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106 Innovation
The Great Repeatable Business Model
Chris Zook and James Allen

124 Technology
Everything You Need to Know About "The Cloud"
Andrew McAfee

27 Idea Watch
What Business Can Learn From Organized Crime
Marc Goodman

What Great Companies Do Differently

They create value for society, solve the world's problems, and still make money, too.

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How Great Companies Think Differently

Instead of being mere money-generating machines, they combine financial and social logic to build enduring success.

by Rosabeth Moss Kanter

IT'S TIME THAT BELIEFS and theories about business catch up with the way great companies operate and how they see their role in the world today. Traditionally, economists and financiers have argued that the sole purpose of business is to make money—the more the better. That conveniently narrow image, deeply embedded in the American capitalist system, molds the actions of most corporations, constraining them to focus on maximizing short-term profits and delivering returns to shareholders. Their decisions are expressed in financial terms.

I say convenient because this lopsided logic forces companies to blank out the fact that they command enormous resources that influence the world for better or worse and that their strategies shape the lives of the employees, partners, and consumers on whom they depend. Above all, the traditional view of business doesn't capture the way great companies think their way to success. Those firms believe that business is an intrinsic part of society, and they acknowledge that, like family, government, and religion, it has been one of society's pillars since the dawn of the industrial era. Great companies work to make money, of course, but in their choices of how to do so, they think about building enduring institutions. They invest in the future while being aware of the need to build people and society.

In this article, I turn the spotlight on this very different logic—a social or institutional logic—which lies behind the practices of many widely admired, high-performing, and enduring companies. In those firms, society and people are not afterthoughts or inputs to be used and discarded but are core to their purpose. My continuing field research on admired and financially successful companies in more than 20 countries on four continents is the basis for my thinking about the role of institutional logic in business.

Institutional logic holds that companies are more than instruments for generating money; they are also vehicles for accomplishing societal purposes and for providing meaningful livelihoods for those who work in them. According to this school of thought, the value that a company creates should be measured not just in terms of short-term profits or paychecks but also in terms of how it sustains the conditions that allow it to flourish over time. These corporate leaders deliver more than just financial returns; they also build enduring institutions.

Rather than viewing organizational processes as ways of extracting more economic value, great companies create frameworks that use societal value and human values as decision-making criteria. They believe that corporations have a purpose and meet stakeholders' needs in many ways: by producing goods and services that improve the lives of users; by providing jobs and enhancing workers' quality of life; by developing a strong network of suppliers and business partners; and by ensuring financial viability, which provides resources for improvements, innovations, and returns to investors.

In developing an institutional perspective, corporate leaders internalize what economists have usually regarded as externalities and define a firm around its purpose and values. They undertake actions that produce societal value—whether or not those actions are tied to the core functions of making and selling goods and services. Whereas the aim of financial logic is to maximize the returns on capital, be it shareholder or owner value, the thrust of institutional logic is to balance public interest with financial returns.

Institutional logic should be aligned with economic logic but need not be subordinate to it. For example, all companies require capital to carry out business activities and sustain themselves. However, at great companies profit is not the sole end; rather, it is a way of ensuring that returns will continue. The institutional view of the firm is thus no more idealized than is the profit-maximizing view. Well-established practices, such as R&D and marketing, cannot be tied to profits in the short or long runs, yet analysts applaud them. If companies are to serve a purpose beyond their business portfolios, CEOs must expand their investments to include employee empowerment, emotional engagement, values-based leadership, and related societal contributions.

What Counts As Good?

—Compiled by HBR's editors

Since the rise of the modern corporation, in the late 19th century, America has subjected the question of what a good company is—or ought to be—to near-constant debate.

THE GILDED AGE

The titans of American industry view the good company as part of an enlightened oligopoly, favoring cooperation over socially destabilizing competition.

Paternalistic corporations oversee their workers' health and moral improvement in company towns like Bisbee, Arizona, and Pullman, Illinois.

Idea in Brief

Traditional theories of the firm are dominated by the notion of opposition between capital and labor, disconnecting business from society and posing conflicts between them. According to this view, companies are nothing more than money-generating machines.

By contrast, great companies use a different operating logic. They believe that business is an intrinsic part of society, and like the family, government, and religion, has been one of its pillars for centuries.

Great companies work to make money, but in their choices of how to do so, they consider whether they are building enduring institutions. As a result, they invest in the future while being aware of the needs of people and society.

There are six facets of *institutional logic,* which radically alters leadership and corporate behavior: a common purpose; a long-term view; emotional engagement; community building; innovation; and self-organization.

Business history provides numerous examples of industrialists who developed enduring corporations that also created social institutions. The Houghton family established Corning Glass and the town of Corning, New York, for instance. The Tata family established one of India's leading conglomerates and the steel city of Jamshedpur, Jharkhand. That style of corporate responsibility for society fell out of fashion as economic logic and shareholder capitalism came to dominate assumptions about business and corporations became detached from particular places. In today's global world, however, companies must think differently.

Globalization increases the speed of change; more competitors from more places produce surprises and shocks. An intensely competitive global economy places a high premium on innovation, which depends on human imagination, motivation, and collaboration. Global mergers and acquisitions add further complexity, with their success resting on how effectively the organizations are integrated. Moreover, seeking legitimacy or public approval by aligning corporate objectives with social values has become a business imperative. Corporations that cross borders face questions of cultural fit and local appropriateness; they must gain approval from governmental authorities, opinion leaders, and members of the public wherever they operate. Their employees are both internal actors and the company's representatives in the external community.

Only if leaders think of themselves as builders of social institutions can they master today's changes and challenges. I believe that institutional logic should take its place alongside economic or financial logic as a guiding principle in research, analysis, education, policy, and managerial decision making. In the following pages, I will describe six ways in which great companies use institutional logic, how it gives them an advantage, and how the perspective can radically change leadership and corporate behavior.

A Common Purpose

Conceiving of the firm as a social institution serves as a buffer against uncertainty and change by providing corporations with a coherent identity.

As companies grow, acquire, and divest, the business mix changes frequently and job roles often vary across countries. So what exactly gives a company a coherent identity? Where are the sources of certainty that permit people to take action in an uncertain world? Purpose and values—not the widgets made—are at the core of an organization's identity, and they can guide people in their efforts to find new widgets that serve society.

Consider the Mahindra Group, an $11 billion multi-business company based in Mumbai that employs 117,000 people in 100 countries. Like many emerging-market enterprises, the Mahindra Group operates in many industries, including automobiles, finance, IT, and several dozen others. And like the great companies, it invests in creating a culture based on a common purpose to provide coherence amidst diversity, proclaiming that it is "many companies united by a common purpose—to enable people to rise."

About the Spotlight Artist

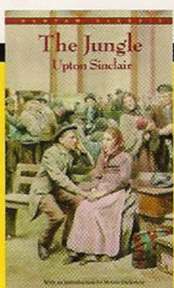
Each month we illustrate our Spotlight package with a series of works from an accomplished artist. We hope that the lively and cerebral creations of these photographers, painters, and installation artists will infuse the pages with additional energy and intelligence to amplify what are often complex and abstract concepts.

This month we showcase **Sarah Morris**, a British-born American artist whose emotive graphic paintings consciously reference architectural motifs. The busy imagery hints at the challenges individuals and institutions confront in trying to stand out in the urban "theater," an apt comparison with the effort that mission-driven companies face in trying to be recognized for their efforts.

View more of the artist's work at **petzel.com/artists/sarah-morris**.

PHOTOGRAPHY BELOW: GETTY IMAGES; TOP RIGHT: JASON SCHMIDT

1906
Upton Sinclair publishes his exposé of bad corporate practices, *The Jungle*, provoking stricter food safety regulations but no improvement in working conditions.



TEENS AND TWENTIES

1913
J.C. Penney introduces a code of conduct that urges employees "to serve the public, as nearly as we can, to its complete satisfaction."

1914
Henry Ford's "Five-Dollar Day" dramatically increases paychecks, promising to turn workers into consumers. Business leaders denounce his extremism.

At many large companies, mild profit-sharing and stock-ownership plans discourage unions and unrest.

Globalization detaches organizations from one specific society but at the same time requires that companies internalize the needs of many societies. Establishing clear institutional values can help resolve this complex issue. For example, PepsiCo has made health a big part of its aspiration to achieve Performance with Purpose. Nutrition, environmental responsibility, and talent retention are pillars supporting the slogan. Performance with Purpose provides strategic direction and motivation for diverse lines of business in many countries. It requires a gradual shift of resources from "fun for you" to "better for you" to "good for you," in PepsiCo parlance. It provides a rationale for acquisitions and investments. It is the logic behind the creation of a new organizational unit, the Global Nutrition Group, and new corporate roles, such as chief global health officer. It guides a quest to reduce or eliminate sugar and sodium in foods and beverages. Above all, it provides an identity for the people who work for PepsiCo all over the world.

Leaders can compensate for business uncertainty through institutional grounding. Great companies identify something larger than transactions or business portfolios to provide purpose and meaning. Meaning making is a central function of leaders, and purpose gives coherence to the organization. Institutional grounding involves efforts to build and reinforce organizational culture, but it is more than that. Culture is often a by-product of past actions, a passively generated outgrowth of history. Institutional grounding is an investment in activities and relationships that may not immediately create a direct road to business results but that reflect the values the institution stands for and how it will endure.

Institutional grounding can separate the survivors from those subsumed by global change. A sense of purpose infuses meaning into an organization, "institutionalizing" the company as a fixture in society and providing continuity between the past and the future. The name can change, but the identity and purpose will live on. In 2007, Spain's Grupo Santander acquired Brazil's Banco Real and folded it into its Brazilian assets. But Banco Real's spirit involved much more than its financial assets. Its then-CEO Fabio Barbosa was put in charge of creating the combined entity, Santander Brazil. Although the new organization faced pressure to increase branch profitability, under Barbosa's leadership Banco Real's focus on social and environmental responsibility, along with its private banking model, were infused throughout Santander Brazil and the parent.

