The Post-9/11 Resilience of American Brands

by John A. Quelch and Douglas B. Holt

American foreign policy initiatives have generated rising anti-U.S. sentiment in many corners of the globe. American multinational corporations (MNCs) have grown increasingly concerned that such perceptions might influence how foreign customers value their brands. They are particularly worried about their businesses in Islamic countries, where anti-American feelings are fierce.

Our research suggests, however, that American MNCs should not overreact. Strong public opposition to American foreign policy doesn't necessarily affect consumer choice. American companies should carefully weigh the costs and benefits of abdicating the "American-ness" of their brands. They should be honest and open about their heritage, and they should not overdo introductions of locally adapted products. That tactic could appear more patronizing than culturally sensitive.

Islamic countries account for only a small fraction of business for most multinationals, even though Muslims represent more than 20 percent of the world's population. Coca-Cola derives only 2 to 3 percent of sales from the Islamic world; only 1 percent of McDonald's restaurants worldwide are in Islamic countries. Furthermore, only 5 percent of people in Islamic countries can afford Western brands.

It's true that American MNCs must succeed in Islamic countries to grow. By 2015, Muslims will account for 30 percent of the world's population. Flat population growth in the developed world overall will require multinationals to seek incremental business in those markets.

Multinationals recognized this trend in the 1990s, when they began to pay more attention to local cultures to improve their penetration of fast-growth markets. They appointed experienced expatriate managers and established Arab regional headquarters in places like Dubai, instead of directing operations from their European headquarters.

Since September 11, 2001, however, American MNCs have lowered their profile in Islamic countries, and they appear confused about how they should proceed. Their new policy seems to be to withdraw senior expatriate staff for security reasons, and generally to lie low. From a brand development perspective, this approach may be counterproductive.

We surveyed consumers in 11 countries about their preferences for American global brands. Our sample came from a broad cross-section of the populations of developed countries, and drew from about the top half of the socioeconomic spectrum in these countries. We looked at preferences for seven global U.S.-based brands in six categories: athletic wear (Nike); dairy products (Kraft); cell phones (Motorola); petroleum products (Exxon-Mobil); automobiles (Ford); and soft drinks

(Coca-Cola and Pepsi).

We wanted to know whether these brands were valued differently in Islamic countries. We looked at consumer perceptions in Egypt, Indonesia, and Turkey, and then compared them with perceptions in other countries — the United Kingdom, Japan, France, Poland, South Africa, Brazil, China, and India. We measured the extent to which our respondents attributed American values to each brand. Then we solicited preferences for these brands over other global corporate brands. When we looked for correlations between the brands' American values and the respondents' preferences, we found none in Islamic or in any other countries.

In addition, we looked generally at whether antiglobalization sentiments affected global brand preferences. Does an antiglobalization segment exist, and is it particularly strong in Islamic countries? We did find a significant antiglobal segment, about 13 percent of our sample. But, remarkably, this segment was not the largest in the three Islamic countries; in fact, the strongest responses came from China and the United Kingdom.

These findings suggest that American multinationals have exaggerated beliefs about how anti-American sentiment is affecting consumer choice, and, therefore, that the current retrenchment is unwise.

An American global brand — whether it is Coke, Pepsi, Nike, Motorola, Ford, or Kraft — is understood foremost as global, not American. Even brands that use American values as part of their symbolism don't seem to positively or negatively sway consumers' opinions of the brand.

We also found that Islamic consumers were even more favorably disposed toward the positive characteristics of global brands — their reputation for quality and status value in particular — than were consumers in non-Islamic countries.

Given our findings, we were not surprised to learn that Coke and Pepsi turned in their most successful year ever in the Arab countries in 2003. American multinationals should wear their global success proudly, rather than try to hide it.

In non-Islamic countries, American MNCs increasingly seek the advice of local partners and franchisees on how to adapt products and advertising to local tastes. They are delegating more product development and marketing-budget authority to local managers, and emphasizing their local ownership. They use more local raw materials and employ more local people so that they can be seen as local companies in the eyes of suppliers and customers.

This is the right approach. American companies should have the confidence to treat Islamic countries as they do all the foreign

Our research suggests that opposition outside America to U.S. foreign policy doesn't necessarily affect consumer choice.

