Lecture Text

Nitin Nohria

What Really Matters

(*edited for clarity*)

What Really Works?

I want to talk to you about some research that I just finished in this book that came out earlier this year. It was based on a five-year project that I did in collaboration with Bill Joyce and Bruce Roberson. The project is called "What Really Works." It was provoked by the first book that I ever wrote at the Harvard Business School, which was called *Beyond the Hype*. And this book sort of started off—it came out in 1992—with the question that every year there is a new mantra about what people believe is the answer to finally getting great business success. This wave of new ideas, I think, started in 1982 with Tom Peters' book *In Search of Excellence,* and since then there's been a stream of management books that have all tried to explain what it is that truly differentiates great companies from companies that don't do so well. And I said, "You know, is there any way we can cut through all of these everyday mantras and ask the question 'What is it that truly works?' "

The Fundamental Question

In order to do that, we began this big project, which said that if I start off with no priors of my own, which is a hard thing for an academic to do, which of the various management practices that people claim contribute to management performance actually really do contribute to management performance?

Research Design

So we set out to say how would we actually study this problem? So I went out and I looked at all of the bestsellers over the last twenty years and extracted from them the wisdom that came out of these books in terms of what really works according to all these people. And I came up with a list of more than 220 things. If you just tried to do all of these things, you'd be in trouble, because it's very hard for anybody to do 220 things. So we had this list of 220 things and then we said, "If we're going to try and sort out which of these 220 things really makes a difference, what kind of research design would we use to help sort out what is compelling and what is not?" So I want to spend just two minutes telling you about the research design that we came up with because I think it's important.

Why study winners?

What is the problem that you have with studies that simply look at winners, which is the *In Search of Excellence* kind of study? How many of the winners remain winners for any sustained period of time? Not very many. I mean, the reason why *In Search of Excellence*, for instance, fell out of favor was that five years after the study came out, everybody said, "You know, all these excellent companies have now become non-excellent companies. What do we make of what happened? Do we conclude that what we learned by studying these winning companies was wrong?" I think it's an overstatement to say that we would conclude that everything that we learned was wrong, but we don't know cause and effect. We really don't know how to sort that out.

Losers as control groups

So then we had people like Jim Collins, who wrote the fabulous book, *Built to Last*, who said that one way we might be able to tease this thing out is to actually study winning companies but then also to have a control group of companies that were losers. Let's look at winners and losers and compare those two groups and maybe we'll learn something out of this, things that distinguish winners from losers; that may be a better thing, right? I think that makes some progress, but you're still left with a problem. What you don't know is that suppose you find out that great talent is something that winners have and losers don't. It leaves you puzzling about whether it is the case that they were winners and got great talent, or is it the case that in fact it was because they had great talent that they became winners? Because you can see how being a winning company might actually attract talent to come to your company. So it's very hard to sort out what's driving what in models like that.

Climbers
There is another thing that Jim Collins himself, to his credit, figured out in his most recent bestseller, *Good to Great*, which I would recommend to any of you if you were looking for a book to read. He said, "I'm going to look at companies and I'm going to look at companies that have sort of been plodding along and then suddenly have this sharp move upwards," which is what I call "climbers" in my studies—companies that have been doing relatively OK and then start climbing up. And let's look at climbers, because what they tell you is what changed that caused these companies' performance to improve. I think that's again a much better study than a study that just looks at winners or just winners and losers alone.

Tumblers
But it still misses the box into which the vast majority of companies fall, which is the box of companies that have been doing very well and then end up tumbling. In fact, you can ask the question: How many companies even meet the statistical odds of being winners? So if you say I want to look at companies that are in the top quartile of business performance in a five-year period and then in the top quartile of business performance in the next five-year period, by sheer mathematical odds you would say it would be one-fourth times one-fourth, which is one-sixteenth, roughly 5 percent of the companies. But only 2 percent of companies actually meet that test. On the other hand, if you look at winners and you say, "How long does a winner actually stay a winner?" the half-life of a winner is three years. So winners have an easy time to become tumblers.

Quads
So we thought we would test these 220 different propositions that we had by looking at forty different industries, four companies each in each of these industries: one company that over a ten-year period was a winner—for the first five-year period and the second five-year period it outperformed its peers and was in the top quartile of industry performance. Another company was a loser. It's remarkable that we allow companies to continue to be in this box forever and ever, but these were companies that were in the lowest quartile of performance in the first five-year period and then stayed in the lowest quartile of performance in the second five-year period. Those companies were losers. A third set of companies were climbers. These were companies who were in the lowest quartile of performance in the first period but then ended up being in the highest quartile up here in the second five-year period. And then the fourth category of companies were tumblers.

To give you an example of one of these "quads," which is what we call them, here is an example of a quad from the retail industry. I choose this because we all shop and so we at least might have some familiarity with some of the companies in this cell. I could have easily put in the winner category a company like Wal-Mart, but that would have been boring because everybody would expect that to happen. So here is this other company that I put up there, a company called Dollar General, which was a winner over this period. The period that I studied is 1986 to 1996. I've replicated the results for the next five years; they come out to be roughly the same.

