined more broadly, several tasks can be integrated into a single job, and people can direct their own work. Fewer managers are needed because deciding how to do things becomes part of each person's or team's job. Further, today's electronic communication systems make it easy and relatively inexpensive for people at all organizational levels to have direct access to data, other employees, managers, suppliers, and customers. They can access information quickly (via the Internet or company intranet), readily check with superiors or others as needed, and take responsible action. Typically, there are genuine gains in morale and productivity when people are provided with the tools and information they need to operate in a self-directed way.

Insofar as all five tasks of strategic management are concerned, a decentralized approach to decision making means that the managers of each organizational unit should not only lead the crafting of their unit's strategy but also lead the decision making on how to execute it. Decentralization thus requires selecting strong managers to head each organizational unit and holding them accountable for crafting and executing appropriate strategies for their units. Managers who consistently produce unsatisfactory results have to be weeded out.

The past decade has seen a growing shift from authoritarian, multilayered hierarchical structures to flatter, more decentralized structures that stress employee empowerment. There's strong and growing consensus that authoritarian, hierarchical organization structures are not well suited to implementing and executing strategies in an era when extensive information and instant communication are the norm and when a big fraction of the organization's most valuable assets consists of intellectual capital and resides in the knowledge and capabilities of its employees. Many companies have therefore begun empowering lower-level managers and employees throughout their organizations, giving them greater discretionary

authority to make strategic adjustments in their areas of responsibility and to decide what needs to be done to put new strategic initiatives into place and execute them proficiently.

Maintaining Control in a Decentralized Organization Structure Pushing decision-making authority deep down into the organization structure presents its own challenge: *how to exercise adequate control over the actions of empowered employees so that the business is not put at risk at the same time that the benefits of empowerment are realized.*[20] Maintaining adequate organizational control over empowered employees is generally accomplished by placing limits on the authority that empowered personnel can exercise, holding people accountable for their decisions, instituting compensation incentives that reward people for doing their jobs in a manner to contributes to good company performance, and creating a corporate culture where there's strong peer pressure on individuals to act responsibly.

Capturing Strategic Fits in a Decentralized Structure Diversified companies striving to capture cross-business strategic fits have to beware of giving business heads full rein to operate independently when cross-business collaboration is essential in order to gain strategic fit benefits. Cross-business strategic fits typically have to be captured either by enforcing close cross-business collaboration or by centralizing performance of functions having strategic fits at the corporate level.[21] For example, if businesses with overlapping process and product technologies have their own independent R&D departments—each pursuing their own priorities, projects, and strategic agendas—it's hard for the corporate parent to prevent duplication of effort, capture either economies of scale or economies of scope, or broaden the company's R&D efforts to embrace new technological paths, product families, end-use applications, and customer groups. Where cross-business R&D fits exist, the best solution is usually to centralize the R&D function and have a coordinated corporate R&D effort that serves both the interests of individual business and the company as a whole. Likewise, centralizing the related activities of separate businesses makes sense when there are opportunities to share a common sales force, use common distribution channels, rely on a common field service organization to handle customer requests for technical assistance or provide maintenance and repair services, use common e-commerce systems and approaches, and so on.

The point here is that efforts to decentralize decision making and give organizational units leeway in conducting operations have to be tempered with the need to maintain adequate control and cross-unit coordination—decentralization doesn't mean delegating authority in ways that allow organization units and individuals to do their own thing. The strategic importance of cross-unit collaboration creates numerous instances when decision-making authority needs to be retained at high levels in the organization and ample cross-unit coordination strictly enforced.

Providing for Internal Cross-Unit Coordination

The classic way to coordinate the activities of organizational units is to position them in the hierarchy so that the most closely related ones report to a single person (a functional department head, a process manager, a geographic area head, a senior executive). Managers higher up in the ranks generally have the clout to coordinate, integrate, and arrange for the cooperation of units under their supervision. In such structures, the chief executive officer, chief operating officer, and business-level managers end up as central points of coordination because of their positions of authority over the whole unit. When a firm is pursuing a related

diversification strategy, coordinating the related activities of independent business units often requires the centralizing authority of a single corporate-level officer. Also, diversified companies commonly centralize such staff support functions as public relations, finance and accounting, employee benefits, and information technology at the corporate level both to contain the costs of support activities and to facilitate uniform and coordinated performance of such functions within each business unit.

But, as explained earlier, the functional organization structures employed in most businesses often result in fragmentation. Close cross-unit collaboration is usually needed to build core competencies and competitive capabilities in such strategically important activities as speeding new products to market and providing superior customer service. To combat fragmentation and achieve the desired degree of cross-unit cooperation and collaboration, most companies supplement their functional organization structures. Sometimes this takes the form of creating process departments to bring together the pieces of strategically important activities previously performed in separate functional units. And sometimes the coordinating mechanisms involve the use of cross-functional task forces, dual reporting relationships, informal organizational networking, voluntary cooperation, incentive compensation tied to group performance measures, and strong executive-level insistence on teamwork and cross-department cooperation (including removal of recalcitrant managers who stonewall collaborative efforts). At one European-based company, a top executive promptly replaced the managers of several plants who were not fully committed to collaborating closely on eliminating duplication in product development and production efforts among plants in several different countries. Earlier, the executive, noting that negotiations among the managers had stalled on which labs and plants to close, had met with all the managers, asked them to cooperate to find a solution, discussed with them which options were unacceptable, and given them a deadline to find a solution. When the asked-for teamwork wasn't forthcoming, several managers were replaced.

See Illustration Capsule 11.2 for how 3M Corporation puts the necessary organizational arrangements into place to create worldwide coordination on technology matters.

Providing for Collaboration with Outside Suppliers and Strategic Allies

Someone or some group must be authorized to collaborate as needed with each major outside constituency involved in strategy execution. Forming alliances and cooperative relationships presents immediate opportunities and opens the door to future possibilities, but nothing valuable is realized until the relationship grows, develops, and blossoms. Unless top management sees that constructive organizational bridge-building with strategic partners occurs and that productive working relationships emerge, the value of alliances is lost and the company's power to execute its strategy is weakened. If close working relationships with suppliers are crucial, then supply chain management must be given formal status on the company's organization chart and a significant position in the pecking order. If distributor/dealer/franchisee relationships are important, someone must be assigned the task of nurturing the relationships with forward channel allies. If working in parallel with providers of complementary products and services contributes to enhanced organizational capability, then cooperative organizational arrangements have to be put in place and managed to good effect.

Building organizational bridges with external allies can be accomplished by appointing "relationship managers" with responsibility for making particular strategic partnerships or alliances generate the

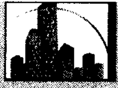


illustration capsule 11.2

Cross-Unit Coordination on Technology at 3M Corporation

At 3M, technology experts in more than 100 laboratories around the world have come to work openly and cooperatively without resorting to turf-protection tactics or not-invented-here mindsets. 3M management has been successful in creating a collegial working environment in which the scientists call on one another for assistance and advice and in rapid technology transfer.

Management formed a Technical Council, composed of the heads of the major labs; the council meets monthly and has a three-day annual retreat to discuss ways to improve cross-unit transfer of technology and other issues of common interest. In addition, management created a broader-based Technical Forum, composed of scientists and technical experts chosen as representatives, to facilitate grassroots communication among employees in all the labs. One of the forum's responsibilities is to organize employees with similar technical interests from all the labs into chapters; chapter members attend regular seminars with experts from outside the company. There's also an annual three-day technology fair at which 3M scientists showcase their latest findings for colleagues and expand their network of acquaintances.

As a result of these collaborative efforts, 3M has developed a portfolio of more than 100 technologies and created the capability to routinely use these technologies in product applications in three different divisions that each serve multiple markets.

Source: Reprinted by permission of *Harvard Business Review.* From "Changing the Role of Top Management: Beyond Structure to Process," by Sumantra Ghoshal and Christopher A. Bartlett, issue 73, No. 1, January–February 1995, pp. 93–94. Copyright © 1995 by the Harvard Business School Publishing Corporation; all rights reserved.

intended benefits. Relationship managers have many roles and functions: getting the right people together, promoting good rapport, seeing that plans for specific activities are developed and carried out, helping adjust internal organizational procedures and communication systems, ironing out operating dissimilarities, and nurturing interpersonal cooperation. Multiple cross-organization ties have to be established and kept open to ensure proper communication and coordination.[22] There has to be enough information sharing to make the relationship work and periodic frank discussions of conflicts, trouble spots, and changing situations.[23]

Perspectives on Structuring the Work Effort

> There is no perfect or ideal way of structuring the work effort.

All organization designs have their strategy-related strengths and weaknesses. To do a good job of matching structure to strategy, strategy implementers first have to pick a basic design and modify it as needed to fit the company's particular business lineup. They must then (1) supplement the design with appropriate coordinating mechanisms (cross-functional task forces, special project teams, self-contained work teams, and so on), and (2) institute whatever networking and communication arrangements it takes to support effective execution of the firm's strategy. Some companies may avoid setting up "ideal" organizational arrangements because they do not want to disturb certain existing reporting relationships or because they need to accommodate other situational idiosyncrasies, yet they must still work toward the goal of building a competitively capable organization.

> Organizational capabilities emerge from a process of consciously knitting together the efforts of different work groups, departments, and external allies, not from how the boxes on the organization chart are arranged.

The ways and means of developing stronger core competencies and organizational capabilities (or creating altogether new ones) have to fit a company's own circumstances. Not only do different companies and executives tackle the capabilities-building challenge in different ways, but the task of building

different capabilities requires different organizing techniques. Thus, generalizing about how to build capabilities has to be done cautiously. What can be said unequivocally is that building a capable organization entails a process of consciously knitting together the efforts of individuals and groups. Competencies and capabilities emerge from establishing and nurturing cooperative working relationships among people and groups to perform activities in a more customer-satisfying fashion, not from rearranging boxes on an organization chart. Furthermore, organization building is a task in which senior management must be deeply involved. Indeed, effectively managing both internal organization processes and external collaboration to create and develop competitively valuable competencies and capabilities is a top challenge for senior executives in today's companies.

ORGANIZATIONAL STRUCTURES OF THE FUTURE

Many of today's companies are winding up the task of remodeling their traditional hierarchical structures once built around functional specialization and centralized authority. Much of the corporate downsizing movement in the late 1980s and early 1990s was aimed at recasting authoritarian, pyramidal organizational structures into flatter, decentralized structures. The change was driven by growing realization that command-and-control hierarchies were proving a liability in businesses where customer preferences were shifting from standardized products to custom orders and special features, product life cycles were growing shorter, custom mass-production methods were replacing standardized mass-production techniques, customers wanted to be treated as individuals, technological change was ongoing, and market conditions were fluid. Layered management hierarchies with lots of checks and controls that required people to look upward in the organizational structure for answers and approval were failing to deliver responsive customer service and timely adaptations to changing conditions. Likewise, functional silos, task-oriented work, and fragmentation of strategy-critical activities further contributed to an erosion of competitiveness in fluid or volatile business environments.

> Revolutionary changes in how companies are organizing the work effort have been occurring since the early 1990s.

The organizational adjustments and downsizing of companies in 2001–2002 brought further refinements and changes to streamline organizational activities and shake out inefficiencies. The goals have been to make the organization leaner, flatter, and more responsive to change. Many companies are drawing on five tools of organizational design: (1) empowered managers and workers, (2) reengineered work processes, (3) self-directed work teams, (4) rapid incorporation of Internet technology applications, and (5) networking with outsiders to improve existing organization capabilities and create new ones. Considerable management attention is being devoted to building a company capable of outcompeting rivals on the basis of superior resource strengths and competitive capabilities—capabilities that are increasingly based on intellectual capital.

The organizations of the future will have several new characteristics:

- Fewer barriers between different vertical ranks, between functions and disciplines, between units in different geographic locations, and between the company and its suppliers, distributors/dealers, strategic allies, and customers.
- A capacity for change and rapid learning.
- Collaborative efforts among people in different functional specialties and geographic locations—essential to create organization competencies and capabilities.

- Extensive use of Internet technology and e-commerce business practices—real-time data and information systems, greater reliance on online systems for transacting business with suppliers and customers, and Internet-based communication and collaboration with suppliers, customers, and strategic partners.

key | points

The job of strategy implementation and execution is to convert strategic plans into actions and good results. The test of successful strategy execution is whether actual organization performance matches or exceeds the targets spelled out in the strategic plan. Shortfalls in performance signal weak strategy, weak execution, or both.

In deciding how to implement a new or revised strategy, managers have to determine what internal conditions are needed to execute the strategic plan successfully. Then they must create these conditions as rapidly as practical. The process of implementing and executing strategy involves:

1. Building an organization with the competencies, capabilities, and resource strengths to execute strategy successfully.
2. Marshaling resources to support the strategy execution effort.
3. Instituting policies and procedures that facilitate strategy execution.
4. Adopting best practices and striving for continuous improvement.
5. Installing information and operating systems that enable company personnel to carry out their strategic roles proficiently.
6. Tying rewards and incentives directly to the achievement of strategic and financial targets and to good strategy execution.
7. Shaping the work environment and corporate culture to fit the strategy.
8. Exerting the internal leadership needed to drive implementation forward and to keep improving on how the strategy is being executed.

The place for managers to start in implementing and executing a new or different strategy is with *a probing assessment of what the organization must do differently and better to carry out the strategy successfully.* They should then consider *precisely how to make the necessary internal changes* as rapidly as possible. Successful strategy implementers have a knack for diagnosing what their organizations need to do to execute the chosen strategy well and figuring out how to get things done—they are masters in promoting results-oriented behaviors on the part of company personnel and following through on making the right things happen.

Like crafting strategy, executing strategy is a job for a company's whole management team, not just a few senior managers. Top-level managers have to rely on the active support and cooperation of middle and lower managers to push strategy changes into functional areas and operating units and to see that the organization actually operates in accordance with the strategy on a daily basis. Middle and lower-level managers are not only responsible for initiating and supervising the execution process in their areas of authority but also instrumental in getting subordinates to continuously improve on critical value chain activities. Thus, all managers need *an action agenda.*

Building a capable organization is always a top priority in strategy execution, and three types of organization-building actions are paramount:

1. *Staffing the organization.*
2. *Building core competencies and competitive capabilities.*
3. *Structuring the organization and work effort.*

Selecting able people for key positions tends to be one of the earliest strategy implementation steps. No company can hope to perform the activities required for successful strategy execution without attracting capable managers and without employees that give it a suitable knowledge base and portfolio of intellectual capital.

Building core competencies and competitive capabilities involves three stages: (1) developing the *ability* to do something, however imperfectly or inefficiently, by selecting people with the requisite skills and experience, upgrading or expanding individual abilities as needed, and then molding the efforts and work products of individuals into a collaborative group effort; (2) coordinating group efforts to learn how to perform the activity *consistently well and at an acceptable cost,* thereby transforming the ability into a tried-and-true *competence* or *capability;* and (3) continuing to polish and refine the organization's know-how and otherwise sharpen performance such that it becomes *better than rivals* at performing the activity, thus raising the core competence (or capability) to the rank of a *distinctive competence* (or competitively superior capability) and opening an avenue to competitive advantage. Many companies manage to get through stages 1 and 2, but comparatively few qualify for the third stage.

Managerial actions to develop core competencies and competitive capabilities generally take one of two forms: either strengthening the company's base of skills, knowledge, and intellect, or coordinating and networking the efforts of the various work groups and departments. Actions of the first sort can be undertaken at all managerial levels, but actions of the second sort are best orchestrated by senior managers who not only appreciate the strategy-executing significance of strong competencies/capabilities but also have the clout to enforce the necessary networking and cooperation among individuals, groups, departments, and external allies.

Strong core competencies and competitive capabilities are an important avenue for securing a competitive edge over rivals in situations where it is relatively easy for rivals to copy smart strategies. Anytime rivals can readily duplicate successful strategy features, making it difficult or impossible to beat rivals in the marketplace with a superior strategy, the chief way to achieve lasting competitive advantage is to beat rivals by performing certain value chain activities in superior fashion. Building core competencies, resource strengths, and organizational capabilities that rivals can't match is one of the best and most reliable ways to beat them.

Structuring the organization and organizing the work effort in a strategy-supportive fashion has five aspects:

1. Deciding which value chain activities to perform internally and which ones to outsource.
2. Making internally performed strategy-critical activities the main building blocks in the organization structure.
3. Deciding how much authority to centralize at the top and how much to delegate to down-the-line managers and employees.
4. Providing for internal cross-unit coordination and collaboration to build and strengthen internal competencies/capabilities.
5. Providing for the necessary collaboration and coordination with suppliers and strategic allies.

The primary organizational building blocks within a business are usually *traditional functional departments* and *process-complete departments.* In enterprises with operations in various countries around the world (or with geographically scattered organizational units within a country), the basic building blocks may also include *geographic organizational units,* each of which has profit/loss responsibility for its assigned geographic area. In vertically integrated firms, the major building blocks are *divisional units performing one or more of the major processing steps along the value chain* (raw materials production, components manufacture, assembly, wholesale distribution, retail store operations); each division in the value chain may operate as a profit center for performance measurement purposes. The typical building blocks of a diversified company are its *individual businesses,* with each business unit usually operating as an independent profit center and with corporate headquarters performing assorted support functions for all the businesses.

Whatever basic structure is chosen, it usually has to be supplemented with interdisciplinary task forces, incentive compensation schemes tied to measures of joint performance, empowerment of cross-functional and/or self-directed work teams to perform and unify fragmented processes and strategy-critical activities, special project teams, relationship managers, and special top management efforts to knit the work of different individuals and groups into valuable competitive capabilities.

In more and more companies, efforts to match structure to strategy involve fewer layers of management authority; managers and workers are empowered to act on their own judgment; work processes are being reengineered to reduce cross-department fragmentation; collaborative partnerships exist with outsiders (suppliers, distributors/dealers, companies with complementary products/services, and even select competitors); and there's increased outsourcing of selected value chain activities, leaner staffing of internal support functions, and rapidly growing use of Internet technology applications to streamline operations and expedite cross-unit communication.

| exercise

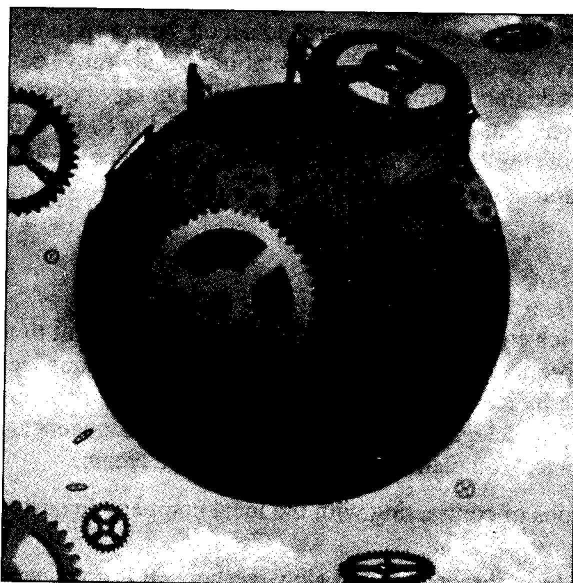
As the new owner of a local ice cream store located in a strip mall adjacent to a university campus, you are contemplating how to organize your business—whether to make your ice cream in-house or outsource its production to a nearby ice cream manufacturer whose brand is in most of the local supermarkets, and how much authority to delegate to the two assistant store managers and to employees working the counter and the cash register. You plan to sell 20 flavors of ice cream.

1. What are the pros and cons of contracting with the local company to custom-produce your product line?
2. Since you do not plan to be in the store during all of the hours it is open, what specific decision-making authority would you delegate to the two assistant store managers?
3. To what extent, if any, should store employees—many of whom will be university students working part-time—be empowered to make decisions relating to store operations (opening and closing, keeping the premises clean and attractive, keeping the work area behind the counter stocked with adequate supplies of cups, cones, napkins, and so on)?
4. Should you create a policies and procedures manual for the assistant managers and employees, or should you just give oral instructions and have them learn their duties and responsibilities on the job?
5. How can you maintain control during the times you are not in the store?

chapter | twelve 12

Managing Internal Operations

Actions That Promote Better Strategy Execution



(© Images.com/CORBIS)

Winning companies know how to do their work better.

—Michael Hammer and James Champy

If you talk about change but don't change the reward and recognition system, nothing changes.

—Paul Allaire
Former CEO, Xerox Corporation

If you want people motivated to do a good job, give them a good job to do.

—Frederick Herzberg

You ought to pay big bonuses for premier performance . . . Be a top payer, not in the middle or low end of the pack.

—Lawrence Bossidy
CEO, Honeywell International

In Chapter 11 we emphasized the importance of building organization capabilities and structuring the work effort so as to perform strategy-critical activities in a coordinated and highly competent manner. In this chapter we discuss five additional managerial actions that facilitate the success of a company's strategy execution efforts:

1. Marshaling ample resources behind the drive for good strategy execution and operating excellence.
2. Instituting policies and procedures that facilitate strategy execution.
3. Adopting best practices and striving for continuous improvement in how value chain activities are performed.
4. Installing information and operating systems that enable company personnel to carry out their strategic roles proficiently.
5. Tying rewards and incentives directly to the achievement of strategic and financial targets and to good strategy execution.

MARSHALING RESOURCES BEHIND THE DRIVE FOR GOOD STRATEGY EXECUTION

Early in the process of implementing and executing a new or different strategy, managers need to determine what resources will be needed and then consider whether the current budgets of organizational units are suitable. Plainly, organizational units must have the budgets and resources for executing their parts of the strategic plan effectively and efficiently. Developing a strategy-driven budget requires top management to determine what funding is needed to execute new strategic initiatives and to strengthen or modify the company's competencies and capabilities. This includes careful screening of requests for more people and more or better facilities and equipment, approving those that hold promise for making a cost-justified contribution to strategy execution, and turning down those that don't. Should internal cash flows prove insufficient to fund the planned strategic initiatives, then management must raise additional funds through borrowing or selling additional shares of stock to willing investors.

core concept
The funding requirements of a new strategy must drive how capital allocations are made and the size of each unit's operating budgets. Underfunding organizational units and activities pivotal to strategic success impedes execution and the drive for operating excellence.

