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BY ART KLEINER

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The influential business author and CEO explains why the practice of enlightened self-governance gives companies an edge.

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Photograph by Matthew Septimus

This interview, formally conducted in January 2012, started as an argument two and a half years earlier, when the economic crisis was at its peak. Dov Seidman — the founder and CEO of LRN, a global firm that helps companies with such matters as legal and regulatory compliance, reputation and principled performance, environmental sustainability, business ethics, governance, leadership, and culture change — had published a book, *How: Why HOW We Do Anything Means Everything…in Business (and in Life)* (Wiley, 2007). In August 2009 he visited the *strategy+business* offices to propose an article about the link between enlightened corporate behavior and performance. The most sustainably successful businesses, he argued, were also the most moral — not through formal programs like corporate social responsibility (CSR), but through what he called "sustainable values" (as opposed to "situational values"). They had an orientation toward sustaining human relationships built into their day-to-day practices and behaviors. Hence his book title: *How* a business is operated, led, and governed is just as important as *what* that business chooses to produce.

I was skeptical. Sure, many companies promoted themselves as ethical and responsible, but was there really a clear cause-and-effect relationship between values and performance? Among the most successful companies were quite a few that were known for visibly amoral — or, in some cases, exploitative — values and practices. Seidman persisted, arguing that the world's growing transparency and interconnectedness were changing the culture of business: making it harder for large companies to operate purely on the basis of expediency and short-term returns. Consumers and employees were shifting their loyalty to companies they perceived as more principled. He added that in part because of the general criticism of corporations that had followed the economic crisis, there was a groundswell of enlightenment among the CEOs he knew. "We're in a world," he said, "in which you have to live and *earn* your reputation; you can't just assert and *manage* it."

We found one intriguing point

of common ground when we talked about the government bailouts of General Motors, AIG, Bear Stearns, and Fannie Mae — companies that had all been dubbed “too big to fail.” Their size wasn’t the reason they had been saved, we agreed. They were really “too connected to fail”: too enmeshed in a chain of suppliers, financiers, customers, and community members. If they went down, too many others would go down with them, so they had to be kept alive. In that light, maybe Seidman’s argument made more sense; maybe companies would increasingly have to justify their existence on the basis of the ways in which their presence benefited an interwoven web of other companies and people.

> **“I was on record claiming that companies with better values would have better performance. If the statistics didn’t match, I’d be toast.”**

Since then, the business world has seen two almost contradictory trends involving corporate values. As organizational learning expert Meg Wheatley recently noted in an interview in this magazine (Winter 2011), many companies seem to be moving away from enlightened management and retreating to command-and-control authoritarianism, often in the name of cutting costs. At the same time, there is indeed a visible wave of interest in the kinds of values that Dov Seidman champions. Banks and health insurance companies are becoming more consumer-centric; food companies are developing healthier packaged goods; automakers are putting less-polluting vehicles on the roads; and some company leaders are talking about authenticity, integrity, and participative management.

Seidman, meanwhile, is back with a new edition of his book, this time with a foreword by former U.S. president Bill Clinton and a new body of independent research demonstrating that values-inspired companies do in fact outperform others. (The research is written up in *The HOW Report: Rethinking the Source of Resiliency, Innovation, and Sustainable Growth* [Global Edition, LRN Corporation, 2012, www.lrn.com/insights-knowledge/how-report]). If Seidman, who has a Harvard Law School degree and advanced degrees in moral philosophy, is correct, companies that actively seek to make a better world through their business won’t merely stand on the moral high ground. They will have a significant, sustainable performance edge.

S+B: Talk about the *HOW Report* and what you learned from it.

SEIDMAN: We were trying to test the link between values and performance, so we surveyed about 5,000 managers and executives in the United States. To track their values, we asked them questions on 22 behavioral dimensions. For example, when people go around their boss because they believe it’s the right thing to do, are they punished or rewarded? Is information hoarded, with people informed only on a need-to-know basis? Are they trusted to make decisions? What is the mix of coercion, motivation, and inspiration?

