The year 2004 was an inflection point for global businesses, as the first tough years of the 21st century finally gave way to a welcome surge in profits, cash flow, and market value. Executives are once again focused on growth and innovation, although their optimism is tempered by the grim news of continuing war, rocketing energy prices, and slow job growth. That sober optimism is reflected in *strategy+business*’s fourth annual survey of the year’s best business books.

As in prior years, we’ve invited noted business practitioners, scholars, and journalists to select and judge the most significant and useful books in their areas of expertise. While this approach is admittedly subjective, we believe the books our contributors have selected are the ones most likely to prove stimulating and insightful for *s+b* readers.

Some of the essays that follow are on subjects of perennial interest to executives. Strategy experts Chuck Lucier and Jan Dyer, for instance, see the outlines in this year’s books of a new framework for viewing corporate strategy. They consider their top choice — *Confronting Reality: Doing What Matters to Get Things Right*, by Larry Bossidy and Ram Charan — to be “the best description we’ve seen of how real-world managers develop integrated strategies.” Recommended in the “Leadership” category is *Alexander Hamilton*, by Ron Chernow. Why a book about a politician who died 200 years ago? Because, as Bruce A. Pasternack and James O’Toole write, “there is a useful leadership lesson on almost every page of this remarkable biography.”

Other essays examine books in behavioral economics, IT and innovation, change management, consumerism, and the Internet bubble (yes, there was an upside, writes former IBM VP John R. Patrick). Our 12 essayists review 35 books in all, and we think you’ll agree that they constitute a thought-provoking cross-section of the best thinking about business today.
Strategy
Confronting Reality: Doing What Matters to Get Things Right
by Larry Bossidy and Ram Charan

Management
The Real Thing: Truth and Power at the Coca-Cola Company
by Constance L. Hays

The Bubble
Rational Exuberance: Silencing the Enemies of Growth and Why the Future Is Better Than You Think
by Michael J. Mandel

IT & Innovation
The Keystone Advantage: What the New Dynamics of Business Ecosystems Mean for Strategy, Innovation, and Sustainability
by Marco Iansiti and Roy Levien

Behavioral Economics
The Company of Strangers: A Natural History of Economic Life
by Paul Seabright

Change Management
Change Without Pain: How Managers Can Overcome Initiative Overload, Organizational Chaos, and Employee Burnout
by Eric Abrahamson

The New Consumer
The Substance of Style: How the Rise of Aesthetic Value Is Remaking Commerce, Culture, and Consciousness
by Virginia Postrel
Great strategy, poor execution” is the excuse most frequently offered by the CEOs and boards of directors of unsuccessful companies. The last decade provides many examples. C. Michael Armstrong purchased cable companies to help the AT&T Corporation bypass local telephone companies to gain access to the home. Thomas Middelhoff committed to a digital future for Bertelsmann AG. Motorola, when it was led by Christopher Galvin, stood steadfastly behind the development of Iridium satellites to serve travelers’ needs for global cell phone coverage. Under Kenneth Lay, Enron spawned a series of knowledge-based businesses. All of these concepts sounded good; many reflected accurate insights into industry dynamics and appreciation of customer needs. Yet all were unsuccessful.

Is it fair to say that these companies had “great strategies” but simply failed to execute? The knee-jerk reaction to this question by many contemporary businesspeople would be “sure, it happens all the time.” But that’s just plain wrong. “Great strategy, poor execution” is, in fact, a pernicious oxymoron, rooted in ineffective concepts that sharply separate the formulation of strategy from its execution, and assume that there is a linear, sequential relationship between the two. These dangerous misconceptions come in four flavors:

- The first views strategy purely as insight into industry dynamics and customer needs, evaluated on the basis of novelty, distinctiveness, analytical depth, or intellectual elegance — rather than on results achieved.
- The second considers strategy as the long view, a step-by-step plan toward a comprehensive vision of a future 15 to 25 years distant — ignoring the reality that timing matters.
- The third views strategy solely as the province of the CEO and the board of directors, which leaves others in the organization to address the grubby details of execution — and fails to mobilize the people who are best equipped to understand emerging opportunities.
- The fourth misconception positions strategy as...
the first and most important driver of decisions about organization and operations — instead of basing strategy on the company’s core strengths and competencies.

So pervasive are these notions — and so widespread is the resulting separation of strategy from execution — that many companies today, in their efforts to increase value, seem to ignore strategy entirely, choosing instead to focus solely on execution. The highly visible failures of companies with poor execution have exacerbated this subtle twisting of the “great strategy, poor execution” oxymoron into a perilous move toward “great execution, no strategy.” Such an approach inevitably consigns a company to producing below-average returns to investors, leaving it vulnerable to competitors.

Integrated Change

Although business gurus have documented the inadequacy of the linear strategy-first-execution-next view in today’s business environment, no one has provided businesspeople with actionable concepts they can use to replace the old thinking. A new framework is needed — one that views strategy as an integrated change program linking together multiple dimensions of strategy: external realities, internal activities and business processes, financial targets, and customers. We think of this as “integrated strategy.”


A few of the best practitioners of strategy are already doing what theorists and authors are attempting to describe and formalize. Successful companies realize that internal activities, financial results, customers, and external results are all equally important — and that the linkages between these aspects of strategy are all bi-directional. For example, not only must operational priorities and organizational structure conform to the strategy, but an effective strategy also must be built upon superior organizational and operational competencies. Further, although companies can aspire to deliver financial returns that delight shareholders, effective strategies are grounded in realistic appreciation of likely financial results.

Successful companies also develop strategies that meet customer needs, while mobilizing customers to participate in discovering their needs and creating superior experiences. Finally, successful strategies are developed not only in light of external threats and opportunities, but also with an eye toward how a company’s strategy affects other firms — changing the rules of the game, accelerating (or hindering) the growth of distribution channels, shifting profit pools in an industry, and discovering unmet customer needs.

Creating a strategy integrated along these multiple dimensions is a difficult intellectual challenge, akin to solving dozens of simultaneous equations, only harder. Real-world managers meet the challenge by developing strategy iteratively, working back and forth across the four aspects of strategy — internal activities, financial results, customers, and external results — until a coherent strategy is created.

Bossidy and Charan’s Confronting Reality offers the best description we’ve seen of how real-world managers develop integrated strategies. The heart of effective strategic management, they argue, is “an organized, rigorous way of looking at the health and profitability of a business, now and in the future” — what they call a “business model.” But unlike the meaningless way this term was tossed around during the dot-com craze, when Bossidy and Charan say “business model” they mean something specific and powerful.

For them, a business model is a mental model that logically breaks down the many elements that make up a business, from its markets to its income statement to its leadership elements; the mental model groups the elements into three components — external realities, internal activities, and financial targets — and then analyzes how all the elements are linked. They write:

The business model starts with a logical breakdown of the many elements that make up a business,
from its markets to its income statement to its leadership development programs. These group into the model’s three components. The first is the environment your business lives in. The second includes your financial targets. The third includes the activities of the business: strategy formation, operating activities, selection deployments, and development of people, and organizational processes and structure. Iteration is the process of harmonizing the three components by repeatedly reviewing them as you add new information, and analyzing the subsequent changes in relationships among them.

It is also an early warning system for real-world changes that pose threats or provide glimpses of opportunities. The business model helps you understand whether the ups and downs every business experiences are the result of cyclical change … or something far more serious … that can have a permanent impact on the profitability of any business or an industry.

Our one critique of their business model concept is that it treats customers as merely an element of the external realities, failing to recognize the increasingly dynamic relationship between a business and its customers. That said, Bossidy and Charan’s construct demonstrates that managers can estimate the likely impact of alternative actions, and guide the iterative development of a strategy. More dynamic than backward-looking analysis, and much more effective than “just do it” experimentation, the business model is central to a manager’s effectiveness.

The authors believe that skill in defining and redefining the business model is more art than science: It requires the kind of savvy and business judgment innate in people with management potential — part analysis and part intuition, honed through experience. They advise young managers: “The earlier in your career you start to develop and practice your mental facilities in this discipline, the sharper your judgments will be as you advance.”

Although experienced managers may find little that’s really new to them in this book, they’ll do well to be reminded of the central theme of Confronting Reality: Some people try to fend off disruptive forces of change by denouncing or ignoring them. But in this new environment, confronting reality has to become a leadership priority of the highest order — a nonnegotiable behavior for everyone at all levels of an organization.

Plenty of savvy businesspeople around the world are willing to try something different. As a result, we predict, most businesses will be required to change more and more often in the coming decade than they have in their previous histories. And if they stick with their old practices and behaviors, a great many won’t be able to handle the changes.

Confronting reality is especially important for CEOs of established companies, often shielded from the marketplace by layers of managers who put their own spin on events. Changing the business model that has made a company successful is difficult because the model itself defines the information managers seek, shapes their interpretation of information, and is embedded in a firm’s metrics. The most critical tasks for a CEO are to recognize when the business model needs to be significantly altered, and to lead the coordinated transformation of the company into its new reality.

Bossidy and Charan don’t offer managers the pragmatic, in-depth advice about how to develop and refine a business model that made their previous collaboration, Execution: The Discipline of Getting Things Done (Crown Business, 2002), so successful. Instead, they offer their perspectives about the business models and changes in business models at Cisco, Sun, Home Depot, and several other businesses. Although the case studies don’t offer the kinds of lessons that could help inform young managers, the description of how effective managers formulate strategy — and the reminder of the need to confront reality — make Confronting Reality a worthwhile read.

**Customer Interaction**

C.K. Prahalad and Venkat Ramaswamy argue that the future of competition will be to offer customers superi-
or experiences by “co-creating unique value” with them. A focus on customer experience isn’t new, of course. Most companies recognize that ever more demanding customers, fast following by competitors, and increasing product parity make customer experience the next frontier. The contribution of Prahalad and Ramaswamy is to recognize that the delivery of superior customer experiences requires a fundamental change in company mind-sets and business models. Traditionally, companies have seen customers as passive — exactly as Bossidy and Charan depict. It has been up to the company to engineer products and value chains to serve customers’ needs. In contrast, Prahalad and Ramaswamy demonstrate that personalized experiences are created through the interaction of companies and customers: More-active customers and less-in-control companies “co-create” value, making customers a full element of the business model.

The authors use four case studies to illustrate the meaning of co-create. Amazon.com is a great example of a company that, instead of offering products, offers “experience environments that shape themselves to consumers’ needs and preferences, not the other way around,” they write. “As a customer, I get recommendations for books, music, and movies based on my tastes, on the selections of those who have purchased the same books I have, on bestseller lists, [and] on reviews by professional critics and fellow Amazon users.” Although Amazon develops the overall environment and contributes data and algorithms, its recommendations also reflect the customer’s past choices: What’s on each screen is co-created.

Another case illustrates how marketers can give customers the opportunity to contribute directly to product development — to improve product targeting, to generate excitement, and to accelerate penetration of new products. Prior to the release of Lord of the Rings: Fellowship of the Ring, New Line Cinema provided more than 400 unofficial Tolkien Web sites with insider tips, rough sketches of costumes, handwritten production notes, and other exclusive content, and then asked for feedback — co-opting the rabid fans and increasing buzz for the movie.

Communities of customers can enhance the experience of each customer, not just through product reviews and rankings, but by performing applications engineering. For example, a customer of Lego Mindstorms Robotics Invention System (a kit including a microprocessor to create toy robots) developed a new unauthorized operating system for the microprocessor and made it available to other customers over the Internet.

Most fundamentally, communities of customers can help shape the evolution of a company’s product lines and its entire business. EBay CEO Meg Whitman embraces the suggestions of the site’s communities of buyers and sellers, who exchange an estimated 200,000 messages a week concerning tips, problems, and possible site improvements.

Co-creation requires major changes in operations. Marketing, for example, must be organized with several “experience gateways”: one for customers interested in extensive help or involvement, another for users who want only a simple transaction, possibly one for users willing to purchase the product over the Internet, and a different gateway for users who want to touch the product or interact with a human being. Operations must be more flexible, capable of providing each customer with a consistently high-quality experience without a significant increase in costs. Management of risk is more important and more difficult, since customers are part of the experience of other customers.

One warning about The Future of Competition: It describes ideas that are still a work in progress. The ever-changing frameworks, the jargon, and the lack of specific guidance about what a company should do may frustrate readers. But it’s a valuable book, we think, because of the importance of the issues that Prahalad and Ramaswamy address and the power of their ideas.

Maps and Metrics

Strategy Maps, by Robert Kaplan and David Norton, continues the intellectual journey begun by the authors in their previous books, The Balanced Scorecard: Translating Strategy into Action (Harvard Business School Press,
The four elements of a strategy map are:

1. **Financial Performance.** This lagging indicator provides the ultimate definition of an organization’s success. Strategy describes how an organization intends to create sustainable growth in shareholder value.

2. **Customer Value Proposition.** Success with targeted customers is a principal component of improved financial performance. In addition to measuring lagging indicators of customer success, such as satisfaction, retention, and growth, the customer perspective defines the value proposition for targeted customer segments.

3. **Internal Processes.** These create and deliver the value proposition for customers. The performance of internal processes is a leading indicator of subsequent improvements in customer and financial outcomes.

4. **Learning and Growth.** Intangible assets are the ultimate source of sustainable value creation. Learning and growth objectives describe how the people, technology, and organizational climate support the strategy. Improvements in learning and growth measures are leading indicators for internal process performance, customer outcomes, and financial performance.

Objectives in the four perspectives are connected in a chain of cause-and-effect relationships: Enhancing and aligning intangible assets leads to improved process performance, for example, which drives success for customers and shareholders.

*Strategy Maps* offers checklists of potential objectives (and associated metrics) that will stimulate any manager’s thinking. Managers with an operational orientation can even use the strategy-maps process for creating and evolving strategy to test and refine their business model. Kaplan and Norton, however, fail to consider the complex dynamics of shareholder value creation. We suggest using their objectives and metrics, but developing your own causality.

Kaplan and Norton’s strategy maps are consistent with both our concept of integrated strategy and Bossidy and Charan’s business model concept. Both include financial targets and customers; internal activities are subdivided into internal processes and intangible assets; and external realities are reflected in the specific metrics that companies select. However, where Bossidy and Charan err on the side of art, Kaplan and Norton come down on the side of science. Indeed, whether it’s intended or not, *Strategy Maps* can lead the reader to think that management is simply a mechanized process of identifying and pulling levers. But that’s precisely the reason these books have power when read side by side — think of them as stepping stones on the pathway toward integrated strategy.

Each of these books offers different value for different readers depending on their knowledge and needs. So we suggest selectively investing your time, depending on your context.

For students of business, these books are all must-reads, both to understand the state of play in the ongoing strategy dialogue and to become familiar with some lasting ideas. Aspiring managers should sample a chapter or two of each, delving deeper into the book that addresses the issues that concern them most directly. Senior managers and strategists will find little that’s new in any of the books, although they may find important reminders and some new avenues for further thought.