A company's ability to marshal the resources needed to support new strategic initiatives and steer them to the appropriate organizational units has a major impact on the strategy execution process. Too little funding (stemming either from constrained financial resources or from sluggish management action to adequately increase the budgets of strategy-critical organizational units) slows progress and impedes the efforts of organizational units to execute their pieces of the strategic plan proficiently. Too much funding wastes organizational resources and

reduces financial performance. Both outcomes argue for managers to be deeply involved in reviewing budget proposals and directing the proper kinds and amounts of resources to strategy-critical organization units.

A change in strategy nearly always calls for budget reallocations. Units important in the prior strategy but having a lesser role in the new strategy may need downsizing. Units that now have a bigger and more critical strategic role may need more people, new equipment, additional facilities, and above-average increases in their operating budgets. Strategy implementers need to be active and forceful in shifting resources, downsizing some areas and upsizing others, not only to amply fund activities with a critical role in the new strategy but also to avoid inefficiency and achieve profit projections. They have to exercise their power to put enough resources behind new strategic initiatives to make things happen, and they have to make the tough decisions to kill projects and activities that are no longer justified.

Visible actions to reallocate operating funds and move people into new organizational units signal a determined commitment to strategic change and frequently are needed to catalyze the implementation process and give it credibility. Microsoft has made a practice of regularly shifting hundreds of programmers to new high-priority programming initiatives within a matter of weeks or even days. At Harris Corporation, where the strategy was to diffuse research ideas into areas that were commercially viable, top management regularly shifted groups of engineers out of government projects and into new commercial venture divisions. Fast-moving developments in many markets are prompting companies to abandon traditional annual or semiannual budgeting and resource allocation cycles in favor of cycles that match the strategy changes a company makes in response to newly developing events.

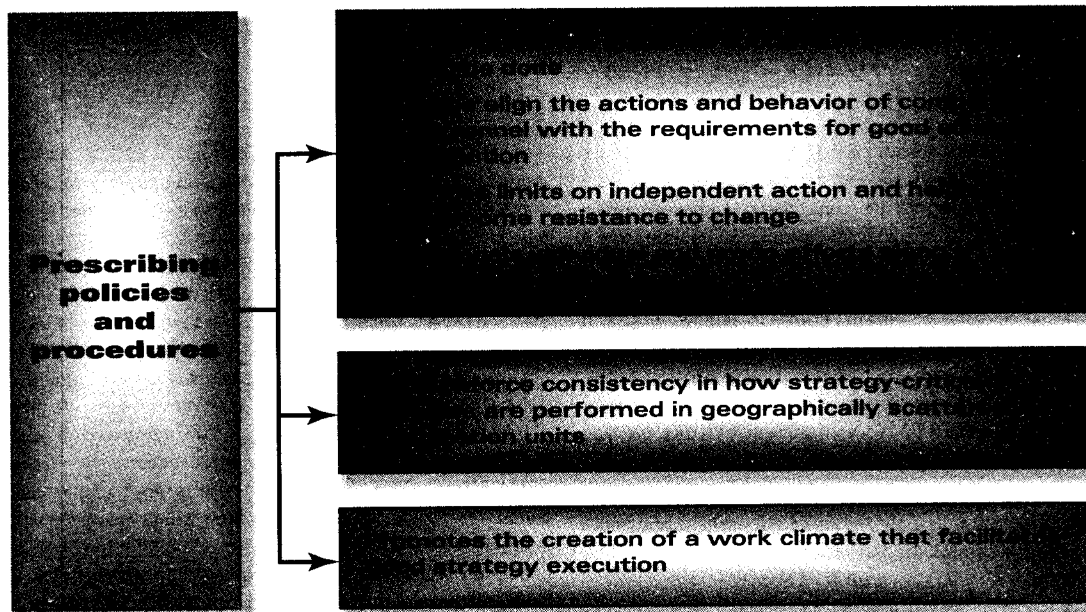
Just fine-tuning the execution of a company's existing strategy, however, seldom requires big movements of people and money from one area to another. The desired improvements can usually be accomplished through above-average budget increases to organizational units where new initiatives are contemplated and below-average increases (or even small cuts) for the remaining organizational units. The chief exception occurs where a prime ingredient of strategy is to create altogether new capabilities or to generate fresh products and business opportunities within the existing budget. Then, as proposals and business plans worth pursuing bubble up from below, managers have to decide where the needed capital expenditures, operating budgets, and personnel will come from. Companies like 3M, General Electric, and Boeing shift resources and people from area to area as needed to support the launch of new products and new business ventures. They empower "product champions" and small bands of would-be entrepreneurs by giving them financial and technical support and by setting up organizational units and programs to help new ventures blossom more quickly.

INSTITUTING POLICIES AND PROCEDURES THAT FACILITATE STRATEGY EXECUTION

core concept
Well-conceived policies and procedures aid strategy execution; out-of-sync ones are barriers.

Changes in strategy generally call for some changes in work practices and operations. Asking people to alter established procedures always upsets the internal order of things. It is normal for pockets of resistance to develop and for people to exhibit some degree of stress and anxiety about how the changes will affect them, especially when the changes may eliminate jobs. Questions are also likely to arise over what activities need to be rigidly prescribed and where there ought to be leeway for independent action.

figure 12.1 **How Prescribed Policies and Procedures Facilitate Strategy Execution**



As shown in Figure 12.1, prescribing new policies and operating procedures designed to facilitate strategy execution has merit from several angles:

1. *It provides top-down guidance regarding how certain things now need to be done.* New policies and operating practices can help align actions with strategy throughout the organization, placing limits on independent behavior and channeling individual and group efforts along a path in tune with the new strategy. They also help counteract tendencies for some people to resist change—most people refrain from violating company policy or going against recommended practices and procedures without first gaining clearance or having strong justification.
2. *It helps enforce needed consistency in how particular strategy-critical activities are performed in geographically scattered operating units.* Eliminating significant differences in the operating practices of different plants, sales regions, customer service centers, or the individual outlets in a chain operation is frequently desirable to avoid sending mixed messages to internal personnel and to customers who do business with the company at multiple locations.
3. *It promotes the creation of a work climate that facilitates good strategy execution.* Because dismantling old policies and procedures and instituting new ones invariably alter the internal work climate, strategy implementers can use the policy-changing process as a powerful lever for changing the corporate culture in ways that produce a stronger fit with the new strategy.

Company managers therefore need to be inventive in devising policies and practices that can provide vital support to effective strategy implementation and execution.

In an attempt to steer "crew members" into stronger quality and service behavior patterns, McDonald's policy manual spells out procedures in detail; for example, "Cooks must turn, never flip,

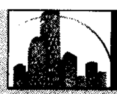


illustration capsule 12.1

Graniterock's "Short Pay" Policy: An Innovatve Way to Promote Strategy Execution

In 1987, the owners of Graniterock, a 100-plus-year-old supplier of crushed gravel, sand, concrete, and asphalt in Watsonville, California, set two big, hairy, audacious goals (BHAGs) for the company: total customer satisfaction and a reputation for service that met or exceeded that of Nordstrom, the upscale department store famous for pleasing its customers. To drive the internal efforts to achieve these two objectives, top management instituted "short pay," a policy designed to signal both employees and customers that Graniterock was deadly serious about its two strategic commitments. At the bottom of every Graniterock invoice was the following statement:

> If you are not satisfied for any reason, don't pay us for it. Simply scratch out the line item, write a brief note about the problem, and return a copy of this invoice along with your check for the balance.

Customers did not have to call and complain and were not expected to return the product. They were given complete discretionary power to decide whether and how much to pay based on their satisfaction level.

The policy has worked exceptionally well, providing unmistakable feedback and spurring company managers to correct any problems quickly in order to avoid repeated short payments. Graniterock has enjoyed market share increases, while charging a 6 percent price premium for its commodity products in competition against larger rivals. Its profit margins and overall financial performance have improved. Graniterock won the prestigious Malcolm Baldrige National Quality Award in 1992, about five years after instituting the policy. *Fortune* rated Graniterock as one of the 100 best companies to work for in America in 2001 (ranked 17th) and 2002 (ranked 16th). Company employees receive an average of 43 hours of training annually. Entry-level employees, called job owners, start at $16 an hour and progress to such positions as "accomplished job owner" and "improvement champion" (base pay of $26 an hour). The company has a no-layoff policy, provides employees with 12 massages a year, and sends positive customer comments about employees home for families to read.

Source: Based on information in Robert Levering and Milton Moskowitz, "The 100 Best Companies to Work For," *Fortune,* February 4, 2002, p. 73, and Jim Collins, "Turning Goals into Results: The Power of Catalytic Mechanisms," *Harvard Business Review* 77, no. 4 (July–August 1999), pp. 72–73.

hamburgers ... If they haven't been purchased, Big Macs must be discarded in 10 minutes after being cooked and French fries in 7 minutes ... Cashiers must make eye contact with and smile at every customer." Hewlett-Packard requires R&D people to make regular visits to customers to learn about their problems, talk about new product applications, and in general keep the company's R&D programs customer-oriented. Mrs. Fields Cookies has a policy of establishing hourly sales quotas for each store outlet; furthermore, it is company policy that cookies not sold within two hours after being baked have to be removed from the case and given to charitable organizations. Illustration Capsule 12.1 describes how Graniterock's "short pay" policy spurs employee focus on providing total customer satisfaction and building the company's reputation for superior customer service.

Thus, there is a definite role for new and revised policies and procedures in the strategy implementation process. Wisely constructed policies and procedures help channel actions, behavior, decisions, and practices in directions that promote good strategy execution. When policies and practices aren't strategy-supportive, they become a barrier to the kinds of attitudinal and behavioral changes strategy implementers are trying to promote. Sometimes people hide behind or vigorously defend long-standing policies and operating procedures in an effort to stall implementation or force it along a different route. Anytime a company alters its strategy, managers should review existing policies and operating procedures, proactively

revise or discard those that are out of sync, and formulate new ones to facilitate execution of new strategic initiatives.

None of this implies that companies need thick policy manuals to direct the strategy execution process and prescribe exactly how daily operations are to be conducted. Too much policy can erect as many obstacles as wrong policy or be as confusing as no policy. There is wisdom in a middle approach: *Prescribe enough policies to give organization members clear direction in implementing strategy and to place desirable boundaries on their actions; then empower them to act within these boundaries however they think makes sense.* Allowing company personnel to act anywhere between the "white lines" is especially appropriate when individual creativity and initiative are more essential to good strategy execution than standardization and strict conformity. Instituting strategy-facilitating policies can therefore mean more policies, fewer policies, or different policies. It can mean policies that require things to be done a certain way or policies that give employees leeway to do activities the way they think best.

ADOPTING BEST PRACTICES AND STRIVING FOR CONTINUOUS IMPROVEMENT

Company managers can significantly advance the cause of competent strategy execution by pushing organization units and company personnel to identify and adopt the best practices for performing value chain activities and, further, insisting on continuous improvement in how internal operations are conducted. One of the most widely used and effective tools for gauging how well a company is executing pieces of its strategy entails benchmarking the company's performance of particular activities and business processes against "best-in-industry" and "best-in-world" performers.[1] It can also be useful to look at "best-in-company" performers of an activity if a company has a number of different organizational units performing much the same function at different locations. Identifying, analyzing, and understanding how top companies or individuals perform particular value chain activities and business processes provides useful yardsticks for judging the effectiveness and efficiency of internal operations and setting performance standards for organization units to meet or beat.

core concept
Managerial efforts to identify and adopt best practices are a powerful tool for promoting operating excellence and better strategy execution.

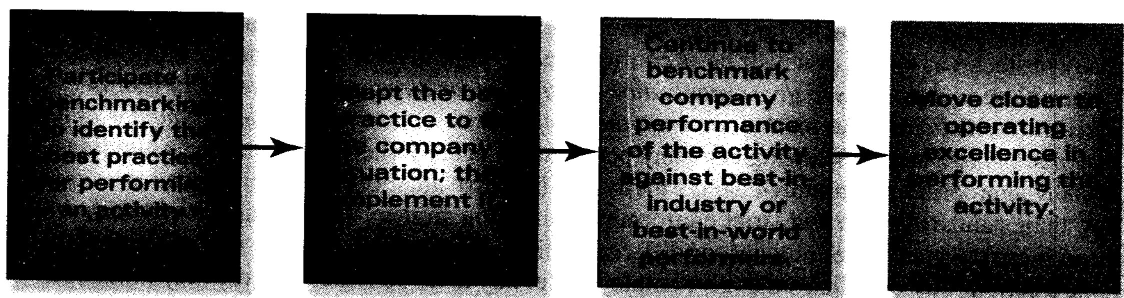
How the Process of Identifying and Incorporating Best Practices Works

A **best practice** is a technique for performing an activity or business process that at least one company has demonstrated works particularly well. To qualify as a legitimate best practice, the technique must have a proven record in significantly lowering costs, improving quality or performance, shortening time requirements, enhancing safety, or delivering some other highly positive operating outcome. Best practices thus identify a path to operating excellence. For a best practice to be valuable and transferable, it must demonstrate success over time, deliver quantifiable and highly positive results, and be repeatable.

core concept
A **best practice** is any practice that at least one company has proved works particularly well.

Benchmarking is the backbone of the process of identifying, studying, and implementing outstanding practices. A company's benchmarking effort looks outward to find best practices and then proceeds to develop the data for measuring how well a company's own performance of an activity stacks up against the best-practice standard. Informally, benchmarking involves being humble enough to admit

figure 12.2 **From Benchmarking and Best-Practice Implementation to Operating Excellence**



that others have come up with world-class ways to perform particular activities yet wise enough to try to learn how to match, and even surpass, them. But, as shown in Figure 12.2, the payoff of benchmarking comes from applying the top-notch approaches pioneered by other companies in the company's own operation and thereby spurring dramatic improvements in the proficiency with which value chain tasks are performed. The goal of benchmarking is to promote the achievement of operating excellence in a variety of strategy-critical and support activities.

However, benchmarking is more complicated than simply identifying which companies are the best performers of an activity and then trying to exactly copy other companies' approaches—especially if these companies are in other industries. Normally, the outstanding practices of other organizations have to be adapted to fit the specific circumstances of a company's own business and operating requirements. Since most companies believe "our work is different" or "we are unique," the telling part of any best-practice initiative is how well the company puts its own version of the best practice into place and makes it work.

Indeed, a best practice remains little more than an interesting success story unless company personnel buy into the task of translating what can be learned from other companies into real action and results. The agents of change must be frontline employees who are convinced of the need to abandon the old ways of doing things and switch to a best-practice mind-set. The more that organizational units use best practices in performing their work, the closer a company moves toward performing its value chain activities as effectively and efficiently as possible. This is what operational excellence is all about.

Legions of companies across the world now engage in benchmarking to improve their strategy execution efforts and, ideally, gain a strategic, operational, and financial advantage over rivals. A survey of over 4,000 managers in 15 countries indicated that over 85 percent were using benchmarking to measure the efficiency and effectiveness of their internal activities.[2] Since 1990, the number of companies instituting best-practice programs as an integral part of their efforts to improve strategy execution has grown significantly. Scores of trade associations and special interest organizations have undertaken efforts to collect best-practice data relevant to a particular industry or business function and make their databases available online to members. Benchmarking and best-practice implementation have clearly emerged as legitimate and valuable managerial tools for promoting operational excellence.

TQM and Six Sigma Quality Programs: Tools for Promoting Operational Excellence

Best-practice implementation has stimulated greater management awareness of the importance of business process reengineering, total quality management (TQM) programs, Six Sigma quality control techniques, and other continuous improvement methods. Indeed, quality improvement processes of one kind or another have become globally pervasive management tools for implementing strategies keyed to defect-free manufacture, superior product quality, superior customer service, and total customer satisfaction. The following paragraphs describe two specific types of programs and then discuss the difference between process reengineering and continuous improvement.

core concept
TQM entails creating a total quality culture bent on continuously improving the performance of every task and value chain activity.

Total Quality Management Programs *Total quality management (TQM) is a philosophy of managing a set of business practices that emphasizes continuous improvement in all phases of operations, 100 percent accuracy in performing tasks, involvement and empowerment of employees at all levels, team-based work design, benchmarking, and total customer satisfaction.*[3] While TQM concentrates on the production of quality goods and fully satisfying customer expectations, it achieves its biggest successes when it is also extended to employee efforts in *all departments*—human resources, billing, R&D, engineering, accounting and records, and information systems—that may lack pressing, customer-driven incentives to improve. It involves reforming the corporate culture and shifting to a total quality/continuous improvement business philosophy that permeates every facet of the organization.[4] TQM aims at instilling enthusiasm and commitment to doing things right from the top to the bottom of the organization. It entails a restless search for continuing improvement, the little steps forward each day that the Japanese call *kaizen.* TQM is thus a race without a finish. The managerial objective is to kindle a burning desire in people to use their ingenuity and initiative to progressively improve their performance of value chain activities. TQM doctrine preaches that there's no such thing as "good enough" and that everyone has a responsibility to participate in continuous improvement. TQM takes a fairly long time to show significant results—very little benefit emerges within the first six months. The long-term payoff of TQM, if it comes, depends heavily on management's success in implanting a culture within which TQM philosophies and practices can thrive.

Six Sigma Quality Control *Six Sigma quality control consists of a disciplined, statistics-based system aimed at producing not more than 3.4 defects per million iterations for any business process—from manufacturing to customer transactions.* The Six Sigma process of define, measure, analyze, improve, and control (DMAIC) is an improvement system for existing processes falling below specification and needing incremental improvement. The Six Sigma process of define, measure, analyze, design, and verify (DMADV) is an improvement system used to develop new processes or products at Six Sigma quality levels. Both Six Sigma processes are executed by personnel who have earned Six Sigma "green belts" and Six Sigma "black belts," and are overseen by personnel who have completed Six Sigma "master black belt" training. According to the Six Sigma Academy, personnel with black belts can save companies approximately $230,000 per project and can complete four to six projects a year.[5]

The statistical thinking underlying Six Sigma is based on the following three principles: All work is a process, all processes have variability, and all processes create data that explains variability.[6] To illustrate how these three principles drive the metrics of DMAIC, consider the case of a janitorial company that wants to improve the caliber of work done by its cleaning crews and thereby boost customer

satisfaction. The janitorial company's Six Sigma team can pursue quality enhancement and continuous improvement via the DMAIC process as follows:

- *Define.* Because Six Sigma is aimed at reducing defects, the first step is to define what constitutes defect. Six Sigma team members might decide that leaving streaks on windows is a defect because it is a source of customer dissatisfaction.
- *Measure.* The next step is to collect data to find out why, how, and how often this defect occurs. This might include a process flow map of the specific ways that cleaning crews go about the task of cleaning a commercial customer's windows. Other metrics may include recording what tools and cleaning products the crews use to clean windows.
- *Analyze.* After the data are gathered and the statistics analyzed, the company's Six Sigma team discovers that the tools and window cleaning techniques of certain employees are better than those of other employees because their tools and procedures leave no streaked windows—a "best practice" for avoiding window streaking is thus identified and documented.
- *Improve.* The Six Sigma team implements the documented best practice as a standard way of cleaning windows.
- *Control.* The company teaches new and existing employees the best practice technique for window cleaning. Over time, there's significant improvement in customer satisfaction and increased business.

Six Sigma's DMAIC process is a particularly good vehicle for improving performance when there are *wide variations* in how well an activity is performed.[7] For instance, airlines striving to improve the on-time performance of their flights have more to gain from actions to curtail the number of flights that are late by more then 30 minutes than from actions to reduce the number of flights that are late by less than 5 minutes. Likewise, FedEx might have a 16-hour average delivery time for its overnight package service operation, but if the actual delivery time varies around the 16-hour average from a low of 12 hours to a high of 26 hours such that 10 percent of its packages are delivered over 6 hours late, then it has a huge *reliability* problem.

A problem tailor-made for Six Sigma occurs in the insurance industry, where it is common for top agents to outsell poor agents by a factor of 10 to 1 or more. If insurance executives offer a trip to Hawaii in a monthly contest to motivate low-performing agents, the typical result is to motivate top agents to be even more productive and make the performance gap even wider. A DMAIC Six Sigma project to reduce the variation in the performance of agents and correct the problem of so many low-performing agents would begin by measuring the performance of all agents, perhaps discovering that the top 20 percent sell 7 times more policies than the bottom 40 percent. Six Sigma analysis would then consider such steps as mapping how top agents spend their day, investigating the factors that distinguish top performers from low performers, learning what techniques training specialists have employed in converting low-performing agents into high performers, and examining how the hiring process could be improved to avoid hiring underperformers in the first place.

The next step would be to *test* proposed solutions—better training methods or psychological profiling to identify and weed out candidates likely to be poor performers—to identify and measure which alternative solutions really work, which don't, and why. Only those actions that prove statistically beneficial are then introduced on a wide scale. The DMAIC method thus entails empirical analysis to diagnose the problem

illustration capsule 12.2
Whirlpool's Use of Six Sigma to Promote Operating Excellence

Top management at Whirlpool Corporation, the leading global manufacturer and marketer of home appliances in 2003, with production operations in 14 countries and sales in some 170 countries, has a vision of Whirlpool appliances in "Every Home, Everywhere." One of management's chief objectives in pursuing this vision is to build unmatched customer loyalty to the Whirlpool brand. Whirlpool's strategy to win the hearts and minds of appliance buyers the world over has been to produce and market appliances with top-notch quality and innovative features that users will find appealing. In addition, Whirlpool's strategy has been to offer a wide selection of models (recognizing that buyer tastes and needs differ) and to strive for low-cost production efficiency, thereby enabling Whirlpool to price its products very competitively. Executing this strategy at Whirlpool's operations in North America (where it is the market leader), Latin America (where it is also the market leader), Europe (where it ranks third), and Asia (where it is number one in India and has a foothold with huge growth opportunities elsewhere) has involved a strong focus on continuous improvement and a drive for operating excellence. To marshal the efforts of its 68,000 employees in executing the strategy successfully, management developed a comprehensive Operational Excellence program with Six Sigma as one of the centerpieces.

The Operational Excellence initiative, which began in the 1990s, incorporated Six Sigma techniques to improve the quality of Whirlpool products, while at the same time lowering costs and trimming the time it took to get product innovations into the marketplace. The Six Sigma program helped Whirlpool save $175 million in manufacturing costs in its first three years.