Successful mergers are noteworthy for their emphasis on values and culture. When the merger of two Swiss pharmaceutical companies formed Novartis in 1996, CEO Daniel Vasella wanted the new company's mission to be globally meaningful and central to the integration and growth strategy. The question was how to provide employees with a tangible experience that reflected those values. When I floated the idea of a global day of community service—unheard of in Europe at that time—Novartis agreed. The company allowed each country organization to determine how it wanted to serve local communities, based on its interpretation of what the two histories and one future would suggest. The day of service has become an annual Novartis event, held on the merger's anniversary.

Affirming purpose and values through service is a regular part of how great companies express their identities. In June 2011, IBM celebrated its 100th anniversary by offering service to the world. Over 300,000 IBMers signed up to perform 2.6 million hours of service on a global service day. They contributed training and access to software tools, many of them developed specially for the occasion, to schools, governmental agencies, and NGOs. Projects included training on privacy and antibullying in 100 schools in Germany; a new website developed in India for the visually impaired, with a launch at 50 locations; and access to small-business resources for women entrepreneurs in the United States. The company gave the tools away, even in cases where the software could form the basis for commercial products, to demonstrate IBM's commitment to being a contributor to society.

THE GREAT DEPRESSION

Faced with a deep and long-lasting crisis, the public expects the government to ensure good corporate behavior.

1933
The New Deal restrains price competition, regulates banking, and forces companies to negotiate with unions. Most businesspeople oppose these popular measures.

1935
Congressional investigations reveal that on the eve of the Depression, executive pay ran high, igniting debates over how profits should be shared among investors, business leaders, and employees.

A Long-Term Focus

Thinking of the firm as a social institution generates a long-term perspective that can justify any short-term financial sacrifices required to achieve the corporate purpose and to endure over time.

Keeping a company alive requires resources, so financial logic demands attention to the numbers. However, great companies are willing to sacrifice short-term financial opportunities if they are incompatible with institutional values. Those values guide matters central to the company's identity and reputation such as product quality, the nature of the customers served, and by-products of the manufacturing process. Banco Real, for instance, created a screening process to assess potential customers' societal standards as well as their financial standing. The bank was willing to walk away from those that did not meet its tests of environmental and social responsibility. This short-term sacrifice was prudent risk management for the longer term.

Companies using institutional logic are often willing to invest in the human side of the organization—investments that cannot be justified by immediate financial returns but that help create sustainable institutions. In South Korea, after the Asian financial crisis of the late 1990s, Shinhan Bank set out to acquire Chohung Bank, a larger and older bank that the government had bailed out. The moment the acquisition was announced, 3,500 male employees of a Chohung Bank union, whose ranks extended to management levels, shaved their heads in protest and piled the hair in front of Shinhan's headquarters in downtown Seoul. The acquirer then had to decide whether to go ahead with the acquisition and, if it did so, what it ought to do about Chohung's employees.

Shinhan's leaders applied institutional logic. They negotiated an agreement with the Chohung union, deferring formal integration for three years, giving equal representation to both Shinhan and Chohung managers on a new management committee, and increasing the salary of Chohung employees to match the higher wages of Shinhan employees.

Great companies identify something larger than transactions to provide purpose and meaning.

The acquirer also handed out 3,500 caps to cover the heads of the protestors. Shinhan invested heavily in what it called "emotional integration," holding a series of retreats and conferences intended not only to spread strategic and operational information but also to foster social bonding and a feeling of being "one bank." According to financial logic, the acquirer was wasting money. In terms of Shinhan's institutional logic, the investments were an essential part of securing the future.

The result: Within 18 months, Shinhan had grown both banks' customer bases, and the Chohung union was having a hard time fomenting discontent against the benign acquirer. Although a formal merger wouldn't occur for another year and a half, Shinhan and Chohung employees were working together on task forces and discussing best practices, and ideas were spreading that began to make the branches look more similar. Employees were, in essence, self-organizing. By the third year, when formal integration took place, Shinhan was outperforming not only the banking industry but also the South Korean stock market.

Emotional Engagement

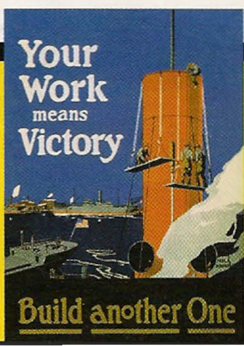
The transmission of institutional values can evoke positive emotions, stimulate motivation, and propel self-regulation or peer regulation.

Utilitarian rationality is not the only force governing corporate performance and behavior inside organi-

PHOTOGRAPHY: GETTY IMAGES

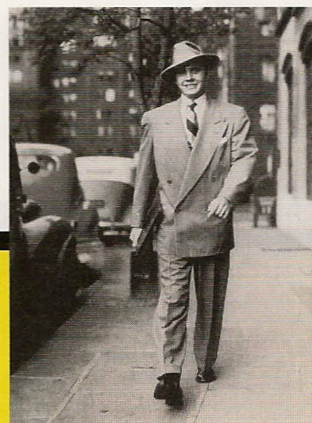
WARTIME

Supporting the war effort is seen as a duty—or at least as smart PR. Good companies limit profits on the matériel they supply to the government.



Technical innovation and creativity, crucial to military production, are important criteria in the public's definition of a good company.

When stability returns, employment is idealized as a compact between worker and employer: loyalty in exchange for a job for life.



The Benefits of Institutional Logic

Companies that operate using institutional logic reap substantive benefits.

INSTITUTIONAL LOGIC is built on a foundation of purpose and values, which serve as a buffer against uncertainty and change.

CONCEIVING OF THE FIRM as a social institution generates a long-term perspective. Short-term financial sacrifice becomes permissible in the interest of positioning the firm for sustainable success.

STRONG INSTITUTIONAL VALUES can evoke positive emotions, stimulate intrinsic motivation, and propel self- or peer regulation.

zations; emotions play a major role, too. Moods are contagious, and they can affect such issues as absenteeism, health, and levels of effort and energy. People influence one another, and in doing so they either increase or decrease others' performance levels, as my study of teams and organizations on winning and losing streaks reveals (see my book *Confidence*, Crown, 2004). Well-understood values and principles can be a source of emotional appeal, which can increase employee engagement. Having a statement of values has become common, so the issue is not whether a set of words called "values" exists somewhere in the company. Adhering to institutional logic makes the regular articulation of values core to the company's work. The CEOs of companies I studied, whether headquartered in the U.S., Mexico, the UK, India, or Japan, allocated considerable resources and their own time to breathing new life into longstanding values statements, engaging managers at many levels in the institutional task of communicating values. The point was not the words themselves but the process of nurturing a dialogue that would keep social purpose at the forefront of everyone's mind and ensure that employees use the organizational values as a guide for business decisions.

As a Procter & Gamble executive, Robert McDonald had long believed that the company's Purpose, Values, and Principles was a cornerstone of its culture, evoking strong emotions in employees and giving meaning to the company's brands. Within a month of becoming CEO in 2010, he elevated the purpose—improving the lives of the world's consumers—into a business strategy: improving more lives in more places more completely.

In P&G West Africa, for instance, every employee has a quantitatively measurable purpose-driven goal: How have I touched this year? So P&G West Africa's Baby Care Group set up Pampers mobile clinics to reduce high rates of infant mortality and help babies thrive. A physician and two nurses travel the region in a van, teaching postnatal care, examining babies, and referring mothers to hospitals for follow-ups or immunization shots. They also register mothers for mVillage, a text-message service (many of the poor in West Africa have cell phones) that offers health tips and the chance to ask questions of health care professionals. At the end of each mobile clinic visit, everyone gets two Pampers diapers. The emotional tugs for P&G employees are strong; they feel inspired by the fact that their product is at the center of a mission to save lives. They also feel proud that Pampers' sales have soared and that West Africa is among P&G's fastest-growing markets.

In companies that think of themselves as social institutions, work is emotionally compelling and meaning resides in the organization as a whole rather than in a less sustainable cult of personality. Top leaders exemplify and communicate the company's purpose and values, but everyone owns them, and the values become embedded in tasks, goals, and performance standards. Rather than de-

THE FIFTIES

Good companies make good products: appliances, cars, and other conveniences that improve the lives of the burgeoning middle class.

1955
For businesspeople, big becomes shorthand for good. The first *Fortune* 500 index of the largest companies appears, with General Motors at the top.

Even advertising is seen as playing a positive social role. By making people want more and better things, the argument goes, ads raise the standard of living.

GREAT COMPANIES SEE BUSINESS as a primary pillar of society. This focus facilitates the kind of cross-border and cross-sector engagement needed to tap global opportunities. Through the formation of public-private partnerships, firms consider the public interest along with business priorities.

THE ATTENTION PLACED ON social conditions often generates experiences and ideas that lead to learning for innovation in products, services, and business models.

IN A FIRM STEERED BY INSTITUTIONAL logic, employees can be treated as self-determining professionals, coordinating and integrating activities and producing innovation through self-organization in addition to formal assignments.

pending on charismatic figures, great companies "routinize" charisma so that it spreads throughout the organization.

Partnering with the Public

The need to cross borders and sectors to tap new business opportunities must be accompanied by concern for public issues beyond the boundaries of the firm, requiring the formation of public-private partnerships in which executives consider societal interests along with their business interests.

