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Photograph by Aditya Kapoor

The idea of putting employees first and customers second might seem counterintuitive, especially when it is advocated by the CEO of a large global high-tech enterprise. But to Vineet Nayar, customers and employees are more directly linked than conventional wisdom would suggest. Nayar is the chief executive of HCL Technologies, a US$2.6 billion business and information technology services company based near New Delhi, India, with operations in 26 countries. (HCL originally stood for Hindustan Computers Ltd.) He argues that the aptitude, ingenuity, and enthusiasm of HCL's more than 65,000 employees leads directly to greater value for customers, and thus to better performance. This is, of course, common management rhetoric, but Nayar is one of the few chief executives who has built a major company by putting it into practice.

In his book *Employees First, Customers Second: Turning Conventional Management Upside Down* (Harvard Business Press, 2010), Nayar tells a compelling story about turning around the company's fortunes in the mid-2000s. HCL — which sells IT-related services such as systems integration, business process outsourcing, and software engineering and high-tech R&D — is known for both its technical strengths and an uncommon focus on internal transparency and employee engagement.

For example, detailed financial performance data broken out by business unit is delivered regularly to employees' desktops. This has stimulated employees to ask more questions, volunteer more ideas, and challenge their managers more often. In turn, everyone is making better decisions — the kind of decisions that directly affect the customer's experience. Nayar calls the customer–employee interface the "value zone." Similarly, in a bold twist on the 360-degree employee appraisal tool, all appraisals are posted on the company's intranet, and anyone at any level can give feedback on anybody else, including the CEO. As Nayar says, "Good or bad, we all learn from the results."

HCL adopted these approaches in 2005, when Nayar — who had joined the company just out of business school in 1985 — was promoted to president. Shiv Nadar, the CEO and chairman at the time, gave Nayar a mandate to improve the company's revenue growth, which had lagged that of rivals during the previous five years. Nayar agreed to take the job, but only on the condition that he could radically change the way the company was run. Drawing on leading-edge management ideas and on his formative years working on a farm in rural India, Nayar set about bringing out the innate entrepreneurial intelligence of the young Indian technologists who made up the bulk of HCL's workforce. During the next five years, with Nayar first as president and then as CEO (beginning in 2007), HCL's revenues grew from $700 million to about $2.6 billion, and its international expansion accelerated.

The idea of engaging employees resonates with the company's innovation strategy as well. HCL is a behind-the-scenes technology-services company with a brand that appears on few nameplates, but it profits when its customers' devices succeed. Thus, much of Nayar's attention is focused on meeting the challenges of convergence: figuring out what types of innovation will be necessary as content producers, telecom companies, and device manufacturers move into their next phase of interdependent business models. HCL's revenue-sharing approach, and its ongoing efforts to learn from customers and other outsiders as well as from employees, represents an ingrained awareness that the most important insights can come from anywhere — if you know how to recognize and absorb them.

In part to keep his own awareness of changing technology up to date, Nayar embraces new media communication tools as avidly as his company's young staff does. He uses Twitter and YouTube, and blogs frequently on management and leadership — a habit that led to the writing and publication of his book. In March 2010, *strategy+business* met with Nayar when he visited New York City for a freewheeling conversation about the evolution of his thinking, the future of work, and the model of Indian management that is emerging as companies like HCL bring their workforce onto the global stage.

S+B: In your book, you say that your approach to management is rooted in your personal history. How did that approach evolve?

NAYAR: When I was a schoolboy in the north of India, I used to work during the summers at a poultry farm. My job was to pick up the eggs from the henhouse and take them to the storehouse. I tried hard to make this process more efficient, but after a couple of weeks I discovered that no innovation was possible. The only thing anyone could do was to stop moving eggs from one place to another. I discovered, at that early age, that I had a passion for making things work better.

I also was strongly influenced by the missionaries who ran my primary school, and who expected us to do social work in the community. For example, we distributed clothes to children. During one visit, I met a little boy who refused to take the coat and sweatshirt I offered him, even though it was very cold. But he continued to stare at my schoolbag. I thought he was interested in my lunch, but when I opened the bag for him and he saw a book inside, he asked what that was for. I said it was for reading, and he asked me to read it to him. The lesson for me was to never make assumptions about what somebody else wants or thinks. It is very important to ask people what they are thinking.

S+B: How did these two lessons lead to where you are now?