A loser over this period, no surprise, is a company like K-Mart. A climber was Target. Here's a company that has done remarkably well recently, but wasn't, in fact, doing as well if you look at the first time period that we studied here, '86 to '91. And a tumbler is The Limited, an extraordinary company that Wexner ran for a long period of time, that did fabulously well and then the wheels seem to fall off. And now they're in the middle of a turnaround yet again.

Collecting data
We looked at four companies like this in forty different industries. If you looked at the companies in 1986, it wasn't apparent which one was going to be which. So we tried to make sure that it wasn't apparent in 1986 which company would fall in which quadrant. And then we said we're going to look at all these 220 management practices across these 160 companies, the same set of companies. Because the other thing that you can do is you can always make your case if you choose the companies that allow you to make your case, right? So it's very easy to conclude anything by picking your favorite example, which is a common error that you see in so many of these studies. So we said, we're going to subject all these practices to the same group of companies so they actually have to meet the test rather than picking favorite examples. And this is what we did.

We collected performance data on each of these management practices in terms of how well the companies did in these management practices over these five-year periods. We used total returns to shareholders as our primary performance measure. If you don't like that measure, every other measure works just as well, but we just use that because it happened to be one that the hard-nosed people who said "but does this really matter when it comes to the marketplace?" would like.

And we looked for the following: We wanted to find management practices that met the following test. The companies that did great did better on that management practice than the companies that were losers. So winners did better than losers. But if you started getting better at those management practices, you were likely to become a climber. And if you started getting worse at those management practices, you were going to become a loser. And our sense was that out of the 220, the practices that survived that test would be the test, at least for now, of what really works. Management is a dynamic business. I'm not going to argue that the same things will necessarily be things that work forever into the future, but at least for now it helps us sort through what we've learned over the last twenty years in terms of what really works.

The Quiz: What Practices Work?
So I'm going to give you a quiz. Now, it really did matter what you were. If you invested a dollar in the winners in 1986, you would have roughly eleven dollars at the end of the ten-year period. On the other hand, if you invested in a tumbler, you'd be doing fine. Your performance would be matching the performance of a winner for the first five-year periods, but then the stock goes sideways and you end up doing no better than the market average. Same thing is true of climbers, which is for the first five years, their performance is no better, is as bad as losers, but then they do better. And that's what we should expect. We should expect the average of the market to be the combination of all these climbers and tumblers.

The sad part is the losers. If you invested in a loser, you were much better putting your money in current savings accounts and, as you all know, this is not the best time to invest in savings accounts. I mean, 1 1/2 percent, 2 percent rates is what you would get and yet you would do better, you would have done better putting your money in those accounts than investing in one of these losers. So it does matter, actually, which of these management practices these companies employ because it does correlate very highly with performance.

And this is the quiz that I'd like you to complete. So here are the questions. Just take two minutes and pick the eight things that you think at the end of the day withstood this test that I talked about. The test being the winners would do better at this than losers. If you start doing better on this particular dimension, you're more likely to become a climber, and if you start doing worse at it, you're more likely to become a tumbler. What eight would you choose?

So let's just go through these one by one.

1. Being One of the Largest Enterprises in Your Industry
So let's start with the first one. How many of you thought that scale, which is really being one of the largest companies in an industry, is a very important predictor of whether you end up being a winner? A very small number of people. It turns out, actually, that in the study that we did, this does not turn out to be one of the most successful things. Interestingly, here is where you have to actually sort out cause and effect. The companies that are winners do end up over time having extraordinary market share. They grow quite rapidly relative to their peers. So here, in fact, this design that we have in terms of sorting out what's leading and what's lagging is an important thing, because what you discover is that market share is important, but it's actually more the outcome of a company doing some things really well rather than a predictor. Because if you looked at the top forty companies it's not at all the case that the forty winners were the largest to begin with, or that they necessarily were even among the largest to begin with. So this one, contrary to most beliefs, doesn't turn out to be one of the predictors of success.

2. A Well Defined and Clearly Communicated Strategy
How about the second one? How many of you think that a well defined and clearly communicated strategy is absolutely important? Well, we won't take your degree away. You're right. It turns out that this is in fact one of the single most important predictors of being a winner in our study. Just to give you a sense of what kinds of things lie underneath this, again as I said, if you look at what the winners do, they outperform the other companies. So if you look at sales growth, yes they do grow much faster, but it isn't the case that that's where they were at the beginning.

Here's what you see in terms of what people who are good at strategy do. First, they have a clear value proposition for the customer. And the customer seems to understand it. Two, they develop strategy very often from the outside in. They have a keen sense of actually being out in the marketplace and figuring out what it is that people on the outside want as opposed to being people who simply develop strategy from the inside out, which is just sitting in their own offices and doing stuff.