To sustain the productivity gains and cost savings, Whirlpool embedded Six Sigma practices within each of its manufacturing facilities worldwide and instilled a culture based on Six Sigma and lean manufacturing skills and capabilities. Beginning in 2002, each of Whirlpool's operating units began taking the Six Sigma initiative to a higher level by first placing the needs of the customer at the center of every function—R&D, technology, manufacturing, marketing, and administrative support—and then striving to consistently improve quality levels while eliminating all unnecessary costs. The company has systematically gone through every aspect of its business with the view that company personnel should perform every activity at every level in a manner that focuses on delivering value to the customer and that leads to continuous improvement. Whirlpool management believes that the companywide Six Sigma program and emphasis on continuous improvement has been a major contributor in sustaining the company's global leadership in appliances.

Source: www.whirlpool.com, accessed September 25, 2003.

(*design, measure, analyze*), test alternative solutions (*improve*) and then *control* the variability in how well the activity is performed by implementing actions shown to truly fix the problem.

General Electric (GE), one of the most successful companies implementing Six Sigma training and pursuing Six Sigma perfection, estimated benefits on the order of $10 billion during the first five years of implementation. GE first began Six Sigma in 1995 after Motorola and Allied Signal blazed the Six Sigma trail. Since the mid-1990s, thousands of companies and nonprofit organizations around the world have begun utilizing Six Sigma programs to promote operating excellence. Illustration Capsule 12.2 describes Whirlpool's use of Six Sigma in its appliance business.

> **core concept**
> Using Six Sigma to improve the performance of strategy-critical activities enhances strategy execution.

Six Sigma is, however, not just a quality-enhancing tool for manufacturers. At one company, product sales personnel typically wined and dined customers to close their deals. But the costs of such entertaining were viewed as excessively high in many instances. A Six Sigma project that examined sales data found that although face time with customers was important, wining, dining, and other types of entertainment were not.[8] The data showed that regular face time helped close sales, but that time could be spent over a cup of coffee instead of golfing at a resort or

taking clients to expensive restaurants. In addition, analysis showed that too much face time with customers was counterproductive. A regularly scheduled customer picnic was found to be detrimental to closing sales because it was held at a busy time of year, when customers preferred not to be away from their offices. Changing the manner in which prospective customers were wooed resulted in a 10 percent increase in sales. A financial services firm utilized Six Sigma techniques to determine whether it was paying an inordinate amount of money to provide customer service.[9] The company knew that it could save money by encouraging customers to use its Web site to get information about their accounts, but customers continued to contact the company's call center for information they could have gotten online. A Six Sigma team examined call center and Web site data and discovered that if the Web site was reconfigured to mirror the questions being asked at the call center, the company could cut costs and increase the quality of customer service. The result was the movement of customers to the Web, rather than the phone, to get account information. A Milwaukee hospital used Six Sigma to map the process as prescriptions originated with a doctor's writeup, were filled by the hospital pharmacy, and then administered by nurses. DMAIC analysis revealed that most mistakes came from misreading the doctor's handwriting.[10] The hospital implemented a program requiring doctors to type the prescription into a computer, which slashed the number of errors dramatically.

The point here is that Six Sigma can be a valuable and potent management tool for achieving operating excellence in both manufacturing and nonmanufacturing situations. A company that systematically applies Six Sigma methods to its value chain, activity by activity, can make major strides in improving the proficiency with which its strategy is executed.

The Difference between Process Reengineering and Continuous Improvement Programs Business process reengineering and continuous improvement efforts like TQM and Six Sigma both aim at improved efficiency and reduced costs, better product quality, and greater customer satisfaction. The essential difference between business process reengineering and continuous improvement programs is that reengineering aims at *quantum gains* on the order of 30 to 50 percent or more whereas total quality programs stress *incremental progress*, striving for inch-by-inch gains again and again in a never-ending stream. The two approaches to improved performance of value chain activities and operating excellence are not mutually exclusive; it makes sense to use them in tandem. Reengineering can be used first to produce a good basic design that yields quick, dramatic improvements in performing a business process. Total quality programs can then be used as a follow-on to reengineering and/or best-practice implementation, delivering gradual improvements. Such a two-pronged approach to implementing operational excellence is like a marathon race in which you run the first four miles as fast as you can, then gradually pick up speed the remainder of the way.

Business process reengineering aims at one-time quantum improvement; TQM and Six Sigma aim at incremental progress.

Capturing the Benefits of Best-Practice and Continuous Improvement Programs

Research indicates that some companies benefit from reengineering and continuous improvement programs and some do not.[11] Usually, the biggest beneficiaries are companies that view such programs not as ends in themselves but as tools for implementing and executing company strategy more effectively. The skimpiest payoffs from best practices, TQM, Six Sigma, and reengineering occur when company managers seize them as something worth trying—novel ideas that could improve things. In most such instances, they

result in strategy-blind efforts to simply manage better. There's an important lesson here. Best practices, TQM, Six Sigma quality, and reengineering all need to be seen and used as part of a bigger-picture effort to execute strategy proficiently. Only strategy can point to which value chain activities matter and what performance targets make the most sense. Absent a strategic framework, managers lack the context in which to fix things that really matter to business-unit performance and competitive success.

To get the most from programs for facilitating better strategy execution, managers must have a clear idea of what specific outcomes really matter. Examples of such performance indicators include a Six Sigma defect rate (fewer than 3.4 errors per million iterations), high on-time delivery percentages, low overall costs relative to rivals, high percentages of pleased customers and few customer complaints, shorter cycle times, and a higher percentage of revenues coming from recently introduced products. Benchmarking best-in-industry and best-in-world performance of most or all value chain activities provides a realistic basis for setting internal performance milestones and longer-range targets.

Then comes the managerial task of building a total quality culture and instilling the necessary commitment to achieving the targets and performance measures that the strategy requires. Managers can take the following action steps to realize full value from TQM or Six Sigma initiatives:[12]

1. Visible, unequivocal, and unyielding commitment to total quality and continuous improvement, including a quality vision and specific, measurable objectives for boosting quality and making continuous improvement.
2. Nudging people toward quality-supportive behaviors by:
   a. Screening job applicants rigorously and hiring only those with attitudes and aptitudes right for quality-based performance.
   b. Providing quality training for most employees.
   c. Using teams and team-building exercises to reinforce and nurture individual effort (the creation of a quality culture is facilitated when teams become more cross-functional, multitask oriented, and increasingly self-managed).
   d. Recognizing and rewarding individual and team efforts regularly and systematically.
   e. Stressing prevention (doing it right the first time), not inspection (instituting ways to correct mistakes).
3. Empowering employees so that authority for delivering great service or improving products is in the hands of the doers rather than the overseers.
4. Using online systems to provide all relevant parties with the latest best practices and actual experiences with them, thereby speeding the diffusion and adoption of best practices throughout the organization and also allowing them to exchange data and opinions about how to upgrade the prevailing best practices.
5. Preaching that performance can, and must, be improved because competitors are not resting on their laurels and customers are always looking for something better.

If the targeted performance measures are appropriate to the strategy and if all organizational members (top executives, middle managers, professional staff, and line employees) buy into the process of continuous improvement, then the work climate becomes decidedly more conducive to proficient strategy execution.

When used effectively, TQM, Six Sigma and other similar continuous improvement techniques can greatly enhance a company's product design, cycle time, production costs, product quality, service, customer satisfaction, and other operating capabilities—and it can even deliver competitive advantage.[13] Not

only do ongoing incremental improvements add up over time and strengthen organizational capabilities, but continuous improvement programs have hard-to-imitate aspects. While it is relatively easy for rivals to undertake benchmarking, process improvement, and quality training, it is much more difficult and time-consuming for them to instill a total quality culture (as occurs when TQM or Six Sigma techniques are religiously employed) and generate lasting management commitment to operational excellence throughout their organizations.

INSTALLING INFORMATION AND OPERATING SYSTEMS

Company strategies can't be executed well without a number of internal systems for business operations. Southwest, American, Northwest, Delta, and other major airlines cannot hope to provide passenger-pleasing service without a user-friendly online reservation system, an accurate and speedy baggage handling system, and a strict aircraft maintenance program that minimizes equipment failures requiring at-the-gate service and delaying plane departures. FedEx has internal communication systems that allow it to coordinate its nearly 60,000 vehicles in handling an average of 5.2 million packages a day. Its leading-edge flight operations systems allow a single controller to direct as many as 200 of FedEx's 650-plus aircraft simultaneously, overriding their flight plans should weather or other special emergencies arise. In addition, FedEx has created a series of e-business tools for customers that allow them to ship and track packages online (either at FedEx's Web site or on their own company intranets or Web sites), create address books, review shipping history, generate custom reports, simplify customer billing, reduce internal warehousing and inventory management costs, purchase goods and services from suppliers, and respond quickly to changing customer demands. All of FedEx's systems support the company's strategy of providing businesses and individuals with a broad array of package delivery services (from premium next-day to economical five-day deliveries) and boosting its competitiveness against United Parcel Service, Airborne Express, and the U.S. Postal Service.

Otis Elevator has a 24-hour centralized communications center called OtisLine to coordinate its maintenance efforts in North America.[14] Trained operators take all trouble calls, input critical information on a computer screen, and dispatch people directly via a beeper system to the local trouble spot. Also, much of the information needed for repairs is provided directly from faulty elevators through internally installed microcomputer monitors, helping keep the outage time on Otis elevators and escalators to less than two and a half hours. From the trouble-call inputs, problem patterns across North America are identified and the information communicated to design and manufacturing personnel, allowing them to quickly alter design specifications or manufacturing procedures when needed to correct recurring problems.

Wal-Mart is generally considered to have the most sophisticated retailing systems of any company in the world. For example, Wal-Mart's computers transmit daily sales data to Wrangler, a supplier of blue jeans; Wrangler then uses a model that interprets the data, and software applications that act on these interpretations, in order to ship specific quantities of specific sizes and colors to specific stores from specific warehouses—the system lowers logistics and inventory costs and leads to fewer stockouts.[15] Domino's Pizza has computerized systems at each outlet to facilitate ordering, inventory, payroll, cash flow, and work control functions, thereby freeing managers to spend more time on supervision, customer service, and business development activities.[16] Most telephone companies, electric utilities, and TV broadcasting systems have online monitoring systems to spot transmission problems within seconds and

increase the reliability of their services. At eBay, there are systems for real-time monitoring of new listings, bidding activity, Web site traffic, and page views.

Amazon.com ships customer orders from fully computerized, 1,300-by-600-foot warehouses containing about 3 million books, CDs, toys, and houseware items.[17] The warehouses are so technologically sophisticated that they require about as many lines of code to run as Amazon's Web site does. Using complex picking algorithms, computers initiate the order-picking process by sending signals to workers' wireless receivers, telling them which items to pick off the shelves in which order. Computers also generate data on misboxed items, chute backup times, line speed, worker productivity, and shipping weights on orders. Systems are upgraded regularly, and productivity improvements are aggressively pursued. In 2003 Amazon's six warehouses were able to handle three times the volume handled in 1999 at costs averaging 10 percent of revenues (versus 20 percent in 1999); in addition, they turned their inventory over 20 times annually in an industry whose average was 15 turns. Amazon's warehouse efficiency and cost per order filled was so low that one of the fastest-growing and most profitable parts of Amazon's business was using its warehouses to run the e-commerce operations of Toys "R" Us and Target.

Well-conceived state-of-the-art operating systems not only enable better strategy execution but also strengthen organizational capabilities—perhaps enough to provide a competitive edge over rivals. For example, a company with a differentiation strategy based on superior quality has added capability if it has systems for training personnel in quality techniques, tracking product quality at each production step, and ensuring that all goods shipped meet quality standards. A company striving to be a low-cost provider is competitively stronger if it has a benchmarking system that identifies opportunities to implement best practices and drive costs out of the business. Fast-growing companies get an important assist from having capabilities in place to recruit and train new employees in large numbers and from investing in infrastructure that gives them the capability to handle rapid growth as it occurs.

It is nearly always better to put infrastructure and support systems in place before they are actually needed than to have to scramble to catch up to customer demand. In businesses such as public accounting and management consulting, where large numbers of professional staff need cutting-edge technical know-how, companies need well-functioning systems for training and retraining employees regularly and keeping them supplied with up-to-date information. Companies that rely on empowered customer service employees to act promptly and creatively in pleasing customers need state-of-the-art information systems that put essential data in front of employees with a few keystrokes. Many companies have cataloged best-practice information on their intranets to promote faster transfer and implementation organizationwide.[18]

core concept
State-of-the-art support systems can be a basis for competitive advantage if they give a firm capabilities that rivals can't match.

Instituting Adequate Information Systems, Performance Tracking, and Controls

Accurate and timely information about daily operations is essential if managers are to gauge how well the strategy execution process is proceeding. Information systems need to cover five broad areas: (1) customer data, (2) operations data, (3) employee data, (4) supplier/partner/collaborative ally data, and (5) financial performance data. All key strategic performance indicators have to be tracked and reported as often as practical. Monthly profit-and-loss statements and monthly statistical summaries, long the norm, are fast being replaced by daily statistical updates and even up-to-the-minute performance

monitoring that online technology makes possible. Many retail companies have automated online systems that generate daily sales reports for each store and maintain up-to-the-minute inventory and sales records on each item. Manufacturing plants typically generate daily production reports and track labor productivity on every shift. Many retailers and manufacturers have online data systems connecting them with their suppliers that monitor the status of inventories, track shipments and deliveries, and measure defect rates.

Real-time information systems permit company managers to stay on top of implementation initiatives and daily operations, and to intervene if things seem to be drifting off course. Tracking key performance indicators, gathering information from operating personnel, quickly identifying and diagnosing problems, and taking corrective actions are all integral pieces of the process of managing strategy implementation and execution and exercising adequate organization control. Telephone companies have elaborate information systems to measure signal quality, connection times, interrupts, wrong connections, billing errors, and other measures of reliability that affect customer service and satisfaction. To track and manage the quality of passenger service, airlines have information systems to monitor gate delays, on-time departures and arrivals, baggage handling times, lost baggage complaints, stockouts on meals and drinks, overbookings, and maintenance delays and failures. Virtually all companies now provide customer-contact personnel with computer access to customer databases so that they can respond effectively to customer inquiries and deliver personalized customer service.

Statistical information gives managers a feel for the numbers, briefings and meetings provide a feel for the latest developments and emerging issues, and personal contacts add a feel for the people dimension. All are good barometers. Managers have to identify problem areas and deviations from plan before they can take actions to get the organization back on course, by either improving the approaches to strategy execution or fine-tuning the strategy. Jeff Bezos, Amazon's CEO, is an ardent proponent of managing by the numbers—as he puts it "math-based decisions always trump opinion and judgment . . . The trouble with most corporations is that they make judgment-based decisions when data-based decisions could be made."[19]

core concept
Good information systems and operating data are essential components of good strategy execution and operating excellence.

Exercising Adequate Controls over Empowered Employees

Another important aspect of effectively managing and controlling the strategy execution process is monitoring the performance of empowered workers to see that they are acting within the specified limits.[20] Leaving empowered employees to their own devices in meeting performance standards without appropriate checks and balances can expose an organization to excessive risk.[21] Instances abound of employees' decisions or behavior having gone awry, sometimes costing a company huge sums or producing lawsuits aside from just generating embarrassing publicity.

Managers can't devote big chunks of their time to making sure that the decisions and behavior of empowered employees stay between the white lines—this would defeat the major purpose of empowerment and, in effect, lead to the reinstatement of a managerial bureaucracy engaged in constant over-the-shoulder supervision. Yet management has a clear responsibility to exercise sufficient control over empowered employees to protect the company against out-of-bounds behavior and unwelcome surprises. Scrutinizing daily and weekly operating statistics is one of the important ways in which managers can monitor the results that flow from the actions of empowered subordinates—if the operating results

flowing from the actions of empowered employees look good, then it is reasonable to assume that empowerment is working.

One of the main purposes of tracking daily operating performance is to relieve managers of the burden of constant supervision and give them time for other issues. But managerial control is only part of the answer. Another valuable lever of control in companies that rely on empowered employees, especially in those that use self-managed work groups or other such teams, is peer-based control.[22] The big majority of team members feel responsible for the success of the whole team and tend to be relatively intolerant of any team member's behavior that weakens team performance or puts team accomplishments at risk. Because peer evaluation is such a powerful control device, companies organized into teams can remove some layers of the management hierarchy. This is especially true when a company has the information systems capability to closely monitor team performance.

TYING REWARDS AND INCENTIVES TO STRATEGY EXECUTION

It is important for both organization units and individuals to be enthusiastically committed to executing strategy and achieving performance targets. Company managers typically use an assortment of motivational techniques and rewards to enlist organizationwide commitment to executing the strategic plan. A manager has to do more than just talk to everyone about how important new strategic practices and performance targets are to the organization's well-being. No matter how inspiring, talk seldom commands people's best efforts for long. *To get employees' sustained, energetic commitment, management has to be resourceful in designing and using motivational incentives—both monetary and nonmonetary.* The more a manager understands what motivates subordinates and the more he or she relies on motivational incentives as a tool for achieving the targeted strategic and financial results, the greater will be employees' commitment to good day-in, day-out execution of the company's strategic plan.

core concept
A properly designed reward structure is management's most powerful tool for mobilizing organizational commitment to successful strategy execution.

Strategy-Facilitating Motivational Practices

Financial incentives generally head the list of motivating tools for trying to gain wholehearted employee commitment to good strategy execution and operating excellence. Monetary rewards generally include some combination of base pay increases, performance bonuses, profit sharing plans, stock awards, company contributions to employee 401(k) or retirement plans, and piecework incentives (in the case of production workers). But successful companies and managers normally make extensive use of such nonmonetary carrot-and-stick incentives as frequent words of praise (or constructive criticism), special recognition at company gatherings or in the company newsletter, more (or less) job security, stimulating assignments, opportunities to transfer to attractive locations, increased (or decreased) autonomy, and rapid promotion (or the risk of being sidelined in a routine or dead-end job). In addition, companies use a host of other motivational approaches to spur stronger employee commitment to the strategy execution process; the following are some of the most important:[23]

core concept
One of management's biggest strategy-executing challenges is to employ motivational techniques that build wholehearted commitment to operating excellence and winning attitudes among employees.

- *Providing attractive perks and fringe benefits*—The various options here include full coverage of health insurance premiums; full tuition reimbursement for work on college degrees; paid vacation

time of three or four weeks; on-site child care at major facilities; on-site gym facilities and massage therapists; getaway opportunities at company-owned recreational facilities (beach houses, ranches, resort condos); personal concierge services; subsidized cafeterias and free lunches; casual dress every day; personal travel services; paid sabbaticals; maternity leaves; paid leaves to care for ill family members; telecommuting; compressed workweeks (four 10-hour days instead of five 8-hour days); reduced summer hours; college scholarships for children; on-the-spot bonuses for exceptional performance; and relocation services.

- *Relying on promotion from within whenever possible*—This practice helps bind workers to their employer and employers to their workers; plus, it is an incentive for good performance. Promotion from within also helps ensure that people in positions of responsibility actually know something about the business, technology, and operations they are managing.
- *Making sure that the ideas and suggestions of employees are valued and respected*—Research indicates that the moves of many companies to push decision making down the line and empower employees increases employee motivation and satisfaction, as well as boosting their productivity. The use of self-managed teams has much the same effect.
- *Creating a work atmosphere in which there is genuine sincerity, caring, and mutual respect among workers and between management and employees*—A "family" work environment where people are on a first-name basis and there is strong camaraderie promotes teamwork and cross-unit collaboration.
- *Stating the strategic vision in inspirational terms that make employees feel they are a part of doing something very worthwhile in a larger social sense*—There's strong motivating power associated with giving people a chance to be part of something exciting and personally satisfying. Jobs with noble purpose tend to turn employees on. At Pfizer, Merck, and most other pharmaceutical companies, it is the notion of helping sick people get well and restoring patients to full life. At Whole Foods Market (a natural foods grocery chain), it is helping customers discover good eating habits and thus improving human health and nutrition.
- *Sharing information with employees about financial performance, strategy, operational measures, market conditions, and competitors' actions*—Broad disclosure and prompt communication send the message that managers trust their workers. Keeping employees in the dark denies them information useful to performing their job, prevents them from being "students of the business," and usually turns them off.
- *Having knockout facilities*—An impressive corporate facility for employees to work in usually has decidedly positive effects on morale and productivity.
- *Being flexible in how the company approaches people management (motivation, compensation, recognition, recruitment) in multinational, multicultural environments*—Managers and employees in countries whose customs, habits, values, and business practices vary from those at the home office often become frustrated with insistence on consistent people-management practices worldwide. But the one area where consistency is essential is conveying the message that the organization values people of all races and cultural backgrounds and that discrimination of any sort will not be tolerated.

For specific examples of the motivational tactics employed by several prominent companies, see Illustration Capsule 12.3.

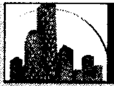


illustration capsule 12.3

Companies with Effective Motivation and Reward Techniques

Companies have come up with a variety of motivational and reward practices to help create a work environment that facilitates better strategy execution. Here's a glimpse of what some companies believe are best practices:

- At Google, the leader in Internet search engine technology and provider of 75 percent of all Web searches as of 2003, there's a sprawling four-building complex known as the Googleplex. The roughly 1,000 employees are provided with free food, unlimited ice cream, pool and Ping-Pong tables, and complimentary massages. Moreover, they are given the ability to spend 20 percent of their work time on any outside activity. Management built the Googleplex to be "a dream environment."
- At Amazon.com one of the most prized awards is Just Do It—winners are employees who do something they think will help Amazon *without* first getting their boss's permission. The action has to be well thought through but doesn't have to succeed.
- Lincoln Electric, a company deservedly famous for its piecework pay scheme and incentive bonus plan, rewards individual productivity by paying workers for each nondefective piece produced. Workers have to correct quality problems on their own time—defects in products used by customers can be traced back to the worker who caused them. Lincoln's piecework plan motivates workers to pay attention to both quality and volume produced. In addition, the company sets aside a substantial portion of its profits above a specified base for worker bonuses. To determine bonus size, Lincoln Electric rates each worker on four equally important performance measures: dependability, quality, output, and ideas and cooperation. The higher a worker's merit rating, the higher the incentive bonus earned; the highest rated workers in good profit years receive bonuses of as much as 110 percent of their piecework compensation.
- Several Japanese automobile producers, believing that providing employment security is a valuable contributor to worker productivity and company loyalty, elect not to lay off factory workers when business slacks off for a period but instead put them out in the field to sell vehicles. Southwest Airlines, FedEx, Lands' End, and Harley-Davidson (all companies that have been listed among the 100 best companies to work for in America) have also instituted no-layoff policies and use employment security as both a positive motivator and a means of reinforcing good strategy execution.
- Procter & Gamble, Merck, Charles Schwab, General Mills, Amgen, Tellabs, and Eli Lilly provide stock awards to all employees. Having employee-owners who share in a company's success (or failure) via stock ownership is widely viewed as a way to bolster employee commitment to good strategy execution and operational excellence.
- Nordstrom typically pays its retail salespeople an hourly wage higher than the prevailing rates paid by other department store chains plus a commission on each sale. Spurred by a culture that encourages salespeople to go all-out to satisfy customers, to exercise their own best judgment, and to seek out and promote new fashion ideas, Nordstrom salespeople often earn twice the average incomes of sales employees at competing stores. Nordstrom's rules for employees are simple: "Rule #1: Use your good judgment in all situations. There will be no additional rules." Nordstrom is widely regarded for its superior in-house customer service experience.
- Kimberly-Clark spends about $6 million annually on events to celebrate employee successes, and FedEx gives out awards to employees whose job performance is above and beyond expectations (in 2001 the company spent over $13 million on such awards).
- Monsanto, FedEx, AT&T, Whole Foods Markets, Advanced Micro Devices, and W. L. Gore & Associates (the maker of Gore-Tex) have tapped into the motivational power of self-managed teams, recognizing that team members put considerable peer pressure on coworkers to pull their weight and help achieve team goals and expectations. At W. L. Gore (a regular member on annual listings of the 100 best companies to work for), each team member's compensation is based on other team members' rankings of his or her contribution to the enterprise.

