Viewpoint

The CEO Balancing Act:

Prospering in the New World of Business

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Today, we live and work in a global economy in which companies routinely cross national boundaries to compete for markets and customers; a highly flexible economy in which companies take themselves apart and put themselves back together in new configurations; a virtual economy in which companies cooperate with competitors, sell to suppliers, and buy from customers; a knowledge economy built on brains, innovation, and speed.

The way I try to make sense of the world – and keep my company one step ahead – is by applying a framework that we have spent several years developing:

the High Performance Business model/ At its center is the „CEO balancing act." In this context, the initials CEO have two meanings: Chief Executive Officer (the U.S. title for the person who runs a business) and customers, employees, and owners – the people for whom the Chief Executive Officer provides leadership and in whose interest he or she runs the organization. I genuinely believe that achieving this CEO balance is the defining challenge facing business leaders today.

Balance and the High Performance Business

But let's start at the beginning: What do I mean by a High Performance Business? It's hard to define in the abstract, but you know one when you see it. A High Performance Business is one whose customers wouldn't think of buying from anyone else, whose employees feel they have the best jobs in the world, whose owners receive returns that far exceed industry standards, and whose communities regard it as an outstanding corporate citizen. It's an ambitious standard, I know. But only by setting their sights this high can companies hope to create real competitive advantage and lasting value.

To become High Performance Businesses, companies must devise strategies that satisfy their customers, employees, and owners; implement those strategies by improving critical business processes; and align their resources and organization to support ongoing process excellence. It sounds simple. In reality, embracing the High Performance Business model requires at least two major shifts in thinking.

The first shift is to move beyond seeing the world in terms of „either/or" choices and to adopt a „both/and" mindset. Too many business leaders still see their companies as a set of trade-offs: high cost or low quality, healthy financial returns *or* well-compensated employees. High Performance companies recognize that while the daily realities of business are mil of conflicts and choices, the genius of long-term success is moving to a „both/and" mindset.

It's the „virtuous circle": satisfied customers mean fewer customer defections; fewer defections mean higher profits and growth; better financial performance satisfies owners; satisfied owners are more willing to make substantial investments in human capital; highly trained people tend to be satisfied employees; and this dedicated workforce unleashes energy to generate superior products and services, which starts the virtuous circle all over again.

In the United States, Motorola is a classic High Performance Business. The company's remarkable financial performance over the last five years reflects its dominant presence in some of the world's most important technology markets: semiconductors, mobile communications, and cellular phones. But Motorola understands – as well as any company I know – that its satisfied owners and customers are inseparable from its committed people.

In 1993, Motorola spent over $100 million on employee education and training. The company calculates that every training dollar delivers $30 worth of productivity gains within three years. Since 1987, Motorola reports, it has cut costs by over $3 billion without massive layoffs or restructuring. Well-trained people work smarter. Indeed, Motorola's sales-per-employee have doubled in the past five years, almost doubling profits. As a result, the stack's value has more than tripled. Because the company is so well-managed, it can meet the needs of its customers, employees, and owners – and provide a high level of satisfaction to all three groups.

The second major shift involves how we see our organizations. High Performance Businesses see themselves as a collection of dynamic processes rather than as a set of rigid structures. This process orientation is key to achieving CEO balance. That's because satisfying multiple stakeholders requires optimizing the organization as a whole rather than individual components – and processes are the chains of connections that cut across the entire organization.

Managing critical processes (as distinct from managing individual functions) allows for remarkable improve ments in productivity, quality, and flexibility – and thus allows the company to satisfy multiple stakeholders.

CEO Balance at ADL

To us at Arthur D. Little, CEO balance is not some abstract concept. It is the heart of how we run the company – and the essence of my job as chief executive.

Let's look first at customers – the „C" in CEO. Needless to say, for a company in the business of selling advice and expertise to other companies, our most valuable asset is solid relationships – that is, satisfied customers. We try to quantify the level of customer satisfaction we achieve by systematically interviewing our clients after we complete an engagement. Over the years, we've conducted more than 5,000 of these interviews, and we constantly analyze the results. We have a pretty clear idea of what we're good at, what we need to work on, and which of our skills our customers value most highly.