These questions go beyond a typical employee-engagement survey, which might ask, “Do you like this company? Do you feel fear?” Employees who feel fear don’t answer questions honestly. Some surveys ask, “Has your boss taken you to lunch lately?” But what if your boss berates you at lunch?

At my firm, the LRN Corporation, we designed the questions, statements, and descriptions used in the survey instrument; they were then tested, refined, and delivered by independent experts in behavioral economics, organizational behavior, and qualitative research. [The experts included University of Southern California professor Edward Lawler, author of “The Talent Lie,” *s+b,* Summer 2008, and Boston Research Group president Warren Cormier.] We kept those processes separate from LRN, because I was clearly biased from the outset. This was the biggest bet of my career.

S+B: What did you wager?

SEIDMAN: I wagered my reputation. In *How* I was on record claiming that companies that scored higher in day-to-day values would have better performance. If the statistics didn’t match, then I’d be toast. How could I keep giving speeches? How could I allow President Clinton’s foreword to be published? I could keep arguing for more principled business be-

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havior, but it would have to be for non-performance-related reasons.

S+B: What were the terms of the bet? That enlightened companies would do better financially?

SEIDMAN: Not just financially, but in every metric that matters: Levels of innovation, receptivity to new ideas, employee loyalty, staff referrals, customer satisfaction, resilience, and corporate reputation.

We found that all the companies fit into one of three general categories. Companies in the first group, called "blind obedience," rely on coercion, formal authority, policing, and top-down command-and-control leadership. The second group, "informed acquiescence" organizations, have clear-cut rules and policies, well-established procedures, and performance-based rewards and punishments — the standards of high-quality 20th-century management. The third group, organizations with "self-governance," are the most farsighted organizations, best positioned to thrive in an interdependent world. People at all levels of the company are trusted to act on their own initiative and to collaboratively innovate; a shared purpose and common values guide employee and company behavior.

In a blind obedience system, there is a great deal of misconduct, compounded by the fact that it's invisible; no one talks about it. In an informed acquiescence system, there is less misconduct, but people still tolerate it. In a self-governance system, when there is misconduct, people talk about it and consciously set up practices to address it.

These are not static categories; they represent a theory of organizational evolution. The prevailing form of management in the industrial era has gradually matured over the past 150 years. It's moved from blind obedience to informed acquiescence, and it's just now moving to self-governance, but it still has a long way to go.

The Self-Governance Premium

S+B: What surprised you most about the results?

SEIDMAN: We didn't realize how much blind obedience still exists: About 43 percent of the companies we surveyed fit into that category. Informed acquiescence came in at 54 percent. Only 3 percent of the responders worked for self-governance-style companies.

But those 3 percent have a definite premium. Ninety-two percent of those in self-governance systems viewed their financial performance to be above average — compared with 77 percent of those in informed acquiescence organizations, and 52 percent of those in blind obedience.

Self-governance companies also scored well on ethics — 94 percent said their companies had above-average reporting of misconduct (people report unethical behavior when they see it), compared to 62 percent for acquiescence and 26 percent for blind obedience. Among those self-governance company respondents, 94 percent also agreed their company was superior in terms of the rapid adoption of new ideas, compared with 67 percent for informed acquiescence and 18 percent for blind obedience.

The study also found that companies with consistent behavior reflecting trust and a sense of higher purpose — key indicators of self-governance — scored 87 percent on employee loyalty. These were the people who said, "I will still be working for this company 12 months from now." Self-governance company respondents were also much more likely to score high on customer satisfaction ("My company has very satisfied customers").

S+B: Some might criticize you for relying on people's own assessments of company performance rather than tracking the financial data.

SEIDMAN: Yes, but the pattern was consistent enough — and what we know about respondents' biases congruent enough — to suggest that it was a reasonably good proxy for actual performance, at least for comparing our three categories. You could also criticize us for talking only to U.S. employees, but since then we've found the same basic correlation in 17 other countries, including most members of the G8.