One paradox of globalization is that it can increase the need for local connections. To thrive in diverse geographies and political jurisdictions, companies must build a base of relationships in each country with government officials and public intermediaries as well as suppliers and customers. Only by doing so can companies ensure that agendas are aligned even as circumstances—and public officials—keep changing. Those external stakeholders are interested as much in the corporations' contributions to the local community as they are in their transactional capabilities. At the same time, great companies want both an extended family of enduring relationships and a seat at the table on policy matters affecting their business.

Public-private partnerships to address societal needs are growing in number and importance, and are especially prevalent among enterprises that think institutionally. Partnerships can take many forms: International activities, conducted in collaboration with the United Nations and other global organizations (such as Procter & Gamble's Children's Safe Drinking Water program with UNICEF and several NGOs); large domestic projects, undertaken in collaboration with government ministries and development agencies (PepsiCo's agricultural projects in Mexico with the Inter-American Development Bank, for example); product or service development to address unmet societal needs (for instance, P&G's linkages with public hospitals in West Africa); or short-term volunteer efforts (IBM's work following the Asian tsunami, Hurricane Katrina, and earthquakes in China and Japan to provide software to track relief supplies and reunite families).

In companies that adhere to an institutional logic, executives cultivate relationships with public officials neither as a quid pro quo nor to push through particular deals. Rather, they seek to understand and contribute to the public agenda even as they influence it. For example, PepsiCo's chief global health officer, who came from the World Health Organization, is planning a cross-sector project to reduce childhood obesity. IBM's CEO, Samuel Palmisano, circumnavigates the globe six or seven times a year to meet with national and regional officials, discussing how IBM can help their countries achieve their goals. This is not sales or marketing; it's a high-level conversation to demonstrate the company's commitment to furthering the development of the countries it operates in. Such engagement at the top helps other IBM leaders get a seat at the table when discussions about the country's future take place.

PHOTOGRAPHY GETTY IMAGES, AP IMAGES

THE SIXTIES

1964
The Civil Rights Act passes, and lack of discrimination becomes the new ethical bar that companies must clear. A year later the first black director joins a major company board.

1965
Ralph Nader's *Unsafe at Any Speed* exposes disregard for safety concerns at car companies, raising consumer awareness. Product safety emerges as a new standard of goodness.

> **Companies' claims that they serve society gain credence when they allocate resources to community projects without seeking immediate returns.**

Institution building requires the efforts of many people. The more interested that top leaders are in external relations, the more likely they are to involve others and to reward them for building relationships with the nation and community. Although relatively few people might hold formal responsibility for these external interfaces, a great many might perform institutional work by volunteering, attending public meetings, and participating in community service. Such activity projects a sense of authentic motivation. Community building is not a hard sell for people native to an area or for long-term residents; there is an emotional pull of place that makes such work desirable. For others whose careers take them across geographies, this work is a way to connect their organizational roles with the places they now live, making them feel more rooted.

When leaders come to see themselves as having societal purpose, they can choose to get involved at local, national, and even global levels. A few years ago, the head of IBM Greater China organized a personal diplomatic mission to Washington, meeting with White House officials and U.S. politicians to discuss the impact of China's emergence as an economic superpower. He had a desire to see both nations thrive and believed that his role in a global company afforded him a unique perspective. After retiring in 2009, he remained an IBM "super alum," in company parlance, and was supported by IBM in attending a major U.S. university for a year, with the company's support, to learn about health care. At the end of 2010, he returned to China and launched an initiative with a Chinese government institute to develop an IT-enabled evidence base for traditional Chinese medicine that will build on IBM ties.

Innovation

Articulating a purpose broader than making money can guide strategies and actions, open new sources for innovation, and help people express corporate and personal values in their everyday work.

Companies' claims that they serve society become credible when leaders allocate time, talent, and resources to national or community projects without seeking immediate returns and when they encourage people from one country to serve another. IBM's Corporate Service Corp, for instance, develops future leaders by sending diverse teams of the company's best talent on monthlong projects around the world. The attention placed on social needs often generates ideas that lead to innovations. For Cemex, operating by institutional logic and considering unmet societal needs produced innovations such as antibacterial concrete, which is particularly important for hospitals and farms; water-resistant concrete, useful in flood-prone areas; and road surface material derived from old tires, desirable in countries that are building roads rapidly. An idea from Egypt for saltwater-resistant concrete, helpful for harbor and marine applications, became a product launched in the Philippines.

Institution building helps connect partners across an ecosystem, producing business model innovation. Cemex started Construrama, a distribution program for small hardware stores, in 2001 as a response to competition from Home Depot and Lowe's, which were then entering Latin America. Construrama offers the small stores training, support, a strong brand, and easy access to products. In accordance with its values, Cemex sought dealers who were trusted in their communities, rejecting candidates whose business tactics didn't meet the company's ethics standards. Cemex owns the Construrama brand and handles promotions but doesn't charge distributors, operate stores, or have decision-making authority. It requires, however, that

THE SEVENTIES

As companies struggle to survive "stagflation," efficiency becomes a mark of goodness.

1978
The Airline Deregulation Act introduces competition to an inefficient industry. Major airlines, unions, and safety advocates all oppose the act, but consumers like the prospect of lower fares.

Encouraged by the success of Japanese imports—and by Peter Drucker—good companies emulate Japan's quality-obsessed industrial practices.

THE EIGHTIES

Under pressure from global competition, business leaders focus increasingly on a single measure of goodness: shareholder value.

stores meet its service standards. Among those is participation in community-building philanthropic endeavors—expanding an orphanage or improving a school, for instance. By the mid-2000s, Construrama had opened enough stores to qualify as a large retail chain in Latin America and was expanding into other developing countries.

Creating opportunities for individuals to use company resources to serve society furthers institution-building goals. Novartis employees serve in hospitals, where they see firsthand the challenges of disease and how their drugs are used. In 2011, P&G employees set out in Tide Loads of Hope vans to visit communities in the southern U.S. ravaged by floods. In the mobile Laundromats, managers and other professionals washed and folded clothes for local people, getting to know them and their circumstances. These kinds of interactions express corporate values and produce valuable learning, too.

Self-Organization

Great companies assume they can trust people and can rely on relationships, not just rules and structures. They are more likely to treat employees as self-determining professionals who coordinate and integrate activities by self-organizing and generating new ideas.

Institutional logic holds that people are not paycheck-hungry shirkers who want to do the bare minimum, nor are they robots that can be ordered to produce high performance. Instead, employees make their own choices about which ideas to surface, how much effort to put into them, and where they might contribute beyond their day jobs. Resource allocation is thus determined not only by formal strategies and budgetary processes but also by the informal relationships, spontaneous actions, and preferences of people at all levels.

Fully understanding a company requires knowledge of its social structure and informal networks, and optimizing performance requires social investments. At Shinhan Bank, the two banks self-integrated through social bonds and relationships well in advance of the three-year mark when official integration was to take place. The new connections manifested in such actions as each bank's voluntarily hanging the other's banner in its headquarters. At Procter & Gamble, managers in Brazil turned strategic and organizational traditions on their head to develop low-cost, high-quality alternatives to premium products. They undertook this risky initiative on their own and self-organized to ensure closer cross-functional teamwork and partnerships with customers. They felt that they had an obligation to improve the lives of consumers who could not afford premium products. Similar institutional logic led the P&G Himalaya team, a global cross-functional group, to find ways to make Gillette razors affordable and desirable to men often bloodied by barbers using rusty or worn-out blades.

Managers in great companies understand that formal structures can be too general or too rigid to accommodate multidirectional pathways for resource and idea flows. Rigidity stifles innovation. Informal, self-organizing, shape-changing, and temporary networks are more flexible and can make connections between people or connect bundles of resources more quickly. Employees' formal roles come to resemble the home base from which they are continuously mobile as they carry out daily tasks and projects, develop work relationships, and participate in team or group activities. Matrix organizations—in which individuals report to two or more bosses depending on the different dimensions of their tasks—become what I dub a matrix on steroids. People are accountable along many dimensions

Articulating a purpose broader than making money can open new sources for innovation.

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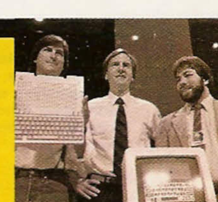
1981
President Reagan's firing of striking air traffic controllers, combined with widespread corporate layoffs, leads to a dramatic falloff in union influence over companies.

1983
Fortune publishes its first list of "America's Most Admired Companies," based on a survey of business leaders. The tech and pharmaceutical industries dominate the top 10.

THE NINETIES

The idea of corporate social responsibility, which has been stuck in academia for 40 years, goes mainstream. Now good companies create CSR departments.



Silicon Valley's success redefines the best companies as the most innovative. Intel and 3M draw envy for disrupting their industries.

Trusting people to make choices about where, when, and with whom they should work makes jobs more engaging.

simultaneously, attending to multiple projects and using their networks to assemble resources for all those projects, often without going through a decision-making hierarchy.

Although there is a drudgery and confinement component to many jobs—plenty of Cemex employees work in factories, Shinhan's banks have tellers stuck behind counters, and every company has stay-at-desk support staff—trusting people to make choices about where, when, and with whom they should work makes jobs more engaging. For example, on any given day about 40% of IBMers in the U.S. do not go to an IBM office. They work at home or at customer sites, moving between locations and taking vacations at times of their choosing. IBM's work-at-home programs, such as the one started in Japan in 2001, have caught the attention of governments interested in keeping women with technical degrees in the workforce. In some cases, IBM offers allowances to support infrastructure in the home, which has enabled a Harvard graduate working in India to combine project work with child-rearing, for instance, and a software manager from Egypt to move with her husband to Dubai.

Institutional logic assumes that people can be trusted to care about the fate of the whole enterprise—not just about their own jobs or promotions—and to catalyze improvements and innovations without waiting for instructions or sticking to the letter of a job description. Job descriptions nowadays document only part of what people do; performance reviews and salary bands capture only some of the activities through which people might add the most value for the company.