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markets in which they operate. Indeed, they would do well to follow the same "glocal" strategies (global reach, local implementation) that have served them well in other parts of the world.

To pursue these courses of action in the Islamic world, however, MNCs must develop more senior executives who understand the cultures and know how to do business there. Similarly, the drive for diversity in the multinational company boardroom should be global, not just national, in its perspective. Today, how many Fortune 500 companies' boards of directors include a Muslim? How many of their top executives are Muslim? All too few. +

Four Antidotes to Change Resistance

by John Jones, Claudia Staub, and Elizabeth Powers

Companies must weather a remarkable array of storms today: rapidly evolving market dynamics that undermine share prices, disruptive technological innovation, and uncertain leadership (the CEO who is riding high and falls is rarely given a second chance). To thrive, companies not only must identify the right new strategy, but also must push it out quickly so it reaches all levels of the organization. Often, however, a strategy that seems perfectly logical at the top falls victim to emotional and cultural booby traps below.

Knowledge alone does not motivate action. Employees' emotions can always provoke resistance. Consider these examples we've encountered:

- A major multiline insurance company needed to change its culture from one in which people avoided confrontation to one in which employees engaged in debate and resolved conflicts before they escalated out of control. But employees were afraid to put themselves on the line in these ways.
- Most workers at an international bank defined job success through the selling and processing of loans. A strategic shift to selling noncredit products touched off fear, confusion, and insecurity about both the definition of success and the nature of customer relationships.
- A telecom company had a long-standing, albeit undocumented, social contract with its employees that guaranteed their jobs. As a result, employees did not believe there would be repercussions if they did not change their behaviors to meet new competitive conditions.
- At a major publisher, employees saw that the editorial department, the firm's cultural center (i.e., the unit that was the major contributor to the organization's revenue and behavioral standards), was not truly required to change despite top management's assertions of urgency, engendering cynicism in the staff.

These situations — and the multitude of similar ones executives regularly face — are not intractable. Our experience is that four strategies can mitigate the emotional and cultural challenges of achieving strategic transformations in organizations:

Bring employees face to face with the external pressures to change. Staff can be energized to participate in a change initiative if they understand how their work contributes to the company's success. A consumer products company used small group meetings to reach all employees and to explain changes in its industry's cost structure and its rapidly declining demand. These meetings, and the effective opening of the books on the industry, prepared the employees to shift from a "blank check" culture in which cost did not matter to a leaner institutional mind-set with fewer personnel and with organization-wide accountability for costs.

Engage change zealots. People who "own" and drive the change can serve as role models. A clear best practice is to identify the zealots early and encourage them to drive the changes. Some will have influence because of their positions or titles; among them will be early adopters and resisters of change, and both will affect the way people around them think. Others will be in the cultural center of the organization. Still others are leaders not because of their titles or positions, but because of their connections and ability to persuade or influence others. Finally, some, whom we call *found change agents,* are already demonstrating the behavior, values, and capabilities crucial to the future operating model. In the consumer products company, the marketing group (the company's cultural center) joined the top team in leading the change. For example, when marketing asked R&D or operations to explore new product dimensions, it asked for information on the cost impact of its requests and offered information about expected revenues so that decisions could be coordinated. The behavior change from the cultural center demonstrated the integrity of the cost-cutting program.

Manage employee feelings. Help people deal with their emotional reactions to change and decide whether they can thrive in the new environment. Booz Allen Hamilton research on severance package acceptance rates, for example, shows that when the magnitude of layoffs and the scope of change are clearly communicated, 10 to 30 percent more employees accept voluntary severance than is the case in firms with less developed programs.

Support the change with new tools and systems. The international bank cited above created customer profitability models to help the sales force identify priority accounts for cross-selling, and developed balanced scorecards to monitor changes in sales behavior and financial results. Incentives were being adapted to reward the selling of noncredit products. The most successful units have used recognition programs to help employees understand the new definitions of success.

However, incentives also need to include negative repercussions for those who resist the change program. The top team needs to communicate that employees who cannot change will need to either move into new positions or leave the company.