Whether you read these books or not, we urge you to keep in mind the insights we have highlighted from each, particularly Bossidy and Charan’s admonition: Confront reality. Every manager should continually question whether his or her business is adequately confronting reality. Will the traditional business model continue to generate profitability? Are traditional competitors changing their models? Are potential competitors testing new business models? Is my business in danger of losing its preeminence?

These are certainly the right questions, and we predict that as the study and theory of strategy evolves, future authors will continue to investigate and emphasize the interrelationships between the external realities and internal operations of businesses, eventually arriving at a consistent, unified theory of integrated strategy.
Doing THE Right Thing

by David K. Hurst

Management is the practice of getting the right things done, individually and collectively: It may use a little bit of science, but mostly it’s an art and a craft. Management competence, as a practice rather than a profession, is not easily taught in the abstract, but is best learned in context through a combination of action and reflection. Thus in management, unlike engineering or medicine, a skilled “layperson” can often outperform a university-trained expert.

Seven of the dozens of management books published over the past year have special merit for that skilled layperson or for those studying management formally. They deal with diverse subjects, from the importance of willpower for managers to the lessons taught by the rise and fall of leaders at the venerable Coca-Cola Company. The authors include such practitioners as Ricardo Semler — the outspoken South American “antimanagement” CEO of Semco — and such academics as Henry Mintzberg, the Cleghorn Professor of Management Studies at Canada’s McGill University. Each is a practical addition to the management bookshelf.

Will to Manage

If you agree that skilled amateurs often make better business leaders than trained professionals, Mintzberg’s comprehensive assault on the MBA degree and the institutions that grant it is a good place to start. In Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development (Berrett-Koehler, 2004), he supports his attack with sound argument and solid evidence.

His book is divided into halves. The overall theme of the first part, titled “Not MBAs,” will be familiar to readers of Mintzberg’s previous books. Like the author, you will wonder how management education, at least in the Western world, has become dominated by self-perpetuating programs that often select cognitively gifted but emotionally blind, self-centered individualists and then train them, not to act, but to control the actions of others. The MBA encourages abstraction and detachment; it favors the hard and the analytical. But management practice itself is soft and social. In the second part of the book, titled “Developing Managers,” Mintzberg provides a comprehensive framework for producing what he calls “engaged” managers who have a
“will to manage” rather than just an interest in business.

Mintzberg’s prescriptions are based on his pioneering International Masters Program in Practicing Management (IMPM), a joint venture among five international business schools, each of which supplies the context for an action/reflection module of the program. (See “Reality Programming for MBAs,” s+b, First Quarter 2002.) The objective of the IMPM is to develop the right people (practicing managers), at the right time (mid-career), with the right outcome (engagement). With management or leadership (Mintzberg uses the terms interchangeably) seen as something to be fostered and evoked rather than injected — to be “pulled” rather than “pushed” — the author describes how the IMPM looks for people who demonstrate the will to manage and who have sufficient experience upon which to reflect.

The course of learning is built around five modules or “mind-sets”: reflection, analysis, worldliness, collaboration, and action. Each is taught at a different university in a different part of the world. Mintzberg does not pretend to have all the answers to what business education should be, but he is asking all the right questions and providing helpful advice on how to develop engaged managers.

Acts of Volition
The concept of will, or volition, to give it its technical name, fell out of favor in the social sciences in the aftermath of World War II because of the close association of the language of volition with the brutal regimes of both Nazi Germany and imperial Japan. It was replaced by the more abstract concept of motivation. The result was a loss in descriptive power, because the idea of will carries connotations of visceral, personal commitment that motivation lacks. More recently, several prominent social scientists have called for the restoration of the concept of volition to respectability.

Heike Bruch, professor of leadership at the University of St. Gallen in Switzerland, and the late Sumantra Ghoshal, of the London Business School, focus on the concept of will in A Bias for Action: How Effective Managers Harness Their Willpower, Achieve Results, and Stop Wasting Time (Harvard Business School Press, 2004). The book defines will as purposeful action with high energy and high focus, and suggests that, in the authors’ experience, only about 10 percent of managers exhibit this behavior.

The book focuses first on the invocation of individual willpower, and then moves on to the contexts that help evoke willpower in others. The “bootstrap,” self-help quality of the first part tacitly acknowledges the fact that the descriptive advantages of volition come packaged with a chicken-and-egg conundrum: Where does willpower come from? In the Western management lexicon, motivation is usually something supplied from the outside in — one motivates someone else via an array of incentives and inducements. Willpower, on the other hand, like confidence and courage, is an inside-out, auto-poietic process: You need willpower to get willpower!

Despite this apparent need for a developmental process to assist individuals in their search for will, Bruch and Ghoshal instead present their advice in the form of context-free strategies to be pursued. This is not entirely satisfactory, as injunctions to “identify and understand your deepest desires” make the reader wonder who this person might be who can stand outside and understand “me.” Clearly a third party — a coach, a therapist, or a supportive team of peers — would be valuable in the process.

For the individual, the marker of the threshold between mere motivation and true volition is what the authors call the “Crossing of the Rubicon,” the moment when the priorities become clear and conflicts between thoughts and emotions disappear. Action begins to flow. In both individuals and organizations, this moment is often precipitated by an external challenge, such as a corporate crisis or a new boss. The authors tell several stories about organizations facing challenges and how the responses of managers to these tests changed the level and quality of energy in the organization. Perhaps the major takeaway for the practicing manager is that if willpower, at its roots, is more a personal characteristic to be developed than a competence to be trained, then organizations should always concentrate on management selection before they turn to management development. Indeed, as Jim Collins observed in Good to Great: Why Some Companies Make the Leap … and Others Don’t (HarperBusiness, 2001), the question “Who?” should take precedence over “What?”

The importance of character to action in an organization is stressed in the U.S. Army development principle “Be, Know, Do.” In The U.S. Army Leadership Field Manual: Battle-Tested Wisdom for Leaders in Any Organization (McGraw-Hill, 2004), the meaning of this mantra is explored at three levels: personal, organizational, and strategic. The manual is packed with quotes
and stirring anecdotes drawn from some of the most dramatic moments in U.S. history.

The conceptual models of leadership used in the book efficiently convey an eclectic set of ideas, although the armed services penchant for acronyms may occasionally bewilder the lay reader, especially as the index supplies no key to them. “Be” consists of personal values and an individual’s mental, physical, and emotional attributes; “Know” is made up of interpersonal, conceptual, technical, and tactical skills; and “Do” is divided into influencing, operating, and improving. Underpinning it all is the army’s concept of will — the warrior ethos with its total commitment to winning the wars and its refusal to accept failure.

For managers in the private sector, this manual is a timely reminder that it is possible to create a cohesive, purposeful organization without leaning on that crutch of modern management, the incentive plan. The army is an institution rather than an occupation, and people join it for every reason other than financial reward. The army also makes a clear distinction between training activities and fighting activities, although its leaders go to great lengths to simulate battle conditions in their training so they build sound habits — conditioned responses — that will be robust under stress. Structured opportunities for reflection on action are seen as a critical part of the learning process. Thus after-action reviews (AARs) are designed to allow learning in a team context after a mission and are clearly distinguished from in-process reviews (IPRs), which are used for control purposes during a mission. In the private sector, this distinction is often blurred.

**Counterculture CEO**
The MBA degree is often a starting point for persons with innate managerial talent, who go on to challenge the conventional management methods they learned about in business school. There is no better example of this than Ricardo Semler, the Harvard MBA from Brazil whose iconoclastic style has made him a folk hero in management lore. His first book, *Maverick: The Success Story Behind the World’s Most Unusual Workplace*, published in 1993 by Warner Books, sold more than a million copies, and case studies of his firm, Semco, are found in business schools all over the world. Now, in *The Seven-Day Weekend: Changing the Way Work Works* (Portfolio, 2004), he updates us on the progress made at Semco over the past 10 years.

In a business that he describes as “sustainably out of control,” Semler and his people have innovated continually, in their management techniques as well as in their products and services. Semler sees himself as a catalyst for change — a Chief Enzyme Officer, as he calls himself — dedicated to finding the middle way between the “airy theories of workplace democracy and the nitty-gritty practice of running a profitable business.” His approach has much in common with open-book management practiced in the United States by firms like Johnsonville Sausage and the Springfield ReManufacturing Corporation.

The systems used at all three companies clearly work: People are empowered and the bottom-line results are there for all to see; but those systems run counter to almost everything taught in the business schools — managing by getting rid of managers, increasing corporate profits by giving more people a share in them, and so on. And once one is over that, there are other questions: Is this system indefinitely scalable? Is it suited only to particular kinds of business? Is it too dependent on one charismatic person at the top of the organization? And how would we get there from here?

The jury is out on many of these questions, and to compound the dilemma, Semler is a vocal critic of retired GE CEO Jack Welch and his famously Darwinian approach to performance assessment. But Semler does offer numerous ideas for programs that might be useful without requiring companies to embrace his whole system. There is the “Rush Hour MBA” program, for example, that runs once a week during the evening rush hour: Employees learn about and discuss the latest management ideas while the traffic dissipates. In another initiative (a personal favorite of this reviewer), a Semco factory created a garden, slung with hammocks, to allow workers to take afternoon cat-naps. Medical science has long recognized that our bodily rhythms predispose us to nap in the afternoon, and prominent...
nappers including John F. Kennedy, Winston Churchill, Albert Einstein, Thomas Edison, and Napoleon Bonaparte have endorsed the benefits.

Semler doesn’t claim that his ideas are unique. Indeed, he is an enthusiastic borrower: The “Lost in Space” initiative that allows young recruits to roam through the Semco companies for a year searching for a place to make a contribution is reminiscent of a similar program at W.L. Gore Associates. Semco’s “cardinal strategy,” with its slightly corny name “Whyway” (to contrast it, presumably, with the widespread My-Way-or-the-Highway management style), in which people are encouraged to ask the question “Why?” at least three times, is clearly lifted from the philosophy of the Toyota Production System. But creative borrowing is a hallmark of learners everywhere, and Semco’s ideas, whether original or borrowed, are edifying.

Just as Semler has learned from Toyota, businesspeople will find much useful insight in Jeffrey K. Liker’s The Toyota Way: 14 Management Principles from the World’s Greatest Manufacturer (McGraw-Hill, 2004). Toyota pioneered the idea of “lean production,” and Liker, a professor of industrial and operations engineering at the University of Michigan, does an admirable job of analyzing this seemingly simple but in fact complex and difficult-to-achieve lean production concept, which is rooted in a ruthless obsession to clear out waste. Liker clarifies Toyota’s 14 principles (many of which will be familiar to readers) by placing them in a four-level pyramid, with philosophy at the base, followed by process, then people and partners, and, finally, problem solving.

Japanese exponents of lean production are fond of using the fable of the tortoise and the hare to contrast their deliberateness and constancy of purpose with the rabbitlike leaps of many of their overseas competitors. At every turn, this contrast seems to capture the inherent counterintuitiveness of lean production to the Western-trained management mind. It highlights the tensions between the visceral and the cerebral, between learning and instruction, and between standards that are enabling and those that are coercive. Everything depends on the appropriate dynamic balance between these apparent opposites. And that balance takes discernment, judgment, and a sense of proportion— all arts for which there can be no formula.

The Real Thing

Cynics sometimes contend that what appears to be management excellence, like superior investment performance, is often the result of a short memory and a rising market, and that over time corporations’ financial results have a way of regressing toward the mean. The ending of the last bull market in North America certainly offers some support for this argument, and there is no better case in point than the rise and fall in the performance of the Coca-Cola Company. In The Real Thing: Truth and Power at the Coca-Cola Company (Random House, 2004), a meticulously researched, beautifully crafted book, Constance L. Hays, the food and beverage reporter for the New York Times, tells the company story. Our choice for the best management book of the year, The Real Thing focuses on the dynamics of the senior management group over the last 20 years, but in the process the author recounts the company’s entire history.

Coke is as much a cult as it is a company, with all those who make it to the top sharing a fierce, unshakeable belief in the transformational powers of sweet carbonated water. The management styles of the three top executives around whom Hays builds her story bear a rough resemblance to Mintzberg’s tripartite division of management into an art, a craft, and a little bit of science. The patrician, Cuban-born Roberto Goizueta, appointed CEO in 1981, was the visionary artist; Coke’s president, the affable Don Keough, was the craftsman; and the cool — some said icy — Douglas Ivester, an accountant who had become chief financial officer in 1985, was the scientist. Goizueta handled Wall Street and the board, and Keough fired up the troops, while Ivester devised the complex financial engineering that allowed Coke, via Coca-Cola Enterprises, to achieve a huge one-time transfer of wealth from its independent bottlers to the Coca-Cola Company itself. Together this triumvirate presided over an astonishing
increase in shareholder wealth as Coke’s share price zoomed from the low single digits in the early 1980s to nearly $90 a share in 1998.

One of the chief beneficiaries of this windfall was the legendary investor Warren Buffett, who had bought into the company in the mid-1980s. But after Roberto Goizueta, the toast of Atlanta and Wall Street, died suddenly of lung cancer in 1997, things began to fall apart. Don Keough had retired in 1992 but continued to be a shadowy presence in the Coke power structure through his access to board members and his huge network of contacts within the company. He opposed the appointment of Ivester as president in 1994 and CEO in 1997, and was critical of his performance. The simmering factional war between the “Keough people,” whose veins ran brown with Coke, and the “Doug-ettes” — gimlet-eyed financial whiz kids hired and promoted by Ivester — eventually boiled over. After several well-publicized external missteps, Douglas Ivester lost the confidence of Buffett and other key directors and was summarily “retired” early in 2000.

Among the first steps taken by the new president, Douglas Daft, was to bring back Don Keough as a special advisor. Alas, even this did not help, and in the downsizing and management turmoil that followed, Coke’s share price slipped steadily. Today it is in the mid-40s, the level it passed nearly 10 years ago on its way up. Perhaps the appearance of management incompetence today in Coca-Cola is as exaggerated and as misleading as were the illusions of management genius during the mid-1990s. Hays has done the field of management a true service in revealing the raw but real dynamics behind the corporate façade.

Fixing the Known

Corporate train wrecks like Coca-Cola’s in the late 1990s may be unforeseeable (even the sagacious Buffett failed to bail out of Coke stock before the fall), but many corporate and societal debacles are preceded by clear warnings, according to Predictable Surprises: The Disasters You Should Have Seen Coming, and How to Prevent Them (Harvard Business School Press, 2004), by Harvard Business School professor Max H. Bazerman and Michael D. Watkins, a consultant, author, and former associate professor at the Harvard Business School.

In their highly readable book, the authors define predictable surprises as the result of problems that are known to exist and that are getting worse over time. Fixing them, however, involves three challenges: First, it will incur a significant cost in the present to avoid a large, uncertain cost in the future; second, people in general want to maintain the status quo; and finally, a small but vocal minority benefits personally from inaction and works to subvert efforts for change. The authors look at the causes of inaction at three levels — human cognitive biases; organizational failures to scan, integrate, and learn; and political gridlock as a result of actions of special interest groups.