Sources: Jeffrey Pfeffer and John F. Veiga, "Putting People First for Organizational Success," *Academy of Management Executive* 13, no. 2 (May 1999), pp. 40–42; *Fortune's* lists of the 100 best companies to work for in America—see the January 12, 1998, January 10, 2000, and February 4, 2002, issues; Jeffrey Pfeffer, "Producing Sustainable Competitive Advantage through the Effective Management of People," *Academy of Management Executive* 9, no. 1 (February 1995), pp. 59–60; and Steven Kerr, "Risky Business: The New Pay Game," *Fortune,* July 22, 1996, p. 95.

Striking the Right Balance between Rewards and Punishment

While most approaches to motivation, compensation, and people management accentuate the positive, companies also embellish positive rewards with the risk of punishment. At General Electric, McKinsey & Company, several global public accounting firms, and other companies that look for and expect top-notch individual performance, there's an "up-or-out" policy—managers and professionals whose performance is not good enough to warrant promotion are first denied bonuses and stock awards and eventually weeded out. A number of companies deliberately give employees heavy workloads and tight deadlines—personnel are pushed hard to achieve "stretch" objectives and expected to put in long hours (nights and weekends if need be). At most companies, senior executives and key personnel in underperforming units are pressured to boost performance to acceptable levels and keep it there or risk being replaced.

As a general rule, it is unwise to take off the pressure for good individual and group performance or play down the stress, anxiety, and adverse consequences of shortfalls in performance. There is no evidence that a no-pressure/no-adverse-consequences work environment leads to superior strategy execution or operating excellence. As the CEO of a major bank put it, "There's a deliberate policy here to create a level of anxiety. Winners usually play like they're one touchdown behind."[24] *High-performing organizations nearly always have a cadre of ambitious people who relish the opportunity to climb the ladder of success, love a challenge, thrive in a performance-oriented environment, and find some competition and pressure useful to satisfy their own drives for personal recognition, accomplishment, and self-satisfaction.*

However, if an organization's motivational approaches and reward structure induce too much stress, internal competitiveness, job insecurity, and unpleasant consequences, the impact on workforce morale and strategy execution can be counterproductive. Evidence shows that managerial initiatives to improve strategy execution should incorporate more positive than negative motivational elements because when cooperation is positively enlisted and rewarded, rather than strong-armed by orders and threats (implicit or explicit), people tend to respond with more enthusiasm, dedication, creativity, and initiative. Something of a middle ground is generally optimal—not only handing out decidedly positive rewards for meeting or beating performance targets but also imposing sufficiently negative consequences (if only withholding rewards) when actual performance falls short of the target. But the negative consequences of underachievement should never be so severe or demoralizing as to impede a renewed and determined effort to overcome existing obstacles and hit the targets in upcoming periods.

Linking the Reward System to Strategically Relevant Performance Outcomes

core concept
A properly designed reward system aligns the well-being of organization members with their contributions to competent strategy execution and the achievement of performance targets.

The most dependable way to keep people focused on strategy execution and the achievement of performance targets is to *generously* reward and recognize individuals and groups who meet or beat performance targets and deny rewards and recognition to those who don't. *The use of incentives and rewards is the single most powerful tool management has to win strong employee commitment to diligent, competent strategy execution and operating excellence.* Decisions on salary increases, incentive compensation, promotions, key assignments, and the ways and means of awarding praise and recognition are potent attention-getting, commitment-generating devices. Such

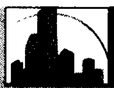


illustration capsule 12.4

Nucor and Bank One: Two Companies That Tie Incentives Directly to Strategy Execution

The strategy at Nucor Corporation, one of the two biggest steel producers in the United States, is to be *the low-cost* producer of steel products. Because labor costs are a significant fraction of total cost in the steel business, successful implementation of Nucor's low-cost leadership strategy entails achieving lower labor costs per ton of steel than competitors' costs. Nucor management uses an incentive system to promote high worker productivity and drive labor costs per ton below rivals'. Each plant's workforce is organized into production teams (each assigned to perform particular functions), and weekly production targets are established for each team. Base pay scales are set at levels comparable to wages for similar manufacturing jobs in the local areas where Nucor has plants, but workers can earn a 1 percent bonus for each 1 percent that their output exceeds target levels. If a production team exceeds its weekly production target by 10 percent, team members receive a 10 percent bonus in their next paycheck; if a team exceeds its quota by 20 percent, team members earn a 20 percent bonus. Bonuses, paid every two weeks, are based on the prior two weeks' actual production levels measured against the targets.

Nucor's [illegible] productivity levels 10 [illegible] unionized workforces of large [illegible] like U.S. Steel and Bethlehem Steel, gives Nucor [illegible] vantage over most rivals, and [illegible] the best-paid in the U.S. steel industry.

At Bank One (one of the 10 largest U.S. [illegible] one of the most profitable, [illegible] operating in a manner that [illegible] of customer satisfaction [illegible] in how well the [illegible] faction [illegible] To [illegible] customers, Bank One [illegible] rise to that [illegible] the branch's ratings [illegible] shifting from [illegible] equal pay for equal performance [illegible] attention of branch [illegible] delighting their customers.

decisions seldom escape the closest employee scrutiny, saying more about what is expected and who is considered to be doing a good job than about any other factor. Hence, when achievement of the targeted strategic and financial outcomes become *the dominating basis* for designing incentives, evaluating individual and group efforts, and handing out rewards, company personnel quickly grasp that it is in their own self-interest to do their best in executing the strategy competently and achieving key performance targets.[25] Indeed, it is usually through the company's system of incentives and rewards that workforce members emotionally ratify their commitment to the company's strategy execution effort.

Strategy-driven performance targets need to be established for every organization unit, every manager, every team or work group, and perhaps every employee—targets that measure whether strategy execution is progressing satisfactorily. If the company's strategy is to be a low-cost provider, the incentive system must reward actions and achievements that result in lower costs. If the company has a differentiation strategy predicated on superior quality and service, the incentive system must reward such outcomes as Six Sigma defect rates, infrequent need for product repair, low numbers of customer complaints, and speedy order processing and delivery. If a company's growth is predicated on a strategy of new product innovation, incentives should be tied to factors such as the percentages of revenues and profits coming from newly introduced products.

Illustration Capsule 12.4 provides two vivid examples of how companies have designed incentives linked directly to outcomes reflecting good strategy execution.

The Importance of Basing Incentives on Achieving Results, Not on Performing Assigned Functions To create a strategy-supportive system of rewards and incentives, a company must emphasize rewarding people for accomplishing results, not for just dutifully performing assigned functions. Focusing jobholders' attention and energy on what to *achieve* as opposed to what to *do* makes the work environment results-oriented. It is flawed management to tie incentives and rewards to satisfactory performance of duties and activities in hopes that the by-products will be the desired business outcomes and company achievements.[26] In any job, performing assigned tasks is not equivalent to achieving intended outcomes. Diligently attending to assigned duties does not, by itself, guarantee results. As any student knows, the fact that an instructor teaches and students go to class doesn't necessarily mean that the students are learning. The enterprise of education would no doubt take on a different character if teachers were rewarded for the result of student learning rather than for the activity of teaching.

It is folly to reward one outcome in hopes of getting another outcome.

Incentive compensation for top executives is typically tied to company profitability (earnings growth, return on equity investment, return on total assets, economic value added); the company's stock price performance; and perhaps such measures as market share, product quality, or customer satisfaction. However, incentives for department heads, teams, and individual workers may be tied to performance outcomes more closely related to their strategic area of responsibility. In manufacturing, incentive compensation may be tied to unit manufacturing costs, on-time production and shipping, defect rates, the number and extent of work stoppages due to labor disagreements and equipment breakdowns, and so on. In sales and marketing, there may be incentives for achieving dollar sales or unit volume targets, market share, sales penetration of each target customer group, the fate of newly introduced products, the frequency of customer complaints, the number of new accounts acquired, and customer satisfaction. Which performance measures to base incentive compensation on depends on the situation—the priority placed on various financial and strategic objectives, the requirements for strategic and competitive success, and what specific results are needed in different facets of the business to keep strategy execution on track.

core concept
The role of the reward system is to align the well-being of organization members with realizing the company's vision, so that organization members benefit by helping the company execute its strategy competently and fully satisfy customers.

Guidelines for Designing Incentive Compensation Systems The concepts and company experiences discussed above yield the following prescriptive guidelines for creating an incentive compensation system to help drive successful strategy execution:

1. *The performance payoff must be a major, not minor, piece of the total compensation package.* Payoffs must be at least 10 to 12 percent of base salary to have much impact. Incentives that amount to 20 percent or more of total compensation are big attention-getters, likely to really drive individual or team effort; incentives amounting to less than 5 percent of total compensation have comparatively weak motivational impact. Moreover, the payoff for high-performing individuals and teams must be meaningfully greater than the payoff for average performers, and the payoff for average performers meaningfully bigger than for below-average performers.
2. *The incentive plan should extend to all managers and all workers, not just top management.* It is a gross miscalculation to expect that lower-level managers and employees will work their hardest to hit performance targets just so a few senior executives can get lucrative rewards.
3. *The reward system must be administered with scrupulous care and fairness.* If performance standards are set unrealistically high or if individual/group performance evaluations are not accurate and well documented, dissatisfaction with the system will overcome any positive benefits.

4. *The incentives should be based only on achieving performance targets spelled out in the strategic plan.* Incentives should not be linked to outcomes that get thrown in because they are thought to be nice. Performance evaluation based on factors not tightly related to good strategy execution signal that either the strategic plan is incomplete (because important performance targets were left out) or management's real agenda is something other than the stated strategic and financial objectives.
5. *The performance targets each individual is expected to achieve should involve outcomes that the individual can personally affect.* The role of incentives is to enhance individual commitment and channel behavior in beneficial directions. This role is not well served when the performance measures by which an individual is judged are outside his or her arena of influence.
6. *Keep the time between the performance review and payment of the reward short.* A lengthy interval between review and payment breeds discontent and works against reinforcing cause and effect. Companies like Nucor and Continental Airlines have discovered that weekly or monthly payments for good performance work much better than annual payments. Nucor pays weekly bonuses based on prior-week production levels; Continental awards employees a monthly bonus for each month that on-time flight performance meets or beats a specified percentage companywide.
7. *Make liberal use of nonmonetary rewards; don't rely solely on monetary rewards.* When used properly, money is a great motivator, but there are also potent advantages to be gained from praise, special recognition, handing out plum assignments, and so on.
8. *Absolutely avoid skirting the system to find ways to reward effort rather than results.* Whenever actual performance falls short of targeted performance, there's merit in determining whether the causes are attributable to subpar individual/group performance or to circumstances beyond the control of those responsible. An argument can be made that exceptions should be made in giving rewards to people who've tried hard, gone the extra mile, yet still come up short because of circumstances beyond their control. The problem with making exceptions for unknowable, uncontrollable, or unforeseeable circumstances is that once good excuses start to creep into justifying rewards for subpar results, the door is open for all kinds of reasons why actual performance failed to match targeted performance. A "no excuses" standard is more evenhanded and certainly easier to administer.

Once the incentives are designed, they have to be communicated and explained. Everybody needs to understand how their incentive compensation is calculated and how individual/group performance targets contribute to organizational performance targets. The pressure to achieve the targeted strategic and financial performance and continuously improve on strategy execution should be unrelenting, with few (if any) loopholes for rewarding shortfalls in performance. People at all levels have to be held accountable for carrying out their assigned parts of the strategic plan, and they have to understand their rewards are based on the caliber of results that are achieved. But with the pressure to perform should come meaningful rewards. Without an ample payoff, the system breaks down, and managers are left with the less workable options of barking orders, trying to enforce compliance, and depending on the good will of employees.

core concept
The unwavering standard for judging whether individuals, teams, and organizational units have done a good job must be whether they achieve performance targets consistent with effective strategy execution.

Performance-Based Incentives and Rewards in Multinational Enterprises In some foreign countries, incentive pay runs counter to local customs and cultural norms. Professor Steven Kerr cites the time he lectured an executive education class on the need for more performance-based pay and a Japanese manager protested, "You shouldn't bribe your children to do their homework, you shouldn't bribe your wife to prepare dinner, and you shouldn't bribe your employees to work for the company."[27] Singling out individuals and commending them for unusually good effort can also be a problem; Japanese culture considers public praise of an individual an affront to the harmony of the group. In some countries, employees have a preference for nonmonetary rewards—more leisure time, important titles, access to vacation villages, and nontaxable perks. Thus, multinational companies have to build some degree of flexibility into the design of incentives and rewards in order to accommodate cross-cultural traditions and preferences.

key|points

Managers implementing and executing a new or different strategy must identify the resource requirements of each new strategic initiative and then consider whether the current pattern of resource allocation and the budgets of the various subunits are suitable. Every organization unit needs to have the people, equipment, facilities, and other resources to carry out its part of the strategic plan (but no more than what it really needs). Implementing a new strategy often entails shifting resources from one area to another—downsizing units that are overstaffed and overfunded, upsizing those more critical to strategic success, and killing projects and activities that are no longer justified.

Anytime a company alters its strategy, managers should review existing policies and operating procedures, proactively revise or discard those that are out of sync, and formulate new ones to facilitate execution of new strategic initiatives. Prescribing new or freshly revised policies and operating procedures aids the task of strategy execution (1) by providing top-down guidance to operating managers, supervisory personnel, and employees regarding how certain things need to be done and what the boundaries are on independent actions and decisions; (2) by enforcing consistency in how particular strategy-critical activities are performed in geographically scattered operating units; and (3) by promoting the creation of a work climate and corporate culture that promotes good strategy execution. Thick policy manuals are usually unnecessary. Indeed, when individual creativity and initiative are more essential to good execution than standardization and conformity, it is better to give people the freedom to do things however they see fit and hold them accountable for good results rather than try to control their behavior with policies and guidelines for every situation.

Competent strategy execution entails visible, unyielding managerial commitment to best practices and continuous improvement. Benchmarking, the discovery and adoption of best practices, business process reengineering, and continuous improvement initiatives like total quality management (TQM) or Six Sigma programs all aim at improved efficiency, lower costs, better product quality, and greater customer satisfaction. *These initiatives are important tools for learning how to execute a strategy more proficiently.* Benchmarking, part of the process of discovering best practices, provides a realistic basis for setting performance targets. Instituting "best-in-industry" or "best-in-world" operating practices in most or all value chain activities provides a means for taking strategy execution to a higher plateau of competence and nurturing a high-performance work environment. Business process reengineering is a way to make quantum progress toward becoming a world-class organization, while TQM and Six Sigma programs instill a commitment to continuous improvement and operating excellence. An organization bent

on continuous improvement is a valuable competitive asset—one that, over time, can yield important competitive capabilities (in reducing costs, speeding new products to market, or improving product quality, service, or customer satisfaction) and be a source of competitive advantage.

Company strategies can't be implemented or executed well without a number of support systems to carry on business operations. Well-conceived state-of-the-art support systems can not only facilitate better strategy execution but also strengthen organizational capabilities enough to provide a competitive edge over rivals. In the age of the Internet, real-time information and control systems, growing use of e-commerce technologies and business practices, company intranets, and wireless communications capabilities, companies can't hope to outexecute their competitors without cutting-edge information systems and technologically sophisticated operating capabilities that enable fast, efficient, and effective organization action.

Strategy-supportive motivational practices and reward systems are powerful management tools for gaining employee commitment. The key to creating a reward system that promotes good strategy execution is to make strategically relevant measures of performance *the dominating basis* for designing incentives, evaluating individual and group efforts, and handing out rewards. Positive motivational practices generally work better than negative ones, but there is a place for both. There's also a place for both monetary and nonmonetary incentives.

For an incentive compensation system to work well (1) the monetary payoff should be a major percentage of the compensation package, (2) the use of incentives should extend to all managers and workers, (3) the system should be administered with care and fairness, (4) the incentives should be linked to performance targets spelled out in the strategic plan, (5) each individual's performance targets should involve outcomes the person can personally affect, (6) rewards should promptly follow the determination of good performance, (7) monetary rewards should be supplemented with liberal use of nonmonetary rewards, and (8) skirting the system to reward nonperformers or subpar results should be scrupulously avoided.

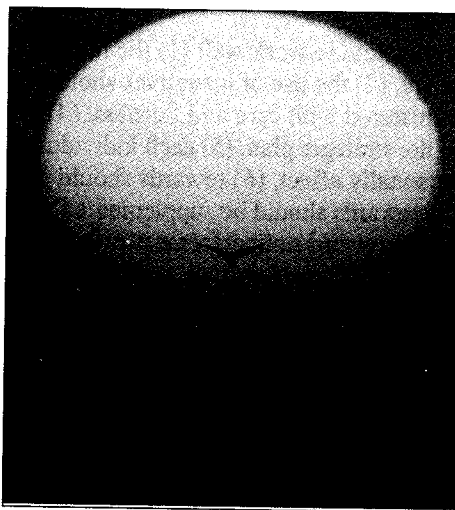
exercises

1. Go to www.google.com and, using the advanced search feature, enter "best practices." Browse through the search results to identify at least five organizations that have gathered a set of best practices and are making information about them available to members. Explore at least one of the sites to get an idea of the kind of best-practice information that is available.
2. Go to www.google.com and do a search on "Six Sigma" quality programs. Browse through the search results and (*a*) identify several companies that offer Six Sigma training and (*b*) find lists of companies that have implemented Six Sigma programs in their pursuit of operational excellence. In particular, you should go to www.isixsigma.com and explore the Six Sigma Q&A menu option.
3. Go to www.google.com and do a search on "total quality management." Browse through the search results and (*a*) identify companies that offer TQM training, (*b*) identify some books on TQM programs, and (*c*) find lists of companies that have implemented TQM programs in their pursuit of operational excellence.
4. Consult the latest issue of *Fortune* containing the annual "100 Best Companies to Work For" (usually a late-January or early-February issue) and identify at least 5, and preferably 10, compensation incentives that these companies use to enhance employee motivation and reward them for good strategic and financial performance.

chapter | thirteen 13

Corporate Culture and Leadership

Keys to Good Strategy Execution



(©Chase Swift/CORBIS)

The biggest levers you've got to change a company are strategy, structure, and culture. If I could pick two, I'd pick strategy and culture.

—Wayne Leonard
CEO, Entergy

An organization's capacity to execute its strategy depends on its "hard" infrastructure—its organizational structure and systems—and on its "soft" infrastructure—its culture and norms.

—Amar Bhide

Weak leadership can wreck the soundest strategy; forceful execution of even a poor plan can often bring victory.

—Sun Zi

Leadership is accomplishing something through other people that wouldn't have happened if you weren't there . . . Leadership is being able to mobilize ideas and values that energize other people . . . Leaders develop a story line that engages other people.

—Noel Tichy

Seeing people in person is a big part of how you drive any change process. You have to show people a positive view of the future and say "we can do it."

—Jeffrey Immelt
CEO, General Electric

In the previous two chapters we examined six of the managerial tasks that are important to good strategy execution and operating excellence—building a capable organization, marshaling the needed resources and steering them to strategy-critical operating units, instituting policies and procedures that facilitate strategy execution, adopting best practices and striving for continuous improvement in how value chain activities are performed, installing information and operating systems that enable company personnel to carry out their strategic roles proficiently, and tying rewards and incentives directly to the achievement of strategic and financial targets. In this chapter we explore the two remaining managerial tasks that shape the outcome of efforts to execute a company's strategy: creating a strategy-supportive corporate culture and exerting the internal leadership needed to drive good strategy execution and the pursuit of operating excellence.

BUILDING A CORPORATE CULTURE THAT PROMOTES GOOD STRATEGY EXECUTION

Every company has its own unique culture. The character of a company's culture or work climate is a product of the core values and business principles that executives espouse, the standards of what is ethically acceptable and what is not, the behaviors that define "how we do things around here," the stories that get told over and over to illustrate and reinforce values and traditions, the company's approach to people management, and its internal politics. The meshing together of shared beliefs, business principles, style of operating, ingrained behaviors and attitudes, and work climate define a company's **corporate culture**.

> **core concept**
> ***Corporate culture*** refers to the character of a company's internal work climate and personality—as shaped by its core values, beliefs, business principles, traditions, ingrained behaviors, and style of operating.