We also use the same diagnostic survey in our work with individual companies. We survey everyone in an executive team, a division, or a whole company, to measure the "how": the habitual thinking and actions. We even include suppliers: "What's it like to negotiate with this company?" We've found the same correlations everywhere.

S+B: Did you test your own company with the same instrument?

SEIDMAN: Yes. It's critical for us, because we're promoting the benefits of this philosophy to our client partners. In some areas LRN scored well, in others not as well. We are still on a journey of our own.

When we got the results, we decided we were going to move up the curve. So we ripped up LRN's org chart and put in new practices. For instance, we changed our performance evaluations; employees now seek the feedback they feel is important from a self-selected "network" of colleagues, who provide it based on our own standards of principled performance and behavior. Individuals give the final score for themselves; the company lives with that self-rating. We have nominations and elections in the company for some of the councils that govern the company. This is in a 300-person global company, one that employs people with diverse skills and cultural backgrounds.

> **"'What if my employees decide to get rid of me because they don't like how I run this place?'"**

LRN scores very high on people having a deep sense of purpose and mission, but we still have work to do on clarifying decision making in our flat structure. We have to be especially mindful because some people carry baggage from previous employment: "My last four bosses did not respect my views or trust me to make decisions. You say you're an ethical company, but how do I know you won't do the same?"

S+B: Much of your book is about leadership and values. But when businesspeople talk about "how," they typically mean execution: processes and routines.

SEIDMAN: That's the "how" of operations, a process or a tactic. But more and more, people see "how" as a strategy or platform for innovation, and a form of leadership behavior. I see a similar shift in attitude among the CEOs I work with. There are two groups of chief executives. One is interested in "reforming" the current system. They may not say it this way, but subliminally they want to leave the company largely the way it is even as they improve it at its margins. The second group wants to "rethink" fundamentals, such as how they operate, how they lead people, and how their company relates to society.

Since the crash, the rethink group is growing. These CEOs say, "I used to run my company with a five-year plan. Then I went to a one-year budget. Now, in a single year, there might be a tsunami, a Greek bond crisis, a bank failure. I can't run my company on a one-year plan anymore."

One CEO, of a very large and well-respected company, said to me, "Dov, it took 17 days for the Egyptians to get rid of Hosni Mubarak, and the guy had a military. What if my consumers and employees decide to get rid of me because they don't like how I run this place?"

Another company has just started rethinking its moral foundation. They're concerned about what it will take for them to flourish in a more complex and uncertain world. One of the experiences that led to this reflection was a conversation between a top executive and a well-respected middle manager. The company had a long-standing practice of recruiting through referrals from its employees. This executive had asked the manager, "So when your brother finishes business school, you'll recommend him to the company, won't you?"

"Hell, no," the middle manager said. "My brother can get a job anywhere." He told the executive he was going to recommend a cousin that nobody else would hire.

They had thought their recruitment policy was one of the most positive aspects of their culture. Now they realized it was a negative. So they held a series of events for people to reflect on "who we were and how we have behaved on our best days to date, and on how we can be *that* kind of company every day in the future."

That story shows why companies need to be ever-vigilant and deliberate about their cultures. People think that being values-based is about being nice. It's really about being principled. You have to be firm, consistent, and even ruthless about your principles, and very few companies are. For instance, only 12 percent of the companies we surveyed practice genuine long-term thinking, which takes a lot of discipline. Short-term thinking is not just reflected in whether the executives run a company quarter by quarter. It also reflects employee behavior: "Do you make decisions to please your boss by Friday?"

S+B: How is long-term thinking different from short-term?

SEIDMAN: In *How,* I describe how the golf pro David Toms disqualified himself at the 2005 British Open tournament. He had a ball that stopped right by the hole; it seemed motionless to everyone, including the referee, and he putted it in and won.

That night, however, he had doubts; maybe the ball had been wobbling on the edge of the hole, which would mean he should be disqualified. In all honesty, he wasn't sure. But the next day, he went to the rules tent to ask the judges about it. They watched the video, and it was inconclusive. The judges told him he could stay in the tournament or leave. They told him it should depend on how he felt about it. He chose to leave.