They argue that both the September 11, 2001, catastrophe and the Enron collapse could, and should, have been averted because in each case it was widely known that key processes — aviation security in the former and auditor independence in the latter — had been seriously compromised. Yet in the absence of “vivid data” about the actual events, actions to fix these processes were not taken in time, largely because vocal minorities — the airlines in the case of aviation security and the accounting profession in the case of auditor independence — lobbied effectively against change.

Bazerman and Watkins’s program for preventing surprises from happening consists of better recognition of threats, prioritization of issues, and the mobilization of people to action. Unfortunately, their recommendations come across more compellingly as a framework for classifying failures in hindsight than they do as tools to avoid surprises in prospect. The value in Predictable Surprises is the description of the contexts that inhibit our responses to known threats, rather than the gathering and prioritization of information that might help us predict new ones. Over time, for example, regulated institutions display an amazing capacity to undercut their regulators and turn the policy-making approach to their advantage. In the authors’ expert view, the auditing profession remains compromised, despite recent reforms such as the Sarbanes-Oxley Act, and thus may still be sowing the seeds of future corporate calamities. The authors list several other disasters looming on the horizon: global warming, the collapse of the U.S. Social Security system, and, more trivially, the continued devaluation of frequent flyer miles.

One predictable surprise missing from Bazerman and Watkins’s book is the possible decline of traditional business schools. Although one senses that the authors might not agree, if Henry Mintzberg, in Managers Not MBAs, and other commentators, such as Harvard Business School’s Clayton Christensen, are right, the MBA educational model as we have known it is well past its
zenith. It will gradually be replaced by a combination of other approaches, including in-house corporate programs and shorter nondegree courses. Some courses will use conventional methods to teach conventional skills; others will make use of the wide range of types of learning and managerial approaches evidenced in the seven books we’ve reviewed. Still others will immerse the learner in problem situations and combine action and reflection in new and different ways. The emphasis will be on selecting the right people with a demonstrated “will to manage” at the right time, and on placing them in the right contexts.

In management there will always be a tension between the left-wing view that every person’s desire to perform well is thwarted by restrictive organizational structures and policies, and the right-wing rejoinder that people are inherently lazy and need to be kept in line continually. It’s not a question of human nature: Context matters, and each view is to some extent a self-fulfilling prophecy. We understand that while some contexts can bring out the worst in people, others will evoke the very best. We need a vision of perfectibility to give us a sense of progress and improvement, and to help us find those managers who can craft and sustain the contexts that will summon the better angels of our nature without unleashing our devils. This will always be a delicate process, difficult to sustain for any length of time in any one organization.

Perfection may forever be beyond our reach, but optimism is always well within our grasp. As one of Oscar Wilde’s characters puts it in Lady Windermere’s Fan: “We are all in the gutter, but some of us are looking at the stars.”

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The case for all the corporate investment and management interest in information technology over the last two decades really rests on one premise: IT is special.

That special nature derives, first, from the technology itself. Yes, information technology (IT) is an input to production for all kinds of goods and services, as they
say in economics. But the stored-program computer is also a versatile, “universal” tool that is a source of productivity, innovation, and competitive advantage for companies, and a transforming agent of economic and cultural change for society as a whole.

Three recent books about IT share that assumption and sort through its implications in different ways, while a fourth gives an agnostic’s qualified dissenting view. Still, the authors of all four agree that now is a crucial time for rethinking the impact and application of information technology: The Internet bubble years are gone but hardly forgotten; IT spending is gobbling up about half of all business capital investment; new technologies are emerging apace; and the Internet’s impact on intellectual property law remains unsettled.

The Keystone Advantage: What the New Dynamics of Business Ecosystems Mean for Strategy, Innovation, and Sustainability, by Marco Iansiti and Roy Levien (Harvard Business School Press, 2004), presents the most original and compelling theme found in these new books. The “keystone” is a term drawn from biology that refers to a species (or corporation, in this case) that occupies the hub of a biological (or business) network and whose behavior improves the health of its ecosystem. Computing is no stranger to biological metaphors. The originators of object-oriented programming compared the behavior of their digital objects to cells in the 1970s. In business, academics and consultants have applied the notion of biological ecosystems to commerce for more than a decade. But Iansiti, a professor at the Harvard Business School, and Levien, a consultant, push the concept in provocative new directions in The Keystone Advantage.

The corporate keystones singled out by Iansiti and Levien include familiar corporate names like Microsoft, Wal-Mart, and eBay, but also some interesting, lesser-known companies. They provide an illuminating account of Li & Fung, a century-old Hong Kong–based trading company, for example, that is a vital hub in the apparel industry and that has relationships with more than 8,000 specialist firms in 40 countries. Using sophisticated IT tools, Li & Fung orchestrates a vast global supply chain to fit the needs of retailers like Gap and the Limited, guiding the production of firms employing more than a million people.

Organisms to Ecosystems
The spread of the Internet in the 1990s drastically reduced the cost of company-to-company communications, but only for a fairly limited kind of interaction, according to Iansiti and Levien. This is a crucial, if somewhat geeky, point in their analysis. Put simply, the first generation of Internet protocols, such as HTML, allowed for linking and viewing documents and Web sites. But the current generation of software protocols known collectively as Web services open the door to machine-to-machine, automated data exchange. In plain English, this would mean, for example, that one company’s manufacturing system can automatically reorder parts from a trusted supplier when a surge in demand indicates that parts are about to run low.

So the goal now within reach, the authors write, is “the creation of a truly interconnected ecosystem in which organizations are integrating both technology infrastructure and business processes.” Clever keystone companies like Li & Fung are moving quickly to adopt such Web services technology, while prodding and helping their business partners to do the same. The helping hand is the distinguishing characteristic of a keystone, for the keystone company succeeds or fails depending on the
strength or weakness of its ecosystem. Competition, Iansiti and Levien argue, is thus being redefined. “The crucial battle,” they write, “is not between individual firms but between networks of firms. Innovations and operations have become a collective activity.”

Successful keystone companies share technology, tools, customer lists, market intelligence, and the value created within their network. They are greedy, but greedy for large long-term rewards. Microsoft, in the authors’ view, is the archetype, having pursued what they call “the most successful keystone strategy of all time.” The linchpin, they assert, is Microsoft’s long-term care and feeding of the 5 million software developers in 20,000 companies and IT departments worldwide who have written more than 70,000 applications to run on Windows, the immensely lucrative center of the Microsoft ecosystem.

Iansiti and Levien assert that there are three possible corporate strategies in the new business environment: keystone, dominator, and niche. The keystone advantage, to borrow the book’s title, is obvious. The niche strategy is to leverage the assets of an ecosystem and specialize. The authors cite niche winners such as Nvidia — a designer and marketer of graphics chips, which works with a keystone, Taiwan Semiconductor Manufacturing Company, to manufacture its chips — and Intuit, the maker of personal finance and tax software, which runs on Windows. The dominator strategy, the authors suggest, is usually shortsighted. Dominators try to hold on to too much themselves, tend not to share information and technology, and never foster a big ecosystem as a result. Apple is the classic dominator.

The biological analogy presented by Iansiti and Levien, like all analogies, has its limits, but their analysis of business ecosystems and strategy is both thoughtful and insightful — an important contribution to the IT literature. The most controversial aspect of the book is its policy prescriptions. According to Iansiti and Levien, keystones are all but paragons of virtue. It is a fallacy, the authors tell us, that keystone companies are chokepoints to innovation, or that they control their industries. The authors say they hope the ideas in their book will “spur a new look at antitrust economics.” It is essential for public welfare, they argue, that “the crucial roles played by these organizations be safeguarded and reinforced.”

**Piracy and Property**

*The Keystone Advantage* can, at times, read like an elaborate defense of Microsoft, which, you will recall, lost a landmark federal antitrust suit not so long ago. Reasonable people can disagree as to whether Microsoft’s conduct can be defended on economic grounds — a subject beyond the scope of this article. But it’s worth noting that one of the authors’ niche winners, Intuit, would have been taken out by Microsoft with a hostile bid had that takeover not been challenged by the U.S. Justice Department.

Lawrence Lessig, a professor at Stanford Law School, uses a different sort of biological analogy to reach a very different conclusion about competition in the IT-driven world of business. In *Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity* (Penguin Press, 2004), he sees the new “knowledge ecology” made possible by the Internet being gravely threatened by powerful corporate lobbyists responsible for a “subtle corruption of our political process.”

Lessig is well known as a forceful advocate for restraint in the application of intellectual property law to the Internet. In previous books, he has set forth his view of what is at stake as the law and new networked technology collide. In *Free Culture*, Lessig warns that things are going badly wrong, largely because a few industries, particularly Hollywood and the music business, have unduly influenced the enforcement of copyright law and the public debate.

The danger, Lessig says, is that in cyberspace we may lose much of society’s “creative commons” — a legally shielded zone of “fair use” that permits the sharing and copying of words, images, and music for personal, academic, and other mostly noncommercial uses. This did not happen, for the most part, with earlier technologies, from the printing press to the video...
recorded. Yet the law’s response so far, notably under the Digital Millennium Copyright Act of 1998, has “massively increased the effective regulation of creativity in America,” Lessig writes. The risk, he asserts, is that we become not the “free culture” of the book’s title but a “permission culture — a culture in which creators get to create only with the permission of the powerful, or of creators from the past.” He adds, “If we understood this change, I believe we would resist it.”

Free Culture is Lessig’s effort to explain the change as he understands it. Much of the book is a reconsideration of two words — piracy and property — as they apply to creative or intellectual property. Who could possibly endorse piracy, a form of theft, taking something that isn’t one’s own? That is certainly the way the record, movie, and software industries have portrayed the issue: as simple right and wrong, legal and illegal.

Yet, as Lessig explains in some wonderfully informative historical passages, new media technologies — film, records, radio, and cable television — have always brought with them unauthorized use, charges of theft, and a period of legal and corporate wrangling before new rules were established. Cable TV, for example, refused to pay the broadcast networks for retransmitting their copyrighted telecasts. Eventually, a fee was set that cable operators did have to pay the broadcasters, but a modest one determined by Congress so the broadcasters did not have power over the emerging technology of cable. “Every generation welcomes the pirates from the last,” Lessig writes. “Every generation — until now.”

The author casts his stance as a call for level-headed moderation against the extremism of the “copyright warriors.” Lessig quotes congressional testimony by Jack Valenti, the recently retired president of the Motion Picture Association of America, in which he says that all Hollywood is asking is that creative property owners be accorded the same rights as all other property owners. While this sounds reasonable, creative property rights have always been treated differently from physical property, notes Lessig. Traditionally, some unauthorized but legal copying has been protected in the interests of education, innovation, and creativity.

Lessig is a clear thinker and a fluid writer. But Free Culture is an advocate’s brief, and he sometimes stretches to try to make his points. He observes that all creative culture borrows from the past, noting that Disney borrowed from fairy tales and legends for its animated classics, from Snow White to Mulan. This “borrowing” he equates with the music-copying mantra, “Rip, mix, burn.” But a teenager pointing and clicking a computer mouse hardly compares to Snow White, the pioneering animated feature and Academy Award winner.

Lessig nevertheless makes a powerful case that the pendulum in intellectual property law has swung too far in favor of powerful rights-holding companies. He cites a string of legal decisions and corporate actions that do run contrary to common sense, including Fox’s demand that a documentary filmmaker pay $10,000 for a scene showing opera stagehands watching The Simpsons on TV for four seconds.

My own sense is that the pendulum in the intellectual property debate has by no means come to rest. Lessig suggests as much at the end of his book: “I’ve told a dark story. The truth is more mixed.”

**Darwin and Silicon Valley**

Both The Keystone Advantage and Free Culture point to technology as a force that opens the door to larger realms — an ecology of innovation and business ecosystems. Two other books focus more narrowly on the technology business and what appears to be its march toward maturity.

The Business of Software: What Every Manager, Programmer, and Entrepreneur Must Know to Thrive and Survive in Good Times and Bad, by Michael A. Cusumano (Free Press, 2004), has grim news for the software industry, declaring that there are probably “too many software companies in the world by a factor of three or more.” But Cusumano, a professor at the Massachusetts Institute of Technology’s Sloan School of Management, regards the Darwinian winnowing not as a sign of graying old age, but as a necessary step toward renewal.

The industry, perhaps more than any other, is a test bed for innovation and new business models largely because its essential ingredient — software — is a building material without material constraints. As one market opportunity fizzes, entrepreneurs quickly retool and chase another. In The Business of Software, Cusumano presents a fascinating litany of successes and failures, including those of startups he knows firsthand, like firstRain (whose distinguished backers include Stanford president John Hennessy).

Cusumano’s theme is that the $600 billion software industry is transitioning from a products orientation to a services orientation. Until the recent technology slump, he writes, “I believed — and I think most venture capital-
ists, managers, and entrepreneurs also believed — that it was better to be mainly a product company. I no longer think this is true.” The industry isn’t so much maturing as evolving, according to Cusumano, as more and more vendors offer their customers hybrid solutions of software and services. This has been IBM’s strategy for years; SAP has its version of the same formula; and even Microsoft, the classic software product company, has moved in that direction by adding in-house experts in everything from banking to health care and forging close partnerships with services suppliers like Accenture.

The Microsoft ecosystem, as Iansiti and Levien would put it, embraces services these days. The value in software is moving up the food chain of business, closer to partners, suppliers, and customers, and farther away from the innards of computing.

A Defensive Weapon
Does IT Matter? Information Technology and the Corrosion of Competitive Advantage, by Nicholas G. Carr (Harvard Business School Press, 2004), is the most skeptical of the books reviewed. Carr, a former editor of the Harvard Business Review and now a consultant, author, and columnist for this journal, argues that IT is going the way of the industrial technologies of the 19th century — think of the railroads and the telegraph — to become an ordinary factor of production. “From a strategic standpoint they began to become invisible; they mattered less and less to the competitive fortunes of individual companies,” Carr writes. “Information technology is heading down the same path.” This is the seemingly subversive thesis of Does IT Matter?

The book is a longer treatment of a Harvard Business Review article, published in May 2003, that touched off a fierce debate, especially among those who read little more than its inflammatory headline, “IT Doesn’t Matter.” Of course IT matters, Carr writes, just not in the way many businesses assume. Yes, he agrees, technology lifts productivity and reduces costs. But Carr asserts that as IT matures, spreads, and becomes more standardized, the strategic value any individual firm can gain from technology diminishes. His strategic advice, then, is to keep a tight grip on the IT budget and “innovate when risks are low.”

In Does IT Matter? Carr is not the counterrevolutionary that the tabloid headline on the HBR article suggested. He says that IT is more a defensive weapon than an offensive one for most companies, but still a vital one. “Indeed,” Carr writes, “as the strategic value of the technology fades, the skill with which it is used on a day-to-day basis may well become even more important to a company’s success.”