When people self-organize to create networks to share information, new initiatives or innovations are often the result. Organizations must encourage the creation of such networks, of course, and facilitate them through communication platforms or meeting spaces, but the networks usually flourish best if they spring from volunteers who do things that bosses might not have anticipated. What's more, these self-organized networks often keep good ideas alive long after an organization would have abandoned them.

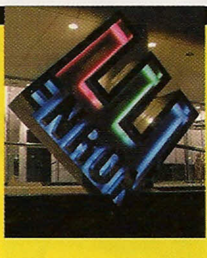
For example, three PepsiCo managers in Latin America had shared a dream for around a decade of developing new kinds of potatoes that were suitable for southern climates, less starchy, and environmentally sustainable. They felt that the initiative should be based in Peru, the potato's birthplace. The troika remained in contact despite their moving to different locations, and even after years of ho-hum response, they presented their ideas wherever they could. They eventually received a boost when a new Peruvian potato chip whose creation they championed became a sensation. The chips, which used multicolored potatoes from small farmers in remote villages in the Andes, combined nutrition, tastiness, and social contribution. Proof of concept turned the dream into reality: In August 2010, CEO Indra Nooyi announced the establishment of a global potato development center in Peru, headed by one of the three champions.

Self-organizing communities can be a potent force for change, propelling companies in directions they might not have taken otherwise. People with no formal orders serve as explorers and entrepreneurs. For example, had it not been for self-forming networks, IBM might have lagged behind or even missed out on two big business ideas: virtualization and green computing. These emerged as among

PHOTOGRAPHY: GETTY IMAGES

1997
The public's rising awareness of sweatshop labor and environmental damage pushes corporations like Nike to keep a closer eye on their global supply chains.

THE NEW CENTURY
In a decade bookended by burst bubbles, corporate reputations suffer as the public directs its anger at corruption and executive pay.



Social entrepreneurs and multinationals see opportunities to make money by finding innovative ways to solve problems in the developing world.

Companies from GE to Walmart redefine their missions to include producing social as well as economic value.

IBM's top strategic priorities after an Innovation Jam in July 2006, a web chat spanning several days to which over 140,000 employees contributed ideas.

The virtualization initiative came together outside of formal structures and, initially, as a voluntary activity. Some 200 early adopters of virtual platforms—such as Linden Labs' Second Life and similar platforms—found each other through the company's chat rooms and created an ad hoc group of people who shared ideas in their free time through avatars and weekly phone calls, with conference lines sometimes open in the virtual world, too. After a year of informal self-organization, the network found an IBM executive sponsor. IBM then designated virtualization an emerging business opportunity and provided funding for it.

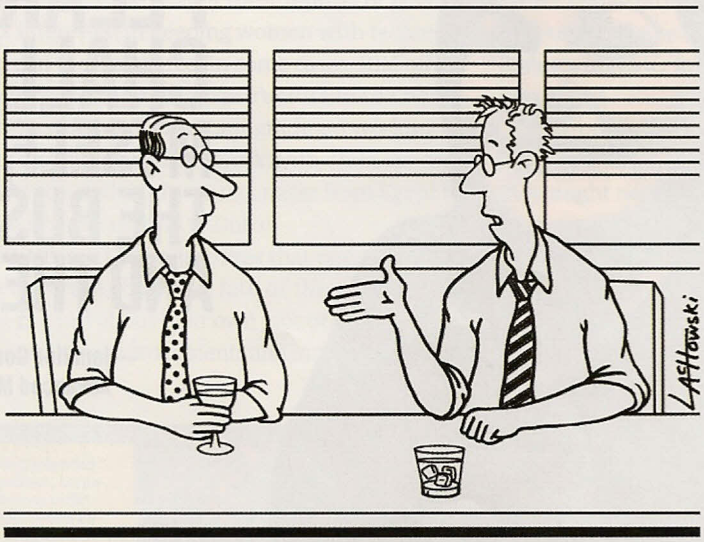
MY ARGUMENT has come full circle. A logic that justifies treating employees as self-determining volunteers—in essence, as true professionals who care about high performance because they believe in the company as institution—makes it important to have a motivating purpose and values to provide coherence and common identity. The first enables the last. The six principles I describe in this article are interrelated and share many characteristics. Especially for great global companies, institution building is not the result of carrying out specific activities but a coherent, holistic pursuit in which elements reinforce one another, are inextricably intertwined, and reflect a logic and leadership style that permeate the corporation.

Skeptics abound, of course. Firms that present themselves as institutions concerned with serving society often come under more scrutiny than others do, and they must withstand criticism about the gap between stated aspirations and performance, financially and socially. If they make money while doing good, they will be criticized for manipulation; if they do some good but not enough to solve complex problems, they will be criticized for lack of courage or commitment. Despite a growing number of advocates for a new kind of capitalism that finds win-win opportunities by creating value for both business and society, there is still controversy over the obligations of business.

The great global enterprises are not waiting for grand new theories or perfect answers. Their leaders already use an institutional or social logic to supplement economic or financial logic in guiding and growing their enterprises. Institutional logic cannot be captured by cost-benefit equations or reduced to the language of economics, and yet it turns out to be a powerful driver of financial performance.

Leaders in the great companies can tell a different story about the basis for their decisions. In so doing, they are able to produce new models for action that can restore confidence in business and will change the world in which we live. ▽

HBR Reprint R1111C

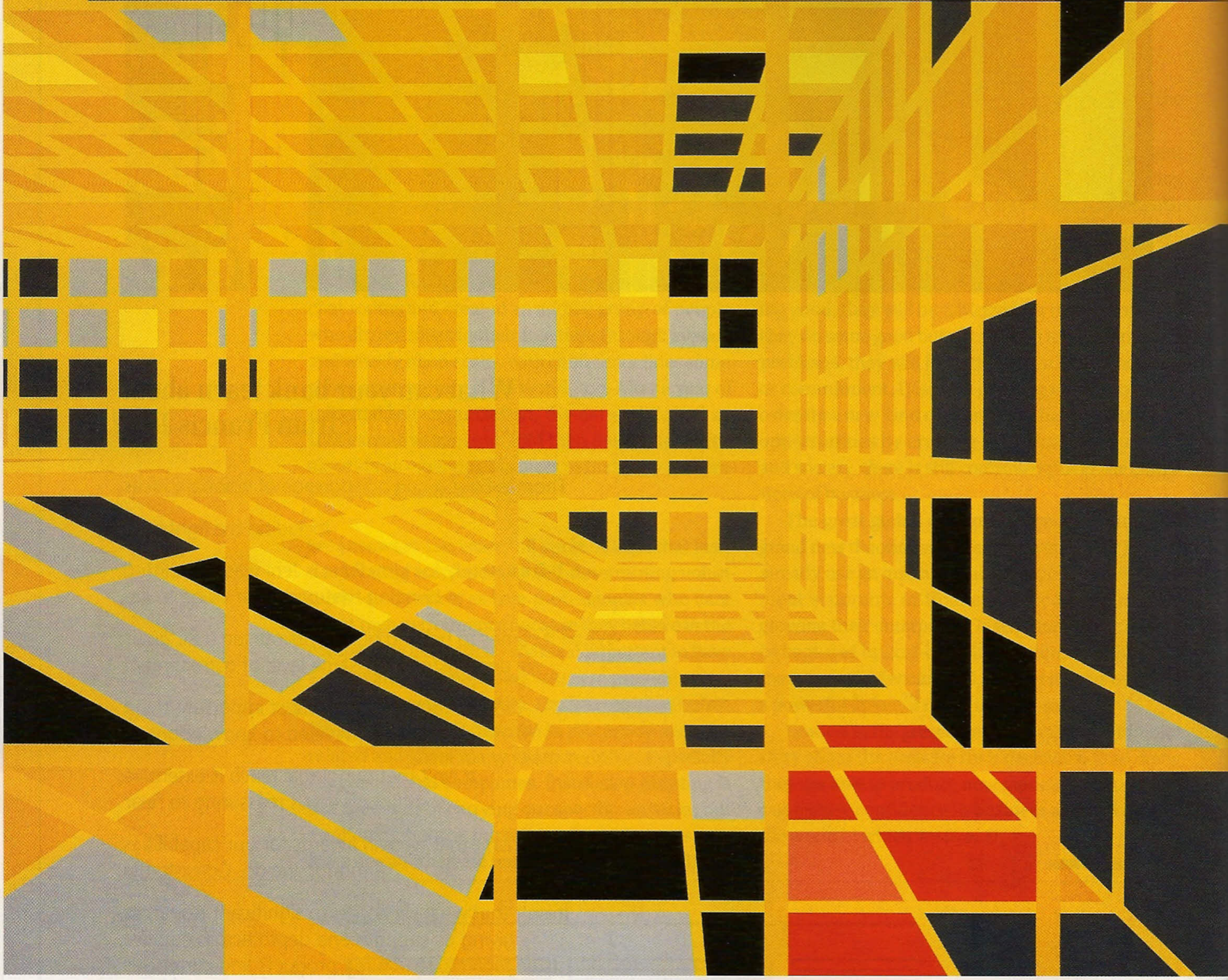


"I was the firm's cutting edge, pushed the envelope, did the heavy lifting, and was the rainmaker. Then I ran out of metaphors."

CARTOON: TIM LACHOWSKI

Spotlight

ARTWORK Sarah Morris, *Pools—Century [Miami]*, 2003,
Gloss household paint on canvas, 214 x 214 cm



"Why Don't We Try To Be India's Most Respected Company?"