NAYAR: After studying engineering as an undergraduate, I became interested in management, because I was interested in making sustainable transformational change happen. In 1985, I earned an MBA at XLRI [Xavier Labour Relations Institute] in Jamshedpur. It is one of the top business schools in India, so I had many choices among billion-dollar companies, but I chose HCL. At that time, it was still a small Indian company offering business minicomputers and systems domestically. Its recruiters told us that although it was only the fourth-largest IT company in India, they wanted it to be the largest. I liked the fact that they were pursuing candidates who wanted to be part of that journey. That was inspiring. I joined the company based purely on that clarity of intention.

From Products to Services

S+B: When did HCL reach those revenue goals?

NAYAR: In the late 1980s. When the Unix operating system came to India in 1987, we saw a great opportunity to help banks in India bypass mainframes. With that single product launch, HCL went to number one in India, and we have stayed there ever since.

Based on that success, we developed other products; for example, we were among the world's first companies to develop multi-proces-

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sor Unix architecture for increased processing power. We went to Sunnyvale, California, and set up our own manufacturing plant to produce a U.S. version. But we fell flat on our face. Nobody in the United States wanted the world's fastest and best computers from an Indian company.

So we decided to change from a product company to a services company. We visited Silicon Valley companies that were facing significant problems developing their own products, and we told them: "We can help you with these issues." Overnight, we went from being a developer of products for ourselves to being a developer of products for our customers. And we took that business worldwide.

S+B: In other words, you discovered that your knowledge of how to create and implement systems was more valuable than the actual hardware.

NAYAR: That was number one. We also discovered that technology development needs intellect more than it needs investment in dollars. But marketing needs dollars more than intellect. We are a very engineering-oriented company; our core competence is on the technology side. We have never been good at marketing. We still aren't today. That's why being a product company was the wrong positioning for us.

So we developed a different business model, involving revenue sharing: We co-designed products with our customers, then shared the revenue with them. Over time, we used this approach more and more, instead of more conventional fee-based and cost-based contracts. In effect, just as our customers use our technological knowledge for their expansion, we use their marketing talent and branding to help fuel our growth. Everybody shares.

This business model was very important for HCL during the Great Recession of 2008–09. When our customers cut back, revenue sharing enabled us to continue working with them, and coming out of the recession we still have those products and customers.

S+B: With this business model, how do you maintain the technological edge to stay distinctive?

NAYAR: We have more than 13,000 people in core R&D and engineering services at HCL. This makes us among the largest research and development houses in the world. Having taken the position that we will not compete with our customers, we are more aware of technology trends and opportunities.

For example, we have developed wireless devices that can be placed inside the human body, and avionics components used by aircraft companies. When you put together the collective intelligence of 13,000 HCL people and customers' knowledge of their own domains, it creates something significantly more valuable than what a customer could create alone.

This is especially true when you consider another trend: the increasing importance of what I call the whole environment of the product. We believe that a customer's competitiveness, and that customer's maximum benefit to the end consumer, comes from the ecosystem built around the product. We call this engineering out of the box. That is, we see opportunities not just in building products, or boxes, but in creating the combination of services and structures that exist around any product.

S+B: For example?

NAYAR: Think about the iPod and its relationship with iTunes; more and more companies are competing by surrounding the product with services that create unique experiences. Another example is the infrastructure that builds up around wireless medical electronic devices that monitor body functions. Or telecom manufacturers that offer services to manage the networks of the service providers.

As they operate in this way, our customers infuse our own capability with more skills and services. This is critical. HCL continues to retain its core competence as a high-tech engineering company, but innovatively adds on the capabilities for providing services. A user of Facebook or iTunes may not realize that behind every complex website are hundreds of design engineers — people who developed the technology and make it operate seamlessly.

The Value of "Employees First"

S+B: What led to the idea to put employees first and customers second?

NAYAR: This came out of a transformation that started in 2005. We had done extremely well up until the year 2000, but then we were caught on the wrong foot. We had not made some investments that were needed, and our growth slowed significantly compared with our competitors.

In 2005, the board was very clear that something radical needed to happen. I was asked to take over as president of the company. I accepted. But before I did, I asked for only one thing from the board: their support to allow me to try nontraditional management approaches.

At that time I was the head of a division responsible for remote infrastructure management. Leading that division, I became aware how easy it is for people in a company to fall in love with their past. Somebody had to yank out that rearview mirror and say that history was not nearly as relevant as the future.

