Leadership: Motivating Change within Organizations

CHAPTER 20

CHAPTER OUTLINE

In 1982, David Kearns was appointed CEO of Xerox Corporation, the leading producer of copy machines in the world.[1] At that time, the company faced serious problems. Between 1976 and 1982, Xerox's share of installations of new copiers in the United States dropped from about 80 percent to 13 percent. Japanese companies—Canon, Minolta, Ricoh, and Sharp—had become major players in this

[1]Details of this example are from D. Kearns and D. Nadler (1992), *Prophets in the Dark* (Harper Business Press: New York).

market. These companies were selling copiers at prices that at times were lower than Xerox's costs for producing competing machines.

A major reason for Xerox's decline in market share was poor product quality. As Kearns put it,

> *Our customer cancellations were rapidly on the rise, our response to the problem was to try to outrun them by pushing hard to get enough new orders to offset the customers we had lost. Customers were fed up with our copiers breaking down and our service response.*

Kearns reasoned that if something was not done, "Xerox was destined to have a fire sale and close down by 1990. [The] only hope for survival was to urgently commit the company to vastly improving the quality of its products and services."

According to Kearns, most Xerox employees understood neither the extraordinary gravity of the problem nor the fundamental importance of improving product quality. He realized that even as CEO, he could not implement his vision of increasing product quality simply by ordering thousands of employees to focus more on quality. First, employees did not necessarily possess all the skills required to produce quality products. Second, unless employees were convinced that it was in their individual interests to focus more on quality, it would be difficult to motivate them to alter their behavior. Certainly, Kearns did not have the time to monitor each employee to see if his vision was being implemented. Third, Kearns faced a difficult balancing act; he feared that painting too dismal a picture would induce some key people to leave the company.

In response to these concerns, Kearns initiated a strategy to shift corporate direction. He realized that many Xerox employees would oppose the kind of dramatic change he envisioned. They might fear for their jobs, worry about changes in job assignments, or be concerned about having to relocate. Kearns began by convincing a select group of key executives that additional focus on quality was essential. These individuals not only helped refine this quality vision, but also helped convince other employees of the potential benefits of this change in focus. Employees throughout the company received substantial training in quality techniques. The importance of quality was emphasized at every opportunity—media releases, management speeches, signs on bulletin boards, and so forth. In addition, they stressed the potential crisis posed by the Japanese successes.

Yet after much training and promotion, the desired change in culture simply was not occurring. It was then that Kearns realized that to affect employee behavior, senior management had to do more than just exhort, cajole, and plead—the performance-evaluation and incentive systems also had to change. As Kearns says,

> *Unless people get rewarded and punished for how they behave, no one will really believe that this is anything more than lip service. A widespread problem [with implementing change] that was singled out was that people said we were still promoting and rewarding employees who weren't true believers and users of the quality process. This was creating noise in the system and sending mixed signals. It had to stop.*

Kearns thereafter initiated changes in the criteria for promotions and compensation decisions, placing major emphasis on customer satisfaction and quality. Eventually, the culture at Xerox did change. In 1989, Xerox won the Malcolm Baldrige National Quality Award.

This example suggests that effective leadership involves a great deal more than just developing an appropriate vision for the company. It is critical to motivate people to implement that vision. Changes in a firm's organizational architecture—the assignment of decision rights, reward system, and performance-evaluation system—can play an important role in motivating material organizational change. Marketing the concept to other employees also is important.

The framework developed in this book provides insights for more effective leadership—both structuring an appropriate architecture as well as implementing new ideas. Rudolph Giuliani stresses that an important responsibility of a leader is to impose a structure suitable to an organization's purpose.[2] This was our focus in Part 3. In this chapter, we concentrate on how effective leaders implement new ideas, which might include a new organizational architecture. The insights in this chapter thus are useful not only for executives at the top of the organization, but also for employees who have the opportunity to assume various leadership roles and want to have their ideas implemented. Our leadership discussion presents an important example of how this book's framework can be used to provide a structured analysis of this popular (though ill-understood) topic.

We begin by discussing the concept of leadership in more detail. Next, we discuss decision making within firms and present a framework for understanding attitudes toward change within organizations. We use this framework to analyze various strategies for motivating employees to endorse proposals for change. These strategies include changing the organizational architecture, analyzing the strategic design of the proposal, and marketing the proposal. In the final sections of the chapter, we provide an analysis of the sources of individual power within an organization and a brief discussion of the use of symbols—role modeling, formal creeds, stories, and legends—in leadership. In the appendix, we present a simple example of the strategic value of commitment and crisis.

Leadership

Webster's defines *leadership* as "leading others along a way, guiding." This definition suggests that there are at least two important characteristics of good leadership. First, the leader must help the organization choose the right path—vision, goal, or plan. Second, the leader must help motivate people to follow it. Much of the popular literature on leadership stresses these two characteristics. To quote John Gardner, "The two tasks at the heart of the popular notion of leadership are goal setting and motivating."[3] Since these tasks are performed by people throughout the organization, leadership is in no sense the exclusive domain of senior executives. Throughout the firm, many employees assume important leadership roles.

Vision Setting

By vision, we simply mean a course of action for the firm.[4] Sometimes leaders devise a corporate vision by themselves. According to Kearns, he was among the first people to envision Xerox as a quality-based organization. But senior executives normally do not have all the relevant specific knowledge and cannot be expected to conceive important

[2]R. Giuliani with K. Kurson (2002), *Leadership* (Hyperion: New York).