The authors of all four of these books, including Carr, suggest that the importance of information technology as a stand-alone thing, the raw bits and bytes, is receding. Yet that is because it is becoming a more integrated part of business and society with the potential for great benefit or mischief, not less important or necessarily a commodity.

The future of information technology and its impact on our world depends on whether it is more like an industrial technology, as Carr suggests, or more like biology. Cusumano, for example, may be skeptical about the fate of many of today’s software companies, but he betrays no doubts about the technology. Software applications, he writes, are “limited mainly by human imagination. Since human creativity is so vast in potential and computer hardware is still evolving by leaps and bounds, it would be foolish to think of software technology as being mature.”

The optimistic “biological” view of IT may ultimately turn out to be wrong. But on the basis of the evidence in these books, it seems to have more power than the “industrial technology” view for explaining the past and present, and more promise for envisioning the future.

We’ve been forced to go a bit afield in choosing this year’s best leadership books. In addition to the usual how-to manuals — two of which provide practical guidance for anyone interested in business — we’ve included two biographies, both abounding with lessons for executives. We’ve also included a work of fiction, and even one journalist’s salacious screed about corporate malfeasance. Given the observed dearth of leadership in the public and private sectors, it is not surprising that the authors of this year’s list of standouts focus on the mistakes leaders make, why they fail so often, and what they need to do to become both more effective and more ethical.

Intel Chairman Andy Grove, surveying the wreckage wrought by the business scandals of the first years of the 21st century, confessed that, “These days I’m ashamed I’m part of corporate America.” Three of the four business books we review here cite Tyco’s Dennis Kozlowski as their poster boy for leadership misbehavior. The implicit conclusion of the authors is that the “take charge” leadership treatises published in the late 1980s and early 1990s didn’t generate the right kind of behavior, so now they say it’s “back to basics.”

**Authentic Leadership**

During the 1990s, CEOs of most American companies focused on the bottom line with the single goal of creating shareholder wealth. The idea was for CEOs to look tough, act tough, and talk tough. Many of them would not have been caught dead discussing soft stuff like ethics, values, openness, or corporate responsibilities to customers, employees, and host communities. When the Enron/Andersen scandal broke, followed by a tidal wave of revelations of similar corporate crimes, the initial reactions among American business leaders ranged from deafening silence to “it’s just a few bad apples.” Not many spoke out in condemnation, and even fewer suggested the need for better executive behavior.

There is something refreshingly old-fashioned, therefore, about Bill George’s *Authentic Leadership: Rediscovering the Secrets to Creating Lasting Value* (Jossey-Bass, 2003). During the 10 years George was CEO of the medical technology company Medtronic Inc., he practiced a philosophy in which “shareholders come third” — the belief that investors can benefit only as the result of efforts of empowered employees who effectively serve customers. To that end, George promulgated such business values as producing top-quality products, treating employees with respect, and acting with integrity in dealing with all his company’s stakeholders. The bottom
line: Medtronic created $60 billion in value on his watch, and investors saw shares appreciate at a compound rate of 32 percent a year.

He says the secret to his stewardship was the practice of “authentic leadership,” the traditional approach to running companies that had been the hallmark of such now nearly forgotten CEOs as Max DePree (Herman Miller), Jim Burke (Johnson & Johnson), David Packard (Hewlett-Packard), Ken Dayton (Dayton Hudson), and J. Irwin Miller (Cummins Engine). These are leaders, in George’s words, who were “committed to stewardship of their assets and to making a difference in the lives of the people they serve,” leaders who had “a deep sense of purpose” and who recognized “the importance of their service to society.”

In fact, unless young leaders are willing to commit themselves to such higher corporate purposes, George believes they shouldn’t bother to enter the profession of business. And he offers eight questions they need to ask themselves before making that commitment, including “How do I balance the conflicting needs of my customers and my employees with the requirement to make bottom-line numbers?” Importantly, he says there is no inherent contradiction between making one’s numbers (he did so himself 55 out of 56 quarters) and demonstrating ethical leadership; instead, he argues that leaders will not find the way to realize those two ends simultaneously if they don’t first establish doing so as their goal.

George doesn’t just spout pieties; he gives concrete examples of what such virtuous leadership entails: focusing on the long term, developing the overall leadership capacity of an organization, providing balance between work and family life, and creating a system of exemplary governance. Some of George’s own leadership practices were counterintuitive, even courageous — as when he bucked the politically correct “when in Rome, do as the Romans do” trend in global business. Rejecting such cultural relativism, he cogently explains why he established a single worldwide standard of ethics for all of Medtronic’s far-flung operations. Most important, George practiced what he preached. Hands down, this was the year’s best book written by a business leader, and is our choice for the best book in this category.

Alan Price’s Ready to Lead: A Story for Leaders and Their Mentors (Jossey-Bass, 2004) is a fictional account that aims at encouraging would-be leaders to follow a path similar to the one Bill George blazed at Medtronic. It is the story of a rising young executive (Mark) who, during his annual appraisal, is asked by his mentor (Patricia) to take on a special assignment. Before he agrees, she asks him, “Are you ready to lead?”

Although somewhat contrived, the book follows Mark on assignment over the next few months as he tries to help the managers of a subsidiary whose business is in trouble. Mark comes on strong with his initial diagnosis: The ship is sinking because nobody thinks the situation is serious, and everyone points to external factors as the cause of their problems. Worse, Mark tells them there is a woeful lack of accountability in which no one is willing to say what they will do, or do what they say.

After Mark ineffectively fumbles around trying to get people in the subsidiary to change, mentor Patricia teaches him that he, too, must become a mentor in order to lead. She teaches him that effective mentors/leaders create challenges that take people out of their comfort zone, while also creating safety nets so that they will be willing to try new things. Mark then proposes a new definition of leadership, which is “the unleashing of human passion toward a goal; while management is the organizing of skills and resources toward a goal.” While agreeing, Patricia proposes that leadership comes down to building “a community of purpose,” a conclusion shared by Medtronic’s George.

Stumble and Fall

Why CEOs Fail: The 11 Behaviors That Can Derail Your Climb to the Top — and How to Manage Them (Jossey-Bass, 2003), a leadership primer by executive coaches David L. Dotlich and Peter C. Cairo, starts with the premise that CEO failures are certainly costly in terms of money, but even more so in terms of negative publicity for companies, the undermining of competitive edge, and the driving away of good employees. They point out
that many of history’s best-known CEO failures were considered strong leaders before they made sudden and fatal blunders: One year you’re a Fortune most admired executive, the next you’re Ken Lay! The authors argue that when executives act in illogical, idiosyncratic, or irrational ways, their behavior is not due to a momentary loss of judgment or insufficient brainpower. In fact, most of those who have crashed and burned had previously demonstrated the intellect, skills, and experience to lead their companies through the challenges they later encountered — but, for some reason, their mojo failed them.

Drawing on Daniel Goleman’s work on emotional intelligence, Dotlich and Cairo conclude that the reason leaders fail has more to do with who they are than with what they know. Leaders are vulnerable to identifiable “derailers,” that is, deeply ingrained personality traits that unconsciously affect their decisions and actions. Paradoxically, these derailers often are excesses of a leader’s greatest strengths. For example, a brilliant analyst may become frozen when under stress because his hardwired penchant for running the numbers is inappropriate for meeting a particular problem at hand — for instance, a sensitive personnel decision. The good news, the authors claim, is that such problems can be prevented if a leader recognizes the telltale signs of derailment, and then learns to act appropriately.

To help leaders with this process, Dotlich and Cairo identify and describe the symptoms of 11 derailers, most of which, like arrogance, volatility, aloofness, and perfectionism, seem perfectly intuitive. More usefully, they provide tests to help leaders see if they have crossed the danger line between the positive aspects of a potential derailer and its negative ones. How, for example, does one tell when healthy self-confidence crosses over to become arrogance? The authors say the willingness to fight for what one believes is a useful leadership trait, but the unwillingness to give up a fight, no matter what, gets leaders in trouble. Similarly, it is positive for leaders to believe their perspectives are correct after evaluating other points of view, but those who believe their perspectives are correct before evaluating others’ ideas are headed for derailment. They warn that leaders who enter the red zone of arrogance display diminished capacity to learn, refuse to

be held accountable, are resistant to change, and are unable to recognize their limitations. The authors cite Tyco’s Kozlowski to demonstrate the point.

### Triangulate the Truth

The cover of Christopher Byron’s Testosterone Inc.: Tales of CEOs Gone Wild (John Wiley & Sons, 2004) tells it all: Superimposed on Mt. Rushmore’s presidential visages are doctored photos of Jack Welch, Al Dunlap, Ron Perelman, and, yup, Kozlowski, all leering at a miniskirted pneumatic blonde. The book is basically four unauthorized — to say the least — biographies of these former CEOs, each with enough skeletons in his closet to decorate a Halloween ball. Unfortunately, Byron’s tawdry and titillating tales obscure what might have been, in other hands, a profoundly useful message: Power corrupts, and character counts, as much in the executive suite as in the Oval Office. The problem isn’t just the yachts, private jets, and other perks unwittingly paid for by shareholders. Byron, an author and columnist for the New York Post, also cites far more serious abuses of executive power that can lead to front-page scandals and destroy the credibility of executives and the companies that employ them.

Byron’s main target is Jack Welch. He sets out to document Welch’s dark side — reputed womanizing, adolescent partying, an insatiable need for power, and abusive behavior toward subordinates. But the picture that emerges of Welch is as fatally unbalanced as the official history of his GE turnaround, Control Your Own Destiny or Someone Else Will (by Noel Tichy and Stratford Sherman; Doubleday, 1993). And it is as absent of Welch’s positive contributions as his memoir, Jack: Straight from the Gut (Warner Business Books, 2001), is of the negatives. Perhaps if you read all three of these books you might be able to triangulate to something close to the truth.

Lost in Byron’s masterpiece of innuendo, supposition, and overstatement is an important message for business journalists, corporate boards, and shareholders: Be on the alert for early indicators of problems from ambitious executives who may be unconsciously seeking compensation for their impoverished childhoods, distant or
missing parents, or whatever psychological wounds they carry. Shareholders of Tyco were the ones who ended up paying for the failure to spot the obvious danger signs in their CEO’s behavior. As Byron usefully points out, nobody wants to call attention to the negative side of executives when stock prices are rising; it is only after a company loses money — or the press runs stories about company-funded birthday parties for the First Spouse in Sardinia — that there is willingness to acknowledge unethical executive behavior and abuses of power.

**Two Treasury Secretaries**

Byron’s book also calls attention to the fact that what’s missing or glossed over in most leadership texts is the real stuff of organizational life: intramural machinations, manipulations, shifting alliances, clashes of ego, and inevitable struggles for wealth, fame, and power among ambitious men and women. To learn how leaders make their way through that thicket, readers may be best served by turning to history or biography, as works about two former U.S. secretaries of the treasury — separated by two centuries but united by their ultimate failures to cope with Washington politics — illustrate brilliantly.

Few people join the Cabinet with more preparation or relevant experience than did Paul O’Neill. Ron Suskind’s *The Price of Loyalty: George W. Bush, the White House, and the Education of Paul O’Neill* (Simon & Schuster, 2004) examines the 2001–02 period during which O’Neill served as the secretary of the treasury under President Bush. A rising star in the Ford administration, O’Neill served in the Office of Management and Budget, where he not only learned firsthand how the White House runs, but became close to two redoubtable public figures, Alan Greenspan and Dick Cheney.

After leaving government in 1977, O’Neill went to International Paper as a senior executive and then was recruited from his position on the board of directors of Alcoa to be its chairman and CEO. There, he famously changed the organizational model and challenged his managers to make Alcoa more than “a compliance company” by setting the environmental standards for the aluminum industry. Because of his government experience and well-earned reputation at Alcoa, he was an obvious choice to be treasury secretary, although he had a reputation for being outspoken and was not entirely in line with the president-elect’s positions.

Suskind describes O’Neill’s reluctance to take the position — a reluctance that was overcome by what he saw as a golden opportunity to act boldly to keep the economy growing and to solve the Social Security mess. In what amounts to a prenup meeting, former colleagues Greenspan and O’Neill engage in a fascinating discussion, carried out in a shorthand bred of years of working together, in which they conclude that tax cuts with triggers (cuts conditional on the health of the budget) are the best way to stimulate growth and, furthermore, open the possibility of reforming Social Security.

Despite feeling there might be difficult political battles ahead, O’Neill decides to take the job. Indeed, early in his tenure he begins to express concern about the substance of the administration’s economic and tax policies. He is an analyst through and through, focusing on key numbers and metrics and then building strategies around the assembled facts. He believes the public is entitled to truth and transparency, and he advocates using “Brandeis briefs,” a process by which policy is made by confronting opposing arguments. Indeed, his M.O. is to “trust process and the ends take care of themselves.”

Ah, as Jon Stewart would say, that might not be the way decisions are currently made on Pennsylvania Avenue. O’Neill starts to worry about his relationships with others in the administration, including the veep, who seems not particularly interested in his old buddy’s analyses, and the president, whose management style is to be “detached” from the process and substance of policy making. As the administration becomes increasingly focused on unseating Saddam Hussein, O’Neill feels his influence wane. At about this time, he senses that ideology is ruling over process, and that therefore his facts and analyses don’t count. Finally, he complains to Suskind that the president expected him to be loyal but hadn’t earned his loyalty.

As we know, O’Neill was forced out by the administration. A lesson to be drawn from his experience: It is a common failure of leaders to overestimate their ability
to change the minds of peers and bosses, or even to influence their modes of decision making.

This is a particular problem for numbers guys, as the first person to sit in the secretary's chair at Treasury also discovered. Ron Chernow's *Alexander Hamilton* (Penguin Press, 2004) is the historical biography that business executives should turn to if they wish to learn what leadership is really about. Unique among the historians who write about politics in early America, Chernow has a profound knowledge of management and finance, and this fine book offers business readers a detailed analysis of how a "numbers man" with the greatest leadership potential of his era derailed his own career. Hamilton was quite possibly the United States' finest civil servant, but he never achieved his goal of the presidency. The unraveling of his career is an object lesson in how not to lead.

Hamilton was perhaps the most brilliant, articulate, accomplished, and farsighted of the Founding Fathers. As well-educated as Adams and Jefferson, he matched their classical scholarship while adding deep practical knowledge of finance, economics, technology, government administration, and business management. He was also the most modern of the founders, a wonk like O'Neill who knew how to run the numbers, and did, producing significant technical reports on such subjects as banking, retiring the national debt, and creating incentives for entrepreneurs. His fertile mind was always racing, devising new plans and financial schemes: The cerebral Hamilton invented sophisticated managerial systems of accounting, planning, and control, some of which are still in use. Moreover, like O'Neill, he had courage, ambition, energy, and a willingness to sacrifice personal financial gain to serve his country. A principled and loyal patriot, as a young man serving in the Revolutionary Army he demonstrated great promise as a leader. Subsequently, he became the second most powerful man in America, developing the best resume to succeed Washington and Adams as president (and he was said to be even prettier than John Edwards). Hamilton is today remembered as "the father of American capitalism," having won the great ideological battle with Jefferson to create the economic system we enjoy today.