He may not appear to be one, but N.R. Narayana Murthy is quite the contrarian. At a time when few Indians felt they could become entrepreneurs, he founded Infosys with just $1,000 in the bank. When no one believed that India could offer the world high-tech products, he dared to develop software services for export. In an era when conducting business ethically was virtually unheard of, he created a values-based corporation. Today, as public anger against rampant corruption in India boils over, Infosys faces a turning point, with Murthy stepping down as chairman. In this edited conversation with HBR's Anand P. Raman, Murthy reflects on his tenure and explains that for companies to be financially successful and good, leaders must demonstrate that values matter at every turn, with every employee.

HBR: "Powered by intellect, driven by values"—that's the Infosys credo. How could you imagine creating a values-driven company in the India of 1981, where corruption, nepotism, and profiteering were—and by all accounts still are—a way of life?

Murthy: In May 1981, seven of us crowded into the tiny bedroom of my rented apartment in Mumbai. I had decided to quit my job to create a professionally managed software company and had invited six colleagues to join me. The meeting was to develop our vision for the new company. One of us suggested that we should try to become India's largest software company. Someone else said that our goal should be to become the country's biggest job creator. A third opinion was that we should strive to be the software firm with the highest market capitalization. When my turn came, I pushed back on those ideas, saying, "Why don't we aim to be India's most respected company?"

What did you mean by that in practice?

If we sought respect from all our stakeholders, I felt, we would achieve our vision. If you seek respect from customers, that means you must deliver what you promise. If you seek respect from employees, you must treat them fairly and with dignity. If you seek respect from investors, you must operate with transparency and accountability. If you seek respect from vendor-partners, you must deal with them on merit. If you seek respect from governments, you must never violate any laws. If you seek respect from society, you must live in harmony with it and create goodwill. If we could do all that, I argued, we would attract customers, employees, vendors, and investors; revenues, profits, and market capitalization would follow.

After much discussion, we agreed to create a values-based organization. The vision statement we drafted that night was to be India's most respected company delivering best-of-breed technology solutions and employing best-in-class professionals. The conversation also laid the foundation for Infosys's value system: C-LIFE, which stands for Client focus; Leadership by example; Integrity and transparency; Fairness; and Excellence in everything we do. Our vision was the answer to the question, What are we trying to achieve collectively? The values answered the query, How will we achieve the vision?

Why would you wish to seek respect—not profit, as other entrepreneurs do? Didn't your cofounders think you were being idealistic or inauthentic?
Not at all. Seeking respect was natural for us. We were all were born into Indian middle-class families and had developed a strong sense of values from childhood. Our parents taught us the importance of education, hard work, decency, courtesy, honesty, respect for others, and putting the community's interest ahead of that of the individual. Our external role models were our teachers, both in school and university, who taught us to be inquisitive, analytical, articulate, and team-oriented. Setting up a values-based company was therefore like a reflex action for us—like breathing.

Since we came from the middle class, our financial expectations were not very high. Making money wasn't essential; earning respect was. Business would come, we believed.

In preliberalization India, where the government regulated business extensively and paying bribes was essential to getting things done, wasn't Infosys at a disadvantage because of your convictions?
When you say that you are committed to values, it implies that you are willing to pay a price for them. Otherwise, there is no meaning in saying you are a values-driven company.

Can you give me an example?
Let me tell you a story that I often tell our people. In February 1984, Infosys decided to import a super minicomputer so that we could start developing software for overseas clients. When the machine landed at Bangalore Airport, the local customs official refused to clear it unless we "took care of him"—the Indian euphemism for demanding a bribe. A delay could have meant the end for us before we had even started. When an Infosys manager informed me about the problem, my only question was, "What is the alternative to paying a bribe?" The manager hesitantly replied that we could pay a customs duty of 135% and then appeal for a refund. I told him: "Do that."

We didn't have enough money to pay the duty and had to borrow it. However, because we had decided to do business ethically, we didn't have a choice. We would not pay bribes. We effectively paid twice for the machine and had only a slim chance of recovering our money. But a clear conscience is the softest pillow on which you can lay your head down at night.

Apart from providing a good night's rest, did any business benefits accrue to Infosys because of your principled stand? You suffered from a competitive disadvantage, I'm sure, since not all your rivals—except TCS and Wipro—followed your example.
It takes time to benefit from putting values first. You feel the pain immediately and you reap the gains only in the long run. The customs episode immediately sent a signal that Infosys's leaders would back employees whenever they chose to take values-based decisions. It gave our people the confidence to follow the right path, even when everyone around them was bending the rules. It also boosted their enthusiasm; they became more committed to the company and more productive. It took just a few years for corrupt officials to stop approaching us for favors. Because of Infosys's ethical image, our clients entrusted us with increasingly bigger projects. Our values have thus become our advantage, gaining us larger revenues, top-flight talent, and great investors and earning us the respect of governments and societies.

How did you deal with senior executives in developed countries who wanted their palms greased? Adhering to values must have been tougher in those cases; outsourcing is a cutthroat business.
To our clients and their representatives, we have always offered our sincere thanks, deep commitment, hard work—and nothing else. We have had an extraordinary set of values-based customers, but there are always exceptions. In the early years, I remember, Infosys bid for a $1 million contract from a large enterprise in a developed economy. When I visited the company, the CIO invited me out for dinner. During the meal, he mentioned several times how much he desired a particular car. Each time, he followed that up by saying that it would be nice if Infosys landed the contract. I guess I was naive. I kept turning it into a joke, saying that while it would be easy for him to buy the car, bagging the contract over the competition wasn't as simple. Finally, the CIO decided to be blunt: "Why don't you buy me that car and I will award you the contract?" he said. That's when I realized that he was asking for a bribe. I politely told him that Infosys didn't do

such things, and the dinner ended quickly. The CIO didn't get his car, but Infosys got the contract, by the way. You have to learn to stand by your principles; it's wrong to believe you have to bribe your way to success.

Surely, it isn't as simple as that. Don't you have to be willing to walk away from customers, segments, and even markets? Why did Infosys exit the packaged software business in India in the late 1980s?
You're right; we had to give that up because we wanted to do business by the book. In those days, we used to import and distribute software packages. The government of India used to levy a customs duty of 135% on imported software packages, but most companies manipulated their invoices to avoid paying duties. This enabled our rivals to reduce the landed cost of software, which was good for the customer, I guess. However, my colleagues and I decided that we would not follow that practice even though it wasn't illegal, according to many lawyers. Infosys needed the cash flow, but since we wouldn't operate in a gray area, we couldn't successfully pursue that opportunity. Getting out was a no-brainer for us.

Isn't it enough for a good company to follow the laws?
A good company must always go beyond following the law. Ethical behavior transcends legal compliance: It's about satisfying your conscience, whereas legal compliance is about satisfying the authorities. Let's say I am walking alone on a deserted path along the Charles River in Cambridge, when I see a $100 bill lying on the ground. There is no one around and no house for miles. No one will know if I pick up the money and walk away. I can hand over that bill to the police, or I can spend the money. Spending it may not be illegal, but it would be unethical. That, to me, is a value—something that stays with you even when you are alone.

Does Infosys have a zero tolerance policy?
Whenever we receive a complaint that an employee is violating our values, we investigate it, give a fair chance to the individual to argue his or her case, come to a conclusion, and take action. We have let several extraordinarily bright and useful people go because they violated the spirit or the letter of our value system. For instance, we fired a project manager for fudging a taxi bill to the tune of $40.

PHOTOGRAPHY: AYUSH RANKA

"Making money wasn't essential; earning respect was."

He was a crucial member of the team, but our zero tolerance policy would not allow us to continue to employ him.

We also applaud good behavior. As part of our annual awards function, we honor the individual who, according to his or her peers, has demonstrated the best commitment to our values that year.

Not every manager in Infosys has always adhered to its values. Take the former head of Infosys's worldwide sales, whose executive assistant in the U.S. accused him of sexual harassment. He had to resign, and Infosys and its insurers paid over $3 million to settle the charges in 2002. How could something like that happen in a values-based company?
I would prefer not to comment on the case, which still saddens me. The person was brilliant, a star performer, brought lots of value to the company, and many considered him my favorite! Still, the moment I learned of the issue, I initiated an investigation and informed the board. The board made

a considered decision, and we implemented it immediately. The individual concerned paid a price for his mistake, and the chapter is now closed.

Infosys has recently been accused of breaking U.S. visa laws by providing full-time workers with visas meant only for visitors. That doesn't sound like something an ethical company would do.
I can't comment on that, either; the matter is sub judice. I can say only that I am saddened that Infosys has been issued a subpoena by a U.S. grand jury.

Should CEOs be totally honest with shareholders, or are there things they are better off not knowing?
Let the good news take the stairs, but make sure the bad news takes the elevator, I always say. Companies must be honest with all stakeholders except on issues that may create asymmetry of information and lead to insider trading. Infosys has demonstrated complete transparency in dealing with our investors, which has always worked in our favor. We learned that in 1995, while waiting for approval from the Reserve Bank of India to open a sales office abroad. We decided to invest the amount allocated for the purpose in the stock market, hoping to make a quick return. Unfortunately, we incurred a significant loss on our investment. At that time, according to the Indian GAAP, Infosys need not have provided the details of its loss to shareholders. But we believed that this was a moment to demonstrate our commitment to the Infosys principle, when in doubt, disclose. We went public with the details, and to our delight, Infosys shareholders took our disclosure as a sign of our transparency and didn't punish us in any way.

"Let the good news take the stairs, but make sure the bad news takes the elevator."

Does Infosys's reputation as a values-based firm put pressure on you to do more in other areas?
As Infosys has grown, society's expectations have risen. People expect us to be environmentally conscious; to lead a movement to improve the standards of corporate governance; to help the community when there are floods and other calamities. It isn't just the man on the street who demands that—our 130,000-plus employees do, too. They're smart, draw their own conclusions, and question us. Infosys must meet those expectations if it isn't to lose employees' hearts, and we do our best on all those counts.