Of course, a big problem for professional service companies like ours is that the needs of customers tend to overwhelm everything else – including our employees' needs for well-rounded lives. Which is why we also survey our people on a regular basis, measure their satisfaction, publish the results, and commit to improving them.

Then there's owner satisfaction. In our case, our employees *are* our owners. Twice a year, we call in outside experts to value the company and assign a share price. I'm pleased to tell you that over the past seven years, the value of our shares has almost tripled.

In many respects, the dramatic changes in business over the last 10 years have been a product of the search for CEO balance – at the level of companies, countries, and even whole regions of the world.

CEO Balance Around the World

Let's look briefly at how the search for CEO balance is unfolding around the world. In the United States, it's hard not to be impressed by the country's economic comeback over the last five years and its bright prospects through the end of the century. Ironically, the takeovers, downsizings, and restructurings of the 1980s and early 1990s – which so much of the world, and so many Americans, interpreted as signs of the country's decline – were in fact signs of its search for a new balance among customers, employees, and owners. The United States looks good today because it was the first country to get serious about the new search for CEO balance.

Why was it first? In large part because its political and economic environment encouraged (some might say forced) companies to begin the search. The twin pressures of foreign competition and domestic deregulation led to a renewed commitment to quality, innovation, effectiveness, and efficiency. Reforms – from just-in-time manufacturing to reengineering – were efforts by U.S. companies to respond to the best practices of their overseas rivals and the increasing intensity of domestic competition.

The „O" in CEO – owners – also played an important role in the search for balance. In the United States, the ownership of public companies is principally in the hands of large institutional investors – mutual funds, retirement plans, etc. Throughout the 1980s, these large shareholders exercised their clout to force management to adjust to the new realities of competition. From 1985 through 1990, the total value of mergers, hostile acquisitions, and LBOs exceeded *one trillion dollars*. Many of the most famous names in the Fortune 500 simply disappeared. No one was safe – so everyone got down to business.

As a result, the governance process has improved considerably. Owners are increasingly pressuring boards of directors, which represent their interests, to hold management accountable for the firm's performance – as evidenced by the recent departures of the CEOs of some very prominent companies. And while it is still true that U.S. owners tend to focus first on short-term financial performance, they are increasingly interested in how companies are gearing up for the longer term. Maybe owners elsewhere should be less patient in addressing urgent competitive issues!

To be sure, the search for CEO balance had its costs. Downsizings and layoffs meant hardship for millions of blue-collar workers and middle managers. But many of the jobs that remain – and the new jobs that have been created – are better than the jobs that were displaced. And however painful the downsizing may have been, consider the alternative. It would certainly have been a lot more painful – for customers, employees, and owners alike – if US. industry had not done what it had to do to stay in business. So, for the moment, the United States seems to be ahead of the rest of the world in achieving a more effective CEO balance.

In Europe, the search for CEO balance is at an earlier stage – and raises different issues. For decades, the genius of the European model of competition was its social contract among governments, workers, and companies. Europe discovered, long before the United States, the power of a sustained commitment to a well-educated population and highly trained employees. Europe's emphasis on quality and technology allowed its companies to thrive in high-end market segments in industries from automobiles to consumer electronics to home appliances.

Over time, however, the competitive model that served Europe so well simply broke down. European companies faced new conditions: market unification at home, increased foreign competition, customer demands for high quality at low cost that undermined strategies focused on the high end. Unfortunately, too many European companies were slow to adjust to the new conditions – in large part because the „E“ in CEO was simply too rigid. Instead of a foundation for excellence, Europe's social contract became a straightjacket. Labor costs in Germany, for example, are the highest in the world – about one third higher than in Japan and about 50 percent higher than in the United States. At the same time, German productivity (measured in terms of cash flow per employee) lags behind productivity levels in Japan and the US. by roughly 50 percent. As a result, Europe is losing share in world markets. According to a study by the Confederation of British Industry, Western Europe's share of global exports fell from nearly 24 percent in 1972 to just over 18 percent in 1992. This disappointing performance abroad is made worse by slow growth at home – a combination that creates a downward spiral.

