



THE
CULTURE
CYCLE

HOW TO SHAPE THE UNSEEN FORCE
THAT TRANSFORMS PERFORMANCE

J A M E S H E S K E T T

Praise for *The Culture Cycle*

“Reading Jim Heskett’s book is not some vague exercise in academic idealism. It is a well-written, practical, compelling manual of how to build an enterprise that will endure for 100 years or more. You cannot afford to ignore it.”

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“*The Culture Cycle* defines and highlights the attributes of culture through numerous examples. It identifies a series of metrics that are meaningful proxies for seeing the impact of culture in an organization (the ‘Four Rs’). It is an excellent read for leaders of organizations small or large, non-profit or for-profit.”

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“In Heskett’s new book on understanding and enhancing the culture imperatives, he takes the reader step by step through complicated waters. This new piece of research and subsequent book will inspire even the most cynical managers to step up and concentrate even more to create cultures that support growth and development.”

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“The body of literature that purports to assist us in understanding and managing organization culture suffers from a lack of systematic data supporting either the frameworks or the corresponding action agenda. Jim Heskett has managed to ‘crack the code’ on both fronts. This is an important book that deserves the careful attention of today’s manager.”

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“The critical role of cultural durability has been evident in sharp relief during the cathartic period since late 2008 when many leaders have put their organizations through wrenching reforms to address declining demand and rapid globalization. Those companies that have enhanced their position have done so through the embodiment of Heskett’s ‘culture cycle.’”

—**Gary W. Loveman**, Chairman of the Board, President and CEO, Caesars Entertainment

“Jim Heskett’s new book shows how culture affects the bottom line and is the most important task a leader faces.”

—**Tom Watson**, Cofounder, Omnicom Group; Vice Chairman Emeritus, Omnicom; and Dean, Omnicom University

“Jim Heskett provides us an in-depth understanding of how cultures can be developed and strengthened with a poignant reminder that they also need to be nurtured and renewed if they are going to grow and continue to flourish. As you read this book, you will be learning from a master teacher with a wealth of experience.”

—**C. William Pollard**, former Chairman and CEO, The ServiceMaster Company; and author, *The Soul of the Firm*

The Culture Cycle
*How to Shape the Unseen Force
That Transforms Performance*

James Heskett

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6

The Culture Cycle: Measuring Effectiveness

Why should you worry about measuring and tracking the effectiveness of an organization's culture? Because it is a predictor of future success.

An effective culture is the product of a set of strongly held shared values. But just as important, it also depends on the way in which members of the organization perceive how (and how well) those values are interpreted and administered by leadership and how they help leadership execute a chosen strategy.

One sign of an effective culture is the organization's longevity. James Collins and Jerry Porras captured this idea in describing "cult-like cultures" in their book *Built to Last*.¹ These are cultures that both "preserve the core" (by means of "fervently held ideology, indoctrination, tightness of fit, and elitism) and "stimulate progress." They remind us that the things that preserve the core produce an early demise unless offset by values that stimulate progress. In their words, "it's important to understand that you can have a cult-like culture of innovation, or a cult-like culture of competition, or a cult-like culture of change."² The implication is that you can't just have a cult-like culture that preserves the status quo if longevity is a goal. They conclude that strong, deeply held core values can actually provide a basis for trust and common understanding on which organizations can allow their members to act creatively in administering by the values. This ensures adaptability and agility necessary for organizational "learning" and long-term survival.

Observations built on a retrospective look at a small number of long-lived, successful organizations—in this case just 18 meeting stringent conditions over more than 180 years—are one thing. Measuring the effectiveness of today’s cultures to predict those that are “built to last” into the future—a particular concern of today’s leaders—is something else.

By now it should be clear that it’s the health as well as the strength of a culture that matters. Too often, we talk about the importance of strong cultures and ignore their health. I speak from experience, having fallen victim to this error in the study described in Chapter 3. When we asked executives whether “there is a (company name) way of doing things” in their respective industries, we were actually measuring strength, whether or not it was beneficial to performance. Organizations named in response to the question displayed both good and poor performance.

A healthy culture must be both strong and centered around the “right” assumptions and values—those most appropriate for an organization’s mission, people, and strategy. The “right” assumptions and values don’t mean much if they are not widely known, shared, and used as guides for decision-making and action. As well, a strong culture that rallies people around an outmoded set of basic assumptions or no-longer-appropriate values for the strategy it is trying to pursue—or that, for example, shuts out the outside world in the continued pursuit of success in the same old time-tested ways—may be equally unhealthy.

An exploration of several examples will help illustrate these points. More important, they provide insights that help clarify important elements of effective cultures that can be organized into what might be called a culture cycle. The culture cycle is a concept that helps us understand the kinds of measurements—a “dashboard” of indicators of effective cultures—that support organization success.

The following vignettes about USAA, Nucor Steel, and Toyota also raise the question of whether, at the beginning of 2009, we could have predicted which of these three organizations would face a culture-driven crisis.

USAA: Effectiveness Through Trust

A visitor to USAA's headquarters in San Antonio, Texas walks just a bit taller than normal. Why? The company's leadership probably has the best posture of any American corporation. It is comprised of former military officers.

The first impression is of USAA's headquarters itself, reputed to be the second-largest office building (next to the Pentagon, an appropriate comparison) in the United States devoted to one organization, housing 10,000 employees. The second impression is of employees intent on what they are doing, but willing to take time to talk about why USAA is a great place to work. The visitor quickly learns that USAA's management has an edge in understanding the needs of its customers. They share military service experiences with them.

USAA was formed by 25 military officers in 1922 who decided to insure each other's vehicles. As time passed and the founding officers reentered civilian life, they continued to sense the special needs of military officers. Members of the military often were rejected or charged higher premiums when they applied for life insurance because of the perceived risks in their occupations. USAA's founders shared an important assumption that escaped the company's competitors. They saw their potential military clients differently. They were a group of honest, honorable, healthy, even risk-averse people who could be served quite profitably by an organization that understood their changing needs and was willing to develop financial products that met these needs. This assumption has served USAA well.