Then, right after I took over, a customer canceled a contract. It was a defining moment. With my entire team, I went to see the customer. We had not done a good job, but there was more to it than that. The customer said, "Vineet, your employees did nothing wrong as individuals. But your organization did not support them."

At a second meeting two months later, the same customer congratulated us for our work on a different contract. What was different about this project? We had given our people what they needed to succeed. I'm not saying management leadership doesn't have a role to play, but we started to recognize that the value that employees deliver through their interactions with customers was far more important than the attention it was getting at HCL.

Calling our policy Employees First, Customers Second was our way of defining this attention as our primary aspiration going forward. It was also a statement about the relationship between leaders and the people who execute. How do you maximize the experience that customers have in the value zone where they meet your company's work? We think the answer is for management to see itself as an enabler, and for employees to see themselves as "doers" with a great deal of accountability and autonomy: the ability to choose much of what they do. In this way, we create organizations in which employees are aligned with the customer.

Our management team loved these ideas because they were unhappy, and they were ready for change. The number of people who are waiting in any organization for a transformation is significantly more than one can ever imagine.

> **"The moment the recession hit, we went to our employees and said, 'We have a problem. We're going to solve it together.'"**

S+B: As long as they recognize it's a genuine change and it won't make them vulnerable.

NAYAR: That is a very important point. During the recession, from September 2008 through January 2010, I don't think many other global IT companies grew at all. They did not work with their employees, and in many cases, they chose to cut their costs primarily through top-down decisions such as across-the-board layoffs. Meanwhile, the moment the recession hit we went out to our employees and said, "We have a problem. We're going to solve it together." We had thousands of ideas coming in, and we implemented them. Most of them were operational: There were no new products, services, geographies, or contracts. But HCL grew 23 percent and increased global market share by 21 percent. Our employees felt they were a part of everything we were doing, because of our inclusive approach. Even if it may take a bit longer to arrive at decisions, this approach helps ensure that implementations are smooth and that initiatives are sustained after the initial hype.

S+B: Do you think Employees First, Customers Second would make sense for most businesses?

NAYAR: I'm not sure it is relevant for everybody. All I am saying is that businesspeople need to give the management–employee relationship more thought. The experiment has worked wonders at our company, and increasingly others are asking, Why not?

Instilling Transparency

S+B: How did you make employees feel comfortable challenging their managers and you?

NAYAR: We used the 360-degree appraisal technique as an employee development tool, but not the way it is typically used. We created a 360-degree process where anybody can give feedback to anybody, including to me. We post the results internally so that all employees can see them. Good or bad, we all learn from the results. It's open, it's transparent, and the impact is positive. We find that this practice is motivating people to change their behavior. They try harder.

We also looked for symbolic ways to be a model of openness. One thing I did was publicly dance in front of all my employees. This was to remove the halo that a CEO has around his head. Meaningful conversation happens after you have set the stage in this way, after you make clear that you are as open as anyone else — crazy but effective.

> **"We discuss everything openly and honestly. We don't always have the solutions to problems, but at least we expose them."**

I started writing a blog called "You and I," in which I encouraged employees to ask me questions in the open. The only rule I made was that when you ask the question, it must have your name attached. All 60,000 employees should see your question and my answer. At first, I was depressed by the result, because I mostly received negative questions that made HCL look bad. People said things like, "Vineet, I don't accept what you're saying." Or, "You lack vision; you haven't articulated what the company's size and scale will be in 2010."

So I held an open house with a group of employees. "I'm feeling pretty bad," I said. "Nobody is saying what is positive about our company. Do you think I've unlocked a genie that is spreading demotivation?"

Their answer was interesting. They said it is good to wash dirty linen in public, in this case on the blog, because it builds trust. There are no rumors. We discuss everything openly and honestly. We don't always have solutions to problems, but at least we expose them. Out of that, I began to share the financial numbers and give my perspectives, and the tenor of the blog comments began to change.

S+B: When you started publishing and sharing the financial numbers internally, how did people react?