Corporate cultures vary widely. For instance, the bedrock of Wal-Mart's culture is dedication to customer satisfaction, zealous pursuit of low costs and frugal operating practices, a strong work ethic, ritualistic Saturday-morning headquarters meetings to exchange ideas and review problems, and company executives' commitment to visiting stores, listening to customers, and soliciting suggestions from employees. At Nordstrom, the corporate culture is centered on delivering exceptional service to customers; the company's motto is "Respond to unreasonable customer requests"—each out-of-the-ordinary request is seen as an opportunity for a "heroic" act by an employee that can further the company's reputation for a customer-pleasing shopping environment. Nordstrom makes a point of promoting employees noted for their heroic acts and dedication to outstanding service; the company motivates its salespeople with a commission-based compensation system that enables Nordstrom's best salespeople to earn more than double what other department stores pay. General Electric's culture is founded on a hard-driving, results-

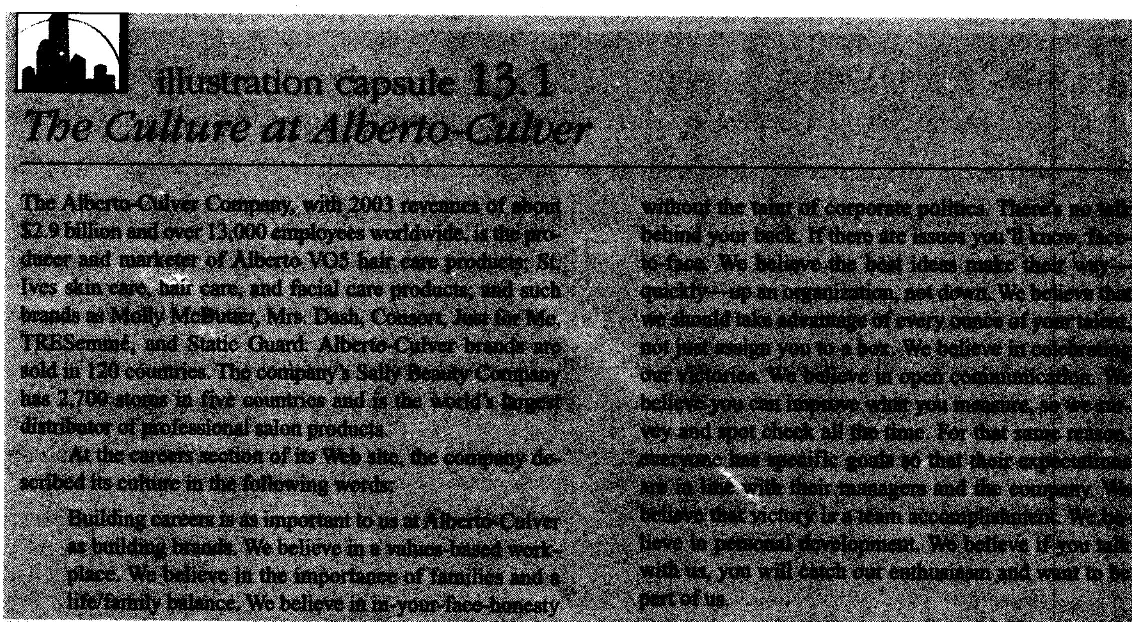


illustration capsule 13.1

The Culture at Alberto-Culver

The Alberto-Culver Company, with 2003 revenues of about $2.9 billion and over 13,000 employees worldwide, is the producer and marketer of Alberto VO5 hair care products; St. Ives skin care, hair care, and facial care products; and such brands as Molly McButter, Mrs. Dash, Consort, Just for Me, TRESemmé, and Static Guard. Alberto-Culver brands are sold in 120 countries. The company's Sally Beauty Company has 2,700 stores in five countries and is the world's largest distributor of professional salon products.

At the careers section of its Web site, the company described its culture in the following words:

> Building careers is as important to us at Alberto-Culver as building brands. We believe in a values-based workplace. We believe in the importance of families and a life/family balance. We believe in in-your-face-honesty without the taint of corporate politics. There's no talk behind your back. If there are issues you'll know, face-to-face. We believe the best ideas make their way—quickly—up an organization, not down. We believe that we should take advantage of every ounce of your talent, not just assign you to a box. We believe in celebrating our victories. We believe in open communication. We believe you can improve what you measure, so we survey and spot check all the time. For that same reason, everyone has specific goals so that their expectations are in line with their managers and the company. We believe that victory is a team accomplishment. We believe in personal development. We believe if you talk with us, you will catch our enthusiasm and want to be part of us.

Source: Alberto-Culver Web site, December 2, 2002, and March 28, 2004.

oriented atmosphere (where all of the company's business divisions are held to a standard of being number one or two in their industries as well as achieving good business results); extensive cross-business sharing of ideas, best practices, and learning; the reliance on "workout sessions" to identify, debate, and resolve burning issues; a commitment to Six Sigma quality; and globalization of the company. At Microsoft, there are stories of the long hours programmers put in, the emotional peaks and valleys in encountering and overcoming coding problems, the exhilaration of completing a complex program on schedule, the satisfaction of working on cutting-edge projects, the rewards of being part of a team responsible for a popular new software program, and the tradition of competing aggressively. Enron's collapse in 2001 was partly the product of a flawed corporate culture—one based on the positives of product innovation, aggressive risk-taking, and a driving ambition to lead global change in the energy business but also on the negatives of arrogance, ego, greed, deliberately obscure accounting practices, and an "ends-justify-the-means" mentality in pursuing stretch revenue and profitability targets. In the end, Enron came unglued because a few top executives chose unethical and illegal paths to pursue corporate revenue and profitability targets—in a company that publicly preached integrity and other notable corporate values but was lax in making sure that key executives walked the talk.

Illustration Capsule 13.1 presents Alberto-Culver's description of its corporate culture.

What to Look for in Identifying a Company's Corporate Culture

The taproot of corporate culture is the organization's beliefs and philosophy about how its affairs ought to be conducted—the reasons why it does things the way it does. A company's culture is manifested in the values and business principles that management preaches and practices, in official policies and

procedures, in its revered traditions and oft-repeated stories, in the attitudes and behaviors of employees, in the peer pressures that exist to display core values, in the company's politics, in its approaches to people management and problem solving, in its relationships with external stakeholders (particularly vendors and the communities in which it operates), and in the "chemistry" and the "personality" that permeate its work environment. Some of these sociological forces are readily apparent, and others operate quite subtly.

The values, beliefs, and practices that undergird a company's culture can come from anywhere in the organization hierarchy, sometimes representing the philosophy of an influential executive and sometimes resulting from exemplary actions on the part of a specific employee, work group, department, or division.[1] Key elements of the culture often originate with a founder or other strong leader who articulated them as a set of business principles, company policies, or ways of dealing with employees, customers, vendors, shareholders, and the communities in which it operated. Over time, these cultural underpinnings take root, become embedded in how the company conducts its business, come to be accepted and shared by company managers and employees, and then persist as new employees are encouraged to adopt and follow the professed values and practices.

The Role of Stories Frequently, a significant part of a company's culture is captured in the stories that get told over and over again to illustrate to newcomers the importance of certain values and the depth of commitment that various company personnel have displayed. One of the folktales at FedEx, world renowned for the reliability of its next-day package delivery guarantee, is about a deliveryman who had been given the wrong key to a FedEx drop box. Rather than leave the packages in the drop box until the next day when the right key was available, the deliveryman unbolted the drop box from its base, loaded it into the truck, and took it back to the station. There, the box was pried open and the contents removed and sped on their way for on-time arrival. Nordstrom keeps a scrapbook commemorating the heroic acts of its employees and uses it as a regular reminder of the above-and-beyond-the-call-of-duty behaviors that employees are encouraged to display. At Frito-Lay, there are dozens of stories about truck drivers who went to extraordinary lengths in overcoming adverse weather conditions to keep store shelves stocked with Frito-Lay products. Such stories serve the valuable purpose of illustrating the kinds of behavior the company encourages and reveres. Moreover, each retelling of a legendary story puts a bit more peer pressure on company personnel to go an extra step when the opportunity presents itself, to do their part to display core values, and to uphold company traditions.

Perpetuating the Culture Once established, company cultures are perpetuated in six important ways: (1) by screening and selecting new employees that will mesh well with the culture, (2) by systematic indoctrination of new members in the culture's fundamentals, (3) by the efforts of senior group members to reiterate core values in daily conversations and pronouncements, (4) by the telling and retelling of company legends, (5) by regular ceremonies honoring members who display desired cultural behaviors, and (6) by visibly rewarding those who display cultural norms and penalizing those who don't.[2] The more that new employees are being brought into the organization the more important it becomes to screen job applicants every bit as much for how well their values, beliefs, and personalities match up with the culture as for their technical skills and experience. For example, a company that stresses operating with integrity and fairness has to hire people who themselves have integrity and place a high value on fair play. A company whose culture revolves around creativity, product innovation, and leading change has to screen new hires for their ability to think outside the box, generate new ideas, and thrive in a climate of

rapid change and ambiguity. Southwest Airlines, whose two core values "LUV" and fun permeate the work environment and whose objective is to ensure that passengers have a positive and enjoyable flying experience, goes to considerable lengths to hire flight attendants and gate personnel who are witty, cheery, and outgoing and who display "whistle while you work" attitudes. Fast-growing companies risk creating a culture by chance rather than by design if they rush to hire employees mainly for their talents and credentials and neglect to screen out candidates whose values, philosophies, and personalities aren't a good fit with the organizational character, vision, and strategy being articulated by the company's senior executives.

As a rule, companies are attentive to the task of hiring people who will fit in and who will embrace the prevailing culture. Usually, job seekers lean toward accepting jobs at companies where they feel comfortable with the atmosphere and the people they will be working with. Employees who don't hit it off at a company tend to leave quickly, while employees who thrive and are pleased with the work environment stay on, eventually moving up the ranks to positions of greater responsibility. The longer people stay at an organization, the more they come to embrace and mirror the corporate culture—their values and beliefs tend to be molded by mentors, fellow workers, company training programs, and the reward structure. Normally, employees who have worked at a company for a long time play a major role in indoctrinating new employees into the culture.

Forces That Cause a Company's Culture to Evolve However, even stable cultures aren't static—just like strategy and organization structure, they evolve. New challenges in the marketplace, revolutionary technologies, and shifting internal conditions—especially eroding business prospects, an internal crisis, or top executive turnover—tend to breed new ways of doing things and, in turn, cultural evolution. An incoming CEO who decides to shake up the existing business and take it in new directions often triggers a cultural shift, perhaps one of major proportions. Likewise, diversification into new businesses, expansion into foreign countries, rapid growth, an influx of new employees, and merger with or acquisition of another company can all precipitate cultural changes.

Company Subcultures: The Problems Posed by New Acquisitions and Multinational Operations Although it is common to speak about corporate culture in the singular, companies typically have multiple cultures or numerous subcultures within the prevailing culture.[3] Values, beliefs, and practices within a company sometimes vary significantly by department, geographic location, division, or business unit. A company's subcultures can clash, or at least not mesh well, if they embrace conflicting business philosophies or operating approaches, or if key executives employ different approaches to people management, or if important differences between a company's culture and those of recently acquired companies have not yet been ironed out. *Global and multinational companies tend to be at least partly multicultural* because cross-country organization units have different operating histories and work climates, as well as members who have grown up under different social customs and traditions and who have different sets of values and beliefs. The human resources manager of a global pharmaceutical company who took on an assignment in the Far East discovered, to his surprise, that one of his biggest challenges was to persuade his company's managers in China, Korea, Malaysia, and Taiwan to accept promotions—their cultural values were such that they did not believe in competing with their peers for career rewards or personal gain, nor did they relish breaking ties to their local communities to assume cross-national responsibilities.[4] Many companies that have merged with or acquired foreign companies have to deal with language- and custom-based cultural differences.

Nonetheless, the existence of subcultures does not preclude important areas of commonality and compatibility. For example, General Electric's cultural components of boundarylessness, workout, and Six Sigma quality can be implanted and practiced successfully in different countries. AES, a global power company with operations in over 20 countries, has found that the four core values of integrity, fairness, fun, and social responsibility underlying its culture are readily embraced by people in most countries. Moreover, AES tries to define and practice its cultural values the same way in all of its locations while still being sensitive to differences that exist among various people groups across the world; top managers at AES express the views that people across the world are more similar than different and that the company's culture is as meaningful in Argentina or Kazakhstan as in the United States.

In today's globalizing world, multinational companies are learning how to make strategy-critical cultural traits travel across country boundaries and create a workably uniform culture worldwide. Likewise, company managements are quite alert to the importance of cultural compatibility in making acquisitions and the need to address how to merge and integrate the cultures of newly acquired companies—cultural due diligence is often as important as financial due diligence in deciding whether to go forward on an acquisition or merger. On a number of occasions, companies have decided to pass on acquiring particular companies because of culture conflicts that they believed would be hard to resolve.

Culture: Ally or Obstacle to Strategy Execution?

A company's present culture and work climate may or may not be compatible with what is needed for effective implementation and execution of the chosen strategy. *When a company's present work climate promotes attitudes and behaviors that are well suited to first-rate strategy execution, its culture functions as a valuable ally in the strategy execution process.* When the culture is in conflict with some aspect of the company's direction, performance targets, or strategy, the culture becomes a stumbling block.[5]

How Culture Can Promote Better Strategy Execution A culture grounded in strategy-supportive values, practices, and behavioral norms adds significantly to the power and effectiveness of a company's strategy execution effort. For example, a culture where frugality and thrift are values widely shared by organizational members nurtures employee actions to identify cost-saving opportunities—the very behavior needed for successful execution of a low-cost leadership strategy. A culture built around such business principles as pleasing customers, fair treatment, operating excellence, and employee empowerment promotes employee behaviors and an esprit de corps that facilitate execution of strategies keyed to high product quality and superior customer service. A culture in which taking initiative, challenging the status quo, exhibiting creativity, embracing change, and being a team player pervade the work climate promotes creative collaboration and a drive to lead market change—outcomes that are conducive to successful execution of product innovation and technological leadership strategies.[6]

A tight culture–strategy alignment furthers a company's strategy execution effort in two ways:[7]

1. *A culture that encourages actions supportive of good strategy execution not only provides company personnel with clear guidance regarding what behaviors and results constitute good job performance but also produces significant peer pressure from coworkers to conform to culturally acceptable norms.* The tighter the strategy–culture fit, the more that the culture pushes people to display

behaviors and observe operating practices that are conducive to good strategy execution. A strategy-supportive culture thus funnels organizational energy toward getting the right things done and delivering positive organizational results. In a company whose strategy and culture are misaligned, some of the very behaviors needed to execute strategy successfully run contrary to the behaviors and values imbedded in the prevailing culture. Such a clash nearly always produces resistance from employees who have strong allegiance to the present culture. Culture-bred resistance to the actions and behaviors needed for good execution, if strong and widespread, poses a formidable hurdle that has to be cleared for strategy execution to get very far.

2. *A culture imbedded with values and behaviors that facilitate strategy execution promotes strong employee identification with and commitment to the company's vision, performance targets, and strategy.* When a company's culture is grounded in many of the needed strategy-executing behaviors, employees feel genuinely better about their jobs, the company they work for, and the merits of what the company is trying to accomplish. As a consequence, company personnel are more inclined to exhibit some passion and exert their best efforts in making the strategy work, trying to achieve the targeted performance, and moving the company closer to realizing its strategic vision.

core concept
Because culturally approved behavior thrives and culturally disapproved behavior gets squashed, company managers are well-advised to spend time creating a culture that supports and encourages the behaviors conducive to good strategy execution.

These aspects of culture–strategy alignment say something important about the task of managing the strategy executing process: *Closely aligning corporate culture with the requirements for proficient strategy execution merits the full attention of senior executives.* The managerial objective is to create and nurture a work culture that mobilizes organizational energy squarely behind efforts to execute strategy. A good job of culture building on management's part promotes can-do attitudes and acceptance of change, instills strong peer pressures for behaviors conducive to good strategy execution, and enlists more enthusiasm and dedicated effort among company personnel for achieving company objectives.

The Perils of Strategy–Culture Conflict Conflicts between behaviors approved by the culture and behaviors needed for good strategy execution send mixed signals to organization members, forcing an undesirable choice. Should organization members be loyal to the culture and company traditions (as well as to their own personal values and beliefs, which are likely to be compatible with the culture) and thus resist or be indifferent to actions and behaviors that will promote better strategy execution? Or should they support the strategy execution effort and engage in actions and behaviors that run counter to the culture?

When a company's culture is out of sync with what is needed for strategic success, the culture has to be changed as rapidly as can be managed—this, of course, presumes that it is one or more aspects of the culture that are out of whack rather than the strategy. While correcting a strategy–culture conflict can occasionally mean revamping strategy to produce cultural fit, more usually it means revamping the mismatched cultural features to produce strategy fit. The more entrenched the mismatched aspects of the culture, the greater the difficulty of implementing new or different strategies until better strategy–culture alignment emerges. A sizable and prolonged strategy–culture conflict weakens and may even defeat managerial efforts to make the strategy work.

Strong versus Weak Cultures

Corporate cultures vary widely in the degree to which they are embedded in company practices and behavioral norms. Strongly embedded cultures go directly to a company's heart and soul; those with shallow roots provide little in the way of a definable corporate character.

Strong-Culture Companies A company's culture can be strong and cohesive in the sense that the company conducts its business according to a clear and explicit set of principles and values, has managers who devote considerable time to communicating these principles and values to organization members and explaining how they relate to its business environment, and has values shared by senior executives and rank-and-file employees alike.[8] Strong-culture companies have a well-defined corporate character, typically underpinned by a creed or values statement. Executives regularly stress the importance of using company values and business principles as the basis for decisions and actions taken throughout the organization. In strong-culture companies, values and behavioral norms are so deeply rooted that they don't change much when a new CEO takes over—although they can erode over time if the CEO ceases to nurture them. And they may not change much as strategy evolves and the organization acts to make strategy adjustments, either because the new strategies are compatible with the present culture or because the dominant traits of the culture are somewhat strategy-neutral and compatible with evolving versions of the company's strategy.

In a strong-culture company, values and behavioral norms are like crabgrass: deeply rooted and hard to weed out.

Three factors contribute to the development of strong cultures: (1) a founder or other strong leader who establishes values, principles, and practices that are consistent and sensible in light of customer needs, competitive conditions, and strategic requirements; (2) a sincere, long-standing company commitment to operating the business according to these established traditions, thereby creating an internal environment that supports decision making and strategies based on cultural norms; and (3) a genuine concern for the well-being of the organization's three biggest constituencies—customers, employees, and shareholders. Continuity of leadership, small group size, stable group membership, geographic concentration, and considerable organizational success all contribute to the emergence and sustainability of a strong culture.[9]

During the time a strong culture is being implanted, there's nearly always a good strategy–culture fit (which partially accounts for the organization's success). Mismatches between strategy and culture in a strong-culture company tend to occur when a company's business environment undergoes significant change, prompting a drastic strategy revision that clashes with the entrenched culture. A strategy–culture clash can also occur in a strong-culture company whose business has gradually eroded; when a new leader is brought in to revitalize the company's operations, he or she may push the company in a strategic direction that requires substantially different cultural and behavioral norms. In such cases, a major culture-changing effort has to be launched.

One of the best examples of an industry in which strategy changes have clashed with deeply implanted cultures is the electric utility industry. Most electric utility companies, long used to operating as slow-moving regulated monopolies with captive customers, are now confronting the emergence of a vigorously competitive market in wholesale power generation and growing freedom on the part of industrial, commercial, and residential customers to choose their own energy supplier (in much the same way as customers choose their long-distance telephone carriers—an industry that once was a heavily regulated market). These new market circumstances are prompting electric companies to shift away from

cultures predicated on risk avoidance, centralized control of decision making, and the politics of regulatory relationships toward cultures aimed at entrepreneurial risk taking, product innovation, competitive thinking, greater attention to customer service, cost reduction, and competitive pricing.

Weak-Culture Companies In direct contrast to strong-culture companies, weak-culture companies are fragmented in the sense that no one set of values is consistently preached or widely shared, few behavioral norms are evident in operating practices, and few traditions are widely revered or proudly nurtured by company personnel. Because top executives don't repeatedly espouse any particular business philosophy or exhibit long-standing commitment to particular values or extol particular operating practices and behavioral norms, organization members at weak-culture companies typically lack any deeply felt sense of corporate identity. While employees may have some bonds of identification with and loyalty toward their department, their colleagues, their union, or their boss, a weak company culture breeds no strong employee allegiance to what the company stands for or to operating the business in well-defined ways. Such lack of a definable corporate character results in many employees viewing their company as just a place to work and their job as just a way to make a living—there's neither passion about the company nor emotional commitment to what it is trying to accomplish. Very often, cultural weakness stems from moderately entrenched subcultures that block the emergence of a well-defined companywide work climate.

As a consequence, *weak cultures provide little or no strategy-implementing assistance* because there are no traditions, beliefs, values, common bonds, or behavioral norms that management can use as levers to mobilize commitment to executing the chosen strategy. While a weak culture does not usually pose a strong barrier to strategy execution, it also provides no support. Without a work climate that channels organizational energy in the direction of good strategy execution, managers are left with the options of either using compensation incentives and other motivational devices to mobilize employee commitment or trying to establish cultural roots that will in time start to nurture the strategy execution process.

Unhealthy Cultures

The distinctive characteristic of an unhealthy corporate culture is the presence of counterproductive cultural traits that adversely impact the work climate and company performance.[10] The following three traits are particularly unhealthy:

1. A highly politicized internal environment in which many issues get resolved and decisions made on the basis of which individuals or groups have the most political clout to carry the day.
2. Hostility to change and a general wariness of people who champion new ways of doing things.
3. A "not-invented-here" mind-set that makes company personnel averse to looking outside the company for best practices, new managerial approaches, and innovative ideas.

What makes a politicized internal environment so unhealthy is that political infighting consumes a great deal of organizational energy, often with the result that political maneuvering takes precedence over what's best for the company. In companies where internal politics pervades the work climate, empire-building managers jealously guard their decision-making prerogatives. They have their own agendas and operate the work units under their supervision as autonomous "fiefdoms," and the positions they take on

issues is usually aimed at protecting or expanding their turf. Collaboration with other organizational units is viewed with suspicion (What are "they" up to? How can "we" protect "our" flanks?), and cross-unit cooperation occurs grudgingly. When an important proposal comes up, advocates try to ram it through and opponents try to alter or defeat it. The support or opposition of politically influential executives and/or coalitions among departments with vested interests in a particular outcome typically weigh heavily in deciding what actions the company takes. All this maneuvering takes away from efforts to execute strategy with real proficiency and frustrates those who are less political and more inclined to do what is in the company's best interests.