**Brilliant Martinet**

But Hamilton never became president because he was insecure, insensitive, opinionated, verbose, compulsive, headstrong, belligerent, proud, and lacking in self-awareness and self-discipline. He was a martinet, and an overstretched, overreaching micromanager. Brilliant in staff support to Washington, he was ineffective when operating on his own. A solo practitioner of the art of leadership, not only would he not tolerate fools, he wouldn't belly up to the bar with lesser intellects who might have become allies and followers. His charm was reserved for the ladies, and therein lay a great weakness: a sense of invincibility that led him to believe he could get away with anything. When a marital infidelity became public knowledge, he compounded the problem, ham-fistedly turning what might merely have been an embarrassment into an act of self-destruction.

Hamilton thought of himself as the paragon of virtue but, in fact, often acted without integrity: He treated those who disagreed with him as disloyal, and went for their jugular. It was not enough for him to win every argument; it was necessary for his opponents to lose, and even better for them to be humiliated publicly. "The intellectual spoilsport among the founding fathers," as Chernow puts it, he seems never to have considered that he could be wrong about anything. A contemporary cited his "pertinacious adherence to opinions he had once formed." This arrogance made him a lightning rod for criticism. Hamilton did not understand the need to nurture relationships, and his insensitivity turned former friends and colleagues into foes: For all their differences, Madison, Jefferson, and Adams found common cause in a distrust of Hamilton.

As a leader, Hamilton was a realist, believing men were basically bad: selfish and dishonest. He had no faith in "the people" and no interest in presenting them with hopeful, inspiring visions of a better tomorrow. Hence, he tried to lead without listening to the needs of follow-
ers. A generous and feeling man in private, he was all head and no heart in public affairs. Caught up in the minutiae of details and facts, he lost sight of the central task of leadership: creating followers. According to Chernow, Hamilton believed it was only necessary to be “right” on the issues:

Hamilton lived in a world of moral absolutes and was not especially prone to compromise or consensus building. Where Washington and Jefferson had a gift for voicing the hope of ordinary people, Hamilton had no special interest in echoing popular preferences ... he lacked what Woodrow Wilson defined as an essential ingredient for political leadership; “profound sympathy with those whom he leads — a sympathy which is insight — an insight which is of the heart rather than of the intellect.”

But Chernow’s book isn’t just about how not to lead. The hero of this biography of Hamilton turns out to be George Washington, the leader you would follow into battle and trust to sire your new nation. Washington, who “consulted much, pondered much, resolved slowly, resolved surely,” was no match for Hamilton intellectually, but he had unerringly good instincts and impeccable judgment. Chernow describes how Washington united a divided nation under the worst of circumstances, and channeled Hamilton’s self-destructive behavior into invaluable service for the fledgling nation. Indeed, there is a useful leadership lesson on almost every page of this remarkable biography.

Today’s business executives may sometimes feel that they’ve been cursed to live in unsettling times. But the challenges of leadership, as this disparate sextet of books demonstrates, never really change — they simply reappear in new and different forms.

Next Steps FOR Boardroom Reform

by Frances Cairncross

The start of the 21st century was not a good time for chief executives. In less than a year, from 2001 to 2002, more than a quarter of the largest American corporations experienced downturns in current or projected revenues, which prompted their stock prices to drop from the $50 range to $1 or less. In the last quarter of 2001, Enron, until then America’s fifth-largest corporation,
lost 99 percent of its value. All too often, managers tried to stave off disaster with misleading or even fraudulent financial reports.

Small wonder that CEOs came to rank in public opinion only a notch above used-car salesmen. Many CEOs are now more self-conscious about the public’s distrust of them. The vogue of the 1990s, the hero-boss, has given way to a fashion of chief executive officers who exhibit humility and straight dealing.

But how to ensure that there are no more Enrons, WorldComs, or Tyco’s? In the past year or so, several books have appeared with advice to offer, from people with a broad range of experience. They agree, for the most part, that the responsibility for corporate rectitude rests with boards of directors. And collectively, they suggest that the conduct of corporations depends, ultimately, more on character and teamwork than on regulation and legislation. But each offers a different viewpoint on the most contentious question in the current U.S. debate on boardroom governance: Whether the role of chairman and CEO must be split between two individuals.

Two of the books are by people who have run sizable businesses, one on either side of the Atlantic. Bill George, the former CEO of Medtronic Inc., having made a success of this big medical technology company (and acquired the splendidly titled role of Executive in Residence at Yale University), has written Authentic Leadership: Rediscovering the Secrets to Creating Lasting Value (Jossey-Bass, 2003). Sir Adrian Cadbury, author of Corporate Governance and Chairmanship: A Personal View (Oxford University Press, 2002), also made a success of his time at the family confectionery firm. One of his retirement jobs was chairing a committee on corporate governance whose code of best practices, published in 1992, has been the basis for corporate governance reforms in Britain over the past decade.

Two other books are by specialists in corporate governance who have spent their careers moving in and out of boardrooms as advisors or as independent directors. Back to the Drawing Board: Designing Corporate Boards for a Complex World (Harvard Business School Press, 2004) — s+b’s choice for the best book in this category — is by Colin B. Carter, a management consultant, and Jay W. Lorsch, a professor at Harvard Business School; The Recurrent Crisis in Corporate Governance (Palgrave Macmillan, 2003) is by Paul W. MacAvoy, a professor at the Yale School of Management, and Ira M. Millstein, a corporate lawyer.

Is “Buff” Enough?
The fifth book in this selection approaches governance from a different angle. In The Naked Corporation: How the Age of Transparency Will Revolutionize Business (Free Press, 2003), Canadian consultants Don Tapscott and David Ticoll attempt to unravel the impacts of information technology on society, the economy, and business. Their starting point is that “the crisis of 2002 was a crisis of disclosure and transparency” — the worst on Wall Street since the crash of 1929. Their antidote: lots more transparency. “If you’re going to be naked,” they counsel, in a sentence that clearly delighted their publishers, “you’d better be buff!”

To describe the collapse of the dot-com bubble as a crisis of disclosure seems rather odd. True, there was dishonesty in some big companies (but in only a small minority: not at GE, say, or GM or Procter & Gamble or a host of
hyped shares of e-companies excessively, persuading the gullible and greedy that pewter was silver and brass was gold. But the stampede into dot-com shares was the sort of mass mania that happens once every two or three generations, with tulips or railways or radio, and would probably have occurred even if every dot-com company had been “buff.”

And what about the “be buff” injunction? Tapscott and Ticoll describe all sorts of areas in corporate life in which, they argue, it is easier for the outside world to see what companies are doing, whether or not the exposure is desirable. Their basic theme — not surprisingly, given their past interest in things digital (their previous collaboration was Digital Capital: Harnessing the Power of Business Web, from Harvard Business School Press in 2000) — is that the Internet has turned the spotlight on corporate performance to an unprecedented extent. From that, they move swiftly to arguing that proactive communication and disclosure is a good thing, in all sorts of ways, and then to urging companies to do more of it. Companies should, for instance, come clean with nongovernmental groups; executives should avoid keeping secrets from employees; they should not be nasty to whistle-blowers.

Still, good information may be available but ignored. A study of the Enron message boards on the Yahoo Finance Web page, quoted by the authors, found enormous numbers of anonymous notes describing the company’s problems. When the dot-com boom was at its height, few investors wanted to listen to voices of caution. Quite a few companies see no benefit in subjecting themselves to the scrutiny that being publicly traded now imposes on them. In August, for example, the public but family-controlled Cox Communications announced plans to go private. Still, most large companies have no choice but to remain public; smaller and medium-sized ones may increasingly choose to remain private.

In Authentic Leadership (also reviewed in “Leadership,” page 18), Bill George has hardly anything to say about transparency as he describes what makes a good leader and examines the relationship between good leadership and good governance. He does, however, have much to say about ethics and authenticity, two key qualities he believes successful leaders must have. Companies that are led by people who are consistently authentic and ethical, one suspects, don’t need to worry much about installing elaborate machinery for corporate governance.

George worries anyway. Like other authors reviewed in this essay, he sees the structure and behavior of the corporate board as the key to good governance. He therefore wants to “restore the power of boards of directors to govern corporations,” and has some sensible, practical suggestions on how to do so.

The board’s job, he says, is oversight of executives who are subject to external pressures that could lead even the most moral among them astray. Indeed, the most striking passage in George’s book is not in his own words, but in those of Daniel Vasella, CEO of Novartis. “Once you get under the domination of making the quarter,” he says, “you start to compromise in the gray areas of your business…. The culprit that drives this cycle isn’t the fear of failure so much as the craving for success…. You are idealized by the outside world, and there is a natural tendency to believe that what is written is true.” If such temptations assail such an honorable and capable chief executive as Daniel Vasella, how much greater is the threat to those with a lesser sense of honor?

To govern well, says George, the board needs a set of governance principles and a governance committee made up of independent directors who nominate new directors, assess the performance of the board and its members, and handle succession planning. There should also be, he believes, a senior independent director (usually referred to as a lead director in the U.S.) who has a good working relationship and shares mutual respect with the CEO. Above all, the independent directors should meet regularly without the presence of the CEO — something George sees as “essential to good governance.” These conditions, he thinks, are of more importance than whether boards should combine the roles of chairman and CEO (as is normal in the United States) or separate them (as in Europe).

Perverse Incentives

More ruthlessly analytical than either the scattergun approach of The Naked Corporation or the genial semi-autobiographical approach of Authentic Leadership is MacAvoy and Millstein’s The Recurrent Crisis in Corporate Governance. Their admirably terse and lucid work has two particularly interesting dimensions. First, they put the evolution of better corporate governance into a historical context. Second, they pay close attention to the evidence that better governance leads to better financial performance.
On the historical front, the authors point out that this is not the first time American corporate governance has been under the microscope. In the 1960s and 1970s, aggressive acquisitive managers seized power from the board and built overstaffed, overdiversified empires through a process of excessive acquisition. The problem, the authors argue perceptively, was the reverse of that of the late 1990s: Then, managers used shareholder returns to overbuild the company and depress share prices; in the recent crisis, the problem was the overinflation of share prices. Then, corporate America paid its most important leaders like bureaucrats, as argued in 1990 by Michael Jensen, a Harvard finance professor, and Kevin Murphy (now at the University of Southern California); in response to such criticisms, corporate America now gives leaders too high a stake in the performance of their corporation’s stock.

Before the Internet bubble, MacAvoy and Millstein confess, they thought that governance had reached “an enviable pinnacle of excellence.” Now, they doubt

MacAvoy and Millstein conclude that the best proof of the efficacy of good governance is the clear undesirability of the alternative.

whether the extensive reforms in the Sarbanes-Oxley Act of 2002 and the new rules introduced by the Securities and Exchange Commission and the New York Stock Exchange have done enough to make boards undertake their duties properly.

Why, though, does it matter whether companies are well governed or not? Obviously, it is important that companies not break the law, and shareholders prefer not to lose money. But MacAvoy and Millstein have a chapter titled “The Ambivalent Results of Extant Research on the Impact of Strong Governance on Corporate Performance.” In a fine survey of the literature, they conclude that the best proof of the efficacy of good governance is the clear undesirability of the alternative: Few would argue that companies would perform better if they were once again governed by their management, with mere rubber-stamping by the board.

To reinforce this view, the authors have done a couple of studies of their own, one in 1997 and one recently. Their latest finding is that stronger corporate governance practices have delivered better performance in those large corporations that adopted them. It would be nice to believe that their finding is true. But it is at least possible that good governance and good management merely go hand in hand.

Like Bill George, Paul MacAvoy and Ira Millstein focus on the independence of the board of directors. “Where Was the Board?” they ask, in the scandals of the late 1990s. The key problem, they argue, was that the most troubled companies did not have adequately independent boards. But unlike George, they see the separation of the roles of chairman and chief executive as crucial to board independence. They also want the board to satisfy itself that the company’s management information systems are good enough to ensure that public financial statements are accurate, and they want sophisticated evaluation of management performance, used to monitor effectiveness and to set compensation.

Such a list of objectives places huge demands on board members. Wise Sir Adrian Cadbury, in his modest but persuasive Corporate Governance and Chairmanship, is more gentle toward the board. He praises the Anglo-Saxon unitary board over the German two-tier model, but he sees significant differences in the way American and British boards operate. There is little doubt which he thinks is more effective. On American boards, he says, the CEO is normally in charge, supported by the board. In Britain, the board is unquestionably in charge. “It is essentially a collegiate body reaching its decisions by consensus, and the CEO reports to it,” he writes.

Do the Split

Sir Adrian’s account of how a well-run board should operate is the best there is. He writes mainly for boards structured British-style, with a mix of senior executives and outsiders and with an independent and usually part-time chairman. The author has a tip for solving every quandary, whether it is what to do when the chairman disagrees with the finance director about a proposal coming to the board, or how to get rid of a chairman who is no longer up to the job. Like MacAvoy and Millstein, Sir Adrian believes in the advantages of splitting the
top job; he also argues that there are signs that the practices in America and Britain may converge, if American boards grow more collegiate, and as a lead or presiding director becomes the norm. But ultimately, as he emphasizes more than any other author, what matters is behavior. Structures matter; getting human relationships right matters more.

Of the past year’s crop of books on governance issues, though, none beats Back to the Drawing Board. Carter and Lorsch have an ideal combination of consultancy, real-world, and academic experience. They are prescriptive but not rigid, realizing that different solutions fit different companies. They both have long memories that allow them to describe what worked in the past, as well as what failed. Unlike MacAvoy and Millstein, let alone Tapscott and Ticoll, these experts remind executives about the international differences in approaches to governance. Ideas of what is appropriate board structure differ widely from one country to another. In Britain, for example, a company that combines the roles of chairman and chief executive is regarded with suspicion by regulators and shareholders alike. In America, the single “Chairman and CEO” is the norm.

Carter and Lorsch’s primary concern, however, is that by focusing on the external pressures for change, boards will ignore the basic actions they must take internally to become more effective. Boards must go “back to the drawing board” — closely examining their role by looking at the obstacles to doing their job properly and at the forces within the corporation that need oversight.

The authors debunk large tracts of accepted wisdom. They argue that the external appearance of boards — the proportion of outside directors, or the frequency of board meetings — bears no relationship to shareholders’ results. What really counts in meeting the oversight, decision-making, and advisory challenges of the 21st century is “the dedication, energy, time commitment, and skills of the directors,” together with a constructive, results-oriented atmosphere around the boardroom table. To that end, Carter and Lorsch preach the gospel of pragmatic eclecticism: “Today’s conventional wisdom suggests that all boards undertake very similar roles, but we believe that boards have considerable leeway in deciding what activities they wish to undertake and that they must address this choice explicitly.”

The pursuit of independent directors also comes at a price. Carter and Lorsch point out the impossible burden of responsibility that modern regulators have placed on independent board members. They note how little time board members have to give to a job in which they are supposed to set the course of great corporations. They worry that the increase in board power and responsibility has harmed relationships between chief executives and their boards.