Over the years, the organization has grown to provide an array of financial services to 7.7 million members (customers), many of whom who are active and retired U.S. military officers and their families who qualify as members. USAA seeks to "facilitate the financial security of its members."³

Even though it operates somewhat under the radar as a company mutually owned by its policyholders, USAA regularly is cited as a great place to work and a provider of exceptional customer service. *Computerworld* magazine recently named it one of the "100 best

places to work in IT.” *Latina Style* magazine cited it as one of the “50 best employers for Hispanic women.” *MSN Money* magazine rated USAA number one in the United States in 2009 as the “company that treats customers the best.” And *Businessweek* in recent years repeatedly has named it one of the top two “customer service champs.” So USAA apparently meets two of the criteria for an effective culture. Not only is it a great place to work, but that work apparently produces something valued highly by its customers.⁴

It takes just a few conversations to impress even an uninformed visitor to USAA that this organization’s culture gains its strength from its shared values drawn from the military (“service, loyalty, honesty, and integrity”) and that the majority of its senior managers are former military officers. USAA’s leadership bought into its values years before joining the organization. A visitor begins to realize that he is in the middle of an organization whose culture is so strong that you, as they say, can “cut it with a knife.”

So far, so good. But how about the health of a culture shared by managers whose personal values all led them to do the same thing—serve in the military, many for multiple tours of duty? The secret lies in the first of the values, “service.” It is practiced in dealings with employees, many of whom perform relatively boring jobs, who are given the opportunity to develop themselves. This is possible through such things as the provision of time and facilities to allow employees to pursue personal fitness and education, a four-day workweek that enables them to lead more balanced lives, and latitude to carry out their various responsibilities at USAA and produce results for members. This latitude is given freely to people at all levels who were hired for their “loyalty, honesty, and integrity.” These qualities provide the foundation for a powerful value—trust—that underlies much of this organization’s success.

“Service” also refers to a set of policies and behaviors that add up to a fanatical focus on the rather special needs of a highly focused group of customers in an effort to “be the provider of choice for the military community.”⁵ Operating from a base of strongly shared values, participants in this “cult-like culture” are then given the latitude to serve USAA’s membership in ways that make sense to the

employee. For example, a soldier being sent to a theater of war may be advised to increase his or her life insurance.

Other service processes are more carefully scripted. A service representative fielding a call from a member involved in an auto accident is instructed to first ask, “Are you hurt?” This is empathetic and at the same time yields important information about the seriousness and complexity of the accident. It enables the representative to determine whether he or she can handle the matter immediately (including authorization to determine the amount of reimbursement to be sent to the member) or whether other USAA specialists will have to be involved. For auto damage only, the policyholder is advised either to take the car to a USAA-approved garage to get it fixed or to just get it fixed and send the company a bill—without the inconvenience of getting multiple estimates, approvals, and the like. This is what is most frequently mentioned when USAA members tell me about the organization’s service. It is evidence that the company trusts its customer-members.

How can the company afford to do this? Remember, customers come preselected by the military. And this saves so much money that USAA offers some of the lowest rates of all insurers.

Instead of working at boring jobs, service representatives at USAA repeatedly get satisfaction from delivering remarkable service resulting in part from the trust placed in them. At the same time, they collect ideas for new services from customers behaving like USAA “owners.”

The operative value here may be service. But what is really practiced is a complete and intensive identification with the needs of the organization’s customers. This produces a continuing awareness of their changing needs for new products and services and fuels continuing success. It’s little wonder that USAA has realized this kind of success for nearly nine decades.

It would be easy to overlook the health of this organization’s culture by examining only its rather unremarkable set of values and failing to measure what they really reflect—trust, meeting expectations, “safety” (in implementing new ideas, for example), and continuous innovation. These lead to such things as high employee and customer “ownership,” low costs, high service levels, and continuing innovation.

It requires an assessment not only of shared assumptions, values, and behaviors but also the following:

- The degree to which they fit with strategies, organizational arrangements, and even the backgrounds of individual managers
- The way in which the values facilitate a strategy, as well as how it is executed
- The degree to which employee expectations are met, especially on the organization's front lines
- The way in which what is delivered and how it is delivered are perceived by customers
- The extent to which the culture encourages behaviors that generate new ideas for future business

Using these criteria, values by which USAA is led fit with a strategy of serving an underserved market, an organization that has for years been staffed with leaders who subscribe to the values, and a hiring policy that creates a clear set of expectations that are then met. Judging from employee surveys and customer service ratings, the result is valued highly by employees and customers alike.

Nucor Steel: A Study in Learning, Accountability, Self-Direction, and Innovation

Nucor Steel gives us a different perspective on the effectiveness of cultures. It operates minimills and even micromills and has grown to become the largest producer of steel in the United States and the largest recycler of steel in the world. It has been lauded many times for its extrinsic methods of motivation through a combination of below-market wages and the opportunity to triple those wages through productivity-based incentives. This makes it sound like a company that Frederick Taylor could only dream about. But in reality it has successfully transformed some of his thinking in ways that he would neither recognize nor approve of.

Nucor has seen more than 150 consecutive quarters of dividends and the highest return to shareholders of any company in the Standard & Poor's 500 between 2004 and 2009. Its success is due in large part to the successful application of technology resulting from innovative ideas generated by both employees and customers. Ken Iverson, who led the company until 2002 and still serves as an inspiration to the organization, attributes 30% of the company's success to technology and industry-leading innovation. What about the other 70%? He attributes that to culture.⁶

There is something special about the culture. For one thing, after declaring in its mission statement that the goal of Nucor's employees is "to take care of our customers," its statements of "responsibilities" and "basic principles" don't mention customers. Responsibilities are to a safer workplace, a cleaner environment, and a stronger community, period. The four basic principles are as follows:

1. Our employees, neighbors, and shareholders should always be treated fairly, honestly, and respectfully.
2. Our decisions should be based on securing long-term survival, not a short-term gain.
3. Management should always be accessible and accountable.
4. Everyone in our company should conduct themselves according to the highest ethical standards.⁷¹

The notion these statements convey is that Nucor Steel's leadership's first concern is about employees, the environment, and the communities in which Nucor operates—the nonnegotiables in its business. This isn't a bad set of priorities for a steel company offering some inherently dangerous jobs in an industry in which pollution is a major concern.

Nucor has pioneered the development of several important processes that are the headlines for a learning organization. These include thin-slab technology, "Castrip" micromill processes for making steel with 95% less energy and pollution, and HIs melt technology that bypasses coke production. Just as important are the day-to-day improvements that result from internal best-practice exchanges

fostered by intermill visits by managers. They are supplemented by a flood of ideas from people on the mill floor about how to do things faster, more productively, and for less money. This wouldn't happen if Nucor's people were afraid to fail. The philosophy is expressed in terms of quotes from managers such as "At Nucor, workers excel because they are allowed to fail." In Iverson's words, "if something's worth doing, it's worth doing wrong.... Get on with it and see if it works."