In less-adaptive cultures where skepticism about the importance of new developments and resistance to change are the norm, managers prefer waiting until the fog of uncertainty clears before steering a new course. They believe in moving cautiously and conservatively, preferring to follow others rather than take decisive action to be in the forefront of change. Change-resistant cultures place a premium on not making mistakes, prompting managers to lean toward safe, don't-rock-the-boat options that will have only a ripple effect on the status quo, protect or advance their own careers, and guard the interests of their immediate work groups.

Change-resistant cultures encourage a number of undesirable or unhealthy behaviors—risk avoidance, timidity regarding emerging opportunities, and laxity in product innovation and continuous improvement. In change-resistant cultures, word quickly gets around that proposals to do things differently face an uphill battle and that people who champion them may be seen as either nuisances or troublemakers. Executives who don't value managers or employees with initiative and new ideas put a damper on product innovation, experimentation, and efforts to improve. At the same time, change-resistant companies have little appetite for being first-movers or fast-followers, believing that being in the forefront of change is too risky and that acting too quickly increases vulnerability to costly mistakes. They are more inclined to adopt a wait-and-see posture, carefully analyze several alternative responses, learn from the missteps of early movers, and then move forward cautiously and conservatively with initiatives that are deemed safe. Hostility to change is most often found in companies with multilayered management bureaucracies that have enjoyed considerable market success in years past and that are wedded to the "We have done it this way for years" syndrome.

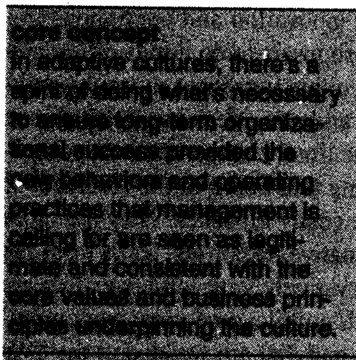
When such companies encounter business environments with accelerating change, going slow on altering traditional ways of doing things can be become a liability rather than an asset. General Motors, IBM, Sears, and Eastman Kodak are classic examples of companies whose change-resistant bureaucracies were slow to respond to fundamental changes in their markets; clinging to the cultures and traditions that made them successful, they were reluctant to alter operating practices and modify their business approaches. As strategies of gradual change won out over bold innovation and being an early mover, all four lost market share to rivals that quickly moved to institute changes more in tune with evolving market conditions and buyer preferences. These companies are now struggling to recoup lost ground with cultures and behaviors more suited to market success—the kinds of fit that caused them to succeed in the first place.

The third unhealthy cultural trait—the not-invented-here mind-set—tends to develop when a company reigns as an industry leader or enjoys great market success for so long that its personnel start to believe they have all the answers or can develop them on their own. Such confidence in the correctness of how it does things and in the company's skills and capabilities breeds arrogance—there's a strong tendency for company personnel to discount the merits or significance of what outsiders are doing and what

can be learned by studying best-in-class performers. Benchmarking and best-practices programs are seen as offering little payoff. Any market share gains on the part of up-and-coming rivals are regarded as temporary setbacks, soon to be reversed by the company's own forthcoming initiatives. Insular thinking, internally driven solutions, and a must-be-invented-here mindset come to permeate the corporate culture. An inwardly focused corporate culture gives rise to managerial inbreeding and a failure to recruit people who can offer fresh thinking and outside perspectives. The big risk of insular cultural thinking is that the company can underestimate the competencies and accomplishments of rival companies and overestimate its own progress—with a resulting loss of competitive advantage over time.

Unhealthy cultures typically impair company performance. Avon, BankAmerica, Citicorp, Coors, Ford, General Motors, Kmart, Kroger, Sears, and Xerox are examples of companies whose unhealthy cultures during the late 1970s and early 1980s contributed to ho-hum performance on the bottom line and in the marketplace.[11] General Motors, Kmart, and Sears are still struggling to uproot problematic cultural traits and replace them with behaviors having a more suitable strategy–culture fit.

Adaptive Cultures


core concept
In adaptive cultures, there's a spirit of doing what's necessary to ensure long-term organizational success provided the new behaviors and operating practices that management is calling for are seen as legitimate and consistent with the core values and business principles underpinning the culture.

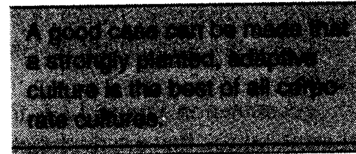
The hallmark of adaptive corporate cultures is willingness on the part of organizational members to accept change and take on the challenge of introducing and executing new strategies.[12] Company personnel share a feeling of confidence that the organization can deal with whatever threats and opportunities come down the pike; they are receptive to risk taking, experimentation, innovation, and changing strategies and practices. In direct contrast to change-resistant cultures, adaptive cultures are very supportive of managers and employees at all ranks who propose or help initiate useful change. Internal entrepreneurship is encouraged and rewarded. Senior executives seek out, support, and promote individuals who exercise initiative, spot opportunities for improvement, and display the skills to implement them. Managers habitually fund product development initiatives, evaluate new ideas openly, and take prudent risks to create new business positions. As a consequence, the company exhibits a proactive approach to identifying issues, evaluating the implications and options, and implementing workable solutions. Strategies and traditional operating practices are modified as needed to adjust to or take advantage of changes in the business environment.

But why is change so willingly embraced in an adaptive culture? Why are organization members not fearful of how change will affect them? Why does an adaptive culture not become unglued with ongoing changes in strategy, operating practices, and behavioral norms? The answers lie in two distinctive and dominant traits of an adaptive culture: (1) Any changes in operating practices and behaviors must *not* compromise core values and long-standing business principles, and (2) the changes that are instituted must satisfy the legitimate interests of stakeholders—customers, employees, shareowners, suppliers, and the communities where the company operates.[13] In other words, what sustains an adaptive culture is that organization members perceive the changes that management is trying to institute as legitimate and in keeping with the core values and business principles that form the heart and soul of the culture.

Thus, for an adaptive culture to remain intact over time, top management must orchestrate the responses in a manner that demonstrates genuine care for the well-being of all key constituencies and tries to satisfy all their legitimate interests simultaneously. Unless fairness to all constituencies is a

decision-making principle and a commitment to doing the right thing is evident to organization members, the changes are not likely to be readily accepted and implemented.[14] Making changes that will please customers and/or protect, if not enhance, the company's long-term well-being is generally seen as legitimate and is often seen as the best way of looking out for the interests of employees, stockholders, suppliers, and communities where the company operates. At companies with adaptive cultures, management concern for the well-being of employees is nearly always a big factor in gaining employee support for change—company personnel are usually receptive to change as long as employees understand that changes in their job assignments are part of the process of adapting to new conditions and that their employment security will not be threatened unless the company's business unexpectedly reverses direction. In cases where workforce downsizing becomes necessary, management concern for employees dictates that separation be handled humanely, making employee departure as painless as possible. Management efforts to make adaptation fair and equitable for customers, employees, stockholders, suppliers, and communities where the company operates, keeping adverse impacts to a minimum insofar as possible, breeds acceptance of and support for change among all organization stakeholders.

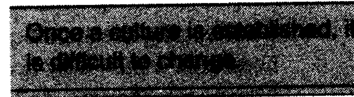
Technology, software, and dot-com companies offer good illustrations of organizations with adaptive cultures. Such companies thrive on change—driving it, leading it, and capitalizing on it (but sometimes also succumbing to change when they make the wrong move or are swamped by better technologies or the superior business models of rivals). Companies like Microsoft, Intel, Nokia, Amazon.com, and Dell Computer cultivate the capability to act and react rapidly. They are avid practitioners of entrepreneurship and innovation, with a demonstrated willingness to take bold risks to create altogether new products, new businesses, and new industries. To create and nurture a culture that can adapt rapidly to changing business conditions, they make a point of staffing their organizations with people who are proactive, who rise to the challenge of change, and who have an aptitude for adapting.



In fast-changing business environments, a corporate culture that is receptive to altering organizational practices and behaviors is a virtual necessity. However, adaptive cultures work to the advantage of all companies, not just those in rapid-change environments. Every company operates in a market and business climate that is changing to one degree or another and that, in turn, requires internal operating responses and new behaviors on the part of organization members. As a company's strategy evolves, an adaptive culture is a definite ally in the strategy-implementing, strategy-executing process as compared to cultures that have to be coaxed and cajoled to change. This constitutes a good argument for why managers should strive to build a strong, adaptive corporate culture.

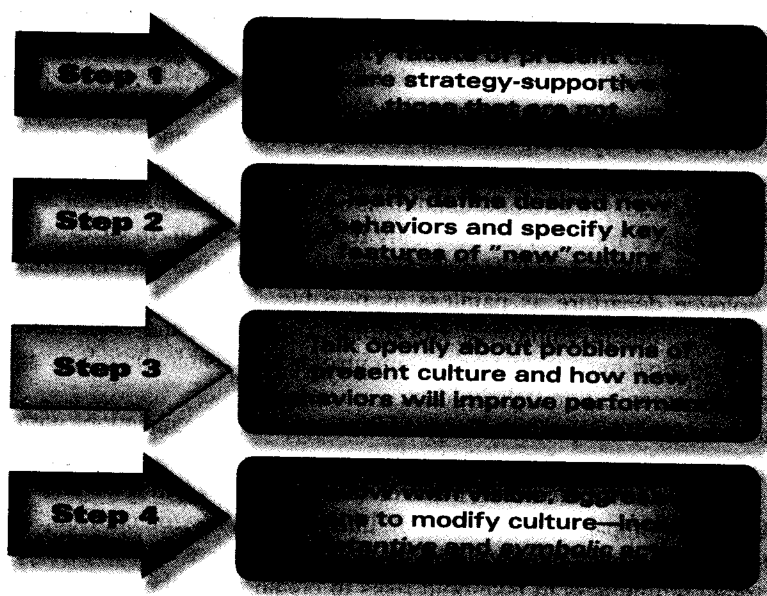
Creating a Strong Fit between Strategy and Culture

It is the *strategy maker's* responsibility to select a strategy compatible with the sacred or unchangeable parts of the organization's prevailing corporate culture. It is the *strategy implementer's* task, once strategy is chosen, to change whatever facets of the corporate culture hinder effective execution.



Changing a Problem Culture Changing a company's culture to align it with strategy is among the toughest management tasks because of the heavy anchor of deeply held values and habits—people cling emotionally to the old and familiar. It takes concerted management action over a period of time to replace an unhealthy culture with

figure 13.1 **Changing a Problem Culture**



a healthy culture or to root out certain unwanted behaviors and instill ones that are more strategy-supportive. *The single most visible factor that distinguishes successful culture-change efforts from failed attempts is competent leadership at the top.* Great power is needed to force major cultural change—to overcome the springback resistance of entrenched cultures—and great power normally resides only at the top.

As shown in Figure 13.1, the first step in fixing a problem culture is to identify those facets of the present culture that are dysfunctional and explain why they pose obstacles to executing new strategic initiatives and achieving company performance targets. Second, managers have to clearly define the desired new behaviors and specify the key features of the culture they want to create. Third, managers have to talk openly and forthrightly to all concerned about problematic aspects of the culture and why and how new behaviors will improve company performance—the case for cultural change has to be persuasive and the benefits of a reformed culture made convincing to all concerned. Finally, and most important, the talk has to be followed swiftly by visible, aggressive actions to promote the desired new behaviors—actions that everyone will understand are intended to produce behaviors and practices conducive to good strategy execution.

The menu of actions management can take to change a problem culture includes the following:[15]

1. Making a compelling case for why the company's new direction and a different cultural atmosphere are in the organization's best interests and why individuals and groups should commit themselves to making it happen despite the obstacles. Skeptics have to be convinced that all is not well with the status quo. This can be done by:
   - Challenging the status quo with very basic questions: Are we giving customers what they really need and want? Why aren't we taking more business away from rivals? Why do our rivals have lower costs than we do? How can we drive costs out of the business and be more competitive on price? Why can't design-to-market cycle time be halved? Why aren't we moving faster to make

better use of the Internet and e-commerce technologies and practices? How can we grow company revenues at 15 percent instead of 10 percent? What can we do to speed up our decision making and shorten response times?

- Creating events where everyone in management is forced to listen to angry customers, dissatisfied strategic allies, alienated employees, or disenchanted stockholders.

2. Repeating at every opportunity the messages of why cultural change is good for company stakeholders (particularly customers, employees, and shareholders). Effective culture-change leaders are good at telling stories to convey new values and connect the case for change to organization members.
3. Visibly praising and generously rewarding people who display newly advocated cultural norms and who participate in implementing the desired kinds of operating practices.
4. Altering incentive compensation to reward the desired cultural behavior and deny rewards to those who resist change.
5. Recruiting and hiring new managers and employees who have the desired cultural values and can serve as role models for the desired cultural behavior.
6. Replacing key executives who are strongly associated with the old culture.
7. Revising policies and procedures in ways that will help drive cultural change.

Only with bold leadership and concerted action on many fronts can a company succeed in tackling so large and difficult a task as major cultural change. When only strategic fine-tuning is being implemented, it takes less time and effort to bring values and culture into alignment with strategy, but there is still a lead role for the manager to play in communicating the need for new cultural behaviors and personally launching actions to prod the culture into better alignment with strategy.

Symbolic Culture-Changing Actions Managerial actions to tighten the strategy–culture fit need to be both symbolic and substantive. Symbolic actions are valuable for the signals they send about the kinds of behavior and performance strategy implementers wish to encourage. The most important symbolic actions are those that top executives take to *lead by example.* For instance, if the organization's strategy involves a drive to become the industry's low-cost producer, senior managers must display frugality in their own actions and decisions: inexpensive decorations in the executive suite, conservative expense accounts and entertainment allowances, a lean staff in the corporate office, scrutiny of budget requests, few executive perks, and so on. If the culture change imperative is to be more responsive to customers' needs and to pleasing customers, the CEO can instill greater customer awareness by requiring all officers and executives to spend a significant portion of each week talking with customers about their needs.

Another category of symbolic actions includes the ceremonial events organizations hold to designate and honor people whose actions and performance exemplify what is called for in the new culture. Many universities give outstanding teacher awards each year to symbolize their commitment to good teaching and their esteem for instructors who display exceptional classroom talents. Numerous businesses have employee-of-the-month awards. The military has a long-standing custom of awarding ribbons and medals for exemplary actions. Mary Kay Cosmetics awards an array of prizes—from ribbons to pink automobiles—to its beauty consultants for reaching various sales plateaus.

The best companies and the best executives expertly use symbols, role models, ceremonial occasions, and group gatherings to tighten the strategy–culture fit. Low-cost leaders like Wal-Mart and Nucor are renowned for their spartan facilities, executive frugality, intolerance of waste, and zealous control of costs. Nucor executives make a point of flying coach class and using taxis at airports rather than limousines. Executives sensitive to their role in promoting strategy–culture fits make a habit of appearing at ceremonial functions to praise individuals and groups that get with the program. They honor individuals who exhibit cultural norms and reward those who achieve strategic milestones. They participate in employee training programs to stress strategic priorities, values, ethical principles, and cultural norms. Every group gathering is seen as an opportunity to repeat and ingrain values, praise good deeds, reinforce cultural norms, and promote changes that assist strategy execution. Sensitive executives make sure that current decisions and policy changes will be construed by organizational members as consistent with cultural values and supportive of the company's new strategic direction.[16]

Substantive Culture-Changing Actions While symbolically leading the push for new behaviors and communicating the reasons for new approaches is crucial, strategy implementers have to convince all those concerned that the culture-changing effort is more than cosmetic. Talk and symbolism have to be complemented by substantive actions and real movement. The actions taken have to be credible, highly visible, and unmistakably indicative of the seriousness of management's commitment to new strategic initiatives and the associated cultural changes. There are several ways to make substantive changes. One is to engineer some quick successes that highlight the benefits of the proposed changes, thus making enthusiasm for them contagious. However, instant results are usually not as important as having the will and patience to create a solid, competent team psychologically committed to pursuing the strategy in a superior fashion. The strongest signs that management is truly committed to creating a new culture include replacing old-culture traditionalist managers with new-breed managers, changing dysfunctional policies and operating practices, instituting new compensation incentives visibly tied to the achievement of freshly set performance targets, and making major budgetary reallocations that shift substantial resources from old-strategy projects and programs to new-strategy projects and programs.

Implanting the needed culture-building values and behavior depends on a sincere, sustained commitment by the chief executive coupled with extraordinary persistence in reinforcing the culture at every opportunity through both word and deed. Neither charisma nor personal magnetism is essential. However, personally talking to many departmental groups about the reasons for change *is* essential; organizational changes are seldom accomplished successfully from an office. Moreover, creating and sustaining a strategy-supportive culture is a job for the whole management team. Major cultural change requires many initiatives from many people. Senior officers, department heads, and middle managers have to reiterate valued behaviors and translate the organization's core values and business principles into everyday practice. In addition, strategy implementers must enlist the support of frontline supervisors and employee opinion leaders, convincing them of the merits of practicing and enforcing cultural norms at the lowest levels in the organization. Until a big majority of employees join the new culture and share an emotional commitment to its basic values and behavioral norms, there's considerably more work to be done in both instilling the culture and tightening the strategy–culture fit.

Changing culture to support strategy is not a short-term exercise. It takes time for a new culture to emerge and prevail. Overnight transformations simply don't occur. The bigger the organization and the greater the cultural shift needed to produce a strategy–culture fit, the longer it takes. In large companies, fixing a problem culture and instilling a new set of attitudes and behaviors can take two to five years. In fact, it is usually tougher to reform an entrenched problematic culture than it is to instill a strategy-supportive culture from scratch in a brand-new organization. Sometimes executives succeed in changing the values and behaviors of small groups of managers and even whole departments or divisions, only to find the changes eroded over time by the actions of the rest of the organization—what is communicated, praised, supported, and penalized by an entrenched majority undermines the new emergent culture and halts its progress. Executives, despite a series of well-intended actions to reform a problem culture, are likely to fail at weeding out embedded cultural traits when widespread employee skepticism about the company's new directions and culture-change effort spawns covert resistance to the cultural behaviors and operating practices advocated by top management. This is why management must take every opportunity to convince employees of the need for culture change and communicate to them how new attitudes, behaviors, and operating practices will benefit the interests of organizational stakeholders.

A company that has done a good job of fixing its problem culture is Alberto-Culver—see Illustration Capsule 13.2.

Grounding the Culture in Core Values and Ethics

A corporate culture grounded in socially approved values and ethical business principles is a vital ingredient in a company's long-term strategic success.[17] Unless a company's executives genuinely care about how the company's business affairs are conducted, the company's reputation and ultimately its performance are put at risk. The recent wave of corporate scandals vividly demonstrates the damage that occurs when the public spotlight is trained on a company's shady business practices and the unethical behavior of certain company personnel. Codes of ethics are not prevalent in large corporations around the world.[18] In the United States, over 90 percent of large companies have a code of ethics, and in Canada the number runs close to 85 percent; over 50 percent of British and German companies have a code, while in France the number is close to 30 percent. Substantial numbers of large companies also have corporate values statements.

While there's no doubt that some companies and some company personnel knowingly engage in unsavory business practices and have little regard for ethical standards, one must be cautious about concluding that a company's core values and ethical standards are just a bunch of high-sounding platitudes that serve only cosmetic purposes. Executives at many companies genuinely care about the values and ethical standards that company personnel exhibit in conducting the company's business; they are aware that their own reputations, as well as the company's reputation, hangs on whether outsiders see the company's actions as ethical or honest or socially acceptable. At such companies, values statements and codes of ethics matter, and they are ingrained to one degree or another in the company's culture—see Table 13.1 for the kinds of topics that are commonly found in values statements and codes of ethics.

Indeed, at companies where executives are truly committed to practicing the values and ethical standards that have been espoused, *the stated core values and ethical principles are the cornerstones of the*

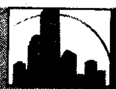


illustration capsule 13.2

The Culture-Change Effort at Alberto-Culver's North American Division

In 1993, Carol Bernick—vice chairperson of Alberto-Culver, president of its North American division, and daughter of the company's founders—concluded that her division's existing culture had four problems: Employees dutifully waited for marching orders from their bosses, workers put pleasing their bosses ahead of pleasing customers, some company policies were not family-friendly, and there was too much bureaucracy and paperwork. What was needed, in Bernick's opinion, was a culture in which company employees welcomed innovation, took risks, and had a sense of ownership and an urgency to get things done.

To change the culture, Alberto-Culver's management undertook a series of actions:

- In 1993, a new position called growth development leader (GDL) was created to help orchestrate the task of fixing the culture deep in the ranks (there were 70 GDLs in Alberto-Culver's North American division). GDLs came from all ranks of the company's managerial ladder and were handpicked for such qualities as empathy, communication skills, positive attitude, and ability to let their hair down and have fun. GDLs performed their regular jobs in addition to taking on the GDL roles; it was considered an honor to be chosen. Each GDL mentored about 12 people from both a career and a family standpoint. GDLs met with senior executives weekly, bringing forward people's questions and issues and then, afterward, sharing with their groups the topics and solutions that were discussed. GDLs brought a group member as a guest to each meeting. One meeting each year is devoted to identifying "macros and irritations"—attendees are divided into four subgroups and given 15 minutes to identify the company's four biggest challenges (the macros) and the four most annoying aspects of life at the company (the irritations); the whole group votes on which four deserve the company's attention. Those selected are then addressed, and assignments made for follow-up and results.
- Changing the culture was made an issue across the company, starting in 1995 with a two-hour State of the Company presentation to employees covering where the company was and where it wanted to be. The State of the Company address was made an annual event.
- Management created ways to measure the gains in changing the culture. One involved an annual all-employee survey to assess progress against cultural goals and to get 360-degree feedback—the 2000 survey had 180 questions, including 33 relating to the performance of each respondent's GDL. A bonfire celebration was held in the company parking lot to announce that paperwork would be cut 30 percent.
- A list of 10 cultural imperatives was formalized in 1998—honesty, ownership, trust, customer orientation, commitment, fun, innovation, risk taking, speed and urgency, and teamwork. These imperatives came to be known internally as HOT CC FIRST.
- Extensive celebrations and awards programs were instituted. Most celebrations are scheduled, but some are spontaneous (an impromptu thank-you party for a good fiscal year). Business Builder Awards (initiated in 1997) are given to individuals and teams that make a significant impact on the company's growth and profitability. The best-scoring GDLs on the annual employee surveys are awarded shares of company stock. The company notes all work anniversaries and personal milestones with "Alberto-appropriate" gifts; appreciative company employees sometimes give thank-you gifts to their GDLs. According to Carol Bernick, "If you want something to grow, pour champagne on it. We've made a huge effort—maybe even an over-the-top effort—to celebrate our successes and, indeed, just about everything we'd like to see happen again."