When I interviewed him, I asked why he disqualified himself, even though he still wasn't sure whether his putt was illegitimate. "I felt like I'd be getting away with something [if I stayed]," he said, "and I would feel like that regardless of how I did in the future." He added, "I plan on playing golf for a long time." He feared that if he let himself slip this way, he would never be able to perform as well again.

Just as David Toms has character, every company has a character, which is the aggregation of how all its people behave. I saw this firsthand through LRN's ethics and compliance business, which was once our bread and butter. Compliance practices are designed to set up rules about what people can and can't do. That can lead to unintentionally perverse incentives, unintended consequences, and the wrong behavior. For instance, a training program might explain the risks of laundering money in your home country. After hearing that warning, a chronic money launderer probably won't stop; instead, he'll move operations offshore.

But if you create a culture where people think like David Toms, your people won't launder money anywhere, because they'll recognize how that erodes performance over time. Instead of just setting rules, a values-based culture inspires people to do what they *should* do.

If a middle manager acted like David Toms, other people in the company would know, from every interaction, the level of his or her moral authority, and that would change the way they thought and behaved. For instance, a customer might say, "I'll sign the contract only if you give me two Super Bowl tickets." How does the manager counsel his people to respond?

In Search of Principle

S+B: Suppose, then, a company wants to become the kind of place where people think like David Toms, or even the kind of place where they recommend really sharp friends instead of their slacker cousins for jobs. What should it do differently?

SEIDMAN: If you want to move from a blind obedience or informed acquiescence to a self-governance company, you're signing up for a long journey, not a six-month program. Businesspeople have systematized many things: HRIS, TQM, CRM, safety, Six Sigma, ERP. But we haven't yet systematized our "hows": We haven't created the kind of human operating system that maps to 21st-century realities.

The human operating system comprises all the behaviors of an organization. It has three basic elements, all of which need to change in most companies. The first is governance: the policies, controls, rules, org charts, goals, and objectives that represent the formal structures of the organization. The second is culture: the values, principles, habits, mind-sets, history, lore, and legends that influence how people behave. And third is the leadership model. How do you lead? Is it through command and control, or connect and collaborate? Are you transparent, or do you share information only on a "need to know" basis?

Once you have focused on these areas individually, you have to fit them together into a single system. Are your governance, culture, and leadership models fighting or reinforcing one other?

S+B: A lot of leaders have tried to change these three elements, usually without success. Some would say it isn't possible.

SEIDMAN: It's hard, and it doesn't happen overnight. But there are precedents in business. In the 1920s, hazardous working conditions were considered normal; for every floor of a skyscraper, a number of deaths and injuries were accepted as an unavoidable cost of construction. Only the foreman was expected to pay attention to hazardous conditions. Today, when there's a frayed wire or an exposed pipe on a worksite, employees consistently report it. Safety is in everybody's consciousness. Companies compete on it: "Come work here; you'll be safer than you'd be with our competitors."

The same thing happened with quality. American CEOs used to consider it merely an aesthetic factor. They installed inspectors to check for defects at the end of the production line. Then, when the Japanese bought Pebble Beach and Rockefeller Center, Americans declared that quality was Job One. At GE, even the lawyers tried to qualify for Six Sigma black belts.

Now the same thing will start to happen with human values. To a hardline businessperson, humanity is even softer and less measurable than quality. But Chevron, Cisco, Dow Chemical, Delta Airlines, Ally Bank, and others all advertise themselves by declaring their humanity.

S+B: What do you mean by humanity in this context?

SEIDMAN: They want a relationship. "Buy from us, work here, because of who we are, what we stand for, and how we behave." They're trading on trustworthiness and integrity. This is a huge strategic shift for many companies, and, like manufacturers in the early days of safety or quality consciousness, they're committing themselves to a body of new practices without being fully aware of the ramifications.

> "People think that being values-based is about being nice. But you have to be firm, consistent, and even ruthless."