[3]J. Gardner (1990), *On Leadership* (Free Press: New York), 11.

[4]The management literature differentiates among the terms *vision, strategies,* and *plans*. Visions represent goals and objectives, whereas strategies and plans relate to how to achieve them. For our purpose, this differentiation is unimportant. We are interested in any type of proposal that implies change for the organization. We use the term *vision* as a catchall for these proposals.

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Vision Setting: Lessons from the Enterprise

In my experience, the best-run companies have a basic philosophy that the people in the company know and understand. Sometimes this philosophy is formalized in a mission statement. Here is the best mission statement I have ever heard:

> These are the voyages of the Starship Enterprise. Her 5-year mission: To explore strange new worlds, to seek out new life and new civilizations, to boldly go where no one has gone before.

Crew members of the Starship *Enterprise* know exactly what they are supposed to do. Suppose you are the dumbest person on the ship. And suppose you encountered a strange new world. What should you do? Explore it, perhaps. There is even an emotion telling you how you should go about exploring it: Boldly.

What if your company encounters a strange new opportunity? Without a basic philosophy, even a business's smartest employees have to improvise when they meet a new or challenging situation. We could do worse than rewriting the Star Trek mission statement for whatever venture we are on. Make the language exact, the goal specific, and even your worst employee will make you proud.

Source: D. Marinaccio (1994), *All I Really Need to Know I Learned from Watching Star Trek* (Crown Publishers: New York).

visions entirely by themselves. In many cases, a vision emanates from a lower-level employee or even from a person outside the firm—for example, a consultant. Often, the information for formulating a vision has to be assembled by combining the knowledge of numerous individuals. Firms typically involve many employees in developing mission statements. One aspect of effective leadership involves structuring organizational architecture in a manner that motivates employees with the relevant specific knowledge to initiate value-enhancing proposals—to take part in vision setting. It is this view that has prompted much of the current literature on the role of managers in empowering employees to "unleash their untapped creativity."

Motivation

Although an appropriate vision is important, it cannot increase a firm's value unless it is implemented. Thus, the task of motivation is at least as important as the task of goal setting. It is often better to implement a pretty good plan than to identify yet fail to implement the perfect plan. Literature on leadership often emphasizes motivation skills:[5]

- *Leadership is the* process of persuasion *or example by which an individual induces a group to pursue objectives held by the leader or his or her followers.*
- *I define leadership as leaders* inducing *followers to act for certain goals that represent the values and the motivations—the wants and needs, the aspirations and expectations—of both leaders and followers.*
- *The one who knows the right thing but cannot achieve it fails because he is ineffectual. The great leader* needs . . . the capacity to achieve.

Some people argue that leaders motivate people to follow visions through personal charisma, style, and inspiration. Under this view, the bonds between leader and follower

[5]Emphases in the following quotes are ours. The quotes are taken, respectively, from Gardner (1990), 1; J. Burns (1978), *Leadership* (Harper & Row: New York), 19; and R. Nixon (1982), *Leaders* (Warner Books: New York), 5.

are more emotional than rational. Certainly, strong emotional ties sometimes motivate individuals to follow a leader's call to action. Leaders often cited as charismatic include Mahatma Gandhi, John F. Kennedy, and Martin Luther King, Jr. Charisma undoubtedly explains much of the behavior of individuals in particular settings (for example, in certain religious cults). Business managers might glean some valuable lessons from studying the styles of inspirational leaders, but for most individuals, charisma is difficult to learn.

Yet the economic framework suggests that other attributes of effective leadership can be learned. Economics stresses that people make choices that are in their own self-interest. They are more concerned about their own welfare (which can include concerns about family, community, and so on) than they are about the welfare of the owners of the company. In this sense, the problem of motivating employees to follow a proposed direction or course of action is just the standard incentive problem. Below, we discuss techniques that managers can use to address this problem.

Decision Making within Firms

Incentive Problems and Organizational Politics

Academic discussions often treat decision making as a purely intellectual exercise: Relevant alternatives are identified, analysis is conducted, and the best alternative is chosen. (Consider the standard treatment of capital budgeting in finance courses.) Implementation problems often are ignored. In this context, good leadership is equivalent to *initiating* good proposals and conducting careful analysis. Within most firms, the decision process is much more complicated than this simple characterization reflects. Although developing good proposals and conducting careful analysis are important, they are far from sufficient for effective leadership. Just because a proposal would increase firm value is no guarantee that it will be either *ratified* or *implemented*.[6] Due to incentive problems, decision making within firms often resembles decision making in *political settings* such as government. There are self-interested people involved in group decision making.[7] To quote Jeffrey Pfeffer,

> *Organizations, particularly large ones, are like governments in that they are fundamentally political entities. To understand them, one needs to understand organizational politics, just as to understand governments, one needs to understand government politics.*[8]

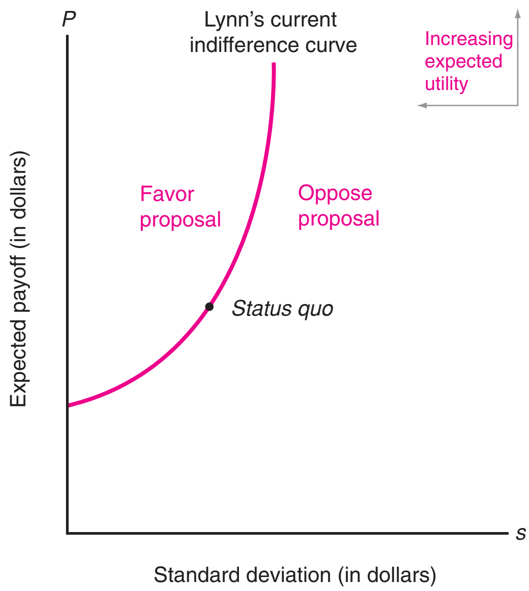
[6]Recall that four important steps in the decision-making process are initiation, ratification, implementation, and monitoring (see Chapter 12).