Since you are unlikely to believe that business should be business's only business, how broadly do you define Infosys's social contract?
Don't get me wrong: Maximizing shareholder value is essential. If Infosys doesn't do that, we won't be strong and will not be able to serve any stakeholders. However, we must maximize shareholder value legally, ethically, and fairly.

The best index of a corporation's success is its longevity, which comes from living in harmony with society. We achieve that objective in many ways. Fifteen years ago, we set up the Infosys Foundation, to which we contribute a certain percentage of our profits every quarter, to address some of the basic needs of the poorest of the poor in India and the United States. In India, the foundation has built hospitals and homes for the destitute, given scholarships to poor children, built libraries in over 15,000 villages, and rehabilitated prostitutes. We have donated PCs to thousands of schools in India. In the United States, we support initiatives to improve science and mathematics education in inner city schools.

You said that values govern your decisions about whether or not to enter businesses and countries. Are Infosys's values therefore part of its strategy process?
Yes. Strategy is what we have to do to create and maintain sustainable differentiation vis-à-vis competitors. One aspect of our differentiation is our emphasis on values. Our values give our customers confidence that we will deliver on our promises, stand by them in every situation, and that we will spare no efforts to make them look good in front of their customers. Still, values cannot be just part of the strategy process; they have to be second nature for everyone in the organization.

Which brings us to the key question: How do you sustain a values-driven culture when the company

"We didn't lose our health, suffer trauma, or break up our families because we followed a values system."

is growing at over 50% per annum, its operations are globalizing, and more than 30,000 young people join the firm while 10,000 leave every year?
For many years, Infosys's values system was unwritten but well practiced. In 1998, we decided to document it. Our employees come from different nationalities, genders, religions, and political points of view, so we have to work to transform that plurality into a shared worldview of ethics and values.

Infosys has a three-step process for disseminating the C-LIFE system: Communication, engagement, and enablement. C-LIFE sessions are mandatory for new entrants and lateral hires. We use Infy TV and Infy Radio to spread Infosys's convictions about values, and we have created points of contact for solving ethical dilemmas. A C-LIFE manual works as a ready reckoner for employees. Our 700 leaders are constantly reinforcing our values; many spend their lunch breaks with young employees, discussing our values.

What is the role you personally play in communicating Infosys's values?
From the day I started Infosys, I made it a point to address every new batch of employees. I told them that I could guarantee them only three things. One, every Infosys transaction will enhance their respect and dignity. Two, the company will conduct itself in a fair, transparent, and ethical manner, so they will never have to hang their heads in shame. Three, they will learn three times more at Infosys than at any other company.

I then recount the Infosys story, lacing it with anecdotes about the difficulties we faced, the bold decisions and sacrifices we made, and how we resolved ethical and moral dilemmas. I describe our progress: From a 100-square-foot office (my bedroom) to 28 million square feet of space today; from \$250 of capital to a market capitalization of \$36 billion; from a \$10,000 kitty to \$3.8 billion of cash today. Yet, we didn't lose our health, suffer psychological trauma, or break up our families because we followed a values system.

Managers often say that leaders don't walk the talk when it comes to values. How do Infosys's leaders avoid that trap?
The best instrument for gaining trust is leadership by example. Most leaders forget that employees and stakeholders are watching them closely and that their every action will be discussed, lauded or criticized, and, often, imitated. Leaders have to be careful not to create dissonance between what they say and do. When we set up Infosys, I took a cut in pay while my colleagues got small increases. Similarly, we awarded 70% of Infosys's equity to people who had hardly 18 months of experience. Decisions like these gave Infosys's employees confidence in their leaders. My younger colleagues didn't hesitate to make sacrifices later because they had seen me do so from the start.

We also follow protocols about punishments whether the person is a CEO or a janitor. On at least three occasions, board members have had to pay heavy penalties for what could be considered minor infractions. Setting an example at the top is the best way to instill confidence throughout the company.

Before this interview is published, you will step down as Infosys's chairman, a position you held for three decades. How confident are you that Infosys will continue to be a values-driven company?
Listening to your conscience helps you do the right thing, so every employee—or Infoscion, as we call them—must be guided by that inner voice in making every decision. As long as Infosys's leadership continues to foster an environment in which employees feel a responsibility to their conscience, it will deliver results.

After August 20, 2011, my title will be chairman emeritus; I will no longer have a role in strategy formation or execution. However, every Infoscion will have the right to consult me, particularly on issues relating to our values. I hope to help Infosys continue to be strong and adhere to its values even in moments of great temptation.

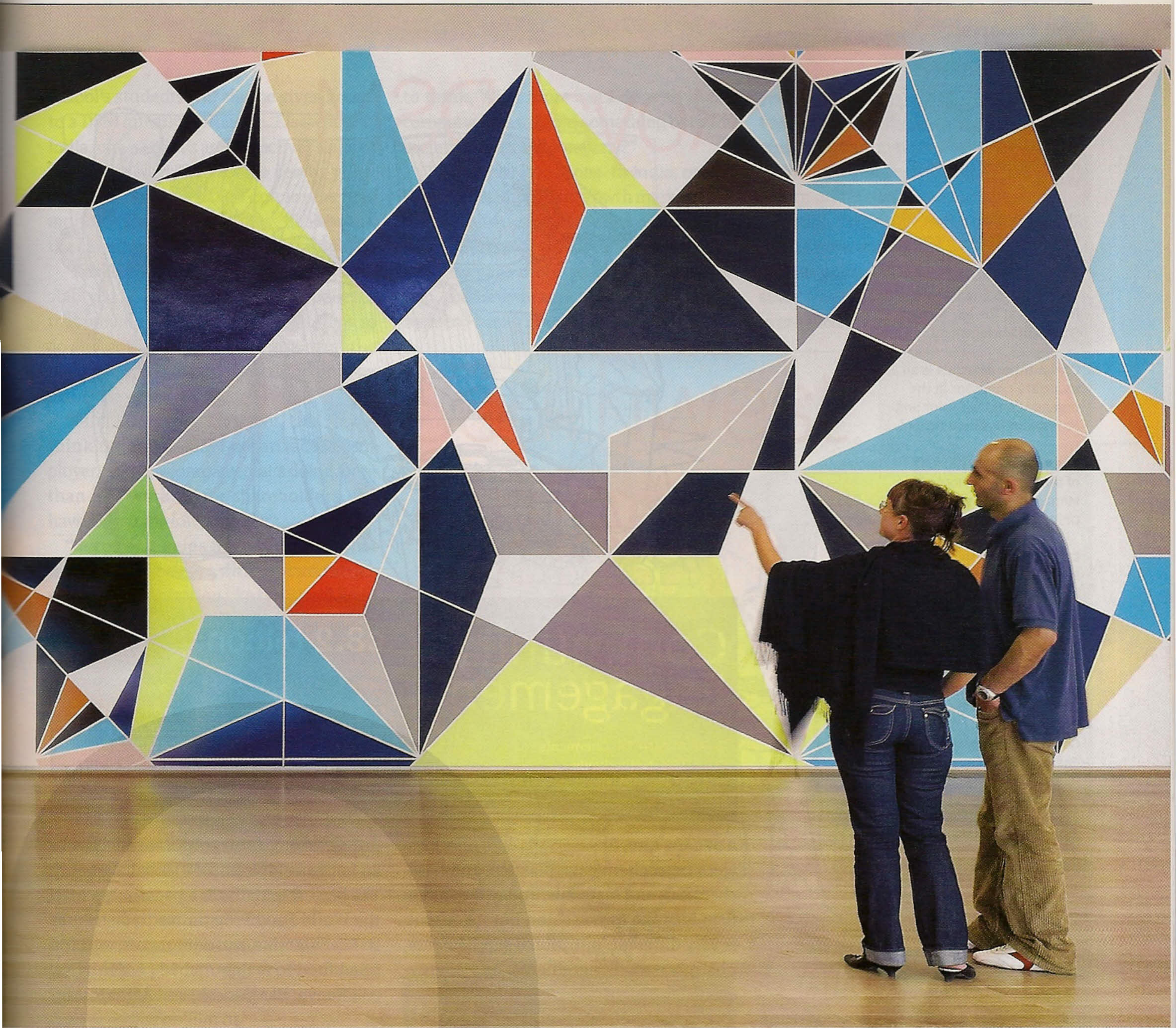
HBR Reprint R1111D

Spotlight

ARTWORK Sarah Morris, *Black Beetle [Origami]*, 2008
Gloss household paint on wall, installation view

It's Hard to Be Good

***But it's worth it. Here are five companies whose success is built on responsible business practices.* by Alison Beard and Richard Hornik**



ON THE FOLLOWING PAGES, HBR profiles five "good" companies that do more than just pay lip service to community engagement, labor relations, environmental protection, corporate governance, and supply chain accountability. Neither our editors nor the academics we consulted have voted them the world's most socially responsible corporations. But each excels in one or more of the areas just listed, and does so by making them part of its internal corporate logic—something that Rosabeth Moss Kanter argues, in another article in this Spotlight, that all businesses should do.

These firms have also succeeded commercially—hard evidence that doing the right thing as a company doesn't conflict with bottom-line imperatives. As Zhang Yue, the founding chairman of Broad Group, says, "The survival and growth of a company is the same thing as its social responsibility."

The Experts

Pamela Hartigan is the director of the Skoll Centre for Social Entrepreneurship at the University of Oxford's Saïd Business School. She is also a founding partner of Volans.

Thomas Kochan is the George Maverick Bunker Professor of Management and a codirector of the Institute for Work and Employment Research at the MIT Sloan School of Management.

Christopher Marquis is an associate professor in the organizational behavior unit at Harvard Business School.