Nucor practices a strategy of self-direction and accountability. It does so through its organization, with just five levels from the bottom to the CEO, and with less than one-half of 1% of its employees at its Charlotte, North Carolina headquarters. It does so through its staffing, with 20,000 employees spread over 200 facilities. In the words of one Nucor executive, "Ironically, we've gotten big by thinking small." And it does so through its compensation policies, reflected in below-market wages with outsized incentive pay based on the amount of prime steel (up to quality standards) produced *each day*. Ironically, this helped Nucor survive the 2008–2009 recession, requiring that it cut its use of available steel-making capacity from 95% to 50% without laying anyone off. Given the compensation policies tied to output, employee compensation declined by as much as 40%, although the company tried to soften the blow with modest year-end bonuses. But people kept their jobs, and Nucor kept its people for the recovery to come.⁸¹

Thus, the managers and employees of each small facility (typically no more than 200) are responsible for running their own facilities and addressing their customers' needs. In fact, during a recession prior to the big one, several mills, facing a need for orders, sent some of their steelmakers out onto the road to sell steel to astounded customers who had never met a steelworker. The steelmakers were so successful that they were soon back in their mills trying to catch up with demand. This experience has led to the practice of regularly sending steelmakers into the field to sensitize them to customer needs and produce ideas for new products that thereby become "presold" to the workforce.

Another story concerns three electricians who were informed that the electrical grid at Nucor's Hickman, Arkansas minimill had failed.

Not long after they arrived at the plant, a fourth electrician from another mill drove in from an Indiana facility he had been visiting. Two others assigned to Nucor's mill in Hertford County, North Carolina flew into Memphis and drove from there to Hickman. Together, working 20-hour shifts, they were able to get the mill up and running in three days instead of seven.

According to the account: "No supervisor had asked them to make the trip.... They went on their own.... There wasn't any direct financial incentive for them." What's most amazing about this story is that at Nucor it's not considered particularly remarkable. According to an officer of the company, "It happens daily."⁹ The mill not only regained its production capability, it went on to break its record for shipments for the quarter.

At Nucor, these kinds of stories are told frequently. Their subjects are the heroes and heroines of the organization. Are these stories entirely accurate? Possibly not. Have they been exaggerated over time? Probably. But that's not the point. These stories fit with and reinforce (rather than detract from) the company's values of treating people with respect and giving them power to influence results.

The culture's values include "granting trust and freedom, giving all workers a stake in the company, and turning everyone into a decision-maker." As you might expect, Nucor uses neither job descriptions nor formal performance appraisals. As Iverson puts it, "We let our employees define their own jobs as they search for ways to optimize their productivity safely." What the values, policies, and practices really signal is self-direction in work, decision-making, compensation, and the generation of innovative ideas. Iverson has been quoted as saying that "employees—not managers—are the engines of progress."

Self-direction and accountability in the workplace and the learning and innovation they foster explain why Nucor's employees earn the highest compensation in the U.S. steelmaking industry and use their ingenuity to achieve the lowest cost per ton of steel "produced safely" in the industry.

Like USAA, Nucor Steel's values are reflected in accepted behaviors. A careful employee selection process helps ensure that Nucor people can be trusted to do what they say. The organization

emphasizes safety in the traditional way. But it also makes it safe to fail in an effort to innovate. The reward, more tons of lower-cost steel and steel products, is reflected in everyone's compensation. So everyone succeeds or fails together. Collectively they decide, control the outcomes, and reap the reward or suffer the losses.

A wide range of responsibilities are delegated to the lowest level of the organization, with a minimum of controls on such things as staffing, the division of labor, and performance reviews. Why does this work? In part, it works because a large organization has purposely been made small. It's much harder to underperform in an organization of 200 than in one of 20,000, especially if each unit is responsible for its own hiring, training, and problem-solving. So the strategy and ways in which it is executed are well aligned with the organization's values and accepted behaviors. As a result, people self-select themselves into not only an organization, but its values and behaviors as well. It's little surprise, then, that their work experiences meet or exceed their expectations, an important measure of the health of a culture. Nucor and its culture are not for everyone, but for the right people, it is perennially ranked as one of the best places to work in the United States.

Cultures both facilitate and impose limits on strategies and how they are executed, as Toyota has found to its regret recently.

Toyota and the Importance of Alignment and Agility

Those examining Toyota's culture as recently as 2008 praised it for how its credo, *The Toyota Way*, embodies a clear statement of values, provides alignment with the execution of its "lean manufacturing" strategy, includes behaviors that delegate authority to the lowest levels of its manufacturing operations, supports continuous improvement, and encourages employee "ownership" behaviors. *The Toyota Way*, described next, is a comprehensive set of statements that prescribes ways of solving problems through continuous improvement and learning; respecting, challenging, and growing people and partners; executing processes that eliminate waste; and thinking and acting

in the firm's longer-term interests. It is also a statement of “the way things are done around here” at Toyota. It has been lauded around the world for both its value in practice (particularly in a manufacturing setting) and the systematic way in which Toyota managers have used it to produce automotive products of good value with high quality and performance for the price. Systematic is the operative word here. The key to The Toyota Way is the manner in which it is implemented. Toyota executives would not say it in so many words, but they are quite confident that no other company could implement The Toyota Way as successfully as Toyota itself. The Toyota Way reflects both the Japanese culture and a firmly held set of principles comprising a culture that has produced phenomenal success over many years. To implement it would require that a competitor completely rethink both its strategy and culture. This helps explain why, in the words of one observer, “Toyota has been remarkably open in sharing its source of competitive advantage with the rest of the world.”¹⁰

The Toyota Way

The Toyota Way comprises the following elements*:

Philosophy (Long-Term Thinking)

Base management decisions on a long-term philosophy, even at the expense of short-term financial gain.

Problem-Solving (Continuous Improvement and Learning)

Continual organizational learning through Kaizen

Go see for yourself to thoroughly understand the situation (Genchi Genbutsu).

Make decisions slowly by consensus, thoroughly considering all operations; implement rapidly.

People and Partners (Respect, Challenge, and Grow Them)

Grow leaders who live the philosophy.

Respect, develop, and challenge your people and teams.

Respect, challenge, and help your suppliers.

continued

* Adapted from Jeffrey K. Liker, *The Toyota Way: 14 Management Principles from the World's Greatest Manufacturer* (New York: McGraw-Hill, 2004), p. 6.

Process (Eliminate Waste)

Create process “flow” to surface problems.

Use pull systems (of inventory control) to avoid overproduction.

Level out the workload (Heijunka).

Stop when there is a quality problem (Jidoka).

Standardize tasks for continuous improvement.

Use visual control so that no problems are hidden.