They have clever and ingenious ways of continuing to monitor what's going on in the market, because it's not like you have a strategy and the strategy works forever. Strategy perpetually needs to be fine-tuned and revised and adapted. And that's one of the things that these companies are very great at. And if you think of Target, it's a company that's been very dynamic. You think of Dollar General. Think of the companies that I've already talked to you about. Very dynamic companies in terms of how they change over time.

The most important thing was how clearly people understood it and how clearly the strategy was communicated. Actually, that turns out to be, of all these variables, the one that has the greatest impact.

So this is the first thing that you want to pay attention to, which is that you really want to have a clear value proposition for your customers. And it doesn't stop there. It's very important to make sure that that value proposition is clearly understood by your employees. Because if they don't understand it, guess what? At the margin, the strategy will start to erode. They're the ones who have to implement it and if they don't understand, they might make choices at the margin that cause stuff to erode.

Similarly, you really want your customers to understand it as best as you can, too. You're not looking for perfection here. But if you can move the needle up on this dial, what we find is that this is what allows companies to stay winners, and the clearer you can get about this, the more likely you are to become a climber. And this was really K-Mart's problem. If you think about K-Mart's problem, people couldn't tell what K-Mart was trying to be. Was it trying to be Wal-Mart because one day it would say, "We're going to be everyday low prices"? The day after that, they would introduce, yet again, blue-light specials. Then they tried to go out into the high end of the business by saying, "We're going to have Martha Stewart lines," and all the rest of this stuff. So from day to day, they were shifting. Some day their value proposition was a Target value proposition; the other day their value proposition was a Wal-Mart value proposition. And this strategic inconsistency confused the heck out of both the front-line employees in the company and also the customer. And it's little surprise that we see a bankrupt organization at the end. So this was the first one that I think we need to pay attention to.

Let's go back and look at the next one you have on your list.

3. Being one of the Lowest-Cost Enterprises in Your Industry
How many people think that this is important? Large number of people. Those who think no? Equally large number of people. This is what makes the Harvard Business School case method work. Some of them are the same people. As faculty members those are the students that you have to be most careful about, right? But Jim, you said no, right?

JIM: I said no. I think if you get the reputation of being cheap on your investment and the investment in people and equipment, that's not necessarily a good thing. I mean, yes, being low cost helps in some areas, but overall I don't think it leads to being a winning company.

PROF. NOHRIA: Low cost if you can manage a value proposition that's consistent with being low cost is good, but can you think of high-cost companies that are winners? Take Sony as an example. Here is a company that has a much higher cost structure than everybody else in this business. But its value proposition is to be a highly differentiated, innovative company. So what matters is the value proposition that you have. In some cases differentiation, which embeds in it cost, can be a value proposition that's very successful. Are there low-cost companies that are winners? Yes, but they are low-cost companies that don't have shoddy quality, that deliver a value proposition that people care about. So this unto itself doesn't turn out to be a thing that is truly differentiating. You'll find low-cost companies that are winners, and you'll find higher-cost companies that are winners. Should every company strive to reduce over time their cost structure and be more productive? Absolutely yes, you'll see that. So what you see is that all of the winners are companies that continue to be leaders in productivity improvements over time. But it could be productivity improvements over a high-cost base relative to their competitors, or productivity improvements over a lower-cost base relative to their competitors.

So cost unto itself doesn't end up being one of the things that we found in our study as being a differentiator among these things.

4. Embracing and Implementing New Information Technology
Information technology. What do you think of this? [Some businesses really don't] need it and others really need it, right? So I mean, what we find out with information technology is exactly that. Being sort of on the cutting edge of information technology is no guarantee of success, unless in fact you can find a way to make it work. And by the way, what's the track record that people have of that? Not good, right? So you see over here people who are first in at CRM, people who are first in at implementing ERP systems, people who are first in at developing and implementing the most fancy technology in the world. And the information is all lying there; none of it is being used. It's not apparent why it was built in the first case. And on the other hand, you have companies like Dollar General, a winner in our study. In the retail business, it's interesting, when you think of how you might beat Wal-Mart, what do most people think? Which direction do you need to go? Up. Here's a company that was successful by going below. So what have they targeted? If you have to go below, whom would you target as your customer segment?

It's really interesting. If you think of America, one of the things we forget is that one of the largest-growing populations we have is people who are now living on fixed incomes. Whether it's Social Security or it's people who are living on retirement benefits or immigrants who have just come to this country, there is a large number of people in this country who live on roughly $20,000 a year. And this is a pretty substantial segment of the market. And if you think about that segment of the market and what they want, Dollar General has essentially figured out a game that works for them. These are not people who go into Wal-Mart. I mean, the way you succeed at Wal-Mart is you say, "The average basket that a person rolls out of Wal-Mart," what do you think is the price on the average basket that a person rolls out of Wal-Mart? On the order of sixty to seventy dollars. It's been increasing, but it's in that order. Now, Wal-Mart's value proposition is that you can find any object in this basket cheaper somewhere else, if you looked at any one of them. You could find on sale any particular item in Wal-Mart's basket cheaper somewhere else. But you would never walk out with a sixty-dollar purchase that was cheaper. I mean, that's really their game. Their game is to say if you look at the bundle, and all of you are going to go in and buy roughly sixty dollars worth of stuff, it's very hard for you to actually walk out of any other store with the same value for sixty dollars. That's their game.