For example, I know many earnest executives in informed acquiescence companies who genuinely believe that they're empowering their people. They tell an individual, "I trust you to innovate." The individual runs off, inspired by the trust, but then has to obtain four approvals for the first round of investment. The individual concludes that the CEO is a hypocrite. "He told me to innovate, but he doesn't mean it." But the CEO isn't a hypocrite. He's just presiding over a system of governance, culture, and leadership that is not in sync.

I described our three categories — blind obedience, informed acquiescence, and self-governance — to the board of a world-famous company, one that had grown rapidly from the founder's original small-scale business to a Fortune 100 enterprise. The founder, who had remained active with the company throughout his long life, had passed away within the living memory of the people in the room.

One board member said to the rest, "You know, when [the founder] was alive, we were self-governing. With all this scale and the rules and the policies, we've regressed to informed acquiescence." Those categories gave them a concrete way to talk about their own culture, which was vital to them but had always seemed elusive and intangible.

S+B: If you were a CEO, how would you start?

SEIDMAN: Begin by looking diagnostically at your own company and culture. Our study found that CEOs are eight times as likely as lower-level employees to perceive their workplace as a self-governance company. It's not because most CEOs are out of touch. Rather, they preside over a 19th-century human operating system that doesn't work anymore. All it takes is one middle manager saying, "Get me this memo by five o'clock" without bothering to say why. Junior people perceive that kind of thing as blind obedience.

I have facilitated sessions with CEOs in which I ask, "How many of you could grab your BlackBerry and in the next five minutes produce a list of your top 25 performers?" All the hands go up. Then I ask, "How many, with the same confidence, could produce a list of your most principled or ethical leaders?" Every hand goes down. They all recognize that if they could answer yes to the second question, they'd be running a better company.

CEOs today are certainly enlightened enough to understand the new world. They know they are more vulnerable than ever. In quiet moments, they say, "I don't have the answers. This is pretty hard." That's why I'm optimistic. I think this is the right time to rethink and change how business is done.

The biggest hurdle is internal contradiction around values. For instance, right now, compliance and risk are major issues, but companies are conflicted. The policies and rules reflect enlightened values: be careful about risk, don't cut corners. Other norms tell you to push yourself extra hard for performance, no matter what it takes. The values contradict each other, and none of them help you delight a customer, which should be the point of the business.

Everybody knows changing the culture is important, but we tend to approach it in an ad hoc fashion. I've sat with business leaders after an acquisition and found out they spent US$1 million on due diligence, and $3 million on legal issues like environmental remediation and intellectual property rights. But they spent nothing on cultural due diligence. It turns out that one CEO took the other out to dinner, and they decided they were kindred spirits, so they thought their thousands of people would be just fine together. If you could put all the executives of any company in a room to talk about their culture, they would all have very strong, intense opinions: "People love it here." "They don't like working here." "They don't see clients enough." "They don't pay enough attention to their own people." But it's all conjecture. They don't have any real facts.

"If I sell you a mortgage, I'd better stand behind it, because the days when I never see you again are over."

When Business Is Personal

S+B: You talk about changing not just individual company cultures, but the culture of business in general.

SEIDMAN: They're interlinked. Remember the line in *The Godfather* when Tessio is found to be a traitor? He tried to set up Michael Corleone to be killed. He says, "Tell Mike it was only business. I always liked him." That idea — that when you take advantage of someone at work it's just business, nothing personal — is deeply embedded in the commercial sphere. You see the same cultural value at funerals of business leaders, where someone eulogizes, "He was a ruthless boss, but a wonderful husband and father." Ruthlessness at work, especially at the expense of your colleagues, employees, suppliers, and customers, should not be celebrated.

Another deeply embedded cultural value is the classical economics concept that the only purpose of a corporation is to return investment to shareholders. And a third one is the notion that you should "just do it." In other words, do what you must and take what you can get — just don't get caught if you do something wrong. Yet another is the HR department's value of motivating people with bonuses and coercing them with threats: using the carrots and sticks of behavioral psychology, instead of improving the intrinsic quality of the work. Finally, in the environmental, health and safety, and risk domains, there's the belief in insulating business from its external costs.