Use only reliable, thoroughly tested technology.

The Toyota Way has been driven so deeply into the psyche of employees at all levels that it has morphed from a strategy into an important element of the company’s culture—the very assumptions, shared values, and accepted behaviors on which the company operates. It is lauded because it works, having enabled Toyota to become the largest and most profitable auto manufacturer in the world. That is, it worked until it didn’t.

In 2008, allegations of defects in Toyota cars began making news. Most were linked to unexpected acceleration in its vehicles that was alleged to have led to crashes, injuries, and deaths. Product defects bedevil all automakers. But coming from “the world’s greatest manufacturer,” this was unexpected. It was so shocking that it may have led to some amount of denial on the part of Toyota’s leadership, as well as many loyal customers.

In testimony before a U.S. Congressional committee, the CEO of Toyota, Akio Toyoda, provided a better explanation: “We grew too rapidly.” In fact, manufacturing data shows that Toyota did indeed increase its output significantly in 2007 in the United States as its competitors there faltered. This was not the case in the rest of the world. Toyoda cited, as an example, the fact that Toyota had increased the number of suppliers to meet its increasingly voracious manufacturing needs. In doing so, it may have challenged a precept of The Toyota Way to “respect, challenge, and help your suppliers.” This assumes a long-lasting relationship with a small, preferred set of suppliers rather

than recruiting anyone who can make a particular part. In addition, demands were placed on Toyota to hire new employees in unprecedented numbers. This in turn burdened the indoctrination process, the very vehicle by which The Toyota Way was inculcated into every employee. This had to dilute the strength of the company's culture.

Something even more basic occurred. In a rush to increase output to meet demand, Toyota violated an important principle that the company should never manufacture new products in a new plant with new people. Traditionally, the company had populated its new manufacturing facilities with a sizeable contingent of veterans from other Toyota plants. That apparently was not done in one or more new plants. In a sentence, Toyota's strategy may have outrun the capabilities of its culture in an organization where culture matters a great deal. Putting it another way, the culture and its importance to Toyota's success imposed limits on the company's growth that were violated. Students of management would term this a loss of alignment in the Seven S's described in Chapter 1—particularly between the "hardware" of strategy and the "software" of systems, staff, skills, and, most important, shared values.

Ironically, after all of this analysis and self-analysis, it turns out that many of the accidents involving Toyota autos were due to driver error, not the product. This raises the question of whether Toyota's primary problem was in the company's products or in how management responded to allegations of defects. To what degree was the nature of the response triggered by The Toyota Way?

A principle in The Toyota Way admonishes managers to "make decisions slowly by consensus, thoroughly considering all operations." Another—Jidoka—advises managers to "stop when there is a quality problem." Yet another, Genchi Genbutsu, suggests a method of problem-solving that requires that managers "go see for yourself." Did this account for Toyoda's perhaps unnecessary admission to the U.S. Congressional committee that Toyota had grown too fast? Given the quest for information about a quality problem and decision-making by consensus, is it possible that Toyota's investigation was incomplete at the time of Toyoda's testimony, and later accounted for the continued delays in Toyota's response?

To this day it can be debated whether the cause of Toyota's problem was a strategy that outran its culture, a culture that failed Toyota, or human error in the implementation of both.

Fortunately for Toyota, its culture encompasses values other than those cited that may allow it to thrive for many more decades. But Toyota reminds us that strong, healthy cultures, if they fall out of alignment with strategy or if they are unable to accommodate rapidly developing events, can still fail to achieve their promise.

These three examples carry with them a warning that we may have difficulty predicting which of today's cultures are designed and executed in ways that will enable their organizations to be "built to last." But surely the task begins with an assessment of the strength and health of a culture.

Measuring a Culture's Strength

Based on their intensive study of a sample of organization cultures, Terrence Deal and Allan Kennedy concluded, in a comment cited previously, that "a strong culture has almost always been the driving force behind continuing success in American business."¹¹ There may be a few exceptions, such as firms with monopolistic market positions or a dominant product (as in big pharma) with patent protection. But over time, the conditions change in such firms, the weak cultures are exposed, and performance declines.

The problem with strong cultures, as we saw in Chapter 3, is that they can also be the driving force behind decline and obscurity. Nevertheless, the first step in assessing a culture is to appraise its strength.

Anyone studying the strength of an organization's culture has to figure out how to measure it. Measurement has challenged leaders and researchers alike. The following sections describe some of the methods and questions that have been used.

Articulation of Mission, Basic Assumptions, Values, Beliefs, and Behaviors

First and most basic, have the organization's mission, basic assumptions, shared values, and beliefs been articulated? We said earlier that they develop naturally, whether nurtured or not. But has

anyone taken the trouble to identify them? When Deal and Kennedy studied 80 large organizations some years ago, they found that only 25 had clearly articulated beliefs.¹² Of these, roughly two-thirds had what they called “qualitative beliefs,” such as “IBM means service.” The other third had widely understood financial goals, which I would argue neither qualify as values or beliefs nor constitute important elements of an organization’s culture. And this work speaks not at all to the question of whether these organizations had examined the basic assumptions behind their shared beliefs, something that is rarely found in organizations today. That’s why ING’s Orange Code, described in Chapter 2, is so unusual. It is an amalgam of mission (“to help people take care of the wealth they make”), values (fairness, truthfulness), and beliefs. But it also includes some basic assumptions such as “We are new here,” “We will be here for everyone,” “We are not here to destroy; we are here to create,” and “We will never be finished.”

The mission, assumptions, values, and beliefs are important only if they are shared throughout an organization. As Peter Senge has commented, “You cannot have a learning organization (the importance of which we will note later) without a shared vision.”¹³ That’s why the process by which mission, assumptions, values, and beliefs are articulated matters. Too often, it involves a few senior members of the organization closeted in a room, sometimes with a consultant, engaged in an exercise designed to produce one or more lists of values. If time permits, the group may spend whatever time remains trying to associate behaviors with the values and beliefs. Alternatively, as we saw earlier, organizations such as IBM have followed a multiphase strategy of having senior executives draft some values, beliefs, and even behaviors and then test and revise them based on widespread discussions of values and/or behaviors throughout the organization. This process not only engages the organization in the task but also facilitates communication, the next step.

Communication of Mission, Shared Assumptions, Values, Beliefs, and Behaviors

Are members of the organization at all levels aware of the mission, shared assumptions, values, and beliefs? Do they know what they stand for? The mission (“know why”) may be of special interest

to potential employees, for example. It will contribute later to their level of engagement and “ownership,” core phenomena critical to an effective culture and the strategies it supports.