Now, the people that Dollar General targets don't want to spend sixty dollars. What do you think the person who earns $20,000, what is their average purchase when they come out of a store, a Dollar General store? Eight to ten dollars. So they're at the eight- to ten-dollar price point and they're trying to make money at the eight- to ten-dollar price point. And they have things, they have fixed price points: one dollar, two dollars, five dollars, eight dollars; they offer bundles—three soaps for one dollar. These kinds of things are the ways this company has built its value proposition. Could this company afford to have all the satellites and the fancy ERP systems and everything else that Wal-Mart has invested in? I mean, Wal-Mart invests billions of dollars in technology each year. It's a very hard thing for this company to do all of that.

So, what we find out is that technology isn't necessarily a ticket to success. The people who use it well, to really advance their value proposition, do well with it.

Now, this is a basic thing that I want to say about all of these twenty things. I don't want anybody to leave with the view that the things that don't work are things that you should not do, OK? Some of these things may be necessary; they just don't create advantage. So it's not the case that trying to be a lower-cost player is a bad thing. Just recognize that it is not one of the things that is going to create sustained competitive advantage. It may be a thing that is necessary to do just to stay in the game, just as IT might be. But it isn't actually something that helps you in the long run. So let's move to the next one.

5. Superior Corporate Governance Practices
There are many of my colleagues who are giving talks on this. What do you think? It turns out that, again, there are some things in this study where not having it can mean you become a tumbler. So what we find is that if you have poor corporate governance, you can be one of the people that ends up being a loser. So it can cause harm. But it isn't the case that great corporate governance makes you a winner. So this is one of those things—and there are others in the study—that is like hedging factors. You've got to have them to stay in the game. It's very important to have them because if you get them wrong, it really increases the risk that you can be a tumbler. But it doesn't, in fact, necessarily make you into a winner or a climber. So getting much better in this isn't one of those things that will, at the end of the day, durably lead to the advantage over a five-year period. It may help you in the short run, but it doesn't actually end up having a lasting benefit. Because the expectation is that more companies should have this right than wrong, even though we've learned recently that that's an expectation that we can't rely upon. But nevertheless, it does turn out to be the case, that this is one of the things you have to get right to prevent becoming a tumbler, but not necessarily something that allows you to be a winner.

6. Operational Execution that Consistently Meets Customer Expectations
What do you think? We got it; we're doing well. So here's the thing on execution. This is really one of the very important things that companies need to do, which is that it really is important to deliver products and services that consistently meet customer expectations. One of the ways in which you help yourself in doing that is to make sure that people who are closer to the front lines actually have the discretion to be able to do things that enable the value proposition to be delivered. And as I mentioned, you want to constantly find ways of taking waste out of a system and enhancing productivity. So customers expect that over time, in terms of the value transfer, you will find ways of transferring more value to them, even as you are executing against their expectations. So it's very important for these companies, even as they execute in a particular way today, to find ways to execute more efficiently to deliver the same value proposition tomorrow. Whatever your value proposition is, I think customers expect that over time there will be a value transfer from the company to them, so you can enjoy super-normal returns for some period of time, but then they do expect benefits to be transferred to them. And great executers figure this out and do this constantly.

It turns out that after strategy, this is the second most important variable that we have in our study in terms of what influences performance in these companies. And many of you, no surprise, figured this one out as well.

7. Financial Engineering Expertise
Again, it's heartening to see that it's as important that you know which ones don't work as which ones do work and nobody raises their hand on this one. So this is not one of those things that ends up being a source of advantage, either. And there's a good reason for it. If you think about how efficient capital markets have become, particularly in the United States, if you do develop any expertise in financial engineering at some point, that experience erodes very quickly because the markets are very efficient at transferring that knowledge. If you figure out a way to do swaps or if you figure out a way to just do some clever financial engineering that will help you reduce the cost of capital or do any of those things, the likelihood of that staying a secret with you, given the nature of the financial markets in which we live, is zero. That stuff will transfer very quickly; everybody else will do it. Treasurers and CFOs, this is what they live their life to do, so that stuff gets eroded very,

very quickly. So even though you might have short-run advantages in financial expertise, it isn't something that we found to be a durable source of advantage in our study. So this doesn't matter.

8. Quality of the Enterprise's Balance Sheet
What do you think of that? How many people think that's important? This is another one of those things that ends up being like market share. You have to be careful about what leads and what lags. Winners end up over time having stronger balance sheets, but it is not apparent that actually having a strong balance sheet is one of the ways in which you become a winner. Having a weak balance sheet, on the other hand, is a way to become a tumbler. It's very important again in this case to recognize that there are some things, like governance, that if you do poorly you're on a slippery slope to go down. But doing great on those things isn't necessarily one of those things that actually makes you do better. You know, most high-performing companies end up having healthier balance sheets than most low-performing companies. But that's just a correlation of how you do rather than the other way around. So this is one of the things that works in the other direction.