[7]As we have discussed in previous chapters, if there were no transaction costs, individuals in the group would agree unanimously on a course of action to maximize value. By maximizing the size of the pie, all of the individuals are made better off: Every individual's piece of the pie can be enlarged by the appropriate side payments. Transaction costs limit the likelihood of this outcome within large organizations. For example, suppose that laying off a group of workers will create value but that the labor union has the power to veto the layoffs. With no transaction costs, the owners and labor will agree on the layoffs. The owners share the increase in value by making appropriate severance payments to the workers. Both parties are better off. Bargaining costs often prevent this result from occurring (asymmetric information is a particular problem). In this case, the parties do not have a shared common interest in maximizing value. Similar to other political settings, conflicts arise as all parties try to increase their own share of the pie.

[8]J. Pfeffer (1992), *Managing with Power* (Harvard Business School: Boston), 8.

Figure 20.1 Framework for Understanding Attitudes toward Change

In this example, Lynn Vestergaard is a department manager at the BCT Corporation. Lynn is risk-averse. Her utility increases with her expected payoffs from the company and falls with the standard deviation of these payoffs. This figure displays her indifference curve associated with the *status quo* (assuming the company does not change its direction). Lynn will support proposals for change in the *favor proposal* region of the figure and be against proposals in the *oppose proposal* region.



Understanding Attitudes toward Change

To provide richer insights into the decision-making process within firms, consider the problem facing Christian Seidler, a general manager at the BCT Corporation. Like David Kearns at Xerox, Chris is convinced that his division must adopt a quality-improvement program to remain competitive. He needs support from Claudia Kobatzki, the CEO, for ratification of the program and support from employees in his division for implementation. Chris does not think that the quality program will be a success unless he has the full support of his department managers. He also depends on these managers for advice, because they have important specific knowledge about whether his proposal is a good idea. If the managers were to oppose his proposal strongly, Chris would consider withdrawing it. We focus on Lynn Vestergaard, a department manager who reports to Chris.

Consider the proposal from Lynn's perspective. She is risk-averse and interested in maximizing her own utility, which increases with the expected payoffs that she receives from BCT, P_L, and falls with the standard deviation of these payoffs, s_L (see Chapter 2):

$$U_L = f(\overset{+}{P_L}, \overset{-}{s_L}) \tag{20.1}$$

Expected payoffs include both monetary and nonmonetary compensation from the company. For instance, Lynn gains utility from her salary, supervising a large number of employees, administering a large budget, and working in California. She will not support Chris's proposal simply because it increases the firm's value. It must increase her personal utility.

Figure 20.1 displays Lynn's expected payoff and standard deviation under the *status quo* (assuming the company does not adopt the proposed program). Also displayed is the indifference curve, which contains all combinations of expected payoffs and standard deviations that provide Lynn with the same utility as the *status quo*. (Recall that

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Henry Kissinger on Decision Making

Former Secretary of State Henry Kissinger offers the following observation about decision making:

> Before I served as a consultant to Kennedy, I had believed, like most academics, that the process of decision-making was largely intellectual and [that] all one had to do was to walk into the President's office and convince him of the correctness of one's view. This perspective I soon realized is as dangerously immature as it is widely held.

Source: H. Kissinger (1979), *The White House Years* (Little, Brown: Boston), 39.

northwest movements in the graph are utility-increasing.) For Lynn to favor Chris's proposal over the *status quo,* she must view the proposal as placing her in the region of the graph labeled "favor proposal."

Lynn will oppose the proposal if it reduces her utility. For instance, if she thinks that the proposal will increase the likelihood that she will be laid off, she is likely to oppose the change. Now Lynn is unlikely to come right out and say that, because she fears for her job, she does not like the proposal. She is more likely to question his underlying analysis—even if she thinks it is right. She might waste time developing spurious evidence to convince people that the proposed program is unworkable. She might try to block the program by failing to do her part during implementation. If many employees in the firm undertake similar actions, the proposal will fail.

Chris cannot observe Lynn's personal preferences. But he can analyze how the proposal is likely to affect her and make an educated guess of how she will react. One important factor to consider is the existing organizational architecture. What decision rights does she have currently and how will she be affected by implementation of the proposal? How is she rewarded? If Lynn is paid a bonus based on divisional sales and the proposal is likely to reduce those sales, it is reasonable for Chris to anticipate that Lynn will oppose the proposal.

