By L. J. Rittenhouse

Culture, Dreams and

Companies create value through the effectiveness of their business leaders and employees. Strong leaders work to ensure that the corporate experience earns highest grades in rewarding employees, customers and investors. In this interview with Laura Rittenhouse, Professor and Author Kotter discusses the value that can come from people building cultures that strive to reach their dreams.

Shareholder Value

Throughout his career, leadership consultant and Harvard professor John Kotter has deepened our understanding of how companies create value through the effectiveness of their business leaders and employees. With colleague, Jim Heskett, in 1992, Kotter combined academic and Wall Street research to answer the question: What kinds of corporate values and behaviors are most strongly linked to sustained superior financial performance? The findings were published in Corporate Culture and Performance, described by Fortune magazine as one of the best business books of the year.

In it, the authors conclude that strong leaders develop work cultures where everyone is highly attuned to meeting the needs of employees, customers, and investors. These leaders encourage initiative and accountability throughout the company to transform intelligence into action and to combat corporate cynicism.

Rittenhouse: Are investors paying more attention to corporate culture now that you've established how strongly it is linked to financial performance?

Kotter: Look at some of history's most successful investors – people like Peter Lynch. He never talked about short-term financial ratios. It wasn't that he didn't look at the hard stuff, but he talked about a company's soft stuff. That's what he cared about. He told people that if they were smart, they'd get a sense of what makes a company succeed by looking at their products, by looking at the way management treats people, or by watching what they say in the media.

Just look at the numero uno investor of our age: Warren Buffett. He's a very smart and sophisticated guy. He knows how to pore through the books, but the people who run companies that he's bought describe him as being as solid-as-a-rock; as a Midwesterner with good values. That's one of the reasons why they think he's a good boss. That's why they enjoy working for him, even if there's pressure to do ever better.

These are very public examples, but there are also examples among my students who've found companies capable of creating significant wealth over time. These students tend not to be narrow financial people. Some have a broader strategic sense, but many are also broader in a humanistic sense. Because they can see opportunities not apparent to others and aren't afraid to take on risk; they've benefited greatly.

A lot of that boils down to what an investor is trying to do. I think traders could care less about culture. Their game doesn't even have that much to do with a particular company. If they think something is going to hit The New

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York Times in four days, they buy it right away, and with a little bit of luck, five days from now they can sell it and make a huge win. They aren't really investors; they're speculators.

Rittenhouse: The Internet and technology are democratizing the financial markets. Last year, the rate of individual ownership of stocks increased while institutional ownership declined. The Web is also reducing the amount of time investors hold stocks and increasing market volatility. How are these trends changing the way companies think about long term or short term shareholder value?

Kotter: The Internet is going to democratize a lot of things including where you put your money. My wife, who's the Harvard MBA in the family, manages her own mini-mutual fund. She has CNBC going in the background and her computer is on all day. What's interesting is that she doesn't trade. She's come up with her own formula, which has been wildly successful.

So why does she watch these screens constantly if she basically only buys and sells once a year? One reason is downside risk handling. She's constantly monitoring to make sure something isn't happening to wipe out her portfolio. She wants to be able to spot trouble and get out in time.

Another reason is that she's constantly learning from it and, like others, gets caught up in the thrill of betting. She reads what's happening in these companies; she listens to the people running them. She watches their financial and stock performance. She gets increasingly more sophisticated about business and finance, and then applies it all to this formula she's created.

Rittenhouse: Is there any linkage between her formula and the cultural things we've been talking about?

Kotter: After she inspects the company's fundamentals, if she doesn't trust the management, she won't touch the company. It doesn't matter if the company fits all the financial criteria she views as crucial to her formula. If she finds that the management of a company she owns doesn't have integrity or values and isn't to be trusted, she immediately looks for a way to get out without being hurt financially.

Valuing All Stakeholders

Rittenhouse: You've been very outspoken about the rewards of owning companies with cultures that value all key stakeholders groups – shareholders, employees, and customers. But recently I spoke to investor relation professionals from blue chip companies who say that this notion of balancing stakeholder interests is passé. In fact, the most important goal of the firm is to reward the shareholder. How do you respond to this?

Kotter: A trader-investor has a stake in short-term performance. And more often than not, there's a pretty good relationship between financial indicators going up fast and senior managements who focus on financial numbers. Notice the qualifiers I placed on that: "short-term, going up fast," "focus on financial matters." The winners in the short term are generally executives who put the stockholder first.

But from a longer-term point-of-view, there is no evidence that putting the shareholder first necessarily makes for a winning enterprise. Indeed, there's considerable evidence that what does work is putting a high premium on all three constituencies: employees, customers, and shareholders. That's what we found and wrote about in the book on Corporate Culture and Performance. The conclusion was clear from our work: winners tend to place a high value on all three groups.