9. Achieving the Most Stringent Quality Levels (e.g., Six Sigma)
So this is again a value proposition question and what we find here, too, is that there's a massive asymmetry. As you see in this next slide, in quality, winners have average quality, high product quality, and a third of them have the highest product quality. What they don't have is they don't have poor quality. So what we've learned is that customers are not going to give you that much on the upside when it comes to quality unless that's a part of your value proposition. But on the downside, boy, are they punishing. You fail to meet a customer expectation in quality, whatever may be the level of quality that you've set, if they perceive that you have poor quality relative to their expectations. They are punishing to a point that is just stunning. The easiest way in our study to become a loser was to have a bad experience, to have customers have a bad experience in terms of a new product introduction, a new service introduction. Any one of these things, initially, within a year, year and a half, led to a slippery slope. So we were actually stunned by how punishing customers were when it came to bad quality and how hard it was to then reverse that opinion.

On the other hand, great quality, yes, you do well and people expect it. It's almost something that people expect. In fact, once you disappoint customers when it comes to quality, it's very, very hard to get you to do well again. But it isn't the case that it buys you that much on the upside. This is one of the things that actually hurts you on the downside but doesn't necessarily buy you that much on the upside.

10. Creating a High-Performance, High-Values Culture
What do you think of that? Creating a high-performance, high-values culture? Yes, everybody buys that? Who doesn't? Nobody's going to raise their hand now. I've frightened you all. That's not good. OK, someone reluctantly raised his hand. Anybody else?

__: As I understood Enron from an industry person, there was a very, very high quotient in that organization for high performance. There was a time a number of years ago when Texas Instruments had the same internal performance criteria and shortly thereafter both organizations had very, very serious problems.

__: I think Enron's a great example of where they didn't have the second part, which was high values. And so it's that balance between the corporate culture that tries to have high quality but also have values and integrity at the same time that makes it a winner.

PROF. NOHRIA: What we find is that both those things are absolutely necessary. So this actually does end up being one of the variables that is a predictor of being successful. But, you know, as critical as the values thing is, in our studies at least, the performance orientation was, of the two things, more important. So you needed to have core values that created boundary conditions, but building communes isn't necessarily the road to success. I mean, you want to make sure that the performance orientation is not lost. You can't have performance orientation at the expense of the betraying values, but the companies that aren't pushing the bar up on an ongoing basis and aren't expecting their people to deliver the highest performance aren't going to be winners. And what we found in our research at least was that it really does matter if you inspire people to be their best. It matters if you reward achievements.

But still, high performance has this knife-edge. It can be a culture of fear, right? And that is usually when values end up being eroded as well. If you create an organization in which the penalty for performance or the rewards associated with performance are so great or the penalties are so sharp that it creates a twinge of fear, then you actually tempt people. For human beings, both their best and their worst are brought out at times when they're afraid. There are some companies in which people feel that performance orientation. But they also have underneath it a sort of twinge of fear, that if you don't do well in this company, you're toast. So there's a little bit that you have to be careful about. Now, it's very hard to see how you drive high performance without at least having a twinge of fear, right? So there's probably going to be a twinge of fear in these organizations in any case. But what you really want to do is to make sure the work environment is seen as challenging, satisfying and guess what? Fun.

So that's one of the other ones that work.

11. Delighting Customers by Exceeding Their Expectations
What do you think? Everybody says yes. Who says no? Dan?

DAN: There's nothing consistent about that. What kind of a strange value proposition is that? That you're going to go around and exceed expectations? That's not what I'm looking for. Just do your job, please.

PROF. NOHRIA: He is a pragmatist, right? What do you think? Is Dan right?

CHARLES: As long as the customers keep coming back and paying you the price that you need to make a profit, you want to exceed their expectations. If you don't have that practice or that policy or that set of values, where are your customers coming from?

PROF. NOHRIA: Again, this may be an issue of semantics and we need to be careful about this. Because as I heard you talk, Charles, I think you were saying if you can do it consistently. Beware of delighting customers if you don't have the operational systems to deliver consistently. I'll tell you a little story that is in a case that we taught about a colleague of ours, actually from the Harvard Business School, who has since left. He was in the highest bracket of customers for Singapore Airlines. Now, Singapore Airlines is a remarkable company. In its industry, it's the only company that I know of in any industry that has won, by its peers, the best service excellence award twenty years in a row. So it's a really remarkable testimony to any company to win an award like that in an industry like that where it takes very little to get people unhappy—to win it twenty years in a row.

So this guy is a customer of Singapore Airlines and he flies to Singapore. He's flying on this complicated trip where he's mixing business and family, and he's going via Singapore to

Bali. So he arrives at Singapore Airport and he tells the ground staff, "I'd like you to take these three bags and keep them here because I'd like to take these back with me because we've just been to Europe. These are bags that have the stuff that we've already used. I don't want to lug them with me. I want to take them back. My family would like to take them back with them on their trip back from here to the United States."