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Mismanaging Organizational Politics at Xerox

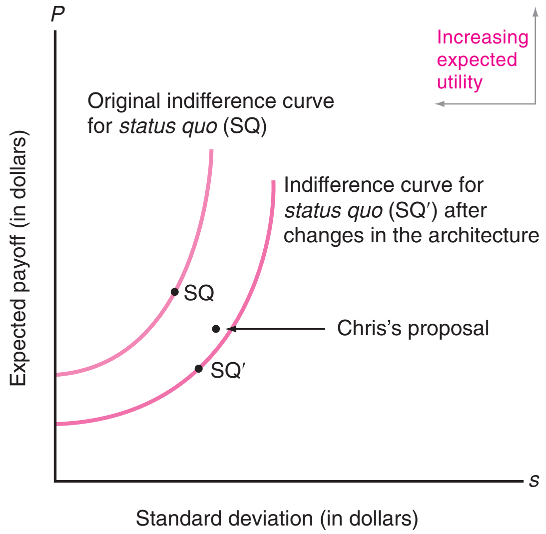
Good analysis is not enough to motivate the implementation of new ideas in an organization. Often, a concerted effort to gain the support of other employees is necessary. Xerox's Palo Alto Research Center (PARC) invented the first personal computer, the first graphics-oriented monitor, one of the first handheld computer mouses, the first word processing program for nonexpert users, the first local area communications network, the first object-oriented programming language, and the first laser printer. Xerox failed to capitalize commercially on any of this inventive technology. One reason was that PARC was physically removed from the rest of Xerox and apparently did not understand the importance of motivating other units in the firm (such as marketing) to support its technological visions. Employees at PARC were characterized as being arrogant and suffering from a "we/they attitude toward the rest of Xerox." In the words of Jeffrey Pfeffer,

> By not appreciating the interdependence involved in a new product launch and the skills required to manage that interdependence, PARC researchers lost out on their ambition to change the world of computing, and Xerox missed some important economic opportunities.

Source: J. Pfeffer (1992), *Managing with Power* (Harvard Business School: Boston), 38–39.

Figure 20.2 Changing the Architecture to Gain Support for a Proposal

In this example, Lynn Vestergaard will not support Chris Seidler's proposal, given her current compensation plan. The *status quo* provides her with higher utility. Chris changes the architecture so that the *status quo* is worse—if Lynn does not improve quality, she is likely to be fired. Now, when Chris introduces the proposal, Lynn will support it and will do her part during the implementation phase.



Suppose that Chris forecasts that Lynn will oppose his proposal. He might gain her support by employing one of three general tactics. First, he could change organizational architecture so that it is in Lynn's interest to support the proposal. Second, he could change the proposal so that she is more likely to support it. Third, he might be able to market the proposal to Lynn by convincing her that actually it is in her self-interest to support the proposal. We discuss each of these general tactics below.

Changing Organizational Architecture

Chris can make two general changes in his division's architecture that would help him gain support for his proposal. First, he can identify individuals who are likely to support the proposal and give them increased decision rights, and correspondingly he can reduce the decision rights of individuals who are likely to oppose the proposal. Second, he can change the performance-evaluation and reward systems so that it is in the self-interest of more employees to support the new program. Kearns implemented both types of changes in architecture at Xerox.

To illustrate the effect of changes in the performance-evaluation and reward systems, suppose that Lynn currently is paid a salary plus a bonus, based on sales by her department. Denote Lynn's expected payoff and standard deviation, given this compensation plan *without implementing* Chris's proposal, as the *status quo* (SQ). The indifference curve associated with SQ is depicted in Figure 20.2 (labeled "original indifference curve"). His proposal makes Lynn worse off relative to the *status quo:* The expected payoff is lower and the standard deviation is higher. Lynn will try to convince Chris that his proposal is a bad idea and should it be adopted is unlikely to exert great effort in implementing it. Now suppose that before suggesting the proposal, Chris changes the performance-evaluation and reward systems. Lynn now will be evaluated on product quality. If the quality in her department is poor, she has an increased likelihood of job loss as well as a lower expected bonus. This change in the reward system produces a new *status quo* (SQ′). Without adopting a quality program, chances are that Lynn's quality would suffer and she might be fired. This change in architecture places her on a lower indifference curve (labeled "after changes in architecture"). Now when Chris proposes his quality program, he receives Lynn's support. She will want to attend quality workshops, provide instruction to her employees in quality techniques, and participate in the program in other ways.[9] She wants to take actions to improve quality in her department because now, participation makes her better off.

Obtaining the approval of the CEO for the program and the support of department managers will not ensure that Chris's proposal will be implemented successfully. There are potential incentive problems with other employees within the division (for example, production workers). He can anticipate some of these problems by carefully analyzing these employees' incentives. For instance, will these employees fear for their jobs, face fewer promotion opportunities, or have less challenging task assignments? Through this analysis, he can identify the employees who are most likely to resist implementation. Chris can make changes in the architecture to reduce the anticipated problems. He can make sure that certain groups of employees are monitored closely in the implementation phase (recall from Chapter 12 that monitoring is the fourth step in the decision-making process). He also might make additional changes in the performance-evaluation and reward systems. For example, he could reward employees—perhaps, through promotions—for successfully implementing the quality concept. Or he might promise employees that they would not lose their jobs due to quality improvements. Such a promise would increase support for these programs (see Web Chapter 23, http://linkhere).