Companies often say that their employees are their greatest asset. Yet the very attributes that make them valuable — their commitment and passion, and the satisfaction, identity, and pride they derive from their work and the company's success — also create formidable barriers to change. With these four techniques, companies can break down these barriers and make change happen, while still treating their employees with dignity and respect. +

A Behavioral Theory of Corporate Finance

by David E. Adler

When thinking about a firm's financing and investment decisions, rational executives are guided by a belief in the efficiency of markets. But what if markets aren't always as efficient as we believe they are? And what if executives *themselves* are not rational, and their decisions are biased in some predictable way? This second question, central to research in a new academic discipline called behavioral corporate finance, forces us to reexamine conventional ideas about corporate finance and compensation strategies.

Behavioral finance (of which behavioral corporate finance is a subdiscipline) integrates psychology and economics into the study of human judgment and biases in decision making under conditions of uncertainty. Because of this work, based largely on the pioneering ideas of psychologists Daniel Kahneman and the late Amos Tversky, we no longer automatically assume that markets are efficient or investors rational. In 2002, Professor Kahneman was awarded the Nobel Memorial Prize in economics. (See "Daniel Kahneman: The Thought Leader Interview," by Michael Schrage, *s+b,* Winter 2003.)

The application of behavioral finance theory to corporate finance is now attracting the attention of a group of academics, many associated with Jeremy Stein, a professor of economics at Harvard University. Behavioral corporate finance argues that in many senses, corporations are natural arbitrageurs. Research by Malcolm Baker of the Harvard Business School and Jeff Wurgler of New York University suggests it is much easier for a chief financial officer to issue more shares when a company is overvalued than it is for a hedge fund to short overvalued shares; if the shares are not truly overvalued, the consequences to the CFO's own job are relatively modest compared to those for the hedge fund manager. Indeed, Professor Baker and Professor Wurgler have found evidence that the issuing of equity does coincide with high market valuation. This is not to say CFOs should become market timers and risk developing an inappropriate capital structure for their companies. But the "job security" advantages they have over fund managers imply they should have discretion when faced with irrational market "exuberance" or pessimism.

In this and other ways, behavioral corporate finance has begun to look at the investing and financing decisions of executives within firms. If executives are overconfident or overoptimistic, how are their decisions about capital structure affected? Are there ways to push them toward optimal behavior?

In a bravura piece of empirical research titled "Managing with Style: The Effect of Managers on Firm Policies," Antoinette Schoar, an assistant professor of finance at MIT's Sloan School of Management, and Marianne Bertrand, a professor of economics at the University of Chicago Graduate School of Business, demonstrate that there is a pronounced "CEO effect" on decisions regarding capital structure. CEO decisions, they found, reflect a chief executive's personal style rather than a set of criteria determined by the firm. Financially aggressive CEOs use more leverage and hold less cash on the balance sheet, and many tend to grow their firms through acquisitions. More conservative leaders have more cash on the balance sheet and grow more through internal investments.

These different styles of capital management have real effects on corporate performance. Indeed, the Schoar–Bertrand study showed that conservative CEOs produced a lower rate of return on assets. Aggressive CEOs had higher returns, with the notable exception of those CEOs who made a lot of acquisitions; though considered aggressive, this group had lower returns on assets. The research also found that CEO styles are generational: Older CEOs tend to be more conservative, holding less debt and more cash on their balance sheets.

The real-world implications of this type of research go against much of the prevailing wisdom regarding corporate governance and CEO compensation. At least until the recent spate of corporate scandals, conventional wisdom held that a CEO's interests should be made to match the firm's and its shareholders' interests; thus, stock options that encourage the CEO to seek increases in the share price are an appropriate incentive. But if a CEO is operating according to a persistent bias or particular leadership style, this form of incentive compensation no longer aligns his or her interests with the firm's. A CEO may do what he or she thinks best, but nonetheless make unsound decisions.

Behavioral finance research indicates that traditional ideas of corporate governance may be too simplistic. The board has to look beyond finding the optimal incentive contract and instead find the CEO with the experience, personality, and management style suited to the company's actual challenges. But this means the board has to know what type of CEO it needs.

Theories from behavioral finance are at the forefront of explaining differences in corporate financial policies and capital structures. Most important, however, behavioral corporate finance has reintroduced humanity — in all its complexity and subtlety — into corporate finance, where indeed it belongs. +

The Art of Underengineering

by Christian Koehler and Robert Weissbarth

Companies waste billions of dollars every year on new product enhancements that consumers do not want, cannot use, or will not pay for. The fact is that most new products, from automobiles to washing machines, are overengineered.