Communication requires more than the distribution of an e-mail or sheet of paper. It requires discussions between managers and their direct reports about the kinds of behaviors on the job that are associated with each of the values. If necessary, it suggests the need for conversations about what happens when behaviors fall out of line with values. It is a good time for “management by story.”

Effective efforts to communicate mission, shared assumptions and values, beliefs, and behaviors seek to answer two questions for others in the organization: What’s in it for the organization?—and—What’s in it for you (or me)?

Acceptance and Practice of Values and Beliefs

Do you subscribe to the values and beliefs? Do they make a difference in how you carry out your work? More important, do you think they work for you and the organization? Do they make you a more effective manager or worker?

Positive responses to these questions suggest that people at all levels in an organization are willing to try to work within the culture to produce successful results.

What people say is important. What they do is even more important. Thus, a telltale measure of strength is whether or not the values and beliefs articulated in a credo or other statement of culture are used regularly in making important decisions.

As these questions suggest, measuring a culture’s strength is a comparatively straightforward exercise. The same cannot be said for measuring its health. But the case examples described earlier help us in this respect.

Measuring a Culture’s Health: The Culture Cycle

There are a number of theories about how an organization’s culture affects performance. These seem to cluster around a few

dominant ideas. Like the magic word uttered by the executive to the recent college graduate in the film *The Graduate*—plastics—secrets of success such as accountability, engagement, ownership, transparency, teamwork, and delegation of authority are trumpeted widely.¹⁴ Each contains useful ideas, but only when they are organized as part of a wider view do they really begin to make sense, as suggested by the USAA, Nucor Steel, Toyota, and other examples described elsewhere in the book. One such wider view is shown in Figure 6-1, a map of the culture cycle, encompassing elements of a healthy culture.

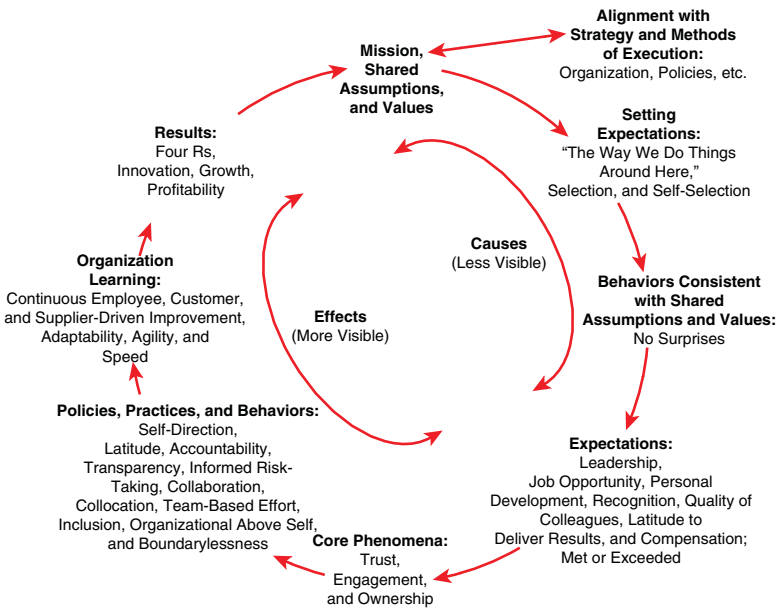


Figure 6-1 The culture cycle

At the top of the map, of course, are the mission (“know why”) and shared assumptions and values (“know how”). They help establish expectations for people who are selected (and who self-select themselves) into the organization.

Meeting Expectations

When individual behaviors and actions are consistent with the values, this sets the stage for a culture in which expectations are met or exceeded regarding things most important to employees—the

“fairness” of my boss, recognition for work done well, opportunity for personal development, the quality of my colleagues, the latitude I have to deliver results, and reasonable compensation. The process of establishing and meeting expectations has been characterized elsewhere as “the deal.”¹⁵ Expectations that consistently are met or exceeded on the job contribute to three core phenomena: trust, engagement, and ownership.

Trust, Engagement, and Ownership

When an organization and its people do what they say they will do, this produces trust in the ranks, making possible other qualities such as speed and agility in how an organization’s strategy is carried out. Trust is reciprocal. USAA provides a good illustration of this. Here leadership’s trust in both customers (members) and employees produces the fastest and lowest-cost claims adjustment process in the property insurance industry. On the other hand, distrust in colleagues or the “system” leads to such questionable behaviors as “workarounds” that subvert policies and procedures, hoarding, slower decisions, and even reduced initiative.¹⁶

Trust also leads to engagement in, or loyalty to, an organization—a phenomenon with significant value, as discussed in Chapter 5. One study concludes that loyalty to an organization is highly correlated with an individual’s perceptions of an organization’s loyalty to the individual.¹⁷ According to the authors, the phenomenon is global in scope. Of particular interest here is that data shows that employees’ perceptions of reciprocal loyalty are higher, for example, in nations of the Middle East and South America than in Europe and the United States.

Engagement, associated with a willingness to recommend the organization to others as a good place to work, can in turn result in ownership. This mentality encourages employees to take the initiative in advancing ideas, solving problems, and growing business relationships—in short, to act as owners. This may involve actual ownership, as at Goldman Sachs or Southwest Airlines. Or it may be an attitude fostered by a strong culture, as at Toyota. It requires the highest level of engagement, evidenced by an employee’s willingness to engage in

continuous-improvement activities as well as recommend her organization as a place to work and to influence and recruit others to join it. For example, teams of “Racksters” at Rackspace, Inc., a web site design and management service, develop goals for growing the customer accounts to which they are assigned. But no one tells them how to meet those goals once they are established. It’s up to the team to figure that out. And figure it out they do. In an industry that has come to be regarded as operating in the “backwater” of the Internet, Rackspace’s growth has, at times, had to be capped at 60% per year to enable the organization to staff itself to meet its high standards for premium customer service.

Ownership among employees tends to foster ownership behaviors among customers. And a customer who is also an “owner” can have a value to a business that is many times that of a typical customer.¹⁸

Both engagement and ownership are encouraged by such things as the organization’s mission; its policies, products, or services; the kinds of jobs it offers; and the quality of people it hires. But above all else, the quality of leadership may have the greatest influence on all three core phenomena, as shown in the trust–engagement–ownership “pyramid” in Figure 6-2.