NAYAR: I characterize the responses in three zones. In Zone 1, we had transformers and go-getters. The people in Zone 2 were lost souls, taking energy away from the organization. They tended to project the idea that things would not work or that I was just trying to get rid of people. Zone 3 had fence sitters, who took no risks or positions. In any transformation journey, you have to first convince the transformers to follow you and ignore the lost souls. Then you have to get more fence sitters to become transformers. That is easier said than done. But one way to achieve this is pushing the envelope of transparency by sharing the financials so people can figure out for themselves whether they are contributing to the growth of the company or not.

When we started publishing detailed business unit financial performance data for employees, it accomplished three things. Employees started asking a lot of questions of their managers, and the managers had to respond. It initiated a lot of action. And there was now only one version of the truth, without multiple interpretations. We used the balanced scorecard approach to lay this version out and relate it to what people did every day.

S+B: What kind of difference do you think this openness will make in the wake of the recession?

NAYAR: Whatever trust is left in command-and-control management structures has been deeply tested during the recession. I am told that in business in general, employee trust in management is at its lowest point ever. We have deliberately tried to prepare for coming out the other end as a winner, which requires a huge amount of energy from employees. There are no guarantees, but we tried to study companies that had transformed their employee–management policies in earlier hard times to win back the trust of their employees.

S+B: That takes a real leap of faith on the part of senior management, though, because every instinct says retrench, keep your top performers, and let everybody else go.

NAYAR: I'm not against retrenchment, layoffs, or any management action that is required. About 3 percent of our employees, the lowest performers, were laid off. The questions are, How do you do it? What is the amount of transparency you exhibit? What is the extra effort you put into communicating the reasons? When the chips are down, how do the leaders act in front of the employees?

Customers as Thought Leaders

S+B: In your book, you also emphasize unstructured annual meetings with customers and business partners. What happens there?

NAYAR: We believe that our customers know more than we do, and that different industries have a lot to learn from each other: financial-services firms from retail, retail from manufacturing, American from Chinese, and Chinese from Japanese. Talking to each other is a big attraction. In 2009, 650 executives at the "chief X officer" level came. We were expecting 400. Each year, attendees include many people who are way ahead of everybody else in their thinking, and some who might be working with our competition.

The meeting lasts one and a half days, with attendees speaking on topics they choose. We invite our customers as thought leaders to talk about what they are doing. They may also talk about our work. For example, in one panel at the 2009 meeting, four CEOs discussed how Employees First, Customers Second had helped customers. No HCL employees sit on these panels, and HCL does not make sales presentations at this gathering. It is all collaborative learning, and is thus very popular with C-level executives.

S+B: We've talked about employees and customers. What about your shareholders?

NAYAR: HCL is a publicly traded company, and shareholders are very important to any growth-oriented company. But we have been very careful in our internal references to shareholders. When we were doing transformation, we did not make too many statements internally about them. And I don't agree that CEO compensation should be linked to share prices, because too many different variables can affect the stock price. Compensation should be based on an audited P&L along with balance sheet results on key factors. For example, it is very important for us to reduce our carbon footprint dramatically. In the short term, however, the market won't understand. CEOs must make decisions that will be good for the business and for society in the long run, but that may not be valued by the market today.

At the same time, we keep refining the way we communicate with our shareholders. On our website, our quarterly results run close to 40 pages. I think that kind of transparency is rare in the world. Once a year, we make a five-year strategy presentation, explaining the megatrends we think are important, and where we are trying to go. We do a lot to educate our shareholders and to help them understand our thinking. We have seen more than a 70 percent appreciation of our stock price in the last 12 months, suggesting that Employees First works for shareholders too.

S+B: You're not concerned about competitors seeing the information?

NAYAR: Somebody said to me about the Employees First program, "Vineet, your competitors will copy this, and therefore, it will not be a differentiator." My response was, "If our competitors can post the results of 360-degree evaluations, more power to them."

S+B: Most of your management innovations could be implemented anywhere. Is there anything that you do that reflects your company's Indian background and cultural roots?

NAYAR: HCL is in 26 countries. During the recession we created jobs in the United States and the United Kingdom. Ninety percent of our revenues come from the U.S. and Europe, and in Europe, more than 90 percent of our employee population consists of people from the local country. Indian philosophy is not appropriate in every situation.

But some management innovations certainly reflect our Asian roots. For example, we are influenced by the idea of microfinance organizations, such as the Grameen Bank. These are self-run, self-governed micro-organizations that make up one big whole, without a formal hierarchy or ownership structure. And yet they have big market caps. I take my inspiration from a book called *The Starfish and the Spider: The Unstoppable Power of Leaderless Organizations,* by Ori Brafman and Rod A. Beckstrom (Portfolio, 2006), which uses the images of those two animals — with similar shapes but very different internal structures — to describe decentralization trends in companies.