As CEO, David Kearns wanted to make dramatic changes in the culture at Xerox. To motivate employees to support these changes, he altered the firm's performance-evaluation and reward systems. But most employees *must exercise leadership within the existing architecture:* They have only limited authority to make changes in either the performance-evaluation or reward systems. Even CEOs often choose to work within the existing organizational architecture, since changing the architecture can be expensive. (Remember, frequent changes in the evaluation and reward systems can discourage employees from making long-run investments and undercut incentives to develop relationships with teammates—see Chapter 11 and Web Chapter 23, http://linkhere.) The following discussion suggests methods that managers can use to get their proposals implemented within the existing organizational architecture. These techniques also can be used in conjunction with changes in the architecture.

Proposal Design

Managers can analyze the incentives of key decision makers and design proposals that are more likely to be supported. We discuss three issues relating to proposal design: flexibility, commitment, and distributional consequences.

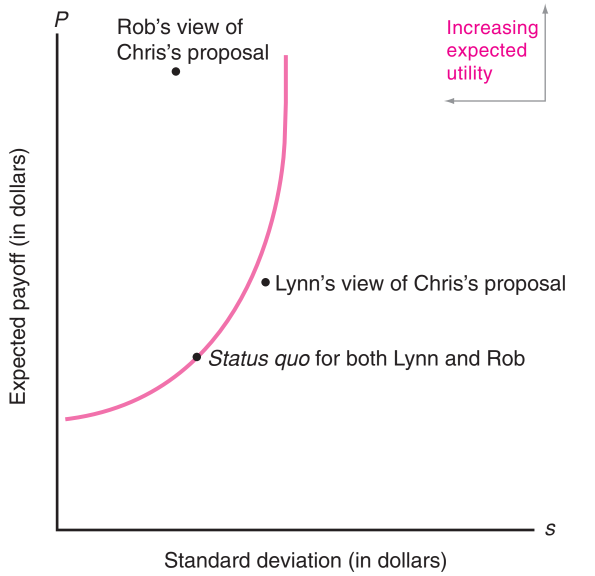
Maintaining Flexibility

Holding the expected payoffs of a proposal constant, employees are more likely to support a new proposal if it entails lower risk. One way to convince people that the risk of a proposal is low is to design the proposal so that it can be modified easily once it is under

[9]In this illustration, the change in the reward system affects Lynn's assessment of the *status quo*. Chris's changes in the reward system also might affect Lynn's expected payoffs and risk under the proposed change. The basic point continues to hold: Chris can influence Lynn's attitude about the proposal by making changes in the architecture.

Figure 20.3 Analyzing the Distributional Consequences of a Proposal

In this example, Chris Seidler's initial design of a proposal would be strongly supported by Rob Lewis and only mildly opposed by Lynn Vestergaard (both have the same initial indifference curve under the *status quo*). Chris can obtain both managers' support by redesigning the proposal. For instance, Chris might reassign some employees who would have reported to Rob under the original proposal to Lynn. Assuming that both Rob and Lynn gain utility from supervising larger departments, Lynn gains and Rob loses utility. Chris's objective is to make changes until both Lynn and Rob view the proposal as being better than the *status quo*.



way. A manager might suggest starting with a limited pilot program, involving only one region or a single product. If this pilot is successful, the program can be expanded. If not, it can be discontinued at low cost. A small-scale test does not commit the firm to adopt the program throughout the company: It provides an option to do so. Experiments of this type commit only limited resources while providing more precise estimates of the costs and benefits of proposed actions. And this information is available both to senior executives who must approve an expanded program as well as to the employees in other areas of the firm where the program might be implemented subsequently.

Commitment

Maintaining flexibility has benefits but also can impose costs. If employees think that senior management is not committed to the change, they have less reason to take the change seriously. In addition, employees who are against the change have increased incentives to take actions to convince senior management that the change is a poor idea. David Kearns made it quite clear that he was committed to the quality program at Xerox and that employees should take the change seriously. In the appendix, we present a more detailed example of the strategic value of commitment.

Distributional Consequences

Most proposals for change have distributional consequences—some employees gain and others lose. For instance, a plan to reduce the power of middle managers will harm middle managers but benefit certain line employees. Managers can design proposals so that the distributional effects promote support among key decision makers. Returning to our example, Figure 20.3 considers the case of Lynn and another department manager, Robert Lewis. Both Rob and Lynn have the same utility function. They also view the *status quo* exactly the same (so they are on the same initial indifference curve). Chris's

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Leverage and Commitment

Firms obtain financing through combinations of equity and debt. Common stock is the most frequently used source of equity capital for large firms. Dividend payments to holders of common stock are discretionary. The board of directors can reduce dividend payments without placing the firm in bankruptcy. Payments to debt holders must be made in a timely fashion to avoid bankruptcy. During the 1980s, many firms increased their amount of debt substantially through activities such as selling bonds and repurchasing common stock.

High leverage can serve as a commitment that management intends to make changes in the firm to increase cash flows to meet the higher debt payments (for example, through cutting costs), since failure to increase cash flows can result in bankruptcy. Managers have their "feet to the fire," since they do not want to lose their jobs. Managers in firms financed primarily by equity can be under less pressure to make changes to increase cash flows, since they have more flexibility to decrease cash payouts to security holders. There are many determinants of the optimal amount of debt in a firm's capital structure. This discussion suggests that one determinant can be the desire of senior managers to commit to employees and outside stakeholders that they will take actions to increase or maintain high cash flows.