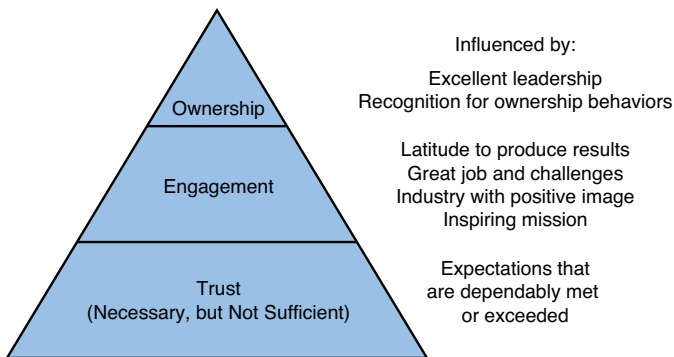


Figure 6-2 Influences on the trust-engagement-ownership pyramid

Policies, Practices, and Behaviors

Trust, engagement, and ownership make possible a number of useful policies, practices, and behaviors, such as self-direction and

latitude, accountability, transparency, informed risk-taking, collaboration, collocation, inclusion, organization above self, and boundarylessness. Many or all of these may be reflected in the core values, and they are often the subject of “single issue” self-help books and articles. They are symptoms of healthy cultures.

Self-Direction, Latitude, and Accountability

These are cornerstones of success at Nucor Steel. They often go hand in hand. Control over one’s job, how it is done, and how much it earns are the order of the day at Nucor. The emphasis is on the result, not how it was achieved, as long as the effort reflects the organization’s values. This philosophy is also true of other remarkable organizations such as Google and W. L. Gore & Associates. The basic assumption is that personal control over one’s work leads directly to higher engagement and responsibility for success. In the case of Nucor, it encourages employees to drop their work to help others and, by extension, the organization without explicit permission from above. Self-direction may vary greatly from one job to another. In some organizations, the employees have much more discretion in some jobs (headquarters) than in others (the distribution center). Nevertheless, self-direction has been demonstrated successfully in all types of jobs and organizations. For example, the hundreds of small subsidiaries of the Illinois Tool Works, as we saw in Chapter 4, represent the method by which the company delegates decisions and holds managers accountable in each of their small manufacturing businesses.

Transparency

Transparency is a popular theme in management circles. But it cannot succeed without trust that managers will distribute and share only information that is in the organization’s best interests. Need to know is a good criterion for practicing transparency. For example, operating information, if shared across business units, may stimulate the sharing of best-practice ideas, as we saw in years past at Banc One. However, this makes sense only if managers feel that performance measures reward such behaviors. On the other hand, there may be little reason to distribute compensation data if it does not contribute to informed decision-making.

Transparency often fosters innovation. It helps explain why Google makes available information about current projects that have yet to be commercialized through its web site, googlelabs.com. Reasons for this practice are that it will facilitate the work of people developing related ideas across its organization as well as attract ideas from interested outsiders.

Informed Risk-Taking

New ideas can fail. How organizations react to that goes a long way in determining whether new ideas will be advanced, particularly from the front line. One recent study found that, particularly in organizations heavily dependent on “high reliability,” there is a strong tendency to “encourage the reporting of errors and near misses, exploiting these incidents to improve their operative processes.”¹⁹ Recall Ken Iverson’s comment at Nucor: “If something’s worth doing, it’s worth doing wrong....” A similar attitude exists at USAA as well. And at Toyota, there may be more deliberation about the implementation of the idea, but all are acknowledged and recognized. This helps explain why hundreds of thousands of such ideas have been advanced in recent years at the automaker as part of the continuous improvement associated with The Toyota Way.

Collaboration, Collocation, and Team-Based Effort

Teams, especially those made up of people from a variety of backgrounds or who have different responsibilities but are located in close proximity to one another, invite the kind of interaction that can lead to such things as outstanding, “seamless” customer service; solutions to complex problems; continuous improvement; and innovation. Learning, at least according to some people, goes hand in hand with team-based effort. As Douglas McGregor pointed out some years ago, “An effective managerial group provides the best possible environment for individual development.”²⁰ At the Harvard Business School, for example, new instructors are often assigned to groups of faculty teaching large, required MBA courses because of the unique opportunity to learn about the craft of teaching that takes place within such groups.

Team-based effort is often linked closely to self-direction, latitude, and accountability. Accountability, when combined with team-based recognition and rewards and the latitude to deliver results, encourages teams to select the right people, ensure behaviors that are consistent with the culture, and meet or exceed their operating goals. This is characteristic of what has happened at Rackspace, Inc., the previously mentioned company that designs and manages web sites for clients. Increasingly, it found itself operating in what many regard as a portion of the Internet beset by modest growth and limited profit. As a result, the company repositioned itself to serve only customers who had complex web site design and operating challenges and were willing to pay a premium for support services. Rackspace reorganized into teams of “Racksters” with the array of interests and capabilities necessary to solve complex customer problems. Employees are located together in “pods” and are given full responsibility for serving and developing business relationships with small portfolios of customers.²¹ The company selects people who can work together to do this. It then entrusts them with managing their teams, from hiring to firing, as well as building Rackspace’s business with their assigned customers. The self-managed teams have come up with so many innovative ideas for customers that Rackspace’s growth and profitability have soared in an Internet neighborhood that other high-tech firms find uninteresting. Appropriately, Rackspace’s innovative team-based organizational arrangement was suggested by one of the firm’s customers. It literally saved the company.

Richard Hackman has pointed out that, based on his research, teams get into trouble when the following occurs:

- They don’t have a clear and compelling direction.
- Members aren’t sure who is on and off the team.
- Tasks are poorly designed, and norms are unenforced.
- Members are not rewarded for team effort.
- They aren’t coached in team process.²²

For example, when the Toyota Production System, focused on team-based effort, was introduced at NUMMI, the joint venture between Toyota and General Motors, initial efforts didn’t work well because GM team leaders didn’t understand their jobs. One observer

commented: “The lesson was clear: don’t implement work teams before you do the hard work of implementing the system and culture to support them.”²³

In my experience, teams function best when they have specific ongoing responsibilities for such things as solving customer problems or turning around a commercial aircraft on schedule—tasks that are repeated many times. This is particularly true in cases where teams have relatively wide responsibility for such things as hiring, training, assignments, problem-solving, and business development. Teams help “shrink” the workplace, injecting self-control into an organization in the form of peer pressure. Hackman suggests that smaller teams are more effective, but if the workforce at a given facility is relatively small and jobs are well defined, team-based effort may extend to nearly every member of the organization and even beyond, as we saw with Nucor’s minimills.