> **"By 2020, many IT departments will evolve from functional groups into spin-off businesses of their own."**

A World of Opportunities

S+B: What are the most important trends that will define the next decade?

NAYAR: The megatrend of technological simplification has produced a shift in focus for us and for our customers. When everything from power to TV entertainment comes through a utility, why not information technology, too? Are we ready for this? No, but it is coming anyway. Licensed software will go away, and people will pay per use for all software and information technology services.

Already, competition in our industry is increasingly based on customizing IT experiences for particular groups, creating service packages tailored for them. We will ideally reach the point where a chief information officer in a given company will care more about what he or she needs from IT and what to pay for it, rather than how it is being delivered and produced.

Computer-based systems are embedded into everyday life, which means consumers themselves are less dazzled by IT bells and whistles. They are not averse to rapid change, as long as it helps their lives positively. Applications like Twitter and Facebook will grow even more disruptive in the future, because the habits of the younger generations are reflected in them.

We are also seeing more Internet devices delivering new services, including in emerging markets.

S+B: For example?

NAYAR: For mobile phones in India, text messaging [known technically as short message service, or SMS] has been more important than voice. When the SMS application was created, however, few observers saw it as a technology that would quadruple mobile phone usage. It may be popular in the U.S., but it is much more important in India, where SMS can change a user's livelihood. A fisherman out in his boat can send an SMS to different markets and take his boat to wherever the price is highest. Likewise, a farmer who is taking his grain to a wholesale shop can go to wherever he can get the best price. [See "A Gandhian Approach to R&D," by Abhishek Malhotra, Art Kleiner, and Laura W. Geller, *s+b,* Autumn 2010.]

The trend toward vertical convergence — a blurring of the boundaries between consumer categories as we have traditionally known them — is extremely significant. In the U.S., Apple is as much a music company as it is a computer company. Similarly, Bharti Telecom is the largest distributor of music in India. This convergence, along with the emergence of new channels, is disrupting existing business models and creating new ones. There is no reason why your mobile phone, two years from now, cannot be your personal health meter for medical conditions that your doctor would like to monitor, sometimes in real time.

This goes back to the concept of our engineering-services team expanding engineering opportunities outside the products and into creating ecosystems around them. For example, we're helping a telecommunications manufacturer create a next-generation product, designed to allow all of the employees at a company to enjoy the same features and level of functionality, whether they work at headquarters or in a small and distant satellite office. We're not only building the product, but also building the ecosystem that end-users will log in to.

Another key trend is the adoption of "smart energy." This is an emerging need felt by industry and political leaders, but it is also being accelerated by the new consumer affection for social causes. Major technological investments are visible in both alternative energy sources and the smarter usage of energy generated from traditional sources. This will affect many devices and services. Energy-consuming devices in homes and businesses will need a lot of embedded technology to tap into energy in a smarter way.

S+B: How do these trends affect strategic decisions at HCL?

NAYAR: Meeting the needs of emerging markets is one of our main priorities. We are working with our customers to address the Indian market, either by reverse-engineering existing products or by adopting "frugal engineering." There exists a large untapped market for us in the emerging geographies. [See "The Importance of Frugal Engineering," by Vikas Sehgal, Kevin Dehoff, and Ganesh Panneer, *s+b,* Summer 2010.]

The other main priority is to invest in services to create distinctive experiences. This makes a big difference to our customers. It also matters to them that we are willing to develop a whole product end-to-end, and to share the revenue. We are making special investments in five core areas — cloud computing, device convergence, enterprise mobility, smart energy, and "ubiquitous device management": real-time monitoring of devices so that problems can be anticipated and maintenance can be proactive. Our aim is to let customers leverage our intellectual property and IT frameworks to enhance their products and services, as well as their own internal processes.

By 2020, the role of the traditional corporate IT department will be questioned. Many IT departments will evolve from functional groups — vulnerable because they sit between technology vendors and the needs of their own company — into spin-off businesses of their own. Service providers like HCL will still exist, but the shape and scope of what we provide customers will have to change accordingly. Employees First, Customers Second is just our way of creating the kind of company that will be ready for this new world. ✚

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