Furthermore, “senior executives and CEOs tell us repeatedly that they question their outside directors’ real understanding of their business,” the authors report. No wonder. The definition of independence on boards “rules out just about anybody who has firsthand knowledge of the company and its industry,” and it takes several years to get to know a company properly. “The ironic truth is that the more independent directors are on the board, the more reliant it is on management for information,” the authors write.

Behind all these books lurks an even more ironic truth. Nearly always, nobody truly owns a public company. The institutional shareholders, at least in Anglo-Saxon countries, own small proportions of shares — perhaps 5 to 6 percent at most. These institutions may own the shares on behalf of a future retiree, who may be quite unaware of a financial relationship with the company. If a single benign owner had control of the company (as is sometimes the case in Europe), and if all minority shareholders were treated as well as big ones, then the problem of governance would probably vanish.

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n recent years, both the breadth of change and the pace of change in business have accelerated to such an extent that change presents personal and professional challenges to people at all levels of responsibility in organizations. In our own work as consultants in change management, we always start at the top of an organization and talk about how the leadership team needs to “model the change.” But the act of modeling change can be superficial — and thus ineffective — in achieving transformational change if leaders don’t recognize that they are asking for deep changes in attitudes and behaviors not only from their employees, but also from themselves.

This year, three very different books expand our understanding of change management techniques, especially those appropriate to large companies. They also explain why some change management initiatives succeed while so many others do not. Collectively, these books address three conditions that must exist for successful change to occur:

• Leaders must change themselves before they can be effective at leading change by example.
• For change to cascade down through the organization, groups and individuals within the organization whose behaviors already embody the desired state must be engaged in the change process.
• People at the top of the organization need to tell a story that resonates throughout the organization and explains why change is necessary and what the role of every employee will be.

Only when these three elements fall into place can middle managers and frontline employees begin to adopt the desired behaviors and bring the change to life.

States of Leadership
In Building the Bridge as You Walk on It: A Guide for Leading Change (Jossey-Bass, 2004), Robert E. Quinn expands on the argument made in his previous book, Deep Change: Discovering the Leader Within (Jossey-Bass, 1996), that significant organizational change doesn’t happen unless the leader genuinely lives the changes he or she is advocating.

Quinn, a professor at the University of Michigan Business School, describes two “states of leadership” that illumi-
nate why so many leaders struggle with change. In what he calls the “normal state of leadership” — a state in which most people operate most of the time — it is very difficult to achieve change because the leader is too self-focused and comfort-centered. Individuals in this state mostly consider what is right for them personally, and they have difficulty seeing the larger picture of what is right for the organization. The preferred state for leading change is what Quinn calls “the fundamental state of leadership.” In this state, individuals are internally directed by a strong sense of right and wrong, and are also externally aware of the larger issues faced by the organization.

In *Building the Bridge as You Walk on It*, Quinn identifies eight practices for achieving the personal transformation that takes an individual from a “normal” to a “fundamental” state of leadership. These are: reflective action, authentic engagement, appreciative inquiry, grounded vision, adaptive confidence, detached interdependence, responsible freedom, and tough love.

The eight practices examined in *Building the Bridge as You Walk on It* are, on one level, exercises to help leaders maintain their integrity under situations of great duress. On another level, they’re avenues to help leaders engage individuals in reflecting on their own experiences with change and in adopting new behaviors.

Each practice is explained at length, and with personal stories. “Authentic engagement,” for example, is the ability to align intentions and motives with actions. If leaders advocate change for the broader good of the company but are not fully committed to seeing it through, the contradiction will be apparent to others. Quinn believes that authentic engagement requires leaders to make a fundamental choice to live by principle, even when faced with pain and sacrifice.

He tells the story of an executive famous within his organization for turning around failing business units. The executive was temporarily placed in a dying unit with the promise of inheriting the top job at the company’s largest business, regardless of his performance in the interim position. For the first time, this executive found he was ineffective at fixing a broken situation. Quinn recounts asking the executive what he would do if the job in the other business unit were not there waiting for him. In response, the executive began to run through the changes he would make. As a result of the conversation with Quinn, he decided to excuse himself from taking the other leadership position, and instead rededicated himself to turning around the failing business unit. The workers in the unit immediately saw the change in his engagement and began to change their own behaviors as well.

“Tough love” describes the leader’s ability to encourage people in the organization to reach for a higher standard while also holding them accountable for meeting those standards. The prime example Quinn gives is GE’s Jack Welch, an executive renowned for pushing his team to reach for the highest standards of performance, but having limited tolerance for those who fell short. Testimonies from managers who reported directly to Welch demonstrate that the first time someone missed the bar, Welch provided considerable support to help him or her shore up his or her skills and prevent the person from repeating the mistake. Only if the individual missed again — after receiving support — were the consequences serious. Jack Welch left no doubt that he believed in his subordinates’ abilities and backed them. But at the same time, these executives knew that if they could not live up to his expectations, they would be let go. Quinn argues that supporting individuals as well as holding them accountable for adopting new behaviors is essential to motivating those individuals to challenge themselves and improve their performance.

**Communication Levers**

When a top executive team has decided on a change initiative, the new approach must be communicated effectively before it can change the way people behave. *Changing Minds: The Art and Science of Changing Our Own and Other People’s Minds*, by Howard Gardner (Harvard Business School Press, 2004), shows how leaders can develop different strategies to communicate change to different stakeholders and audiences, helping these groups to internalize the change more effectively.

Gardner, a psychologist and professor at Harvard, was one of the first to propose the theory of multiple intelligences (such as logical, spatial, interpersonal, and intrapersonal) in his earlier books, *Frames of Mind: The Theory of Multiple Intelligences* (Basic Books, 1983) and *Multiple Intelligences: The Theory in Practice* (Basic Books, 1993). *Changing Minds* applies his theory to the business community. Because people with different types of intelligence respond to different stimuli, the process Gardner proposes for changing minds appears to be an almost artistic endeavor, in which messages are crafted to speak to the hearts and minds of specific audiences, and are enhanced by the natural talents and sympathies of the person leading the change.
At the core of Gardner’s approach are six levers for changing minds. Four of them are obvious: reason, research, rewards, and real-world events. Two others are less obvious. “Resonance” is the language in which an argument is couched. The choice of language can either make an argument seem trivial to the listener, effecting no change, or make it “feel right,” causing the argument to move the listener toward a new frame of mind. “Representational redescription,” he explains, is a way to present an argument in different modes — through mathematics, graphics, or language. This is necessary because people respond differently to these modes of expression. He also describes what he calls “resistances,” which are the specific hurdles that must be overcome using the other six levers for changing minds; these are the assumptions and ways of thinking a person develops beginning in childhood.

*Changing Minds* comes alive when Gardner uses narrative examples to show how these levers work in different contexts, ranging from changing the minds of a nation to changing minds within a business unit to changing one’s own mind. A comparison of Margaret Thatcher and Bill Clinton illustrates the mastery of all six levers required to change the minds of a large and diverse population. Here these leaders use logical, simple stories based on facts, couched in rhetoric that speaks to people’s hearts, backed up by multiple visual images, directly addressing sources of resistance. Both politicians used their rise from middle-class backgrounds to relate to a broad spectrum of people; both were able to judge which arguments or stories would be most persuasive to a given audience. In contrast to Margaret Thatcher, however, Bill Clinton was unable to achieve transformative goals, in part, Gardner argues, because his behavior undermined his skills as a communicator. “Clinton seemed unable to ‘go to the mat’ for issues in which he apparently believed.”

A more practical example for business leaders is the story told in the book of Lord John Browne’s transformation of British Petroleum in the early 1990s. Gardner describes how Lord Browne applied the concept of redescriptive representation to engage his work force in a change from a hierarchical company with low accountability and initiative to a flatter organization that valued experimentation and the sharing of best practices. Gardner shows how Lord Browne, having developed his new strategy, organization design, and implementation plan for BP, convinced a team of managers to adopt the new way of thinking to overcome their resistance, to help the entire organization embrace the new model, and to make a public commitment to achieving results.

**Creative Recombination**


Abrahamson’s central thesis is that most change programs are incorrectly centered on the concept of creative destruction, that a company going through a major transformation must break down its current structure, process, or culture in order to create something new and better. This destruction, he believes, is what causes pain, anxiety, and resistance among employees, and ultimately leads to failed transformation programs.

Abrahamson takes the position that “creative recombination” is a better way to reinvent a company. Most companies, he claims, have capabilities that can be reassembled to create a winning new direction more easily and effectively than one could be created by destroying the old. His idea is to redeploy people rather than to fire or replace them; to salvage and refine processes rather than to reengineer them completely; to recombine organization structures around their key components rather than to reorganize them radically; to revive old cultural values rather than to redefine them; and to preserve and leverage social networks rather than to eliminate them through too much automation.

*Change Without Pain* is filled with case studies and stories that describe how managers successfully identified and reassembled their companies’ components to create capabilities that excelled in the marketplace.

Early in the book, Abrahamson uses the example of
GKN PLC, the U.K.-based automotive and aerospace parts supplier and one of the oldest companies listed on the U.K. stock exchange, to illustrate his notion of creative recombination and how it differs from creative destruction. For example, in the 1980s a high level of contract cancellations was a chronic problem for GKN. Each time the company landed a new contract, it would quickly assign engineers to the project. The trouble was that when a customer canceled or postponed a contract with GKN, many of its engineers were left idle. Instead of laying them off, several of GKN’s business units decided to “rent out” their engineers to other companies for short-term assignments. This created a fluid pool of engineers who could easily be reassigned if a contract was canceled, or be pulled back into GKN if it needed them. Initially, individual business units adopted the practice, but it was so successful in increasing revenue and profits and improving staff skills that GKN eventually made it a formal part of its business model. Abrahamson writes: “GKN recombined its reputation for attracting top flight engineering talent as well as its talent for developing engineering skills, and its extensive network of contracts, to start what was, for all intents and purposes, a highly sophisticated employment agency.”

Abrahamson spends considerable time fleshing out how to implement creative recombination through three distinct “action techniques” he calls “cloning, customizing, and translating.” Each action requires looking internally to see what components of the organization are working in the desired way, and adapting them to create a new model. Action techniques can be applied in many different contexts to change social networks, organizational structure, culture, and business processes.

Cloning Capabilities
Successful “cloning,” Abrahamson explains, involves taking a fundamental capability from one division and replicating it in another — or across the entire firm. Cloning can be done by moving people around, through process transference, or by requiring the entire organization to adopt a standard way of doing business. For example, when GKN’s Meineke automotive franchise developed a Web-based training course for some franchises, it discovered it could roll out the course, unmodified, to all its new and existing franchises.

“Customizing” refers to refitting and reusing parts of the organization. It is more difficult than cloning because executives must consider how a particular process should be modified to meet new market demands. Abrahamson notes this was a lesson the Walt Disney Company learned well when it tried and failed to clone its Disney theme park formula in a location outside Paris. He argues Disney would have done better had it used a customization approach to understand why and how Disney theme parks worked so well in the U.S. and Japan, and what aspects would not work in a European context.

“Translating” is the most complex of the recombination techniques. It forces executives to interpret and redefine their approach in order to meet different needs in the marketplace. An example: a multinational that must translate its corporate values so that they are expressed in words and in processes that are appropriate to and understood in each country where the company operates.

Too many executives, Abrahamson argues, use a clean-sheet approach and a totally new model when taking on a new assignment, rather than looking within at what is already working. The result is often initiative overload, change-related chaos, repetitive changes, and employee cynicism. We agree with Abrahamson’s view here, and believe this book provides the most practical and useful counsel on the subject of change management of the three books we reviewed. The concept of creative recombination forces executives to think through exactly what the company’s assets are, how they are deployed, why they are valuable, and who is capable of driving the change. This is a pragmatic approach to change: Build on what you have rather than start from scratch.

Change is hard; transformation is harder still, whether it involves an individual or an entire organization. Together, these books show why those at the top of an organization need to undergo deep personal change in order to alter the behavior of their organization.

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As Internet companies began to implode in large numbers during the final months of 2000, an early warning sign of the extent of their difficulties was a Wall Street Journal story about the failure of a European e-tailer, headlined “Boo.com’s Collapse Further Darkens E-Tailing Picture.” The implication was gloom and doom, and it was prescient. Webmergers.com reported that at least 210 Internet companies folded in the year 2000. By December 27, 2001, the Journal reported that the “Dot-Com Death Toll” had more than doubled, to 537. The “bubble” had popped.

The giddy inflation and grim deflation of the Internet bubble had major effects on the broader stock market and the U.S. and world economies. In its aftermath, the bubble continues to influence the way people think about business, technology, markets, and growth. Even now, three years after that crescendo of bad news, it can be difficult to separate the myths from the realities.


Neither book provides a comprehensive framework for sorting out what went on, and neither sufficiently addresses the potential future effects of the Internet. But a few facts can be asserted: One is that the failures of the Internet companies themselves were not such a big deal by some standard business and economic measures — it was the ripple effects, which grew to tsunami-like proportions, that make the bubble’s memory so painful. Another is that the bursting of the bubble changed, often in overly negative ways, the way many businesspeople and others think about the impact of the Internet on business and the economy as a whole. Indeed, in my view, the visions of some of the most ambitious Web pioneers of...
the 1990s may ultimately be vindicated, although it will happen in ways that they could not foresee.

Self-Defeating Excess

Lowenstein’s *Origins of the Crash* allocates many pages to corporate scandals. Talking little about the dot-coms, it instead examines the few but huge failures that made the front covers of major magazines around the world. Although some of these companies, notably Enron and WorldCom, were related in some ways to the Internet phenomenon — or at least to Wall Street’s bubble-induced and untested valuation models — the demise of these companies had little to do with the Internet itself. Lowenstein reveals details of excessive executive compensation, stock option abuse, naive shareholders, overly friendly auditors, and the era’s hyper-focus on short-term financial gain.

The excruciating detail that Lowenstein provides about the collapse of once-major corporations reflects great shame on American business. He explains complex financial reporting in admirably simple terms, but sometimes at the expense of important nuances: It is always easier to second-guess accounting decisions after the fact. And in many respects, he tars all the companies that failed with the same brush. Certainly there were huge abuses such as he describes, but it seems unfair to imply that U.S. corporate management was rotten to the core.

In time we will know even more intimate details of these mega-failures, as a result of the lawsuits currently under way or still to come, but so far it appears that the lack of integrity and the excessive greed were concentrated in a fairly small number of senior executives. A large corporation has thousands of senior managers; most of them were victims, not beneficiaries.

The final chapters in the author’s saga of greed and corruption remain to be written. Although some of the executives involved in the stock market bubble have been convicted of serious crimes, what may be the climax of the entire episode — the trial of Enron Chairman Kenneth Lay and his top lieutenants for their part in the collapse of the former energy-trading company (and for the billions of dollars lost by employees who were encouraged to hold on to their stock) — won’t even begin until 2005.