Feedback from employees about the quality of their workplaces tells us that the quality of team members matters greatly. Everyone likes to work with “winners.” The better the team members, the lower the turnover, according to one study of securities analysts in 24 securities firms over a nine-year period. It concludes that “...analysts working with higher quality colleagues are less likely to turn over.”²⁴

Teams flourish when authority with accountability is delegated to them. They also benefit from team-based incentives, recognition, and rewards, and the collocation of those encouraged to collaborate. They benefit as well from inclusion.

Inclusion

Inclusion is used here to mean many things, including people with diverse backgrounds, training, interests, and ideas. Studies have shown that these kinds of diversity are related to success in innovation when a conscious effort is made to bring them together both organizationally and through collocation. We will examine this topic in more detail in Chapter 8.²⁵

Team members’ diverse backgrounds may enhance learning. An analysis of 108 empirical studies of performance in more than 10,000 teams has concluded that “cultural diversity (in teams is associated

with)...increased creativity and satisfaction.”²⁶ This same study, however, noted that “cultural diversity (in teams)...leads to process losses through task conflict and decreased social integration.”

Organization Before Self

At Goldman Sachs, Nucor, and Toyota, we have seen examples of organizations in which employees go out of their way to help colleagues solve problems of importance to their companies. This is often done without regard for extra compensation or recognition. But extraordinary examples of these efforts become the subject of organization lore and the stuff of legends that are told repeatedly.

Boundarylessness

Boundaryless behaviors include visits to centers of excellence found in outside organizations; efforts to assist others in one’s own organization, regardless of functional boundaries; and the sharing of resources. It requires such things as encouragement from leadership, rewards for sharing resources, budgets for travel, and recognition of how these efforts can support continuous improvement.

The prime purpose of many of these policies, practices, and behaviors is to support the organization learning critical to innovation as well as adaptive and agile organization strategies and actions.

Organization Learning: Continuous Improvement, Adaptability, Speed, and Agility

As we saw in Chapter 3, a healthy culture must support constant change that reflects responses to a changing competitive, social, and legal environment. The policies, practices, and behaviors just described provide a basis for maintaining such a culture. But it requires devices—“listening posts”—for the transfer of ideas and suggestions from customers, employees, and suppliers. For example, this is the lifeblood of the software development and improvement processes at Intuit, the developer and marketer of personal finance software. It means that some of the most talented people at Intuit are

assigned responsibility for what might be called “customer service” but is in fact a major contributor to product development.

Best-practice information sharing is one of the best vehicles for continuous improvement, especially in organizations with multiple operating sites. So why is it so often overlooked or underutilized? The most frequent cause is a set of performance measures and incentives that ignore or even discourage the activity. This leads managers to believe that what is a gain for one has to be a loss for another—a “zero-sum” result that discourages the sharing of ideas.

Benchmarking and other “boundaryless” behaviors provide rich sources of ideas from outside the organization. Although they are most effective in the transfer of processes and practices, they can even lead to the development of new product ideas. This helps explain why it has been standard practice, recognized and rewarded, in innovative organizations such as GE for years.

Speed and agility are particularly important in industries competing in the fast-moving worlds of fashion and high technology. They require delegation and informed risk-taking, as well as the assurance that mistakes made in the name of agility or speed will not be unduly criticized. Speed and agility are linked to the core phenomena of the culture cycle. When I asked a head of human resources how her company was able to act with unusual speed and agility in a fashion business, she replied with one word: “Trust.”

Organizations with strong cultures sometimes have curious ideas about the acceptance of new ideas. There is a fear that new ideas (and even their bearers) may somehow disrupt something that is working now. By way of contrast, learning organizations are frequently found engaging in benchmarking, internal best-practice initiatives, information and personnel exchanges of various kinds, and boundaryless behaviors that lead to cross-functional, cross-business, and other kinds of developmental assignments.

The effects of employee turnover on learning are unclear. The value of ideas brought by new employees may be offset by a lack of continuity in innovative effort. But one of the more extensive studies of a large longitudinal database of Danish manufacturing firms led to a conclusion that, at least in those firms, “in- and outflows of human resources...(affect) organizational learning negatively.”²⁷

Assessing the Payoff and the Need for Change

The final “station” of the culture cycle comprises the measurement of results, as shown in Figure 6-1. A strong and healthy culture in synch with an organization’s strategy and how it is executed should have a significant payoff. This can be expressed variously in terms of the Four Rs, introduced in Chapter 5, as well as others included in the following list:

- Relative measures of employee trust, engagement, and “ownership” (such as the percentage of new employees recruited by existing employees) (referrals)
- Employee loyalty (retention)
- Returns to labor or productivity (cost per unit of activity)
- Relations with customers (resulting in both retention and referrals)
- Innovation (the rate of new-product development or the proportion of total revenues produced by new products)
- Value (the ratio of results to costs) for customers
- Ultimately, growth and profitability

The relationships shown in Figure 6-1 are reflected in comments by executives such as Stephen Sadove, chairman and CEO of Saks, Inc., who said:

I have a very simple model to run a company. It starts with leadership at the top, which drives a culture. Culture drives innovation and whatever else you’re trying to drive within a company. And that then drives results. When I talk to Wall Street, people really want to know your results, what are your strategies, what are the issues. Never do you get people asking about the culture, about leadership, about the people in the organization. Yet, it’s the reverse, because those are what ultimately drive the numbers and the results.²⁸

It may require some time for the effects of culture to appear on the bottom line. Measures of payoff begin to show the effects of the behaviors and decisions generated by a culture some time after the actions themselves. Thus, careful measurement requires longitudinal observation followed by analyses that “lag” outputs from inputs

to establish such relationships. One such analysis was performed at Sears in the 1990s. It concluded that an effort to raise employee engagement in a sample of stores produced a 5-unit improvement in employee satisfaction, a 1.3-unit improvement in customer satisfaction, and a store-level revenue growth rate of 0.5% above the average of stores in a control group. This provided the evidence needed to suggest ways of turning the company around, at least for a while. However, it was found that this chain of cause-and-effect required about 18 months, testing the patience of Sears' managers who perhaps needed faster, more dramatic results.²⁹

Matters of time lags and the like may be of more interest to academics than to managers, who are more concerned with how such measures can help their organizations produce both short-term and long-term results.

Practical application of the relationships shown in Figure 6-1 is more likely to involve snapshot measures of the practices and performance of an organization against a peer group. In some cases, the peer group may include competitors. Gaps in both effort (causes) and performance (effects) can be identified and used as a means of taking corrective action. This is a version of benchmarking that generally involves comparing one organization's practices and accomplishments against another's.