That's the bad news. The good news is that the search for CEO balance is under way. Thanks largely to the ongoing (if sometimes halting) movement toward economic unification, European customers are in a better position than ever to insist on high quality, great service, and competitive prices. There are still plenty of legitimate concerns about Fortress Europe – in particular, trade policies that limit Asian competition. But the simultaneous unification and opening of European markets is unleashing new customer-driven pressures across the continent.

To respond to those pressures, the first challenge for European companies is simply to cut costs – to engage in the downsizing and restructuring that U.S. companies began in the 1980s. That downsizing process is well under way. In Germany, Mercedes-Benz cut over $1 billion from its annual operating costs in 1992 and 1993. In France, Peugeot Chairman Jacques Calvet reports that his company's productivity has increased by 50 percent over the past five years – and is calling for another 50 percent gain over the next five years. In Italy, state-owned Alitalia will eliminate 1,500 jobs from its 20,000-person workforce.

The unique opportunity for Europe, given its longstanding social contract, is to devise strategies for „downsizing with a human face“ – policies that allow companies to become flatter and more flexible without imposing as much turmoil and social pain as in the United States. That brings the „0“ in CEO balance into the equation: can employees and owners reach new governance agreements that make companies more flexible – without losing the human-capital advantages that have been so important to Europe?

The challenge for Japan is more subtle than for the U.S. or Europe. There is no denying that Japan's once-unassailable position as a global competitor has eroded over the last few years. Its meteoric growth rate has slowed considerably and even turned negative. And the weakness of its financial markets – from bonds to equities to real estate – has eliminated the cost-of-capital advantages that fueled its investment boom in the 1980s.

Many of Japan's most prominent business leaders have been vocal about the need for new strategies and policies. And the idea of reengineering has taken Japan by storm; at least 20 new books have been published on the topic in the last two years.

However, in Japan, no single element of the CEO balance explains the problem. Some of Japan's current difficulties involve macroeconomic factors such as domestic recession, trade policy, and exchange rates rather than managerial weaknesses. But the real challenge is to the very model of competition that served Japan so well in the 1980s – a model that stressed lifetime employment, just-in-time production, and an aggressive commitment to market-share gains.

This model created a CEO balance that worked well for more than a decade. In return for lifetime employment, Japanese workers demonstrated levels of commitment and productivity that companies in other countries could only marvel at. Because of the cross-ownership patterns of Japan's *keiretsu* system, shareholders were willing to pay the short-term price for market share in return for long-term asset appreciation. And while individual consumers often paid higher-than-necessary prices for everything from rice to personal computers, they also recognized that Japan's producer-first economy created economic and social stability that had undeniable benefits. Business customers valued the world-class quality and on-time performance of their suppliers and partners.

Today, every dimension of this model is open to question. Many large companies have eliminated their commitment to lifetime employment in favor of more flexible approaches to their workforces. Even more companies have announced their intention to stress profitability over market share – a reflection of pressures from owners, stung by the collapse of Japan's financial markets, to improve short-term financial performance. And Japanese customers – from people shopping for gifts at Toys R Us to computer manufacturers shopping the world for high-performance semiconductors – expect greater choice and more open markets.

In response, great companies from Canon to Honda to Sony to Toyota are in the midst of wrenching dislocations. But those dislocations should not obscure the fundamental strengths of these companies. Their factories are as productive as ever; their products are as high-quality as ever; their workers are as committed as ever. Business

leaders outside Japan who interpret that country's search for a new CEO balance as the end of the Japanese miracle misunderstand its resilience – and risk a rude awakening.

That's how we at Arthur D. Little see the world right now: companies and countries with different strengths, different challenges, different opportunities – but on more or less the same search. That search – for a new, dynamic balance among customers, employees, and owners – will be the story of business right through the end of the century.

No one knows precisely how the search will turn out. What we do know – and what we see in successful companies and economies around the world – is that the search works best when open markets give customers the widest choice, when governance systems allow owners to hold managers accountable, and when companies forge relationships with employees that offer training and empowerment without strangling flexibility. Under these conditions, management stands the best chance of achieving an effective CEO balance – and a High Performance Business.

[1] *For a more detailed discussion of the High Performance Business, see* Prism*, first quarter 1992.*

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