If nothing else, Lowenstein’s book gives you an appreciation for the Sarbanes-Oxley Act and other regulatory reforms. Most executives of U.S. companies agree that some of these reforms were necessary, but there are also critics who consider them to be overkill. Reading *Origins of the Crash*, it’s hard not to agree that the reformers have the stronger case. (See “Governance,” page 23).

In *Rational Exuberance*, Michael Mandel takes a different and substantially more positive approach to analyzing the bubble and its aftermath. *Business Week*’s Mandel is passionate about the importance of what he calls exuberant economic growth. He makes the case that exuberant growth goes hand in hand with the creation of life-changing technologies like the Internet, even if it also breeds some self-defeating excesses.

During the mid-1990s, Mandel began to write about the “New Economy,” describing the positive impact of technology and aggressive financial markets. He was not talking about a new economy in which profitability was an afterthought, but rather an economy that could expand and create both jobs and wealth as a result of innovation. Mandel predicted the Internet bubble in his book *The Coming Internet Depression* (Basic Books, 2000). But the warning he is issuing today should be heeded: Without exuberant, technology-driven growth, the economies of the world will not be able to support the social programs that are needed by their populations.

Mandel systematically builds the case for how technology innovation leads to economic growth and improved standards of living, and how it has the potential to continue to do so. He explores many examples of this potential in the communications, manufacturing, health-care, energy, and transportation sectors. For example, he notes that exploration and exploitation of outer space, already a multibillion-dollar industry, has the potential to be enormous. In all these sectors, he relates, breakthrough ideas are already being worked on that could ultimately employ millions of people.

Mandel worries that America may not be able to maintain its long tradition of technological leadership;
the number of graduate students produced by American universities has been declining, he notes, especially in science and engineering. He urges that funding for graduate studies be increased, but writes that new funding, instead of being tied to particular fields of study or specific research grants to faculty members, as is often the case today, should be allocated in a more flexible manner to encourage broad exploration to seek out the next big thing.

Just as Rational Exuberance builds the case for technology-based innovation, it also makes an articulate case against the many “enemies” of growth. Some research economists have consistently argued against rapid innovation and growth, with some arguing that these lead to federal deficits. Many political leaders of both parties have been unenthusiastic supporters of investment for technology innovation. More than a few have blamed technology for many of the world’s problems, including job dislocations resulting from automation, invasions of privacy and Internet spam, and — more generally — for disruptions of the status quo. For many of these anti-growth advocates, the boom and bust of the Internet bubble is a convenient argument for why we should be loath to invest in technology.

**Bubble Myths**

In weighing the negative message of Origins of the Crash against the forward-looking promise of Rational Exuberance, it’s worth looking back and considering what the Internet bubble was and wasn’t. On the surface, 537 Internet-related bankruptcies in 2001 sounds like a huge number, especially compared with the approximately 110 public companies that PricewaterhouseCoopers forecasts will file for bankruptcy in 2004. But what’s easily forgotten is that most of the Internet or dot-com companies were not yet public companies. When we examine the total number of business bankruptcies, we see a much different picture. In 2001, the year the bubble burst, 40,099 businesses failed. From this perspective, the 537 Web-related failures were a drop in the bankruptcy bucket.

The job losses that followed the bursting of the Internet bubble were serious. Beyond the losses caused by the bankruptcies themselves were many more layoffs, including cuts made by surviving Internet companies trying to convince investors that they could be profitable. Through the end of 2001, dot-com companies had announced nearly 100,000 layoffs, more than double the number in 2000. But although those layoffs were devastating for many people, dot-com layoffs numbered less than 10 percent of total layoffs in the U.S. economy in 2001.

Another fact, often ignored, is that the vast majority of Internet companies did not fail. Webmergers.com estimated near the end of 2001 that 7,000 to 10,000 Internet companies — more than 90 percent of them — remained in operation. The survivors learned the lessons of becoming successful companies: to segment their markets and understand the needs and wants of their customers; to set prices that make sense in the market; to manage their costs to something less than the price; to create effective fulfillment systems; and to provide excellent customer service. Those are the factors that have always separated winners from losers.

In retrospect, these books show us that much of what looked like the “new” economy of the bubble years was a false promise. Some CEOs measured their success by how much investor capital they took in, instead of by earning real revenue from real customers. Many companies were formed to use the Internet to link the supply chains across entire industries, even though the supply chain processes and data inside the companies in those industries were still managed in unconnected silos. New companies called application service providers were born to eliminate desktop-computing applications, even though relatively few employees or consumers had reliable high-speed Internet connections. The companies that bought into the bunk were the ones that failed. Since many had famous investors or managers, every move they made — from small layoffs to restatements of earnings — made front-page news. The drumbeat of bad news made it appear as though the magic of the Internet was unraveling when, in fact, it was the absence of sound business models that brought the startups down.

The rosy picture painted by Mandel in Rational Exuberance may not be rosy enough. I believe we have seen less than 5 percent of what the Internet has in store for our business and personal lives. Soon, a billion people will be using the Internet, empowering themselves to get what they want “on demand.” This simple concept, already becoming something of a catchphrase in business circles, in fact, represents a profound change in the way companies do business, and is causing a rebirth of growth in information technology, both for established companies and for startups.

For organizations of all kinds, “on demand” computing will be able to provide access to all the processes and
data that are needed by their constituencies — customers, employees, business partners, analysts, shareholders, and stakeholders — when they want it, from wherever they are, using whatever kind of device they may be using to connect to the Internet. The most critical requirement for organizations to survive and thrive in this new world is to achieve integration of their strategies, business processes, and technologies, with the Internet as their central nervous systems. By doing this, organizations will be able to present one face to the customer.

Few, if any, businesses have yet delivered on the promise of “on demand,” but leaders are moving in that direction. Companies like American Express, GE, DaimlerChrysler, IBM, and UPS are investing heavily to become truly integrated businesses. Many startup companies are emerging to take advantage of “on demand,” too. But older companies have significant advantages over startups if they can achieve integration quickly enough. They have loyal customers and employees, access to capital, established channels of distribution, and information technology infrastructure, as well as many legacy applications that could become assets.

The post-bubble backlash against the business models and profit potential of pure Internet companies may continue for some time. The early Internet companies demonstrated both the opportunities of the new technology and the potential mistakes that could be made applying it. Many of the surviving and newer dot-coms have been working to do better ever since.

A business not fully exploiting the Internet today is like a business in the 1950s not having a telephone. Industry by industry, the pacesetters are emerging. Many people who left the established companies to join startups returned to their former employers and are sharing what they learned out on the frontier. This may be the lasting legacy of the Internet bubble.

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ences, three new books suggest economics could do the same: The Economy of Esteem: An Essay on Civil and Political Society, by Geoffrey Brennan and Philip Pettit (Oxford University Press, 2004); The Paradox of Choice: Why More Is Less, by Barry Schwartz (Ecco, 2004); and The Company of Strangers: A Natural History of Economic Life, by Paul Seabright (Princeton University Press, 2004). None is a straight popularization of a conventional part of economic knowledge. Instead, each is an example of how economists are taking an interdisciplinary approach to their research and writing, which is helping make their work more accessible and relevant. Some of the best economists have always done this: Think of past winners of the Nobel Prize in economics, such as Herbert Simon, for his insights into how real-life businesses make economic decisions; or Gunnar Myrdal and Friedrich August von Hayek, for their insights into the ways social and economic institutions shape each other.

Today, economists are increasingly making links to history, law, urban studies, biology, anthropology, and psychology. This is a change since the mid-1980s, when most academics worked in the neoclassical tradition of abstract models of profit- or income-maximizing rational individuals. So strong has the trend been that the borders of the subject are becoming mainstream.

**Stuck with Choice**

In The Paradox of Choice, Barry Schwartz, a professor of social theory at Swarthmore College, draws on a growing body of research into how psychology affects economic outcomes — and how economic outcomes affect our psychology — to address two questions: Do the facts of human psychology mean that, contrary to a basic postulate of economic theory, we do not make choices rationally? And does prosperity actually make us happy?

The answers provided by this very readable and stimulating book are, in brief, yes and no, respectively. According to economic theory, more choice is inevitably better. People can always look at the alternatives, figure out what benefits they expect to derive, and decide whether or not to buy. But even aside from the time taken to assess all the choices, our psychology means we don’t evaluate the alternatives in this purely objective way. There is increasing evidence that people’s choices diverge in quite systematic ways from the rational ideal of economic textbooks. For example, most of us prefer small, reasonably sure gains to large but uncertain ones, even if the expected outcomes (the size of the gain multiplied by the probability of its occurrence) are the same. Most people fear losses more than they desire gains. And all our choices depend on what we start with and how we think about or “frame” them: A discount off a high price for paying cash and a surcharge on a low price for paying on credit are perceived very differently even if the final price is the same in both cases.

The implication is that more choices can actually make us worse off. A Sony CD player is on offer at $99, a great price. Researchers cited by Schwartz found that 66 percent of the people they surveyed would buy it without searching any further and 34 percent would not buy. Yet offered a choice between the Sony at $99 and a top-of-the-line Aiwa at $169, 27 percent would buy the Sony, 27 percent would buy the Aiwa, and 46 percent would wait. Faced with a trade-off between price and quality, nearly half the potential customers would avoid a purchase altogether. Schwartz comments: “When people are presented with options involving trade-offs that create conflict, all choices begin to look unappealing.”

Another example concerns the proliferating choices of investment options in retirement plans. Studies find that, typically, employees simply divide their money equally among their options. If there are four options — for
example, one low-risk and three with higher risk — people tend to put 25 percent of their funds in each. As the book points out, a manager offering this choice to employees is actually subtly handing over the responsibility for the individual’s retirement security. It’s fair to ask, however, whether most people have the expertise to make wise choices in this important financial decision (and in fact this is being asked in the U.S. in the policy debate over the future of Social Security).

This analysis seems to lead logically to the conclusion that there are too many brands of cereal on the shelves for our psychological well-being. It taps into an important new literature on economics and happiness arguing that people in rich countries are happier than people in poor countries. But beyond a certain level of development, extra economic growth does not increase people’s happiness. Economists are taking seriously this question of how economic growth is related to our well-being. Schwartz’s message will also resonate with many people uneasy with modern capitalism, including environmentalists.

There are some real difficulties with his argument, though. The psychological evidence is clear, but its implications are not. Consider other areas of choice: book titles, say, or charities. In both, there has also been an explosion of choice in recent times. But few of us would be so willing to accept the argument that there’s too much choice in these cases. Whatever the psychological stresses, we recognize the great merits of alternatives. But who’s to say when the benefits of choice outweigh the costs? Economists? Professors of social theory? Government officials? Journalists? Or do we say it ourselves?

Trade-offs are part of the human condition. Every course of action has an opportunity cost (an essential insight of economics). Is it better not to make the trade-offs explicit, for the sake of our peace of mind? Surely not. For this reason, it’s hard to recommend a reduction in choice, and so the book ends with several chapters of rather banal advice on how to avoid the stress, such as not overindulging in shopping and reminding yourself to be grateful for everything you have. Halfhearted self-help aside, this is a thought-provoking treatment of some of the most exciting new ideas emerging from the study of economics.

**Kindness of Strangers**

In *The Company of Strangers*, Paul Seabright, professor of economics at the University of Toulouse in France, also draws on the accumulated evidence from human psychology, evolution, and anthropology to explore the everyday miracle of coordination in the modern global economy. It is only for the past 10,000 years — just a blink on the evolutionary timescale — that humans have had regular nonviolent contact with people other than their genetic relatives. Prior to that, a meeting with a stranger would probably end fatally — humans are the most violent of the apes. And yet the degree of specialization that has made economic growth possible means we now depend on the efforts of many strangers for our lives.

In these days of terror and conflict, Seabright’s stunning exploration of this human social experiment is timely. He points out that there has never been less violence in human history than there is now: Only 1 percent of deaths are due to violence, compared with up to 40 percent in preindustrial times. More people commit suicide than are killed by others. You are 20 times more likely to die from an infectious disease caught from a stranger on a suburban train than from a terrorist.

Yet we are all, rightly, wondering about the fragility of the social order.

*The Company of Strangers* argues that self-reinforcing institutions sustain prosperous societies; these institutions originated during the transition from a hunter-gatherer existence to settled agriculture. Economic specialization rests on trust, as it is rare to exchange goods and services simultaneously, like the exchange of hostages in an old-fashioned spy thriller. Usually there’s a gap in time, and the transaction is mediated by symbols such as paper currency or electronic records.

The trust among billions of people that makes our global economy function can be sustained only thanks to the institutions that make it worth everybody’s while to participate. “Modern political institutions temper their appeals to the deep emotions, to family and clan
loyalty, with just enough abstract reasoning to help Homo sapiens, the shy murderous ape, emerge from his family bands in the savanna woodland in order to live and work in a world largely populated by strangers,” Seabright writes. Money is a good example of such an institution.

Seabright argues that this mutual consent to trust one another is based partly on rational calculation that we’ll be better off by being trusting, and partly on our psychological inclination toward reciprocity. “Tit for tat” has a firm foundation in evolutionary psychology.

The book ends by asking whether the logic of economic organization could undermine the social institutions that underpin it. Can the openness and flexibility needed by a modern industrial society coexist with the need to trust strangers on an ever-greater scale? The answer — “who knows?” — is not exactly comforting. Our safety and prosperity depend on how fast we can evolve our social and political institutions. This is a book every concerned citizen should read, along with any-body in business who ever has to tangle with government regulations or the law, and who wants to understand why those relationships are so complex.

**The Intangible Hand**

Seabright’s emphasis on the importance of institutions for economic success is becoming a common theme in economics. This is a revival of the subject’s early tradition found in the work of pioneers such as Adam Smith and David Hume. Smith’s *The Theory of Moral Sentiments* is far less well known than his later *The Wealth of Nations*, but he regarded it as providing the philosophical scaffolding for his analysis of the economy, and his conclusions about how the benign results of the market rest on virtuous behavior. Smith’s “moral sentiments” are the subject of *The Economy of Esteem*, by Geoffrey Brennan, an economist at the Australian National University, and Philip Pettit, a political philosopher at Princeton University. They argue (in a book slightly more technical than the other two) that there are three fundamental human drives: drives for property, for power, and for esteem, defined as the good opinion of others.

Social scientists have long studied property (the invisible hand) and power (the iron fist), but the desire for esteem as a motive in human society has been overlooked. The authors apply the methods of economic analysis to this missing driving force and consider the part it plays in the institutions of the economy.

Mobilizing the “intangible hand” of esteem, they say, can help support desirable social norms and institutions.

Why? Because esteem is mutually reinforcing. As David Hume put it in his *Treatise of Human Nature*: “Tho’ fame in general be agreeable, yet we receive a much greater satisfaction from the approbation of those whom we ourselves esteem and approve of, than of those whom we hate and despise. In like manner, we are principally mortified with the contempt of persons upon whose judgment we set some value, and are, in great measure, indifferent about the opinions of the rest of mankind.” Esteem is a compliance mechanism. For example, the recycling of household waste started out as an unusual activity, an ostentatious signal of virtuous concern for the environment. This warm glow of virtue attracted others to recycle their trash as well. This trend steadily reduced the special kudos of being ultra-green, and in the end recycling has become normal. Now only those who want to make a strong statement of their anti-environmentalism will never use recycling centers.