For operators of multiple-unit businesses, such measurements can be used to fuel best-practice initiatives on the part of unit managers. For years, the Banc One organization (which eventually was merged into what is now J.P. Morgan) was run on a best-practice system that calculated and circulated to all of its bank managers a common set of cost ratios and other operating results. The CEO, John B. McCoy, had to call an unprepared poor performer only once before that manager began making sure that he checked out best practice with at least one other strong performer before McCoy called again to inquire about the actions being taken to improve performance. Before long, proactive calls among managers on at least a monthly basis became habit. Chapter 7 presents an example of best-practice analysis applied to three offices of the same organization.

Persistent failure to meet targets set for the Four Rs, innovation, growth, and profitability may trigger inquiries into the need for

change in the organization's culture, its strategy, methods of execution, or all three in an effort to produce a self-reinforcing fit between them. We'll return to this matter in Chapter 13.

Measuring a Culture's Fit

A healthy culture, if it “fits” with an organization strategy and how that strategy is executed, produces remarkable results. It is characterized by a high degree of employee and customer satisfaction, loyalty, engagement, and ownership that in time produce growth and profit. In addition, it confirms and reinforces the “rightness” of a set of shared assumptions and values, triggering another turn of the culture cycle.

By now, it should be clear that managers who begin their planning processes by setting goals for growth and profitability—or who plan strategic moves without considering their impact on culture—are putting the cart before a horse that has many working parts. They are pursuing risky practices at best—practices that inevitably, over time, put the entire organization at risk.

The culture cycle map is not simple. It comprises both proven and unproven relationships. It could occupy the efforts of researchers for years. But it provides the specifications for efforts necessary to measure the health of cultures. Some questions used to provide such measurements, keyed to elements of the culture cycle, are suggested in Appendix A. But in applying them, it is important to keep in mind that not all are of equal importance for all organizations. They have to be adapted to a particular set of values and expected behaviors. Furthermore, experience suggests that the consistent application of the questions and an analysis of trends in the information they produce are of greater importance than the particular set of questions used. In other words, there is room for error; a search for perfection shouldn't drive out the good in measurement efforts.

Earlier we addressed the issue of a culture's fit with strategy, how it is executed, and the competitive environment, implied in the illustration of the culture cycle shown in Figure 6-1. Circumstances may require different values and behaviors. But a set of basic questions can help you determine whether fit is being achieved. The following

are some examples that characterize the nature of these questions (although they are by no means a complete list):

- How much growth does a strategy require? Can the culture—particularly the staffing and orientation mechanisms—support that kind of growth?
- What demands are placed on the organization by the nature of the business in which it is engaged? For example, what premium is placed on speed of decision-making and action, generally referred to as agility? To what degree can the culture deal with this need?
- How important are innovation and new-product development to the success of a strategy? Do the values of the organization's culture place sufficient emphasis on them? Do behaviors reflect these needs? Do often-repeated stories feature heroes characterized by their willingness to persist in the face of disinterest or opposition?
- To what degree does continuous improvement lead to superior processes and the higher quality and/or lower cost they produce that are central to the strategy? Is it similarly reflected in elements of the organization's culture?

Caveats

The culture cycle is derived from a personal, subjective appraisal of a number of observations and anecdotal case studies that have appeared in print. Its elements are not meant to be a complete list of drivers of success. Instead, they represent an interpretation of what has worked for a number of organizations, each with its own set of needs.

This presents a measurement challenge. Does it mean that an organization has to achieve high values on every dimension, particularly “policies, practices, and behaviors,” to achieve success? Probably not. There may be different profiles for sustained competitive performance, depending on an industry's rapidity of change and need for innovation, among others. It's up to each organization to define its own culture cycle.

Summary

An effective culture is a predictor of an organization's future success. That's why it's important to measure and track both its strength and health.

Based on a number of examples described throughout this book, a strong culture can be indicated by the following:

- Efforts to articulate and communicate assumptions, values, beliefs, and behaviors.
- Knowledge and acceptance of the assumptions, values, beliefs, and behaviors on the part of members of an organization.

Measuring the health of a culture is more complex but doable. It requires exploring employees' perceptions of the degree to which:

- Their expectations are met by their actual experiences for things important to them in affiliating with an organization.
- They trust that people do what they say they will do on the job and feel safe in taking informed risks (thereby innovating) and coming forth with ideas and constructive suggestions (measures of engagement and "ownership").
- They have control over how they do things on the job.
- They are held accountable for what they do.
- They have sufficient shared information (transparency) with which to bring insight to their jobs.
- They are encouraged to search for new ideas and methods outside the organization (transparency and boundarylessness).
- Collaboration and team-based effort often are important to their success and job satisfaction.
- Inclusiveness and diverse inputs contribute to innovative products and methods.
- They are willing to put the organization's interests before their own.

A systematic way of measuring the health of a culture can be keyed to the culture cycle. It is centered on shared values that provide a basis for the selection and self-selection of employees who will exhibit behaviors consistent with the values. This raises the probability that

expectations of employees for such things as “fairness” of treatment, job opportunity, feedback and personal development, the quality of colleagues, latitude to deliver results, and reasonable compensation will be met. Expectations that are met foster trust, engagement, and “ownership”, important drivers of “policies, practices, and behaviors” such as self-direction, accountability, transparency, informed risk-taking, collaboration and teamwork, innovation, inclusion, organization above self, and boundarylessness. These, in turn, support continuous customer-, employee-, and supplier-driven improvement, adaptability, agility, and speed, all directly related to the “organizational learning” that is so critical to the long-term success of organizations and their cultures that are “built to last.” Favorable trends in measures such as the Four Rs—referrals, retention, returns to labor, and relationships with customers; the rate of innovation; and growth and profitability suggest success, again confirming the usefulness of the culture (and fueling another turn of the cycle).

Cultures both facilitate and pose limits on strategies and how they are implemented. No matter how strong or healthy it is, an effective culture has to fit with a strategy and how it is executed. This requires a subjective appraisal involving the question of whether a culture can support such things as the growth rate; particular business demands for speed, agility, innovation, and new-product development; and continuous improvement called for in the strategy.

Strong and healthy cultures that fit with an organization’s strategy and how it is executed produce employee and customer behaviors that lead to high productivity, good value in products and services, innovation, and ultimately growth and profitability. These behaviors include assistance in recruiting new employees and customers and providing recommendations for ways to improve products, services, and processes. That’s why the strength and health of cultures are important predictors of future success and why it is so important to measure and track them over time and employ this information in the day-to-day management of an organization.

To show how the health of cultures affects performance, I went into the field to apply the ideas from Chapters 5 and 6 to a functioning organization. What I found is next.