But corporate efforts to rein in excessive engineering costs frequently fail. CEOs and CFOs at manufacturing companies tell the same story: To achieve a margin on new products, engineers know they need to hit a target cost, but somehow they don't. Why not? Engineers argue they need to spend more to meet consumers' expectations.

This problem is especially acute in the automotive industry, where consumers have come to expect much more for less. In the past, vehicle manufacturers got around the problem of meeting consumer demands without raising costs by putting pressure on suppliers. But the returns on this strategy are diminishing, because today's automotive suppliers, struggling to survive, have no more margins to squeeze.

There is an alternative: design-driven cost reduction, a methodology for taking out cost by modifying the product design of both current products and products in development. Design-driven cost reduction is especially important in the automotive industry, but it can be applied to nearly all manufactured products.

For most assembled products, including automobiles, the cost of components and materials from suppliers typically accounts for 40 to 60 percent of the final price. To protect their margins, manufacturing companies continually chip away at costs. Automotive companies generally rely on purchasing departments to cut costs by 3 percent a year; at a company with sales of $100 billion spending $40 billion on raw materials, that could mean $1.2 billion in annual savings. In practice, they are lucky to achieve 1 to 2 percent reductions.

On average, 70 percent of the cost of any new product is fixed by the specifications and design. In other words, more than two-thirds of the total cost is designed into the product. By identifying what is integral to an automobile's appeal and what is an expensive waste, manufacturers can modify the product design to dramatically reduce unit costs and give consumers the products they want at competitive prices.

Design-driven cost reduction allows engineers to become "idea owners," accountable from beginning to end.

In practice, realizing savings through design is extremely challenging. Most cost-reduction initiatives that attack the design process don't stick, no matter whether the ideas come from a "value analysis" (taking out cost without compromising value) of an existing product or a "value engineering" approach to designing a new product. Resistance to new ideas also keeps design changes from being implemented.

Although value analysis and value engineering can identify potential savings, true design-driven cost reduction does much more. It combines idea generation with analysis to establish clear targets for cost savings. It sets a timetable to ensure fast action and infuses collaboration and flexibility into the implementation process. It is cross-functional; it can be customized for specific engineered products; and it embraces commercial as well as technical improvements. Engineers become "idea owners" and are held accountable for a cost-reduction proposal from beginning to end.

Using design-driven cost reduction, manufacturers can achieve an additional 3 percent annual savings for current products; savings can reach 10 to 30 percent for products in development. The European division of one global vehicle manufacturer introduced design-driven cost reduction in 2001. A team of 200 engineers generated and evaluated ideas to take cost out of product design. This co-located group, which reported directly to top management, was freed of other responsibilities to focus exclusively on the effort. (Previous cost-reduction programs were part-time projects and lacked management support and targets.) The result: cost savings of more than $400 million over the first 30 months. Similar programs at another manufacturer have yielded 20 percent savings in three years.

Design-driven cost reduction has four cornerstones:

• **Process discipline** is imposed at every stage: idea generation, evaluation and prioritization, and implementation through production. Each step has an expected duration, and every idea is tracked. A highly disciplined approach to validation and implementation ensures that the cost benefits are realized in the shortest possible time.

• **Target setting and transparent reporting** add to the discipline. Targets for cost reduction are derived from competitive benchmarking, component by component. Suppliers play a valuable role here in assessing cost differences. Transparent reporting ensures that deviations from targets are quickly corrected.

• **A cross-functional organization** that removes organizational barriers — physical and cultural — is essential to fostering collaboration. Soft management issues, especially culture change, play a vital role in reducing natural conflicts among engineering, purchasing, and marketing.

• **Management commitment** empowers design-driven cost reduction teams to make and implement difficult decisions. Key supporting management roles include setting targets, reviewing progress, removing roadblocks, and supporting critical decision trade-offs among product cost, weight, performance, and functionality.

Design-driven cost reduction is not a panacea. But it is a powerful management resource to help companies realize better margins — not at the expense of their suppliers and customers, but through better design that benefits everyone. +