Roger Martin is the dean of the Rotman School of Management at the University of Toronto.

Dan Esty is the Hillhouse Professor of Environmental Law and Policy at Yale University. He is also the director of the Yale Center for Environmental Law and Policy and the Center for Business and the Environment at Yale, and the commissioner of the Connecticut Department of Energy and Environmental Protection.

Royal DSM

ILLUSTRATION: BRETT AFFRUNTI

NOTABLE STRENGTH

Community Engagement

CORE BUSINESS Chemicals
COUNTRY Netherlands
YEAR FOUNDED 1902
EMPLOYEES 22,000

2010 REVENUE

€8.2 billion

10-YEAR ANNUALIZED TOTAL SHAREHOLDER RETURN 9.6%

FACT A group of South African primary school children who ate porridge fortified with MixMe, a DSM multi-micronutrient powder, saw their mean store of body iron double over the course of a 23-week company-sponsored clinical study.

A DECADE AGO, Royal DSM's core offerings were petrochemicals, plastics, and base chemicals and materials. Today the Dutch firm is in the same sector, but its output is very different: nutritional supplements, pharmaceutical ingredients, and energy-efficient building materials.

If the company's first step on the path to being a good corporate citizen was to develop and sell more-sustainable, health-enhancing technologies and products, the second step is even bolder—and less obviously commercial: giving them away to those who need them most.

But both moves are strategic and designed to promote long-term corporate success in an increasingly complex global economy. The biggest initiative is a partnership with the World Food Programme to distribute DSM's vitamins, nutrient mixes, and fortified food to malnourished people in Nepal, Kenya, Bangladesh, and Afghanistan; 10 million will be served by the end of this year. But the company, which has 250 sites in 50 countries, also participates in many smaller initiatives. For instance, it has contributed lightweight composite modules to a new school in Pune, India, which reduced the costs, time, and environmental impact of construction; the

"A lot of companies' CSR initiatives have nothing to do with their core business. DSM, by contrast, has used its savoir faire, its expertise, and mobilized staff to improve the nutrients in the food given in situations of famine or hunger. If we could clone Feike Sijbesma, the CEO, the world would be a better place."
Pamela Hartigan, Saïd Business School

NOTE ALL TOTAL SHAREHOLDER RETURN FIGURES ARE AS OF AUGUST 2011

Alison Beard is a senior editor, and **Richard Hornik** is a contributing editor, at HBR. **Heather Wang, Meghan Ennes, Erin Rush,** and **Samantha Presnal** provided additional reporting for this article.

school's students will also be given access to a DSM nutrition program. Elsewhere in India, one of DSM's anti-infectives units offers free medical services to nearby villagers. And in Mexico, DSM employees hold monthly seminars on safety, health, and the environment for local schoolchildren.

Fokko Wientjes, the director of sustainability at DSM, says the company believes that providing aid is both the right thing to do and critical to the future growth of the business. "The benefit isn't difficult to explain," he says.

"First, in the war for talent, this way of thinking makes DSM an attractive employer. This is a company that's doing more than just working for shareholders. We have extremely low turnover.

"Second, it helps us understand what the needs are in the different countries where an organization like the World Food Programme operates, which helps us innovate.

"And third, when you work with these groups you really get the message out on issues like the importance of nutrients. And in the end that will lead to interventions and investments that could be profitable."

The service mentality starts at the top with CEO Feike Sijbesma, who spearheaded the sustainability-focused rebalancing of DSM's product portfolio. Rank-and-file employees participate by nominating small projects for the company to fund. In the middle, local managers are encouraged to budget for outreach and engagement in their communities.

"You look at your environment and think, What can I contribute here?" says Wientjes, whose stints with DSM's South American and Egyptian operations involved work on safer house construction and environmental cleanup. There's just one rule: "It needs to be linked to our strategy, to our expertise. We wouldn't do language lessons for children. But chemistry and math? That suits our company. That's what we know.

"With big projects, you have to find the right partner and the right cause. You have to think, What more can I do with these competencies to build something both for society and for the company?"

It's not just donations. In India, one of DSM's most important growth markets, the company has a subsidiary tasked with helping local base-of-the-pyramid businesses move toward more-sustainable production, primarily in agriculture (for example, by using better cow feed to improve milk yields) and energy (by providing enzymes to improve the efficiency of gas plants powered by animal manure).

Wientjes acknowledges that DSM's return on its social investment is hard to quantify. "We don't really put a value on it right now, and maybe we should to have the investor community better understand," he says. "But shareholders haven't ever called me and said, 'Please stop.'" ■

Southwest Airlines

NOTABLE STRENGTH

Labor Relations

CORE BUSINESS Airline
COUNTRY United States
YEAR FOUNDED 1967
EMPLOYEES 35,000
2010 REVENUE
$12.1 billion
10-YEAR ANNUALIZED TOTAL SHAREHOLDER RETURN -6.9%
FACT Southwest consistently has the lowest ratio of complaints per passengers boarded of all major U.S. carriers reporting statistics to the U.S. Department of Transportation.

SOUTHWEST'S FIRST NEWSPAPER ad, published in 1971, promised that its flight attendants—then called air hostesses—would serve from the heart. (Later commercials made it clear they would also wear hot pants.) But what the marketing campaigns didn't explain was how the company planned to create its energetic corps of customer-loving, costume-wearing employees. The strategy was simple: Southwest would make its staff happy. Customer satisfaction and profits would follow.

Today that doesn't sound new. But back then it was. And the philosophy has paid off.

Southwest is now the largest U.S. domestic air carrier and has been profitable for 38 consecutive years, during which many competitors declared bankruptcy or operated in the red.

Last May, on the day the company finalized its $3.2 billion merger with AirTran, Southwest's management team flew to AirTran's Atlanta headquarters to throw an air-hangar barbecue for the 6,000 acquired employees based there. CEO Gary Kelly helped serve brisket. The next day the executive group went back to work on a plan that will merge seniority lists in 16 collective bargaining agreements and preserve the job of every manager below the C-suite, though some might be required to relocate. This approach highlights two key elements of Southwest's employees-first strategy: meaningful interaction between staff and management, and good relationships with organized labor.

The company also champions a corporate culture—"warrior spirit, servant's heart, fun-loving attitude"—that promotes collaboration. There is a "culture committee," which is made up of 200 employees from all levels and meets quarterly to plan activities. One favorite initiative is "Delight and Surprise," when committee members unexpectedly greet the crew of an arriving flight with food and drink and relieve them of plane-cleaning duties.

Employee development starts with intense onboarding and continues through the company's six-week MIT (managers-in-training) program. Two poster children for career advancement at Southwest are Mike Ryan, a VP of labor relations who started in the mail room, and Teresa Laraba, senior VP of customer services, who began as a part-time agent in the El Paso airport.

Southwest's pay and benefits are above the industry average. In 1973 it was the first airline to establish profit sharing, and employees now own 5% of company stock. Diversity is a priority, and HR policies allow for small but critical concessions like letting flight attendants trade hours.

Much of this is negotiated with the unions, with which Southwest has always worked well. Senior labor relations counsel Joe Harris, who has represented the company since 1972, remembers the initial thinking of founder and CEO Lamar Muse and his legendary successor, Herb Kelleher. "They simply adopted the position that our employees needed an effective voice so we would partner with these organizations," Harris recalls. Of course, "we've had very contentious negotiations over the years. But we're not like the Hatfields and the McCoys, where we keep fighting after the fight is over. At the end of the day we have a common objective to keep the company healthy and prosperous."

"Southwest has been consistently successful by staying true to its values. Other airlines have said, 'We know we should improve labor relations, but we have 9/11, Asian flu, gas prices...' It's always, 'We'll get to that.' Southwest has said, 'The only way we can turn these planes around quickly is by having committed, problem-solving employees that work together. So what kind of HR practices promote that?'"
Thomas Kochan, MIT Sloan School of Management

Southwest reinforces the employee ownership mentality through aggressive internal communication at live events like Kelly's annual "message to the field" speaking tour and through new technologies. The company offers text alerts for corporate news and has a smartphone app for its intranet, where Kelly posts a weekly audio update and senior managers blog and respond to comments.

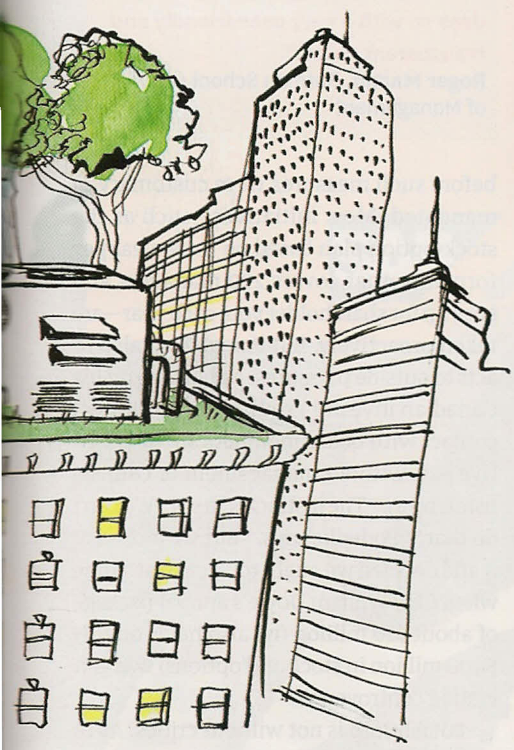
Will Southwest be able to keep it going and remain a profit leader among airlines even as the economy stagnates, margins tighten, and competitors cotton on to the employees-customers-shareholder continuum? "It's a tremendous challenge," Harris acknowledges. "But this philosophy really does still permeate the entire organization." ■

Broad Group

"RESPONSIBILITY IS MORE important than growth." "Protecting the environment is more important than profit." "Love is more important than anything else."