Of course, the bandwagon effect of the esteem economy is not always beneficial. Think of the emergence of a social norm among corporate executives to base their mutual esteem on the large size of their pay and options packages. As in any self-reinforcing process, there are many possible outcomes in the development of such norms. But understanding the nature of the process is essential if we hope to steer the outcomes.

This is very far from the kind of economics so many of us suffered through in Econ 101. As Brennan and Pettit note, until recently the rise of economics as a conventional academic subject meant the eclipse of the traditional concern of political economy. But markets are not abstractions. Economies consist of relationships between people — usually strangers — within a framework of specific institutions. The analytical rigor of conventional economics needs to be combined with a rich understanding of the human context. Fortunately, that is what more and more economists, including the authors of these three books, are doing.

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THE FALL OF THE MALL
by Kate Jennings

The Shops at Columbus Circle, a much-anticipated urban mall, opened in New York City in June 2004 inside the new Time Warner Center. The reaction: a New York shrug. The reasons for this indifference tell us much about the mind-set of the typical American consumer. The four floors of the mall proper are imposing — vaulted marble, miles of gleaming glass providing a view of Central Park — yet the stores are all rented to familiar, solid middle-rung retailers: J. Crew, Eileen Fisher, Benetton, Coach, Crabtree & Evelyn. These purveyors of straightforward, practical clothing and accessories are overwhelmed by their grand surroundings. Worse, in many of the center's stores, the clothes, shoes, and handbags are laid out sparingly, as if they were special or luxury items. Most of all, shoppers never have the feeling of adventure and discovery that accompanies much shopping in New York, where a rich variety of products is part (and parcel) of daily life.

Downstairs in the basement, though, the Shops at Columbus Circle get it right. There, one can find the second Whole Foods Market to open in Manhattan. (If the shopper can find it. Unbelievably, signage indicating the market's whereabouts is nonexistent.) Like all markets and bazaars through the ages, Whole Foods is an enticing hive of activity and mounds of goods. Even its hefty prices and laugh-provoking pretensions — a sign at the bakery counter advising, "If you are concerned about the organic integrity of the bread, slice it at home" — are forgiven because of the vitality of the overall surroundings. Seeing this, it becomes apparent why the Whole Foods Market chain has gone from being a hang-out for crunchy types to being a contender for the Fortune 500 list of largest businesses in the United States. In an interview in The New York Times Magazine, John Mackey, the chain's founder, explained why he took up the challenge of stimulating his customers: "We love to shop. And Americans love to eat. But paradoxically we don't love to shop for food. Grocery shopping in America is for the most part a chore.”

Chiefly, John Mackey predicted that consumers would pay a premium for organic foods, something that even 10 years ago no one would have imagined. With his finger to the wind of change, he understood that the average American consumer was evolving from a herd animal into a sophisticated, knowledgeable, and assertive creature.

Paco Underhill, author of Call of the Mall: The Geography of Shopping (Simon & Schuster, 2004), is another person who has long known that bland, emotionless, one-size-fits-all approaches to retailing no longer cut it with consumers. As founder and managing director of Envirosell, a firm that advises merchants around the world on customer behavior, Underhill would have a field day dissecting the reasons the Time Warner Center's mall stumbles upstairs but succeeds in the basement.

Two other books of note published this year illuminate the changing character of the American consumer.
Just as 10 years ago we could not have imagined customers paying a premium for organic foods, we could not have foreseen the role that design would play in giving products a competitive edge, a trend that Virginia Postrel examines in her dynamic book, *The Substance of Style: How the Rise of Aesthetic Value Is Remaking Commerce, Culture, and Consciousness* (HarperCollins, 2003).

While we are on trends affecting consumer behavior, it’s also worth looking at a nation-changing one that has been building for years in the United States: the population shift from the cities to the suburbs. Conservative commentator David Brooks calls the phenomenon “the suburban supernova” in his entertaining book *On Paradise Drive: How We Live Now (And Always Have) in the Future Tense* (Simon & Schuster, 2004).

**Retail Anthropology**

Paco Underhill, a self-described retail anthropologist, first caught the business world’s attention with his eye-opening bestseller, *Why We Buy: The Science of Shopping* (Simon & Schuster, 1999). His new book, *Call of the Mall*, is equally revelatory. After reading it, no one can be involved in retailing without an Underhill-like commentary running through his or her head.

The call of the mall, he says, has always been with us. “The saga of humankind can be told at least in part through the story of shopping,” he writes. “Even the simplest agrarian societies needed places to assemble to trade in goods, and from that basic impulse came everything else, marketplaces, villages, towns, cities. The mall is just another organizing principle.” But it’s an organizing principle that, Underhill persuasively argues in *Call of the Mall*, is past its prime.

To show why, he takes readers on a tour of an average American suburban mall. Nothing escapes Underhill, from the blasted heath of the parking lot and the unimaginative stores to the bilious food joints and the purely functional restrooms. With the exception of city shopping centers, where local government often demands community facilities and design equity in exchange for building rights, the American mall is mostly a utilitarian affair.

Essentially, malls evolved from a simple concept: Stores in strip malls were turned to face one another and a roof put over it all. After that, in the American way, the result was sanitized, homogenized, large-sized, and thoroughly air-conditioned. We learn from Underhill that U.S. malls are usually undistinguished because they are traditionally erected not by the merchant princes responsible for department stores but by developers whose mandate it is to turn suburban plots into gold mines at the lowest outlay. A mall can be thought of as “a store of stores,” argues Underhill. But the malls’ proprietors don’t think of them as stores with something to sell, only as real estate. Thus, we get the typically ugly exteriors — “A big wall with a mouse hole,” in the words of one unashamed developer — and the bland interiors with their dull, unhelpful signage.

The problem facing American mall developers is the radical change in customers’ expectations. They’ve been exposed to and are excited by exotic foods, fashion labels capable of responding to weekly fluctuations in tastes, and even avant-garde architecture. Because alluring buildings such as the Guggenheim Museum in Bilbao, Spain, designed by American architect Frank Gehry, draw so many tourists, other cities are falling all over themselves to get their own signature piece of architecture. Consumers aren’t content to read about aesthetic advancements; they want them to be a part of their world.

Retailers are responding to this, too. A designer's flagship retail store, such as the Rem Koolhas–designed Prada emporium in New York City’s Soho, is no longer just a fashion destination for the elite. The architecture has become a tourist attraction, even though the clothes are too expensive for middle-class consumers. At the store of couture designer Issey Miyake in New York’s Tribeca, a proud sales assistant, pointing to the waves of tortured metal decorating the ceiling, declaimed, “Our aluminum is by Gehry.”

Underhill also points out that in Europe, one can already find more attractive, pleasurable malls, such as the Vasco Da Gama and Colombo centers in Lisbon or Diagonal Mar in Barcelona. These consumer environments reflect what shopping can be when attention is paid to consumers’ evolving needs and desires. Erected by visionaries with mercantile DNA, these European malls feature a broad variety of entertainment and distractions for those who want to socialize or idle away time; starred restaurants and high-quality, take-home prepared food; and such service offerings as child care providers, boot makers, butchers, and bakers (real bakers, not the mass bakery franchises found in American malls). Ensuring their longevity, European malls, and some in Japan and Latin America, are incorporated into neighborhoods in such a way that they become community
gathering places, accessible by public transport or bicycle or even (and this is very un-American) by foot.

Old-style malls in the U.S. are still operating, even if they are not thriving. Little by little, however, with the rise in popularity of Main Street and village complexes, whether built from scratch or renovated, one can say that the roof is being taken off and the elements restored. “The mall was a little too hermetically sealed for our tastes,” writes Underhill. “This trend renews my faith in humanity.”

Moreover, according to Underhill’s research, when consumers in the U.S. are given a choice between a mall and a Main Street, they choose the latter because that kind of shopping complex not only is exposed to the natural elements, but has smaller, cozier buildings that encourage serendipitous browsing and don’t overwhelm shoppers.

Looking into his crystal ball, Underhill sees the best and most agile of American malls surviving and the others receiving makeovers as convention sites or even ethnic hubs. The most successful transformations so far have involved the latter — malls repurposed as specialty centers catering to immigrant cultures. Korean, Japanese, Vietnamese, Chinese, Caribbean, and Latin malls, or a mixture of all these, are attracting not just their target group but Americans curious about global differences and hungry for anything new.

**Aesthetic Abundance**

In *The Substance of Style*, Virginia Postrel tells a different story about the evolving sophistication of the average consumer. She argues that through television, the Internet, and catalogs, the middle classes have become literate in the language of aesthetics and its history, once realms of an elite, and they are increasingly aware of its ability to help them “work hard, play hard, and live well,” as the promo for the cable television show iDesign trumpets. Businesses, pressed by customer demand and shrinking profit margins, have wised up to the need for greater product differentiation, and are hiring more design professionals than ever before. (The number of industrial designers employed in the U.S., Postrel records, has increased by 32 percent in the last five years, and membership in the American Institute of Graphic Arts has shot up from 1,700 to 15,000 since 1995.)

Postrel presents another harbinger of what’s to come in her description of what is happening at GE Plastics’ R&D center, which is staffed by engineers who listen as designers and marketers “talk about their dreams” and respond by providing them with customized new products in a plethora of colors and special effects. Because these new plastics command high prices, General Electric’s engineers are working overtime to invent new ones. At the moment, the company is able to ply its customers with an array of hues and tints that make a Pantone color chart look anemic. In the future, its engineers predict, plastics will feature dazzling visuals — the shimmer of water or the sparkle of diamonds — or have the sort of weight and texture that conveys quality. GE hopes to eventually invent plastics with evocative smells, such as that of a summer beach or the air after a rainstorm. In the words of a company spokesperson, “The sky’s the limit.”

In her brainy yet accessible book, Postrel describes GE’s ambitions and other manifestations of the surge of interest in styling, capping it all with a thesis contending that in the U.S., design has been held back by a confused attitude toward aesthetics. In a culture that is shot through with Puritan values, she argues, the pleasure derived from aesthetics is suspect because it is immediate and emotional; only afterward can the intellect be applied. Postrel quotes a mid-century designer’s definition of aesthetics as “the art of using line, form, tone, color, and texture to arouse an emotional reaction in the beholder.” Americans fear being suckered or regarded as superficial if they succumb to aesthetics. “The trick,” she writes, “is to appreciate aesthetic pleasure without confusing it with other values.” Aesthetic style now comes in many forms, from which Americans are learning to pick and choose to give shape to their identities.

To Postrel, attention to aesthetics is not just a business strategy; it’s a major ideological shift away from cultural leaders’ dictation of a dominant aesthetic that will lead to enlightenment (and imbue its keepers with power). One observer whom she quotes went to the nub of the matter when he said, “Mass production offered
millions of one thing to everybody. Mass customization offers millions of different models to one guy.”

Aesthetic abundance fuels consumption, whether at Crate & Barrel or Apple Computer, which hasn’t escaped the attention of finger-wagging social critics prone to viewing the world in black-and-white terms. To hear them tell it, we are all victims of crass materialism. For example, in economist Robert Frank’s ideal world, “we would all benefit if men could agree to wear cheap, ugly suits and spend their money on more important and substantial things — a vision of fashion not unlike the British Utility scheme that took the ornament out of furniture and declared bookcases more essential than easy chairs,” writes Postrel. She posits that in adopting this view, social critics seem blind to the human impulse to take pleasure in adornment for adornment’s sake.

**Suburb Rings**

In *On Paradise Drive*, David Brooks sets about dispelling the common view of the populations of the suburbs as an undifferentiated mass. Instead he presents a highly differentiated demographic framework — one that sees the populations of the suburbs as if they were living in the many rings of Saturn.

In the ring closest to the city center is “the progressive suburb, populated by urban exiles who consider themselves city folks at heart but moved out to suburbia because they need more space.” Next comes “the affluent inner-ring suburbs, those established old-line communities,” the habitat of doctors, lawyers, and executives, who haven’t gone to war but “have endured extensive home renovations.” In the ring beyond are “the semi-residential, semi-industrial zones,” home to strip malls and the immigrants who service the overachievers and who once would have settled in the inner city but now go straight to these “underutilized urban gaps.” Then comes the ring that most resembles the conventional notion of a suburb: basketball hoop in the drive, carports, and ranch homes. In the ring farthest from the center are the new “exurbs,” which are eating up farmland at an alarming rate and replacing it with snout houses — those ungraceful homes that seem to be all garage — big-box stores, and office parks.

With that nuanced view of American suburbs in mind, it becomes clear why a one-size-fits-all attitude to retailing is a nonstarter. But Brooks’s real agenda in this book is a larger one: to prove that Americans are not empty-headed, debt-building, shopping-crazed con-

consumers. To do this, he reads and cites all those writers who have cast a jaundiced eye on America, venturing back to the 19th century and the English philosopher Morris Birbeck, who summarized the American spirit as “Gain! Gain! Gain! Gain! Gain!” and working his way forward to the current crop of negativity peddlers. Brooks shakes his head sadly at the miasma of gloom these writers have collectively created. Even observers known to be keen on American vitality, such as Alexis de Tocqueville, find it necessary, Brooks writes, to “slip in a little shiv of equivocation about our shallow souls.”

Through statistics, Brooks demonstrates the fallacy of suppositions about America’s vacuity. For example, Americans apply even more energy to worship than they do to consuming, with 86 percent believing in heaven. (In their never-ending quest for self-improvement, Americans shop among religions, changing faith more often than does any other nationality.) While they lavish $40 billion on their lawns, more than the tax revenues of India, Americans also each donate on average more than $1,000 a year to charity, a sum much higher than any other nation’s, and 80 percent of those shallow souls belong to volunteer organizations, compared with, for example, 6 percent of the British. Not to forget their high-octane industriousness: Americans work even longer hours than the Japanese.

Principally, however, in the words of Harvard Business School’s social psychologist Shoshana Zuboff, Americans these days “are seeking more control over the quality of their lives, not just the quantity of their stuff,” a sentiment that shines through all the books under discussion. This is a sensible response to the lifestyle complexity generated by globalization and technology.

Not even the most brilliant seer knows where all these developments will take us. But common sense says that companies are going to have to do a much better job of listening to consumers, and doing more with what they have to say. In fact, retailers, manufacturers, and marketers might do well to turn H.L. Mencken’s damning dictum, “No-one in this world, so far as I know … has ever lost money by underestimating the intelligence of the great masses of the plain people,” on its head. +

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IT & INNOVATION

The Business of Software: What Every Manager, Programmer, and Entrepreneur Must Know to Thrive and Survive in Good Times and Bad, by Michael A. Cusumano [Free Press, 2004]


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