Now, Singapore Airlines, high-service organization, if you're the gate agent, if you're the ground staff person who is checking this in, what do you do with this customer? You figure it out, right? You want to delight the customer. That's part of your value proposition, so you're going to figure it out. So this woman says, "OK, I'm going to do it. That's my game, I'm going to do this thing." So do you think this is an easy thing to do, if you decide to do this thing? It's enormously costly and inefficient if you don't have the systems to do it. This is what you have to do to actually get this thing done. So she has to take the bags and store them in left luggage because there's no way you can store bags for a week somewhere out in the back. So she personally goes and stores the bags in left luggage. She has to get them screened for safety because who knows what this guy is leaving in these bags? I mean, *we* know he's a Harvard Business School professor, but they don't. So she does this thing. She changes her shift duty to be sure to be there when the other flight that he's on comes back. Because she needs to go out, take the bags out of the hold, make sure that the bags can actually be met at the same time so that they're there. And since she's there she knows who's going on. This is delighting the customer, right? I mean, this is going well beyond anybody's expectations to try and get this thing done.

My good friend goes to Bali and has a wonderful vacation. On his way back, he goes to the gate agent at Bali airport and says to that gate agent, "These three bags, I want to have them go off. These two I'd like to take back with me in Singapore." It happened to him once, so what does he think? That it's regular. So the gate agent at Denpasar says, "Sorry. I can't do any of these things," because they just aren't willing to go through this whole big rigmarole to get this thing done. And he's irate; he's beyond himself now. He starts writing letters to all kinds of people up and down the organization about the poor service that he received at Bali. What's the moral of the story? Be very careful about delighting your customers. Now that's part of the message. How does Singapore Airlines respond to this thing? Say you're Singapore Airlines and your value proposition is to perpetually be pushing the boundaries. One, they actually asked this guy to write a case on this thing. I mean, it's interesting. They want to learn from this situation. They want to ask themselves what they can do about this. They've now created protocols and they've built operating systems that allow them to do this occasionally for one of their rarest customers and they've created protocols so they can do this consistently. But what they understand is that even delighting the customers, you need to know whether you can do it consistently. Because random delighting is not necessarily delighting. I mean, even if you're delighted for a moment, then you end up being in trouble.

__: The expectations have to be managed, too.

PROF. NOHRIA: Yes, exactly. And that's what I'm saying. So as wonderful as this phrase is and as much as we really must in every organization keep striving to do more, it's very important to make sure that the operating systems of the company keep pace with the expectations that we embed in our customers and in our employees. And unless you do that, this is something you can do in some ways at your peril.

12. A Structure that Simplifies Working in and with the Organization

So we are now into twelve, a structure that simplifies working in and with the organization. How many people say yes? OK, you're right. I mean, again, what's interesting about this measure is that I, for the early part of my career, spent a lot of time doing organization design. I would spend hours working with companies on whether they should be organized by function or by geography or by matrix, and all this stuff. It turns out that that's all a wash. It doesn't matter at all which particular way you're organized. So all of this stuff is just fancy things that we do to kind of keep ourselves preoccupied, including us professors. What matters more than anything else in companies is: Do people experience, at the end of the day, whatever changes you've made as being changes that simplify their lives? And the most important thing to think about in organizations is: Are the structural changes that you're going to make going to simplify work for people within the company?

Some amount of bureaucracy is always necessary. There is never going to be an organization in which there isn't bureaucracy. But bureaucracy isn't value added for the most part. Some of it is value added, but the vast majority of it is not. So the more you can reduce it, the more you enable the greatest resource that you have. If you think about the definition of an organization as people coming together to do what none of them could have done individually, you want that collective effort to be useful—useful for customers, useful for creating value rather than just useful to coordinate with each other. And that's what structure should be really designed to do. Also to the extent that you can promote cooperation, that's good. This third thing is finding ways of putting good people near the front lines. This comes out again and again in many of our findings. Very often we take our best people and we think the right answer is for them to be as far removed from the front lines as possible. And the companies that are winners usually make sure that they really do pay great attention to the quality of the people in the front lines and make sure that they're good people in these organizations. So this is another one of the things that does end up being one of the things that work.

13. Superior Talent at All Levels
How about number thirteen? Superior talent at all levels of the organization. Is that one of the ways of winning? In fact, one of the things that we found in this study is that there were four primary practices that you had to excel at to be a winner. Those four we've already discussed: strategy, execution, culture, and structure. You've got to do well in those four to be a winner. After that, you have a choice. You have to have two out of four other things at which you can excel in order to be a winner. One of them is talent. But it isn't the case that everybody can do it that way. It's a very hard thing to do and not everybody can, in fact, create a talent-rich organization. And the only way to actually create a talent-rich organization is to really be able to feel confident of the following test. If at any level in my organization, I looked at that person in comparison to an equivalent person at my competitor, in how many cases would my person win? What do you think you need to be able to have as an answer in terms of what percentage of times should your person win to feel that you have a high-talent organization?