You might expect to find those lines in the values statement of a company that makes energy-efficient air conditioners. But would you expect them from one based in hypercompetitive, high-pollution China? From one with industrial customers in more than 70 countries and more than $500 million in sales? From one led by a man worth an estimated $850 million? From one that might soon go public?

Broad Group, the Changsha-based business we've just described, doesn't see a trade-off between responsibility and growth. Instead, the company—which makes not only air conditioners but also air filtration systems and prefabricated



NOTABLE STRENGTH

Environmental Protection

CORE BUSINESS Industrial Products
COUNTRY China
YEAR FOUNDED 1988
EMPLOYEES 2,600

2010 REVENUE
RMB 3.6 billion
10-YEAR ANNUALIZED TOTAL SHAREHOLDER RETURN Undisclosed
FACT Broad Town, the company's one-square-kilometer headquarters, comprises 28 buildings made of recycled packing crates and shipping pallets. Three times a day, employees there are served meals sourced from an on-site organic farm.

"Broad Group continually pushes forward new ideas, products, and services that not only help them meet bottom-line objectives but also satisfy their core mission—solving environmental problems in a way that connects to their existing business."
Christopher Marquis,
Harvard Business School

energy-efficient buildings—is proof that the two can go hand in hand.

"Being good itself is competitive," says Zhang Yue, who founded the company with $3,000 in 1988 and is now its chairman. "A bad company may be competitive in a market for a while, but it won't last long. If you offer something of social value, you will survive, and you will prosper."

Of course that wasn't clear in the 1990s or even the early 2000s, when Broad was trying to persuade industrial customers to switch to its air conditioners. Its technology, which counterintuitively uses natural gas or waste heat to cool, is better for the environment—it avoids the ozone-depleting refrigerants used in electric cooling, reduces the load on power grids, and requires less energy overall. But the up-front costs are still significantly higher than those of less environmentally friendly options, making it a harder sell.

The company's earliest successes were in locales with unstable electric systems. Now Broad Group exports to developed markets around the world, supplying airports from Madrid to Bangkok as well as military bases in the United States. It claims to triple the energy efficiency of facilities while dramatically reducing emissions.

The company's other "good" products were developed partly as a response to social and environmental crises: Its air purification systems were designed after the 2002–2003 SARS outbreak in Asia (a cell phone that monitors air quality is on the way); its prefab building system—which allows for fast, zero-pollution construction of sturdy, well-insulated structures—followed the 2008 Sichuan earthquake.

Zhang sees that system, the BSB (Broad Sustainable Building), as the company's future. "Buildings consume 40% of the world's energy," he explains. As soon as the BSB standards are verified by the Chinese government, the company will tackle its goal of producing 700 million square feet of energy-conserving space by 2020. Working through 100 franchised distributors, it hopes to win a 30% share of the global construction market. "We boldly dream that one day the whole world will cut CO_2 emissions by 40% using this technology," Zhang says.

Observers have been impressed by a video showing a prototype 15-story hotel built in 90 hours. But it's a long way to world domination—hence the desire to raise more capital by taking the company public.

A stock market listing will bring new stakeholders, but Zhang thinks he can hold fast to the company's ethos and culture. Indeed, investors will know exactly what they're buying into: a company with environmental protection at its core, led by an outspoken tycoon who recently renounced his private jet and who refuses to contribute to overpopulation by having a second child.

Zhang really does seem to think he can build a global business on love. "If everybody and every business becomes socially responsible," he says, "then the earth will become a beautiful hometown for us all." ■

Potash Corporation

NOTABLE STRENGTH

Corporate Governance

CORE BUSINESS Fertilizers
COUNTRY Canada
YEAR FOUNDED 1975
EMPLOYEES 5,500

2010 REVENUE
US$6.5 billion
10-YEAR ANNUALIZED TOTAL SHAREHOLDER RETURN 27.4%

FACT After BHP Billiton launched a hostile takeover of PotashCorp last year, the company's board of directors met 35 times (compared with eight times in a typical year), with an attendance record of 97%. The bid was eventually quashed by the Canadian government.

A DECADE AGO, after the grand corporate frauds at Enron and WorldCom unleashed a wave of scandal-inspired regulation, the executives and directors of Potash Corporation made a decision. The Canadian fertilizer producer wouldn't just follow the new rules. It would get ahead of them.

"There was this groundswell around governance in the academic, shareholder, and regulatory communities, and that made us stop and take a comprehensive look at what we were doing," says Joe Podwika, general counsel. "We had established a sustainability committee, and we realized one of the pillars had to be good corporate governance. Instead of adhering to the minimum requirements, we could implement best-practice programs that in the long run would be good for the company."

What started with a core values statement and code of conduct has grown to include a host of shareholder-friendly initiatives, from directors elected by majority vote to "say on pay" for executives—all before such measures were customary or mandated. Most initiatives—such as the stock-option plan based on three-year performance that covers 220 managers and goes up for shareholder vote each year—are taken proactively. But PotashCorp also reacts to outside pressures. Not long ago a big Canadian investor group requested direct contact with board members about executive pay, without management or counsel listening in. "The instinct is to say, 'We can't do that,'" Podwika says. "But we looked at it and decided we ought to"—even at a time when CEO William Doyle's annual package of about $10 million (he also held roughly $400 million in stock and options) was generating controversy.

PotashCorp is not without critics. As recently as 1989 it was a debt-burdened government entity. Its mining operations create serious short-term environmental damage, even if it invests heavily in land reclamation. The company also still places "maximize long-term shareholder value" at the top of its key goals, followed by ones related to customers, communities, employees, and the environment (in that order).

But when it comes to governance, PotashCorp is by all accounts doing the right thing. What benefit does the company get as a result? "One way to think about the ROI is that it's like an insurance policy," says Podwika. "There's a generally understood principle that the real value of the company is our reputation. I'd say that everybody has it on their consciousness—our CEO, our CFO, and certainly our board. People in every part of the company. We talk about it all the time." ■

> **"Potash shows leadership in the clarity and forthrightness of its compensation disclosure. Rather than giving the minimum required and forcing the investor to try to figure out what the compensation really is, it voluntarily reports how much its executives earn from exercising stock options—even though in recent years it has been an embarrassingly high number. And it does so with a very user-friendly and transparent chart."**
> **Roger Martin,** Rotman School of Management

Unilever

NOTABLE STRENGTH

Supply Chain Accountability

CORE BUSINESS Consumer products
COUNTRY UK/Netherlands
YEAR FOUNDED 1930
EMPLOYEES 167,000
2010 REVENUE
€44.3 billion
10-YEAR ANNUALIZED TOTAL SHAREHOLDER RETURN 4.2%
FACT It takes 3.5 million pounds of eggs from 125,000 cage-free hens to make the 30 million jars of Hellmann's Light mayonnaise sold in North America.

TO UNDERSTAND THE challenge of making Unilever's supply chain sustainable, consider this: Each year, the company sells 170 billion products across 180 countries, sourcing materials from 150,000 suppliers and operating more than 250 factories. It's hard to manage that network, much less improve its performance on sustainability. But, according to Pier Luigi Sigismondi, Unilever's chief supply chain officer, doing better in that area is a strategic imperative. "We have to do business this way to sustain our long-term business goals," he says. After all, the maker of Lipton tea, Knorr soup, and Dove soap can't ignore farmland degradation or threats to the world's water supply. And a leading consumer goods company must respond to consumer demand for sustainably sourced products.

"Unilever has developed a pathbreaking framework for looking at products in a cradle-to-grave, value-chain-wide way. That represents a real step forward in companies' taking on a higher burden."
Dan Esty, Yale Law School

Execution rests on a "prioritize and conquer" approach. For agricultural sourcing, Unilever identified its top 10 raw materials (as measured by volume, strategic importance, and consumer interest in sustainability) and set out goals for moving to sustainable supply (as measured by 11 factors from soil quality to labor practices). For example, it buys 1.4 million tons of palm oil annually, or 3% of the global yield, but this year more than half of that will come from growers certified by the Roundtable on Sustainable Palm Oil, a group it helped establish. By 2015 the company intends to use sustainable palm oil exclusively.

In manufacturing and logistics, the company has set goals for reducing its environmental impact both directly (in factories, distribution centers, and transport) and indirectly (via better packaging and consumer education). Factories are required to submit monthly scorecards on their waste disposal and energy and water use. "We monitor it just as we monitor cost and sales," Sigismondi says. By 2020 the company aims to reduce CO_2 emissions from manufacturing and logistics by more than 40% from a 1995 baseline. So "we know we need to do 4% or 5% a year."

Unilever typically works with governments and NGOs to ensure that its supply chain is following best practices. Though Sigismondi was recently in India visiting vegetable farms, he admits "it's impossible to do it all on a one-to-one basis." Suppliers in markets with no certification bodies are told to "self-certify" against Unilever's Sustainable Agriculture Code; their progress is monitored with software tools and audits. And when activist groups unearth problems, as Greenpeace did in some of Unilever's Southeast Asian palm plantations, the company responds (in the plantations' case by revoking their contracts).

All this requires investment, and the return is variable. Tea growers certified by the Rainforest Alliance offer higher yields, which reduce product costs, but for sustainable palm oil the balance-sheet defense has yet to materialize. Still, "we're big enough to afford the premiums, and we believe this is the future of the industry," Sigismondi says. "Today we're investing. We'll see the return in years to come."

There's more to do. Unilever has not set targets for sustainable sourcing of chemicals, minerals, and packaging other than paper and board. It continues to explore ways to convince customers that they must behave responsibly, too. "Sixty-five percent of our environmental footprint is related to how consumers use our products," Sigismondi says. "We have to lead beyond our own four walls."

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