The culture change effort at Alberto-Culver North America was viewed as a major contributor to improved performance. From 1993, when the effort first began, to 2001, the division's sales increased from just under $350 million to over $600 million and pretax profits rose from $20 million to almost $50 million.

Source: Reprinted by permission of *Harvard Business Review.* From "When Your Culture Needs a Makeover," by Carol Lavin Bernick, issue 79, no. 6, June 2001, p. 61. Copyright © 2001 by the Harvard Business School Publishing Corporation; all rights reserved.

table 13.1 The Content of Company Values Statements and Codes of Ethics

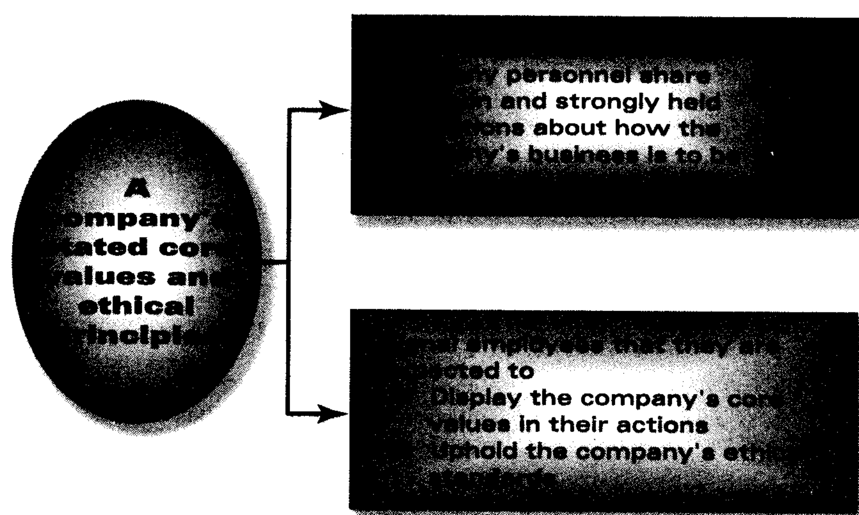
Topics Commonly Appearing in Values Statements	Topics Commonly Appearing in Codes of Ethics
• Commitment to such outcomes as customer satisfaction and customer service, quality, product innovation, and/or technological leadership • Commitment to achievement, excellence, and results • Importance of demonstrating such qualities as honesty, integrity, trust, fairness, quality of life, pride of workmanship, and ethics • Importance of creativity, taking initiative, and accepting responsibility • Importance of teamwork and a cooperative attitude • Importance of Golden Rule behavior and respect for coworkers • Making the company a great place to work • Importance of having fun and creating a fun work environment • Duty to stakeholders—customers, employees, suppliers, shareholders, communities where the company operates, and society at large • Commitment to exercising social responsibility and being a good community citizen • Commitment to protecting the environment • Commitment to workforce diversity	• Mandates that company personnel will display honesty and integrity in their actions • An expectation that all company personnel will comply fully with all laws and regulations, specifically: —Antitrust laws prohibiting anticompetitive practices, conspiracies to fix prices, or attempts to monopolize —The Foreign Corrupt Practices Act —Securities laws and prohibitions against insider trading —Environmental and workplace safety regulations —Discrimination and sexual harassment regulations • Prohibitions against giving or accepting bribes, kickbacks, or gifts • Avoiding conflicts of interest • Fairness in selling and marketing practices • Supplier relationships and procurement practices • Acquiring and using competitively sensitive information about rivals and others • Political contributions, activities, and lobbying • Avoiding use of company assets, resources, and property for personal or other inappropriate purposes • Responsibility to protect proprietary information and not divulge trade secrets

A company's values statement and code of ethics communicate expectations of how employees should conduct themselves in the workplace.

corporate culture. As depicted in Figure 13.2, a company that works hard at putting its stated core values and ethical principles into practice fosters a work climate where company personnel share common convictions about how the company's business is to be conducted and where they are expected to act in accord with stated values and ethical standards. By promoting behaviors that mirror the values and ethics standards, a company's stated values and ethical standards nurture the corporate culture in three highly positive ways: (1) they communicate the company's good intentions and validate the integrity and aboveboard character of its business principles and operating methods, (2) they steer company personnel toward doing the right thing, and (3) they establish a "corporate conscience" and provide yardsticks for gauging the appropriateness of particular actions, decisions, and policies (see Figure 13.3).[19]

Companies ingrain their values and ethical standards in a number of different ways.[20] Tradition-steeped companies with a rich folklore rely heavily on word-of-mouth indoctrination and the power of tradition to instill values and enforce ethical conduct. But many companies today convey their values and codes of ethics to stakeholders and interested parties in their annual reports, on their Web sites, and in internal

figure 13.2 **The Two Culture-Building Roles of a Company's Core Values and Ethical Standards**



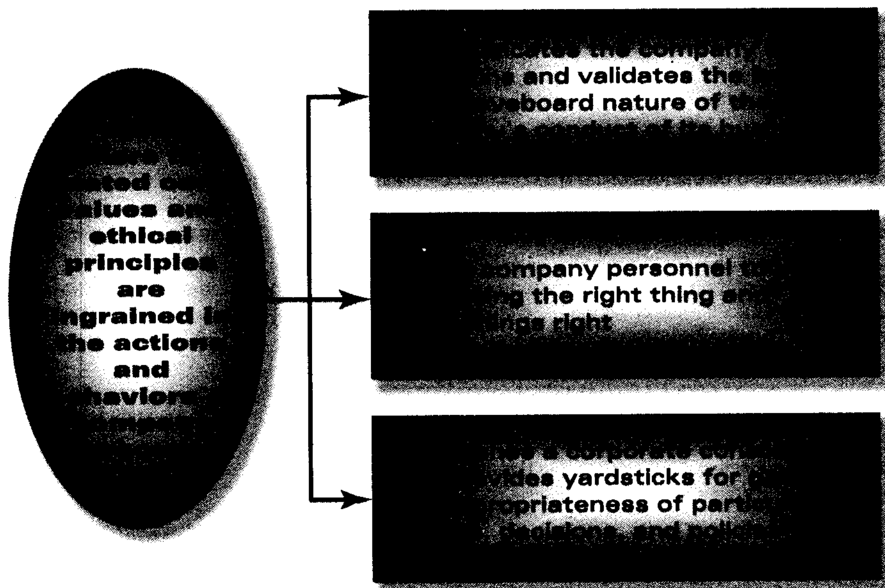
communications to all employees. The standards are hammered in at orientation courses for new employees and in training courses for managers and employees. The trend of making stakeholders aware of a company's commitment to core values and ethical business conduct is attributable to three factors: (1) greater management understanding of the role these statements play in culture building, (2) a renewed focus on ethical standards stemming from the corporate scandals that came to light in 2001–2002, and (3) the growing numbers of consumers who prefer to patronize ethical companies with ethical products.

However, there is a considerable difference between saying the right things (having a well-articulated corporate values statement or code of ethics) and truly managing a company in an ethical and socially responsible way. Companies that are truly committed to the stated core values and to high ethical standards make ethical behavior *a fundamental component of their corporate culture.* They put a stake in the ground, making it unequivocally clear that company personnel are expected to live up to the company's values and ethical standards—how well individuals display core values and adhere to ethical standards is often part of their job performance evaluations. Peer pressures to conform to cultural norms are quite strong, acting as an important deterrent to outside-the-lines behavior. Moreover, values statements and codes of ethical conduct are used as benchmarks for judging the appropriateness of company policies and operating practices.

At Darden Restaurants—a $4.5 billion casual dining company with over 1,200 company-owned Red Lobster, Olive Garden, Bahama Breeze, and Smokey Bones BBQ Sports Bar restaurants—the core values are operating with integrity, treating people fairly, and welcoming and celebrating workforce diversity; the company's practice of these values has been instrumental in creating a culture characterized by trust, exciting jobs and career opportunities for employees, and a passion to be the best in casual dining.[21]

Once values and ethical standards have been formally adopted, they must be institutionalized in the company's policies and practices and ingrained in the conduct of company personnel.[22] Imbedding the values and code of ethics entails several actions:

figure 13.3 **How a Company's Core Values and Ethical Principles Positively Impact the Corporate Culture**



- Incorporation of the statement of values and the code of ethics into employee training and educational programs.
- Explicit attention to values and ethics in recruiting and hiring to screen out applicants who do not exhibit compatible character traits.
- Frequent reiteration of company values and ethical principles at company events and internal communications to employees.
- Active management involvement, from the CEO down to frontline supervisors, in stressing the importance of values and ethical conduct and in overseeing the compliance process.
- Ceremonies and awards for individuals and groups who display the values.
- Instituting ethics enforcement procedures.

In the case of codes of ethics, special attention must be given to sections of the company that are particularly vulnerable—procurement, sales, and political lobbying. Employees who deal with external parties are in ethically sensitive positions and often are drawn into compromising situations. Company personnel assigned to subsidiaries in foreign countries can find themselves trapped in ethical dilemmas if bribery and corruption of public officials are common practices or if suppliers or customers are accustomed to kickbacks of one kind or another. Mandatory ethics training for such personnel is usually desirable.

As a test of your ethics, take the quiz on page 388.

Structuring the Ethics Compliance and Enforcement Process If a company's executives truly aspire for company personnel to behave ethically, then procedures for enforcing ethical standards and handling potential violations have to be developed. Even in an ethically strong company, there

A Test of Your Business Ethics

As a gauge of your own ethical and moral standards, take the following quiz and see how you stack up against other members of your class. For the test to be valid, you need to answer the questions candidly and not on the basis of what you think the right answer is. When you finish the test, you should compare your answers to how your future employer would likely want you to answer each of these questions. Which are likely to be considered vital?

1. Is it unethical to make up data to justify the introduction of a new product if, when you start to object, your boss tells you, "Just do it"?
   ____Yes ____No ____Unsure (it depends) ____Need more information
2. Do you think that it is acceptable to give your boss a $100 gift to celebrate a birthday or holiday?
   ____Yes ____No ____Unsure (it depends) ____Need more information
3. Would it be wrong to accept a $100 gift from your boss (who is of the opposite sex) to celebrate your birthday?
   ____Yes ____No ____Unsure (it depends) ____Need more information
4. Is it unethical to accept an invitation from a supplier to spend a holiday weekend skiing at the supplier company's resort home in Colorado? (Would your answer be different if you were presently considering a proposal from that supplier to purchase $1 million worth of components?)
   ____Yes ____No ____Unsure (it depends) ____Need more information
5. Is it unethical to give a customer company's purchasing manager free tickets to the Super Bowl if he or she is looking for tickets and is likely to make a large purchase from your company?
   ____Yes ____No ____Unsure (it depends) ____Need more information
6. Is it unethical to use sick days provided in your company benefits plan as personal days so that you can go attend a family event or leave early for a weekend vacation?
   ____Yes ____No ____Unsure (it depends) ____Need more information
7. Would it be wrong to keep quiet if you, as a junior financial analyst, had just calculated that the projected return on a possible project was 18 percent and your boss (*a*) informed you that no project could be approved without the prospect of a 25 percent return and (*b*) told you to go back and redo the numbers and "get them right"?
   ____Yes ____No ____Unsure (it depends) ____Need more information
8. Would it be unethical to allow your supervisor to believe that you were chiefly responsible for the success of a new company initiative if it actually resulted from a team effort or major contributions by a coworker?
   ____Yes ____No ____Unsure (it depends) ____Need more information
9. Is it unethical to fail to come forward to support an employee wrongfully accused of misconduct if that person is a source of aggravation for you at work?
   ____Yes ____No ____Unsure (it depends) ____Need more information
10. Is it wrong to use your employer's staff to prepare invitations for a party that you will give when clients or customers are among those invited?
    ____Yes ____No ____Unsure (it depends) ____Need more information
11. Is it wrong to browse the Internet while at work if all your work is done and there is otherwise nothing you ought to be doing? (Would your answer be the same if you were downloading music files using file-sharing software from Kazaa? What if the Web sites you visited were pornographic?)
    ____Yes ____No ____Unsure (it depends) ____Need more information
12. Is it unethical to keep quiet if you are aware that a coworker is being sexually harassed by his or her boss?
    ____Yes ____No ____Unsure (it depends) ____Need more information
13. Is there an ethical problem with using your employer's copier to make a small number of copies for personal use (for example, your tax returns, your child's school project, or personal correspondence)?
    ____Yes ____No ____Unsure (it depends) ____Need more information
14. Is it unethical to install company-owned software on your home computer without the permission of your supervisor and the software vendor?
    ____Yes ____No ____Unsure (it depends) ____Need more information
15. Is it unethical to okay the shipment of products to a customer that do not meet the customer's specifications without first checking with the customer?
    ____Yes ____No ____Unsure (it depends) ____Need more information

Answers: We think a strong case can be made that the answers to questions 1, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, and 15 are yes and that the answer to question 2 is no. Most employers would consider the answers to questions 10 and 13 to be yes unless company policy allows personal use of company resources under certain specified conditions.

can be bad apples—and some of the bad apples may even rise to the executive ranks. So it is rarely enough to rely on an ethically strong culture to produce ethics compliance.

The compliance effort must permeate the company, extending to every organizational unit. The attitudes, character, and work history of prospective employees must be scrutinized. Company personnel have to be educated about what is ethical and what is not; this means establishing ethics training programs and discussing what to do in gray areas. Everyone must be encouraged to raise issues with ethical dimensions, and such discussions should be treated as a legitimate topic. Line managers at all levels must give serious and continuous attention to the task of explaining how the values and ethical code apply in their areas. In addition, they must insist that company values and ethical standards become a way of life. In general, instilling values and insisting on ethical conduct must be looked on as a continuous culture-building, culture-nurturing exercise. Whether the effort succeeds or fails depends largely on how well corporate values and ethical standards are visibly integrated into company policies, managerial practices, and actions at all levels.

A company's formal ethics compliance and enforcement mechanisms can entail such actions as forming an ethics committee to give guidance on ethics matters, appointing an ethics officer to head the compliance effort, establishing an ethics hotline or Web site that employees can use to either anonymously report a possible violation or get confidential advice on a troubling ethics-related situation, and having an annual ethics audit to measure the extent of ethical behavior and identify problem areas. Increasing numbers of companies, wary of the damage to their reputations from public exposure of unethical behavior by company personnel, have begun openly encouraging employees to blow the whistle on possible ethical violations via toll-free hotlines, e-mail, and special Web sites. If a company is really serious about enforcing ethical behavior, it probably needs to do four things:

1. Have mandatory ethics training programs for employees.
2. Conduct an annual audit of each manager's efforts to uphold ethical standards and require formal reports on the actions taken by managers to remedy deficient conduct.
3. Require all employees to sign a statement annually certifying that they have complied with the company's code of ethics.
4. Openly encourage company personnel to report possible infractions via anonymous calls to a hotline or posting to a special company Web site.

While these actions may seem extreme or objectionable, they leave little room to doubt the seriousness of a company's commitment to ethics compliance. And most company personnel will think twice about knowingly engaging in unethical conduct when they know their actions will be audited and/or when they have to sign statements certifying compliance with the company's code of ethics. Ideally, the company's commitment to its stated values and ethical principles will instill not only a corporate conscience but also a conscience on the part of company personnel that prompts them to report possible ethical violations. While ethically conscious companies have provisions for disciplining violators, *the main purpose of the various means of enforcement is to encourage compliance rather than administer punishment.* Thus, the reason for openly encouraging people to report possible ethical violations is not so much to get someone in trouble as to *prevent further damage* and heighten awareness of operating within ethical bounds.

As was discussed in Chapter 10, transnational companies face a host of challenges in enforcing a common set of ethical standards when what is considered ethical varies either substantially or subtly from

country to country. While there are a number of mostly universal and cross-cultural ethical standards—as concerns honesty, trustworthiness, fairness, avoiding unnecessary harm to individuals, and respecting the environment, there are shades and variations in what societies generally agree to be "right" and "wrong" based on the prevailing circumstances, local customs, and predominant religious convictions. And certainly there are cross-country variations in the *degree* or *severity* to which certain behaviors are considered unethical.[23] Thus transnational companies have to make a fundamental decision whether to try to enforce common ethical standards and interpretation of what is ethically right and wrong across their operations in all countries or whether to permit selected "rules bending" on a case-by-case basis.

Establishing a Strategy-Culture Fit in Multinational and Global Companies

In multinational and global companies, where some cross-border diversity in the corporate culture is normal, efforts to establish a tight strategy–culture fit is complicated by the diversity of societal customs and lifestyles from country to country. Company personnel in different countries sometimes fervently insist on being treated as distinctive individuals or groups, making a one-size-fits-all culture potentially inappropriate. Leading cross-border culture-change initiatives requires sensitivity to prevailing cultural differences; managers must discern when diversity has to be accommodated and when cross-border differences can be and should be narrowed.[24] Cross-country cultural diversity in a multinational enterprise is more tolerable if the company is pursuing a multicountry strategy and if the company's culture in each country is well aligned with its strategy in that country. But significant cross-country differences in a company's culture are likely to impede execution of a global strategy and have to be addressed.

As discussed earlier in this chapter, the trick to establishing a workable strategy– culture fit in multinational and global companies is to ground the culture in strategy-supportive values and operating practices that travel well across country borders and strike a chord with managers and workers in many different areas of the world, despite the diversity of local customs and traditions. A multinational enterprise with a misfit between its strategy and culture in certain countries where it operates can attack the problem by reinterpreting, de-emphasizing, or even abandoning those values and cultural traits which it finds inappropriate for some countries where it operates. Problematic values and operating principles can be replaced with values and operating approaches that travel well across country borders but that are still strategy supportive. Many times a company's values statement only has to be reworded so as to express existing values in ways that have more universal appeal. Sometimes certain offending operating practices can be modified to good advantage in all locations where the company operates.

Aside from trying to ground the culture in a set of core values and operating principles that have universal appeal, management can seek to minimize the existence of subcultures and cross-country cultural diversity by:

- Instituting training programs to communicate the meaning of core values and explain the case for common operating principles and practices.
- Drawing on the full range of motivational and compensation incentives to induce personnel to adopt and practice the desired behaviors.
- Allowing some leeway for certain core values and principles to be interpreted and applied somewhat differently, if necessary, to accommodate local customs and traditions.

Generally, a high degree of cross-country homogeneity in a company's culture is desirable and has to be pursued. Having too much variation in the corporate culture from country to country not only makes it difficult to use the culture in helping drive the strategy execution process but also works against the establishment of a one-company mind-set and a consistent corporate identity.

LEADING THE STRATEGY EXECUTION PROCESS

The litany of managing the strategy process is simple enough: Craft a sound strategic plan, implement it, execute it to the fullest, adjust it as needed, and win! But the leadership challenges are significant and diverse. Exerting take-charge leadership, being a "spark plug," ramrodding things through, and achieving results thrusts a manager into a variety of leadership roles in managing the strategy execution process: resource acquirer and allocator, capabilities builder, motivator, policymaker, policy enforcer, head cheerleader, crisis solver, decision maker, and taskmaster, to mention a few. There are times when leading the strategy execution process entails being authoritarian and hardnosed, times when it is best to be a perceptive listener and a compromising decision maker, times when matters are best delegated to people closest to the scene of the action, and times when being a coach is the proper role. Many occasions call for the manager in charge to assume a highly visible role and put in long hours guiding the process, while others entail only a brief ceremonial performance with the details delegated to subordinates.

For the most part, leading the strategy execution process has to be top-down and driven by mandates to get things done and show good results. Just how to go about the specifics of leading organization efforts to put a strategy in place and deliver the intended results has to start with understanding the requirements for good strategy execution, followed by a diagnosis of the organization's capabilities and preparedness to execute the necessary strategic initiatives, and then decisions as to which of several ways to proceed to get things done and achieve the targeted results.[25] In general, leading the drive for good strategy execution and operating excellence calls for several actions on the part of the manager-in-charge:

1. Staying on top of what is happening, closely monitoring progress, ferreting out issues, and learning what obstacles lie in the path of good execution.
2. Putting constructive pressure on the organization to achieve good results.
3. Keeping the organization focused on operating excellence.
4. Leading the development of stronger core competencies and competitive capabilities.
5. Displaying ethical integrity and leading social responsibility initiatives.
6. Pushing corrective actions to improve strategy execution and achieve the targeted results.

Staying on Top of How Well Things Are Going

To stay on top of how well the strategy execution process is going, a manager needs to develop a broad network of contacts and sources of information, both formal and informal. The regular channels include talking with key subordinates, attending presentations and meetings, reading reviews of the latest operating results, talking to customers, watching the competitive reactions of rival firms, exchanging e-mail and holding telephone conversations with people in outlying locations, making onsite visits, and

listening to rank-and-file employees. However, some information is more trustworthy than the rest, and the views and perspectives offered by different people can vary widely. Presentations and briefings by subordinates may not represent the whole truth. Bad news or problems may be minimized or in some cases not reported at all as subordinates delay conveying failures and problems in hopes that they can turn things around in time. Hence, managers have to make sure that they have accurate information and a feel for the existing situation. They have to confirm whether things are on track, identify problems, learn what obstacles lie in the path of good strategy execution and develop a basis for determining what, if anything, they can personally do to move the process along.

core concept
Management by walking around (MBWA) **is one of the techniques that effective leaders use to stay informed about how well the strategy execution process is progressing.**

One of the best ways for executives in charge of strategy execution to stay on top of things is by making regular visits to the field and talking with many different people at many different levels—a technique often labeled **managing by walking around (MBWA).** Wal-Mart executives have had a long-standing practice of spending two to three days every week visiting Wal-Mart's stores and talking with store managers and employees. Sam Walton, Wal-Mart's founder, insisted, "The key is to get out into the store and listen to what the associates have to say." Jack Welch, the highly effective CEO of General Electric (GE) from 1980 to 2001, not only spent several days each month personally visiting GE operations and talking with major customers but also arranged his schedule so that he could spend time exchanging information and ideas with GE managers from all over the world who were attending classes at the company's leadership development center near GE's headquarters. Some companies have weekly get-togethers in each division (often on Friday afternoons), attended by both executives and employees, to create a regular opportunity for tidbits of information to flow freely between down-the-line employees and executives. Many manufacturing executives make a point of strolling the factory floor to talk with workers and meeting regularly with union officials. Some managers operate out of open cubicles in big spaces populated with open cubicles for other personnel so that they can interact easily and frequently with coworkers. Jeff Bezos, Amazon.com's CEO, is noted for his practice of MBWA, firing off a battery of questions when he tours facilities and insisting that Amazon managers spend time in the trenches with their people to avoid abstract thinking and getting disconnected from the reality of what's happening.[26]

Most managers rightly attach great importance to spending time with people at various company facilities and gathering information and opinions firsthand from diverse sources about how well various aspects of the strategy execution process are going. Such contacts give managers a feel for what progress is being made, what problems are being encountered, and whether additional resources or different approaches may be needed. Just as important, MBWA provides opportunities for managers to talk informally to many different people at different organizational levels, give encouragement, lift spirits, shift attention from the old to the new priorities, and create some excitement—all of which generate positive energy and help mobilize organizational efforts behind strategy execution.