Source: M. Jensen (1986), "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *American Economic Review* 76, 323–329.

proposal benefits Rob substantially but harms Lynn slightly. Chris can obtain support from both Rob and Lynn by modifying the original proposal so that Rob is less well off and Lynn is slightly better off. For instance, some of the employees who would have reported to Rob under the initial proposal might be reassigned to report to Lynn in the revised proposal. If Lynn values supervising a larger number of employees, she is more likely to support the revised proposal.

Marketing a Proposal

Employees' attitudes toward a proposed change depend on their assessment of the expected payoffs and risk under the new proposal, relative to the *status quo*. The sponsor of the proposal often will have information that can affect this assessment. The sponsor might be able to convince an employee to support the proposal by conveying this information credibly to the employee.

Careful Analysis and Groundwork

Chris can anticipate initial opposition to his quality proposal because people are risk-averse. Individuals who are confronted with a new idea are likely to be unsure of the personal consequences of the action relative to the *status quo*—thus, they are likely to oppose it. Chris correspondingly should take time to explain his analysis to key employees and to convince them that his analysis is correct. He might meet with these employees to discuss the proposal and answer questions. He might give speeches on the topic, write an article for the company paper, and so on. By carefully communicating the reasons he supports the plan—by lowering the costs for others to analyze the consequences—uncertainty is reduced. Correspondingly, there is increased support for the proposal: More people view the proposal as being in the "favor proposal" region of Figure 20.1.

As a general rule, it is unwise to introduce important proposals at meetings and then request on-the-spot decisions. Without laying the appropriate groundwork, such proposals are likely to be tabled for further study or simply rejected. Since people are risk-averse, they tend to favor the *status quo* until they are convinced otherwise.

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Some Tips on Being a Leader

Many of our most memorable leaders have emerged during wars or crises: Winston Churchill, Abraham Lincoln, and, more recently, Rudy Giuliani and George W. Bush. People want to be led out of a "devotion born of distress" as sociologist Max Weber observed. People want leaders to be a repository of people's fears. A few simple tips can help make you a more effective leader, especially in times of crises.

Stand up and be seen. Followers are more reassured if the leader is visible and seen as taking charge of the situation.

Be brutally optimistic. Showing fear will make team members pessimistic. Tell people the bad news straight, but remind them that eventually they will succeed. Remember Churchill's famous statement of "blood, toil, tears, and sweat" in the near term, but England would prevail "however long and hard the road may be."

Stick to the facts. Do not exaggerate successes, gloss over risks, or wade into questions that can't be answered. Speak either straightforwardly or not at all.

Think long term. Don't worry about short-run profits. This sends the wrong message to team members that they are expendable.

Make team members feel important. Every person has an important role to play in resolving the crisis. Find that role and instill it.

Find a story. Use simple narratives, not complicated PowerPoint slides, to convey your vision; be forward looking. Recall Churchill's message: "This is not the end, it is not even the beginning of the end, but it is the end of the beginning."

Source: A. Wheat (2001), "What It Takes," *Fortune* (November 12), 126.

Relying on Reputation

People have reasons to listen to a person with an established reputation for offering sound proposals. First, past success is an indicator of analytical and organizational skills and thus the likelihood of future success. Second, a successful person has strong incentives to conduct a careful analysis to avoid damaging that established reputation. If other employees are confident that a manager usually makes good decisions, they will attach less risk to that manager's proposals and hence are more likely to support them. A manager with an established reputation can garner support for a proposal by asserting forcefully that it is beneficial. It is important for managers not to misuse their reputations by

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Reputation and Influence

Decision makers often rely on the advice of people with established reputations. This tendency is emphasized by H. Mintzberg:

> I found that chief executives faced complex choices. They had to consider the impact of each decision on other decisions and on the organization's strategy. They had to ensure that the decision would be acceptable to those who influence the organization as well as ensuring that resources would not be overextended. They had to understand the various costs and benefits as well as the feasibility of the proposal. They also had to consider questions of timing. All this was necessary for the simple approval of someone else's proposal. At the same time, however, delay could cost time, while quick approval could be ill considered and quick rejection might discourage the subordinate who had spent months developing a pet project. One common solution to approving projects is to pick the man instead of the proposal. That is, the manager authorizes those projects presented to him by people whose judgment he trusts.

Source: H. Mintzberg (1975), "The Manager's Job: Folklore and Fact," *Harvard Business Review* (July–August), 49–61.

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Wage Concessions at United

In November 2002 United Airlines announced that it had negotiated wage concessions totaling $5.4 billion from its employees. These reductions were accepted by United's unions to help the firm avoid bankruptcy. Given the fall in demand and increases in costs following the September 11, 2001, terrorist attacks as well as the bankruptcy filing by US Airways, it certainly was credible for United to argue that the *status quo* was not sustainable.

Source: M. Maynard (2002), "United and Machinists Reach Deal on Concessions," *The New York Times* (November 21) C1.

arguing passionately for marginal proposals. A manager's reputation is diminished whenever proposals turn out to be unsuccessful.

Steve Jobs, CEO of Apple Computer, has been dubbed one of America's 25 Best Leaders by USNews.com. He has had a tempestuous career—founding Apple and building the first Macintosh in 1976, being fired in 1985 for his erratic nature, followed by his 1996 triumphant return to lead Apple. Throughout this experience Jobs has been called a "transformational leader," a commercial innovator, cultural inspiration, and entrepreneurial icon. His passionate perfectionism created the soul of many new machines—iMacs, iBooks, iPods—and altered the way people compute, play music, and view video. Victor Vroom at the Yale School of Management says, "[Jobs] is the supreme example of the transformational leader who stands for higher-order values . . . he has caused people to do things they might never have done before." Since his return as CEO, Apple's stock price has risen from below $10 to over $60.[10]

A sponsor also can increase support for a proposal by obtaining the endorsement of other managers with good reputations. Therefore, it is often useful to conduct detailed discussions with these managers. If they agree with the analysis, it is more likely that it is correct. Moreover, their endorsements will garner additional support and forestall opposition from elsewhere within the organization.