Fifty-one percent is enough in your judgment? It turns out that in two-thirds of the cases—whether these companies overstated, I don't know—but in our research what we found is that if you can say that credibly two-thirds of the time, that's what allows you to be a high-talent organization. Very few people can do that. There are some that are examples of companies that you have like that. So you take store managers—I mean store managers at Target, that organization, merchandising, store management—everybody in the industry believes that person-to-person they have some of the best people in at least two-thirds of the cases. There are some categories in which they don't, but that is an organization for instance that has that reputation in the business. And in every industry, actually if you go around an industry, there are some companies that are seen as these talent production engines. We have in our study companies that have succeeded by having average people.

So this is not one of the necessary conditions. It was one of these four secondary things, but it is one of the four secondary things that turns out to be important.

14. Adopting a Balanced Scorecard
These are the kinds of performance measurement systems that you have, which my colleague at the school, Kaplan, talks about. Companies that have a balanced way of thinking about performance, and measure performance rather than being totally driven by financial performance, and focus on other performance measures as a way to drive the company, are likely to be more successful than others. What's your sense of that? It actually doesn't turn out to be true; it doesn't turn out to meet this test. You know, again, it's a good thing to have, I think, if you can do it. So I don't believe that these are things that don't help a company. But it isn't something that is a source of comparative advantage for a firm.

15. A Great Leader
How about having a great leader? Take leadership; leadership is actually one of these other, secondary variables. You don't have to have a great leader at the top necessarily to drive a company to being a winner. But if you had one, that can be one of the things that you can use to drive change. So, for instance, what is it that people look for when they say that someone's a great leader?

So what is it that these people, at least in our study, of all the things that we pointed out, what do you think people say when they think about great leaders?

__: Sets a very clear strategy, communicates it very well.

PROF. NOHRIA: There you go. Those are all the other [primary] things, right? No, that is certainly the task of the leader, but if you think about the personal qualities of the leader, what do people look for in terms of these? So the functions of the leader are to do the things that we just talked about. This is, at the end of the day, a study in leadership. It helps focus leaders on what they should be doing. But beyond that, are there any personal characteristics? Do you think people care about charisma? We tested thirty different characteristics. Is the person authoritarian, touchy-feely, cooperative, makes all the decisions themselves, delegates all the decisions to other people? You name it; we tried to get all kinds of style/personality types of things. Which ones of them do you think matter at all?

__: Empowering and encouraging.

PROF. NOHRIA: You say empowering and encouraging.

__: But he's thorough, someone who—

PROF. NOHRIA: That somehow the other people are kind of willing to follow him? Yes?

__: Integrity.

__: He has to be trusted.

__: I would say vision.

__: Has to be consistent.

__: A person who knows how to get listened to.

PROF. NOHRIA: Many of these things received some support, but what we ended up getting is the following: There are only two things in terms of characteristics that matter. One is that somehow or other these leaders establish a personal connection between them and the people in the organization. People feel personally connected to them. This may be to your point, that people feel that they're ready to follow them or something like that. But they have the sense of personal connection with these leaders. And they're not always described as being personally connected because they're warm and fuzzy, OK? So I just want to be very clear that this is not some OB professor who says let's go to the land of holding hands and sitting in California bathtubs. I mean, that's just not the kind of leader that necessarily people feel connected to. So they can be quite authoritarian and yet people feel connected to them, so that's an important thing to recognize.

And the second thing is that people keep talking about people having this nose. And when we actually went out and did interviews, it's amazing how much that was talked about, the leaders they felt were great were people who just have this instinct about being able to spot problems and opportunities just a little bit earlier than others, finding ways and then translating that into things that the organization can do. And when I heard this, you know, it's quite contrary to the vision thing that we often talk about. I remember a talk that Larry Summers gave, our current president, in a program on leadership. And he made this point. He said, "Look, certainly vision is important and it's not that one should underestimate it. But what's far more significant in any leader's life of any tenure is how they react when events happen and how quickly they're able to spot the consequences of these events and how well they're able to react." He said, "Take Giuliani. This is not necessarily the guy who you would have said is this, that, or the other. But on the other hand, he had the ability to kind of know how to make sense of these situations and react to it."

And I've often said that a visionary may simply be the person who acts ten seconds earlier than everybody else in everything they saw, because with the benefit of hindsight, that person then ends up looking like a visionary. So that's one of the things that we see in this study.

In terms of boards, we were struck by the fact that if we were to follow Sarbanes-Oxley, none of those things would make a difference. In fact, Sarbanes-Oxley might be taking us backwards in some cases in terms of what matters because the only criterion that mattered was board members who deeply understood the company. Now in our definition of independence, we may actually make it harder for anybody who really understands a company to be on the board. Now, I hope that people's commonsensical interpretation of Sarbanes-Oxley will not be seen as the literal interpretation of the norms that have been promulgated. And I think most people are sensible enough to not go the direction of being crazy. And we've made it harder and harder for people to hold a stake in the company. The board members who were really powerful were people who actually had bought into the company with their own money. And in addition to that, they got options and things like that. But what really distinguished the people in our study was that these were board members who themselves had paid on average $300,000 to buy shares in the company. So they really bought their own stake in the company.