These are all amoral beliefs. If you endorse them, you will end up building a culture of blind obedience or, at best, informed acquiescence. If you want self-governance, you have to give them up. When a trader at a bank can lose $2 billion in a way that affects every other businessperson around the world, we are all morally interdependent. We can't keep talking about business strategy only in the amoral language of risk, compliance, and managing uncertainty. If I sell you a mortgage, I'd better be prepared to stand behind it, because the days when I will never see you again are over.

S+B: Is it fair to ask everyone in a company to take on the attention and

responsibility required in a self-governance company?

SEIDMAN: It's a shift, but virtue has always been its own reward. If you recognize that business is personal, and work and life are not separate spheres, you realize that neither blind obedience nor informed acquiescence is efficient. Neither can be profitable. In the end, we don't have a choice.

Why are employee engagement scores today the lowest they've ever been? Why are seven out of 10 employees not engaged on the job? Because people can't elevate their behavior in an informed acquiescence organization. The world is not going to get any less connected or less exposed. Our connections and exposure will accelerate, and our children will out-navigate us. We'd better expose them to the values of self-governance; they'll need it.

Look at it from an evolutionary perspective. Blind obedience was a great improvement on anarchy. The Allies won World War II with, by and large, a blindly obedient army. But no one could win a major war with that kind of army today; things happen too fast. In the 1970s, 1980s, and 1990s, informed acquiescence was a much-needed improvement. But it, too, is inadequate today. In a system of informed acquiescence, a valued employee will leave when someone offers him or her more salary. But in a company with self-governance, employees have many more reasons to stay and deeper reasons to be loyal.

The same is true with customers. If the only reason you buy from Netflix, for example, is price, the minute the company raises the price, you're out of there — as we saw when 800,000 or so subscribers bolted overnight.

Let me net this out: In an interconnected world, the nature of a company's connections with its people and customers is exposed. If the only reason you work for a company is a paycheck, you will leave when you are offered a bigger one. If the only reason you buy from a company is price, you'll switch your loyalties if someone else sells a similar product. Leaving and switching are easy. Companies that create richer, deeper, more loyal and enduring connections will create sustainable advantage.

S+B: Do you see companies acting on this insight?

SEIDMAN: Yes. I run a growing company; our revenue is an indicator. Businesses are hiring LRN to work on their culture. In the past, when I talked to CEOs about ethics and behavior, they would typically say, "This is important. Speak to my general counsel or chief risk officer." Today, they're asking, "How do we get to be the best?" They need help because many of them are stuck in the "valley of C."

S+B: What is that?

SEIDMAN: When I was a teaching fellow at Harvard College, I realized that there was a paradox in the way people made progress in mastering knowledge. The students who typically got As had mastered the material and integrated it into their being. Some could even teach the class. I called this the "hill of A." The B students had acquired a basic level of knowledge; they were at a lower level, on the "hill of B." But the C students were, in many cases, closer to real mastery than the Bs. It's just that they were confused. They had fallen into what I came to call the "valley of C." As they move from basic competence to true mastery, they struggle with confusion, and their grades go down. It looks like they have lost their way, but they're actually improving.

All journeys toward acquiring knowledge are curvilinear — indirect, often involving a step back to take two forward.

An organization's journey to self-governance is similarly curvilinear. Being an informed acquiescence company is like being on the hill of B. You get some success. But then when you want to go further toward self-governance, it first feels like you're going backward. You have traveled down and entered the valley of C, which is unavoidable, and your challenge is to keep from getting stuck there.

Many companies are deeply stuck. They understand instinctively that the financial and environmental crises of our time require new behaviors. "We can't just seek profits and shareholder return. We have to do more." They're just beginning to take the journey: to create the human operating system that would allow them to keep that promise, and propel them to self-governance, where both success and significance await them. +

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