Emphasizing a Crisis

A complementary strategy to overcome the normal preference for the *status quo* is to argue that the current situation is worse than people currently recognize. The popular literature frequently argues that employees are most likely to favor change when an organization faces a *crisis:* If change doesn't occur, the organization is going to fail. Managers can promote a willingness to change if they can convince employees that the firm faces a crisis. Kearns gained support for his program at Xerox by repeatedly highlighting the threat from Japanese competition. Of course, this strategy works best if in fact the firm faces an actual crisis. Individuals understand the incentives that proponents of proposals have to state that the organization faces a crisis and correspondingly are unlikely to accept this argument unless it is credible. In the case of Xerox, it was easy to document the lost business. Also, it was easy to point to other industries, such as steel and automobiles, which were having similar experiences. The effect of this action is to reduce employee assessments of the utility associated with the *status quo*. This shift enlarges the support region, similar to the analysis in Figure 20.2. Thus, Chris can gain Lynn's

[10]Source: www.usnews.com/usnews/news/articles/051031/31jobs.htm; and http://en.wikipedia.org/wiki/Steve_Jobs.

support if he provides her with new information that causes her to be less optimistic about the *status quo*. In the appendix, we illustrate how an employee's attitude toward change can depend on whether the firm faces a crisis.

Organizational Power

Economics suggests that an employee's attitude toward change will depend on the personal effects of the proposal. These effects are likely to depend on the identity of the sponsor. Some proposal sponsors have more personal *power* than others to affect the payoffs received by other employees. To be effective, it is important for managers to understand the sources of this power and how to acquire it.

Sources of Power[11]

What is the source of power within organizations? There are no laws that require people to obey or support the wishes of others within the firm. Corporate power does not come from the ability to force others to follow commands. Ultimately, it comes from other people who *voluntarily agree* to comply with a leader's wishes or proposals. For this voluntary action to occur, it must be in the interests of these people to cooperate with the leader. This section discusses potential sources of power and influence.

Formal Authority

Some power comes from the formal position within the organization. If a manager has the right to fire, promote, and compensate an employee, the employee obviously has an economic incentive to comply with the manager's wishes.[12] In our example, Chris

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Leaders Require Followers

Ben Hermalin at the University of California, Berkeley, argues that since leaders must have followers, and since following is a voluntary act (one cannot coerce followers to follow), then to understand what makes leaders, one should understand what causes followers to follow. In other words, followers determine their leaders. And a leader's reputation for honesty and trustworthiness is what motivates followers.

Anu Shukla, founder of RubiconSoft, learned the value of faithful followers. When she started Rubric, several of her employees followed her from Compuware, where she started as vice president for marketing. After selling Rubric for $386 million, she started a new venture RubiconSoft, and several of her former colleagues followed her to her new venture, some even becoming investors. Ms. Shukla understands the value of retaining talented employees. "It was a very competitive time in the technology industry, with companies all stealing talent from each other. I saw the value of working with people over time and making sure they stuck with me."

Source: B. Hermalin (1998), "Toward an Economic Theory of Leadership: Leading by Example," *American Economic Review,* 1188–1206; and C. Hymowitz (2004), "In the Lead: The Best Leaders Have Employees Who Would Follow Them," *The Wall Street Journal* (February 10) B1.

[11]This section draws on Pfeffer (1992).

[12]Assuming the employee cannot shift to a comparable position costlessly at another firm.

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Power and Resource Control—Voting on Antitakeover Amendments

Economic theory suggests that the control of important resources provides a person with power. Other people are afraid not to support the person's proposals because they fear that they will lose access to the important resource.

An illustration of the importance of this argument is provided by studies of corporate voting on antitakeover amendments. These amendments make it more difficult for outsiders to take control of a company through a corporate takeover. The existing evidence suggests that some of these amendments reduce the wealth of shareholders but benefit incumbent managers who become more secure in their jobs. The decision on whether to adopt these management-sponsored amendments is held by the shareholders, who would appear to have the incentives to vote against the amendments. Management, however, has power over certain institutional investors, such as banks and insurance companies, because they derive business from the firm that is under management control: If they don't vote in favor of management-sponsored amendments, they risk losing important business. Empirical evidence indicates that these types of institutional investors are more likely to support management-sponsored antitakeover amendments than other, more independent, investors. The evidence also suggests that management groups who lack the power to get amendments passed tend not to propose amendments because they do not want to bear the reputation costs of proposing an amendment that fails.

Source: J. Brickley, R. Lease, and C. Smith (1994), "Corporate Voting: Evidence from Charter Amendment Proposals," *Journal of Corporate Finance* 1, 5–31.

can count on some support from his employees even if the employees think that the proposal will harm them because not supporting it might harm them even more—Chris might be less supportive of raises or promotions; he might even fire them. For instance, these employees are likely to speak in favor of the proposal at public meetings. In addition, his formal authority gives Chris the right to make certain decisions without consulting others. But power attached to a formal position is not without limits. There is the usual incentive problem that employees might ignore their manager's wishes. Also, employees can take actions to get the manager replaced (a "palace revolt"). Disgruntled employees might form a coalition to complain to the CEO that Chris is incompetent. Finally, some companies conduct 360-degree performance reviews where employees provide formal input into the performance evaluations of the managers.