16. Driving Innovation in Your Industry

That's again one of these four secondary ways to win. Everybody can't do it that way and not everybody should try. It's very important to recognize that you can't always be the person who drives changes in technologies and business models or uses technology. And the third thing, which is the most important thing, is that most companies are hesitant to cannibalize their own product. Great innovating companies, what distinguishes them from anybody else, is that they're looters. These are people who drive change. They're not always the inventors, by the way. So take Microsoft. Microsoft invented nothing. It stole it all—all, not just one thing. I mean, literally starting from DOS onwards; DOS they bought for $50,000. Excel, WordPerfect, I mean just go down the list. There's not a single product that they had at which someone else wasn't a pioneer. But they drove the change. They embraced it, they drove it, and that's what it takes. It's much more important to be the person who's early in and drives change in an industry rather than necessarily being the inventor. So you take Sony, even another company, right? You think of Sony as being one of the most pioneering companies, but if you actually look at the track records of their successors, only half of them are first in. The other half have been quick followers and really have been quite successful with being a quick follower.

17. A Great Brand
I want to just sort of tell you what the last one is because we're going to run out of time. A lot of people think brand. Just think Kodak. Just think Polaroid. And very quickly you'd be disabused of the idea about how powerful great brands are. In fact, Interpublic does a very interesting study of the fifty greatest brands in the world, and every year they publish this list. Just look at the list for the last ten years and you'd be amazed as to how brand is something that seems to me to be a thing that builds with success, can be quite durable, but is no guarantee of being a winner over long periods of time. So Kodak still has the third-highest recall. Still today, the third-highest recall of any brand in the world, and this is not a company that any one of you wants to invest a dime in at least over the last twenty years. And we didn't find any support for that.

18. Developing Strong Mergers and Partnerships Capability
M&A. None of us expected this. I must confess that this was the one I least expected would show up as being a significant secondary practice. Actually it does turn out to be a significant secondary practice. The companies who can do M&A well are rare. In fact, this was the rarest secondary practice in our data set. Only a quarter of the companies who were winners or climbers had this, but for those that did, it does end up being one of the ways in which you can become a climber. And if you're good at it but then mismanage it, it's a surefire way to fail, too. So M&A is a way in which lots of companies become tumblers. Think about the number of companies who did a deal that overextended them and then caused them to fail. So it is one of the ways in which you can fail. It is one of the ways in which if you keep doing it badly, you'll be a loser forever. But if you do it really well, you're going to be pretty good for long periods of time.

Conclusion
So I want to end by saying that the formula that I want to leave you with is a formula that is a back-to-basics kind of formula. So the four primary practices that work—strategy, execution, culture, and structure—you've got to get all four of these right. If you don't get all four of these right, you're unlikely to be a winner. And then there are four secondary practices: talent, leadership, innovation, and mergers and partnerships. Choose any two from this list—you don't have to do all four. Choose any two from this list and if you have any two on this list, the likelihood of your being a winner is greatly increased.

Now in our study if you got six of these things right, four of the primary and two of the secondary, there was a 90 percent chance of your being a winner. Or if you started doing better at this, there was a 90 percent chance you would become a climber. Now here's the rub and this is the metaphor I wanted to leave you with. How many of you have seen street jugglers? Everybody, right? I would hope everybody had. How many balls do street jugglers juggle? Three, occasionally four, right? The vast majority does three and then you'll see four, right? If you have to see a juggler juggle six balls, it's very rare.

Also odd numbers are easier to juggle than even. You go to Cirque du Soleil, you will see people juggle eight balls. Seven, eight. There are things that people will do that is a larger number and I think that the message I want to leave you with is that winners are like master jugglers. And this is a complicated thing and why winning is so rare in business and why it had a half-life of three. Because it's very hard to juggle six balls in the air at the same time. I mean, if you think about what a juggler has to do, it takes focus. It takes concentration. What is the inevitable thing that happens with balls? They fall, right? So you have to perpetually impart this energy to keep the thing in the air. And the difficulty that you have is that it takes constant energy. Even as you're doing six things, it takes constant energy to do this stuff. And this is not the only set of things they're going to do, because there are other things that you have to do that are necessary but don't create advantage. And that's what makes winning so hard.

By the way, what happens to jugglers usually when one ball falls? They all fall. And it's the same in business. What we found is that that's all it takes to fail, to be a tumbler. You don't have to start doing badly at all six of these things. You start doing badly in one or two and you go down the tube. So I want to leave you with that metaphor because that's the metaphor that really captures what it means to be a winner. Think of these six balls. I hope you enjoyed this. Thank you for your time.