Notice, there's a slight difference between the language I just used and the language you used earlier. Language being as important as it is, it's worth taking a look at that difference. I said we found that winners place a high value on all three constituencies. You described the importance of balancing their interests.

There is a subtle, but important difference there. Balanced means the company is trying to reach a kind of equal grade for each constituency. But winners don't try to get three B's, which is what balance usually implies; they want to get three A's. Of course, it's infinitely more difficult to get three A's than it is to get three B's; in fact, it's more difficult to get three A's than it is to get one A, one B and one C. That's why most firms don't achieve it. It requires a better management with a keen strategic sense.

Rittenhouse: The notion of balance implies limitations. People seem to think that if I give something to one stakeholder it means I have to take something away from another. But you're saying that companies which move beyond this notion can foster greater change and prosperity.

Kotter: Yes. We have to satisfy all these stakeholder interests very highly. People argue about causality, but I view it in terms of association. When you look at a firm where the management truly believes it must hit a homerun for stockholders, employees and customers, that firm tends to be associated with great performance measured in any manner over a significant length of time.

There is a theory, floating around over the last 20 years, which came from my colleagues, Jim Heskett, W. Earl Sasser and Leonard Schlesinger when they were all at Harvard. They called it the "Service Profit Chain." It states that if the corporation is smart about creating conditions that make people want to work there, those people will create and provide products and services needed by the company's customers. They'll get enough customers to buy so that with the right economies of scale, they make a lot of money. It's an employee to customer to financial results causality model.

That sounds good, and I'm sure it's often the case. But what does seem crystal clear to me is this association of getting straight A's for your three constituencies with a measure of prosperity over a significant period of time.

Balance suggests a tradeoff, as in the example of sharing the pie. Everybody ends up with a piece of the pie, but nobody gets a whole pie. Some people quite logically conclude, " In this day and age, if you don't say you're giving the shareholders a whole pie, they'll get pretty grumpy."

Sustaining Leadership

Rittenhouse: In your book, you talk about the importance of leadership. Do you believe there's a kind of CEO cult today? As an example, consider Roberto Goizueta. He was regarded as one of the great CEOs in the last century. Since he's gone, Coca-Cola has not done well. How do you view that from a leadership perspective?

Kotter: First of all, he got good marks as a leader because two things converged simultaneously. He always came across, at least in one-on-ones, as a very nice man. When you combine that with the fact that the firm did incredibly well during his tenure, it became very easy for people to say, "This guy has to be a great leader."

That may be true, but it may not be true. A lot of what he did was to take a goldmine that had fallen into disrepair and make it productive again. It's essentially the same thing that Michael Eisner did. Walt Disney created an unbelievable goldmine. Walt was one of the greatest characters of our century. And when the Disney company fell into total disrepair, Eisner was smart enough and lucky enough to come along.

Goizueta did that, too. But he didn't develop an organization strong enough to handle the more challenging times after he left. One of the things that great leaders increasingly do is consider the time horizon well beyond their own retirement. If you really value your employees, it's very hard to be consistent with that and only plot things to look good until the day you retire.

Rittenhouse: Creating CEO cults is contrary to your recommendation that companies think about management succession in terms of teams.

Kotter: The CEO cult doesn't help at all. Ironically, it doesn't even help the CEOs because it puts too much weight on their shoulders. It may flatter them, but it doesn't help them get the job done. The last thing the really smart CEOs want is to be part of a CEO cult. That means they're expected to do it all and make magical things happen.

Leadership for Today's World

Rittenhouse: In your book, Leading Change, you say, "History has not prepared us for the transformational challenge." What kind of leadership is needed to meet this challenge?
Kotter: I'm convinced there's a form of leadership that becomes more important in an increasingly fast-moving, competitive world. If you don't watch out, you can end up with a 30-year labor force getting booted out the door and all the social consequences that go along with that. Even if you're a dot-com, in order to survive, you have to go 225 miles per hour, and that has other consequences.

Under these circumstances, the kind of leadership that really pays off is one that helps people tap deep within themselves so they can find the energy to make and meet high standards. Then they can work hard without feeling like they're on a treadmill 18 hours a day. You need standards that connect to basic human values and help people create a sense of community. This holds them together against all the forces that drag us apart these days.

Rittenhouse: It's funny you say that. In the last two years that I've begun to see CEOs talk extensively about values in their letters to shareholders.
Kotter: That's very interesting. I think it gets back to what I said in my book: if people really care deeply about the three major constituencies, they simply won't let themselves get boxed into a position in which, to serve one, they have to harm the other two. If their values are real, such an act would make them feel horrible; it's simple human psychology.

Interestingly, that authenticity is highly transparent. If you're an employee or a customer or a stockholder, and you see that the management team honestly cares about your interests, it gives you confidence that dealing with them is a good idea. It becomes easier for the company to attract and maintain employees and customers, and that, in turn, makes them more attractive to investors.