Putting Constructive Pressure on the Organization to Achieve Good Results

Managers have to be out front in mobilizing organizational energy behind the drive for good strategy execution and operating excellence. Part of the leadership requirement here entails nurturing a results-

oriented work climate. A culture where there's constructive pressure to achieve good results is a valuable contributor to good strategy execution and operating excellence. Results-oriented cultures are permeated with a spirit of achievement and have a good track record in meeting or beating performance targets. If management wants to drive the strategy execution effort by instilling a results-oriented work climate, then senior executives have to take the lead in promoting certain enabling cultural drivers: a strong sense of involvement on the part of company personnel, emphasis on individual initiative and creativity, respect for the contribution of individuals and groups, and pride in doing things right.

Organizational leaders who succeed in creating a results-oriented work climate typically are intensely people-oriented, and they are skilled users of people-management practices that win the emotional commitment of company personnel and inspire them to do their best.[27] They understand that treating employees well generally leads to increased teamwork, higher morale, greater loyalty, and increased employee commitment to making a contribution. All of these foster an esprit de corps that energizes organizational members to contribute to the drive for operating excellence and proficient strategy execution.

Successfully leading the effort to instill a spirit of high achievement into the culture generally entails such leadership actions and managerial practices as:

- Treating employees with dignity and respect. This often includes a strong company commitment to training each employee thoroughly, providing attractive career opportunities, emphasizing promotion from within, and providing a high degree of job security. Some companies symbolize the value of individual employees and the importance of their contributions by referring to them as cast members (Disney), crew members (McDonald's), coworkers (Kinko's and CDW Computer Centers), job owners (Graniterock), partners (Starbucks), or associates (Wal-Mart, Lenscrafters, W. L. Gore, Edward Jones, Publix Supermarkets, and Marriott International). At a number of companies, managers at every level are held responsible for developing the people who report to them.
- Making champions out of the people who turn in winning performances—but doing so in ways that promote teamwork and cross-unit collaboration as opposed to spurring an unhealthy footrace among employees to best one another.
- Encouraging employees to use initiative and creativity in performing their work.
- Setting stretch objectives and clearly communicating an expectation that company personnel are to give their best in achieving performance targets.
- Granting employees enough autonomy to stand out, excel, and contribute.
- Using the full range of motivational techniques and compensation incentives to inspire company personnel, nurture a results-oriented work climate, and enforce high-performance standards.
- Celebrating individual, group, and company successes. Top management should miss no opportunity to express respect for individual employees and their appreciation of extraordinary individual and group effort.[28] Companies like Mary Kay Cosmetics, Tupperware, and McDonald's actively seek out reasons and opportunities to give pins, buttons, badges, and medals for good showings by average performers—the idea being to express appreciation and give a motivational boost to people who stand out in doing ordinary jobs. General Electric and 3M Corporation make a point of ceremoniously honoring individuals who believe so strongly in their ideas that they take it on themselves to hurdle the bureaucracy, maneuver their projects

through the system, and turn them into improved services, new products, or even new businesses.

While leadership efforts to instill a results-oriented culture usually accentuate the positive, there are negative reinforcers too. Managers whose units consistently perform poorly have to be replaced. Low-performing workers and people who reject the results-oriented cultural emphasis have to be weeded out or at least moved to out-of-the-way positions. Average performers have to be candidly counseled that they have limited career potential unless they show more progress in the form of more effort, better skills, and ability to deliver better results.

Keeping the Internal Organization Focused on Operating Excellence

Another leadership dimension of the drive for good strategy execution is keeping the organization bubbling with fresh supplies of ideas and suggestions for improvement. Managers cannot mandate innovative improvements by simply exhorting people to "be creative," nor can they make continuous progress toward operating excellence with directives to "try harder." Rather, they have to foster a culture where innovative ideas and experimentation with new ways of doing things can blossom and thrive. There are several actions that organizational leaders can take to promote new ideas for improving the performance of value chain activities:

- *Encouraging individuals and groups to brainstorm, let their imaginations fly in all directions, and come up with proposals for improving how things are done*—Operating excellence requires that everybody be expected to contribute ideas, exercise initiative, and pursue continuous improvement. The leadership trick is to keep a sense of urgency alive in the business so that people see change and innovation as necessities. One year after taking charge at Siemens-Nixdorf Information Systems, Gerhard Schulmeyer produced the first profit in the merged company, which had been losing hundreds of millions of dollars annually since 1991; he credited the turnaround to the creation of 5,000 "change agents," almost 15 percent of the workforce, who volunteered for active roles in the company's change agenda while continuing to perform their regular jobs.
- *Taking special pains to foster, nourish, and support people who are eager for a chance to try turning their ideas into better ways of operating*—People with maverick ideas or out-of-the-ordinary proposals have to be tolerated and given room to operate. Above all, would-be champions who advocate radical or different ideas must not be looked on as disruptive or troublesome. The best champions and change agents are persistent, competitive, tenacious, committed, and fanatic about seeing their idea through to success.
- *Ensuring that the rewards for successful champions are large and visible and that people who champion an unsuccessful idea are not punished or sidelined but rather encouraged to try again*—Encouraging lots of "tries" is important since many ideas won't pan out.
- *Using all kinds of ad hoc organizational forms to support ideas and experimentation*—Venture teams, task forces, "performance shootouts" among different groups working on competing approaches, and informal "bootleg" projects composed of volunteers are just a few of the possibilities.

- *Using the tools of benchmarking, best practices, business process reengineering, TQM, and Six Sigma quality to focus attention on continuous improvement*—These are proven approaches to getting better operating results and facilitating better strategy execution.

Leading the Development of Better Competencies and Capabilities

A third avenue to better strategy execution and operating excellence is proactively strengthening organizational competencies and competitive capabilities. This often requires top management intervention. Senior management usually has to *lead* the strengthening effort because core competencies and competitive capabilities typically reside in the combined efforts of different work groups, departments, and strategic allies. The tasks of managing human skills, knowledge bases, and intellect and then integrating them to forge competitively advantageous competencies and capabilities is an exercise best orchestrated by senior managers who appreciate their strategy-implementing significance and who have the clout to enforce the necessary networking and cooperation among individuals, groups, departments, and external allies. Stronger competencies and capabilities can not only lead to better performance of value chain activities and pave the way for better bottom-line results. Also, in today's globalizing economy, strategy leaders are well positioned to spot opportunities to leverage existing competencies and competitive capabilities across geographical borders.

Aside from leading efforts to strengthen *existing* competencies and capabilities, effective strategy leaders try to anticipate changes in customer-market requirements and proactively build *new* competencies and capabilities that offer a competitive edge over rivals. Senior managers are in the best position to see the need and potential of new capabilities and then to play a lead role in the capability-building, resource-strengthening process. Proactively building new competencies and capabilities ahead of rivals to gain a competitive edge is strategic leadership of the best kind, but strengthening the company's resource base in reaction to newly developed capabilities of pioneering rivals occurs more frequently.

Displaying Ethical Integrity and Leading Social Responsibility Initiatives

For an organization to avoid the pitfalls of scandal and disgrace and consistently display the intent to conduct its business in a principled manner, the CEO and those around the CEO must be openly and unswervingly committed to ethical conduct and socially redeeming business principles and core values. Leading the effort to operate the company's business in an ethically principled fashion has three pieces. First and foremost, the CEO and other senior executives must set an excellent example in their own ethical behavior, demonstrating character and personal integrity in their actions and decisions. The behavior of senior executives is always watched carefully, sending a clear message to company personnel regarding what the "real" standards of personal conduct are. Moreover, the company's strategy and operating decisions have to be seen as ethical—actions speak louder than words here. Second, top management must declare unequivocal support of the company's ethical code and take an uncompromising stand on expecting all company personnel to conduct themselves in an ethical fashion at all times. This

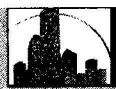


illustration capsule 13.3

Lockheed Martin's Corrective Actions after Violating U.S. Antibribery Laws

Lockheed Martin Corporation is among the world's leading producers of aeronautics and space systems, with 2002 sales of $26 billion. The company designed and built the P-38 fighter, B-29 bomber, U-2 and SR-71 reconnaissance aircraft, C-130 cargo planes, F-104 Starfighter, F-16 Fighting Falcon, F-22 Raptor, and Titan and Trident missiles. It has been a major contractor on the Mercury, Gemini, Apollo, Skylab, and shuttle space programs.

Lockheed Martin's status as a U.S. government contractor was jeopardized in 1995 when company officials admitted that the company had conspired to violate U.S. antibribery laws. The infraction occurred in 1990 when Lockheed Martin paid an Egyptian lawmaker $1 million to help the company secure a contract to supply Egypt with C-130 cargo planes. The U.S. government fined Lockheed Martin $24.8 million and placed it on three-year probation during which further ethics violations could bar the company from bidding on government contracts.

After the conviction, Lockheed Martin's CEO and other senior executives put a comprehensive ethics compliance program in place to guard against subsequent violations. Completion of an online ethics training course was made mandatory for all employees; the course covered Lockheed Martin's code of ethics and business conduct. The online software system records when employees complete online sessions on such topics as sexual harassment, security, software-license compliance, labor charging, insider trading, and gratuities. It also gives the company the capability to conduct up-to-the-minute ethics audits to determine how many hours of training have been completed by each of Lockheed Martin's 170,000 employees.

Lockheed Martin's ethics software programs provide company managers with a variety of statistics related to ethics violations that do occur at the company—like the number of detected violations of misuse of company resources, conflicts of interest, and security breaches. In addition, the system gives an accounting of the number of Lockheed Martin employees discharged, suspended, and reprimanded for ethics violations. Lockheed Martin managers and the U.S. government use the database to assess the state of business ethics at the company.

Lockheed Martin's renewed commitment to honesty, integrity, respect, trust, responsibility, and citizenship—along with its method for monitoring ethics compliance—paved the way for the company to receive the 1998 American Business Ethics Award. Upon receiving the award, the company's chairman and CEO, Vance Coffman, said, "At Lockheed Martin, we have stressed that the first and most important unifying principle guiding us is ethical conduct, every day and everywhere we do business. Receiving the American Business Ethics Award is a strong signal that we are achieving our goal of putting our Corporation on a firm ethical foundation for the challenges of the 21st century."

Source: The Wall Street Journal, Eastern Edition [Staff Produced Copy Only] by Staff. Copyright 1999 by Dow Jones & Company, Inc. Reproduced with permission of Dow Jones & Company, Inc. in the format textbook via the Copyright Clearance Center.

means iterating and reiterating to employees that it is their duty to observe the company's ethical codes. Third, top management must be prepared to act as the final arbiter on hard calls; this means removing people from key positions or terminating them when they are guilty of a violation. It also means reprimanding those who have been lax in monitoring and enforcing ethical compliance. Failure to act swiftly and decisively in punishing ethical misconduct is interpreted as a lack of real commitment.

See Illustration Capsule 13.3 for a discussion of the actions Lockheed Martin's top executives took when the company faced a bribery scandal.

Demonstrating Genuine Commitment to a Strategy of Social Responsibility As was discussed in Chapter 10, business leaders who want their companies to be regarded as exemplary corporate citizens must not only see that their companies operate ethically but also take a lead role in

crafting a social responsibility strategy that positively improves the well-being of employees, the environment, the communities in which they operate, and society at large. The CEO and other senior executives must insist that the company go past the rhetoric and cosmetics of corporate citizenship and employ a genuine strategy of social responsibility. *What separates companies that make a sincere effort to carry their weight in being good corporate citizens from companies that are content to do only what is legally required of them are company leaders who believe strongly that just making a profit is not good enough. Such leaders are committed to a higher standard of performance that includes social and environmental metrics as well as financial and strategic metrics.*

Companies with socially conscious strategy leaders and a core value of corporate social responsibility move beyond the rhetorical flourishes of corporate citizenship and enlist the full support of company personnel behind social responsibility initiatives.

One of the leadership responsibilities of the CEO and other senior managers, therefore, is to *step out front,* wave the flag of socially responsible behavior for all to see, marshal the support of company personnel, and integrate social responsibility initiatives into an everyday part of how the company conducts its business affairs. Strategy leaders have to insist on the use of social and environmental metrics in evaluating performance and, ideally, the company's board of directors will elect to tie the company's social and environmental performance to executive compensation—a surefire way to make sure that social responsibility efforts are more than window dressing. To help ensure that it has commitment from senior managers, Verizon Communications ties 10 percent of the annual bonus of the company's top 2,500 managers directly to the achievement of social responsibility targets. One survey found over 60 percent of senior managers believed that a portion of executive compensation should be linked to a company's performance on social and environmental measures. The strength of the commitment from the top—typically a company's CEO and board of directors—ultimately determines whether a company will pursue a genuine, full-fledged strategy of social responsibility that embraces some customized combination of actions to protect the environment (beyond what is required by law), actively participate in community affairs, be a generous supporter of charitable causes and projects that benefit society, and have a positive impact on workforce diversity and the overall well-being of employees.

Leading the Process of Making Corrective Adjustments

The leadership challenge of making corrective adjustments is twofold: deciding when adjustments are needed and deciding what adjustments to make. Both decisions are a normal and necessary part of managing the strategy execution process, since no scheme for implementing and executing strategy can foresee all the events and problems that will arise. There comes a time at every company when managers have to fine-tune or overhaul the approaches to strategy execution and push for better results. Clearly, when a company's strategy execution effort is not delivering good results and making measurable progress toward operating excellence, it is the leader's responsibility to step forward and push corrective actions.

The *process* of making corrective adjustments varies according to the situation. In a crisis, it is typical for leaders to have key subordinates gather information, identify and evaluate options (crunching whatever numbers may be appropriate), and perhaps prepare a preliminary set of recommended actions for consideration. The organizational leader then usually meets with key subordinates and personally presides over extended discussions of the proposed responses, trying to build a quick consensus among members of the executive inner circle. If no consensus emerges and action is required immediately, the burden falls on the manager in charge to choose the response and urge its support.

When the situation allows managers to proceed more deliberately in deciding when to make changes and what changes to make, most managers seem to prefer a process of incrementally solidifying commitment to a particular course of action.[29] The process that managers go through in deciding on corrective adjustments is essentially the same for both proactive and reactive changes: They sense needs, gather information, broaden and deepen their understanding of the situation, develop options and explore their pros and cons, put forth action proposals, generate partial (comfort-level) solutions, strive for a consensus, and finally formally adopt an agreed-on course of action.[30] The time frame for deciding what corrective changes to initiate can take a few hours, a few days, a few weeks, or even a few months if the situation is particularly complicated.

Success in initiating corrective actions usually hinges on thorough analysis of the situation, the exercise of good business judgment in deciding what actions to take, and good implementation of the corrective actions that are initiated. Successful managers are skilled in getting an organization back on track rather quickly; they (and their staffs) are good at discerning what actions to take and in ramrodding them through to a successful conclusion. Managers that struggle to show measurable progress in generating good results and improving the performance of strategy-critical value chain activities are candidates for being replaced.

The challenges of leading a successful strategy execution effort are, without question, substantial.[31] But the job is definitely doable. Because each instance of executing strategy occurs under different organizational circumstances, the managerial agenda for executing strategy always needs to be situation-specific—there's no neat generic procedure to follow. And, as we said at the beginning of Chapter 11, executing strategy is an action-oriented, make-the-right-things-happen task that challenges a manager's ability to lead and direct organizational change, create or reinvent business processes, manage and motivate people, and achieve performance targets. If you now better understand what the challenges are, what approaches are available, which issues need to be considered, and why the action agenda for implementing and executing strategy sweeps across so many aspects of administrative and managerial work, then we will look on our discussion in Chapters 11–13 as a success.

A Final Word on Managing the Process of Crafting and Executing Strategy In practice, it is hard to separate the leadership requirements of executing strategy from the other pieces of the strategy process. As we emphasized in Chapter 2, the job of crafting, implementing, and executing strategy is a five-task process with much looping and recycling to fine-tune and adjust strategic visions, objectives, strategies, capabilities, implementation approaches, and cultures to fit one another and to fit changing circumstances. The process is continuous, and the conceptually separate acts of crafting and executing strategy blur together in real-world situations. The best tests of good strategic leadership are whether the company has a good strategy and whether the strategy execution effort is delivering the hoped-for results. If these two conditions exist, the chances are excellent that the company has good strategic leadership.

key | points

A company's culture is manifested in the values and business principles that management preaches and practices, in the tone and philosophy of official policies and procedures, in its revered traditions and oft-repeated stories, in the attitudes and behaviors of employees, in the peer pressures that exist to display

core values, in the organization's politics, in its approaches to people management and problem solving, in its relationships with external stakeholders (particularly vendors and the communities in which it operates), and in the atmosphere that permeates its work environment. Culture thus concerns the personality a company has and the style in which it does things.

Very often, the elements of company culture originate with a founder or other early influential leaders who articulate the values, beliefs, and principles to which the company should adhere. These elements then get incorporated into company policies, a creed or values statement, strategies, and operating practices. Over time, these values and practices become shared by company employees and managers. Cultures are perpetuated as new leaders act to reinforce them, as new employees are encouraged to adopt and follow them, as stories of people and events illustrating core values and practices are told and retold, and as organization members are honored and rewarded for displaying cultural norms.

Company cultures vary widely in strength and in makeup. Some cultures are strongly embedded, while others are weak or fragmented. Some cultures are unhealthy, often dominated by self-serving politics, resistance to change, and inward focus. Unhealthy cultural traits are often precursors to declining company performance. In adaptive cultures, the work climate is receptive to new ideas, experimentation, innovation, new strategies, and new operating practices provided the new behaviors and operating practices that management is calling for are seen as legitimate and consistent with the core values and business principles underpinning the culture. An adaptive culture is a terrific managerial ally, especially in fast-changing business environments, because company personnel are receptive to risk taking, experimentation, innovation, and changing strategies and practices—there's a feeling of confidence that the organization can deal with whatever threats and opportunities come down the pike. In direct contrast to change-resistant cultures, adaptive cultures are very supportive of managers and employees at all ranks who propose or help initiate useful change; indeed, there's a proactive approach to identifying issues, evaluating the implications and options, and implementing workable solutions.

A culture grounded in values, practices, and behavioral norms that match what is needed for good strategy execution helps energize people throughout the company to do their jobs in a strategy-supportive manner, adding significantly to the power of a company's strategy execution effort and the chances of achieving the targeted results. But when the culture is in conflict with some aspect of the company's direction, performance targets, or strategy, the culture becomes a stumbling block. Thus, an important part of managing the strategy execution process is establishing and nurturing a good fit between culture and strategy.

Changing a company's culture, especially a strong one with traits that don't fit a new strategy's requirements, is one of the toughest management challenges. Changing a culture requires competent leadership at the top. It requires symbolic actions and substantive actions that unmistakably indicate serious commitment on the part of top management. The more that culture-driven actions and behaviors fit what's needed for good strategy execution, the less managers have to depend on policies, rules, procedures, and supervision to enforce what people should and should not do.

Healthy corporate cultures are grounded in ethical business principles, socially approved values, and socially responsible decision making. One has to be cautious in jumping to the conclusion that a company's stated values and ethical principles are mere window dressing. While some companies display low ethical standards, many companies are truly committed to the stated core values and to high ethical standards, and they make ethical behavior *a fundamental component of their corporate*

culture. If management practices what it preaches, a company's core values and ethical standards nurture the corporate culture in three highly positive ways: (1) they communicate the company's good intentions and validate the integrity and aboveboard character of its business principles and operating methods, (2) they steer company personnel toward both doing the right thing and doing things right, and (3) they establish a corporate conscience that gauges the appropriateness of particular actions, decisions, and policies. Companies that really care about how they conduct their business put a stake in the ground, making it unequivocally clear that company personnel are expected to live up to the company's values and ethical standards—how well individuals display core values and adhere to ethical standards is often part of their job performance evaluations. Peer pressures to conform to cultural norms are quite strong, acting as an important deterrent to outside-the-lines behavior.

To be effective, corporate ethics and values programs have to become a way of life through training, strict compliance and enforcement procedures, and reiterated management endorsements. Moreover, top managers must practice what they preach, serving as role models for ethical behavior, values-driven decision making, and a social conscience.

Successful managers have to do several things in leading the drive for good strategy execution and operating excellence. First, they stay on top of things. They keep a finger on the organization's pulse by spending considerable time outside their offices, listening and talking to organization members, coaching, cheerleading, and picking up important information. Second, they are active and visible in putting constructive pressure on the organization to achieve good results. Generally, this is best accomplished by promoting an esprit de corps that mobilizes and energizes organizational members to execute strategy in a competent fashion and deliver the targeted results. Third, they keep the organization focused on operating excellence by championing innovative ideas for improvement and promoting the use of best practices and benchmarking to measure the progress being made in performing value chain activities in first-rate fashion. Fourth, they exert their clout in developing competencies and competitive capabilities that enable better execution. Fifth, they serve as a role model in displaying high ethical standards, and they insist that company personnel conduct the company's business ethically and in a socially responsible manner. They demonstrate unequivocal and visible commitment to the ethics enforcement process. Sixth and finally, when a company's strategy execution effort is not delivering good results and the organization is not making measurable progress toward operating excellence, it is the leader's responsibility to step forward and push corrective actions.

exercises

1. Go to www.hermanmiller.com and read what the company has to say about its corporate culture in the careers sections of the Web site. Do you think this statement is just nice window dressing, or, based on what else you can learn about the Herman Miller Company from browsing this Web site, is there reason to believe that management has truly built a culture that makes the stated values and principles come alive? Explain.