The problem we had during the time of our study – and maybe this is changing today – is that too often the value discussion was disconnected from any notion of financial performance; it was soft and fuzzy. Companies would tell us what a pleasant workplace they had. They'd tell us how people had opportunities to express themselves at work. A lot of that noise attracted attention from certain small groups, but it never really caught on because it always seemed like a disconnected voice in the wilderness — and a naïve voice at that.

I still bump into companies where senior management talks about values, and it sounds like their Human Resources people wrote the speech. They seem to think, 'Well, maybe this is a good thing to say; it can't hurt. Human Resources knows about people, and if they're telling us this will help with our industrial relations, that's fine.'

When people hear this kind of gobbledy-gook from senior management and it turns out to be deeply insincere and manipulative, they become very cynical.

Rittenhouse: There's a pervasive cynicism about communication in our entire culture. Yet, a number of times in your book, you refer to the importance of "honest dialogue."
Kotter: That's right. Cynics see communication as manipulation in the crudest sense. They see it as dishing out limited information at the right time in the right place to have some effect. They don't see it as having anything to do with straightforward, truthful dialogue.

Rittenhouse: And that cynicism gets transmitted both internally and externally.
Kotter: The internal cynicism is a killer in the New Economy these days. The more things speed up, the more you need valid information flowing quickly inside firms. And the more you practice these information-as-manipulation games or these low-information-passing games, the more it kills you. That's why a lot of the big, older firms that developed non-candid, ultra-political cultures are getting killed when forced into head-to-head competition with new startups.

Going for A++

Rittenhouse: I sometimes find that people reject the importance of values because they understand how hard it is to really live them. Businesses are performance driven so it's natural that when a leaders says we must live these values, first it has to start at the top to be believable. If you're not able to do it, then you've failed. And no one wants to fail. But success in living values needs to be judged differently.

Dennis Bakke, the CEO of AES, actually tries to run his global independent power business based on the values of integrity, social responsibility and fun. If you want to work at AES, you're expected to live their corporate values in all you do. But Bakke says, "We make progress at living our values, and we're never going to get there. We're always going to fail. It's in the trying that we succeed."

Kotter: It's interesting how he says that. He's using the word "values" to mean something like "ideals" or even, "hopes and dreams". More and more, I'm convinced that in the turbulent world we're moving into, with these comfortable oligopolies crashing all around us, it's essential to maintain extremely high standards in order to win. And those high standards apply to all dimensions: financial performance, customer satisfaction and making employees love the firm.

It's one thing to have four top executives who feel that way, but it's another to get enough of the management feeling it so they can make it happen. One way you do that is by recognizing that most of us have ideals that were plugged into us as children. We often ignore them as adults, because it's troublesome to look at them and then see how we live. But if you can get people to connect with those ideals, it becomes impossible to set mediocre goals. If you can get a group to do that, the probability that you'll survive in an increasingly competitive milieu goes up greatly.

One of the things they're trying to communicate, at least on a subtle level, is a goal. I can set B+ goals. People do that all the time. They reason to themselves, 'The average in this industry is a C, so we're going to be a B+.' But dreams don't operate at the level of C, or even B+.

Rittenhouse: At what level do they operate?

Kotter: Dreams operate at A+.

Rittenhouse: And beyond?

Kotter: Absolutely. At the end a speech I gave at the beginning of the year, I spontaneously started talking about A++ goals. I was speaking to 150 people who run a well-known company. After four hours, I'd broken through some of the BS that's on the surface of any company. That's critical.

Then I hit them with this A++ idea and I noticed that they didn't blanch. I had them lower their heads and cover their eyes so that nobody could see what anybody else was doing. Then I said, " I want to know your personal aspirations for the firm. You're putting your heads down because I don't want any group effect. I don't want anybody to feel like other people are going to think you're naïve or not ambitious. You all get to vote with your heart. I don't know you, so I won't be able to report to anybody. Now because you're a high-reaching group, we'll forget B, C, D and E. I'm just going to give you four choices: A-, A, A+ and A++. If you want to go below A-, don't raise your hand."

It was incredible how many people in that audience raised their hand for A++. In fact, the people who run that company have made it into a campaign for the year. They talk about it at their meetings. They've printed luggage with it! The cynics would say creating an A++ culture is just another manipulation from the top. That's true, but at the same time it's very sincerely tapping into ideals and dreams which, as I said, don't operate at a B+ level.

Rittenhouse: Does this mean they're now more adept at the transformational challenge?

Kotter: Sure, it's related. If you talk honestly to people who've been raised in the world of the last 40 years — people who are at least my age – words like values, ideals, hopes and dreams are tough stuff. Interestingly, the same conversation with a 30-year-old gets a much different reaction. They seem much more clued in. They are much less wary or pessimistic.

Rittenhouse: So is that group more open to dreams?

Kotter: You bet. SV