Control of Budgets and Resources

People are granted rights to control resources within organizations. Some individuals have budget authority, and others decide on the allocation of office space or the priority for using copy machines. Control over these resources is a source of power. Individuals are reluctant to challenge a person who controls an important resource because they fear that it will affect their access to this resource. For example, department managers might support Chris because he controls the budget from which they receive funds.

This discussion suggests that individuals can increase their organizational power by gaining control over key resources. This concept can be important in deciding whether to apply for a particular job or task within the firm: Jobs and tasks are more attractive if they contain decision rights over resources others value. Also, a person sometimes can create power by developing a service or product that becomes important to other people within the organization. For example, the data processing manager in a company might increase personal influence and power by offering a repair service for computers within the organization. This action will create greater power if

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The Power of Information: Evidence from a French Tobacco Factory

An interesting example of the power of information comes from a French cigarette plant in the 1960s. The equipment in this plant was highly automated and subject to mechanical failures. The manuals that explained how to repair this equipment had been destroyed in a fire, and the only people with the knowledge to fix the machines were the maintenance engineers at the factory. This monopolistic access to important information gave the engineers enormous power. Without them, the plant could not run, and it was impossible to replace them. Indeed, the engineers had sufficient power to have a managing director of the company removed from his job. When new engineers were trained in the plant, they were instructed verbally and asked to destroy any notes once they mastered the material. These actions helped these engineers maintain their power over time.

Source: M. Crozier (1964), *The Bureaucratic Phenomenon* (University of Chicago Press: Chicago).

the firm prohibits the use of external vendors, requiring employees to use this internal service for computer repair.

Throughout this book, we have argued that it is important to link decision rights and specific knowledge. Our current discussion suggests a secondary factor that executives might consider in assigning decision rights over key resources: It can be important to grant power to managers who have the most potential to increase firm value.[13] For example, suppose that an executive can assign decision rights over corporate computing to one of two divisional managers, Sanjai Kumar or Maria Lopez. Both managers have the specific knowledge to manage the computer resources effectively. Sanjai, however, has a greater potential to affect the firm's value through his proposals than Maria (Sanjai manages a division with greater opportunities to create value). Further, Sanjai's proposals require the support and cooperation of employees in other divisions of the firm. In this case, the executive might want to assign the decision rights over computing to Sanjai, since they will give him control over additional resources that he can use to persuade others to support his proposals.

Control of Information

A particularly important resource in most organizations is information. The information held by any particular employee depends on things like the employee's position, office location, social network, and special skills. Not all employees have equal access to information. Since most employees require various types of information to be effective in their jobs, people with information have power—they can trade information for support. Some employees at BCT might support Chris because they depend on him to keep them informed about what is going on in the company. Individuals can attempt to increase their access to information (and power) by lobbying for centrally located office space (for example, at the corporate headquarters), developing a social network within the organization, applying for jobs that are "in the information loop," or volunteering for key committee assignments.

Viewing the firm as the focal point for a set of contracts (see Chapter 10) provides a useful way to think about the control of information in a firm. Under this view, the

[13]This point relates to Hart's argument that the allocation of power and control of resources can affect investment decisions and thus value. O. Hart (1995), *Firms, Contracts, and Financial Structure* (Oxford Press: Oxford, UK).

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Logrolling in Government and Business

Many of the classic examples of logrolling come from government. For example, one stylized example involves big business, unions, and farmers, where a winning coalition consists of any of the two groups. Farmers have an advantage in this setting because their demands are less likely to be inconsistent with the demands of unions or big business while the demands of big business and unions are more likely to be inconsistent with each other. Indeed, farmers often want things that are relatively unimportant to the other two groups. Farmers, in turn, often don't care much about the demands of the other groups. This mutual indifference makes farmers good partners in a coalition. In contrast, big business and labor unions are likely to make a poor coalition. This helps explain why farmers have been unusually successful in getting favorable regulation established by the government.

Although many of the examples of logrolling come from government, it is also prevalent in most types of organizations. For example, a marketing executive and a manufacturing manager might form a logroll to provide mutual support for each other's funding requests. In contrast, two manufacturing executives who are interested in mutually exclusive projects would not enter into a coalition. To quote Professor James March,

> Logrolls are found not only in the United States Congress, but also in business firms, military organizations, and universities.

Source: J. March (1994), *A Primer on Decision Making* (Free Press: New York), 157–159.

firm is characterized as a network of contracts between the firm and other parties such as suppliers, customers, and employees. Many of these contracts are informal, and important information is held by people at the various contracting nodes. Controlling access to this information can vest a person with substantial power. It would be quite difficult for a firm to fire an employee who has been the primary contact with a key customer for 20 years. The employee possesses specific information on issues from company promises to customer requirements, and turnover in this position would be costly for the firm.[14]

Friends and Allies

Having close personal ties with decision makers increases the likelihood that they will act on your behalf. Managers sometimes hire or promote their friends into key positions over more qualified candidates. One reason for such actions is that the managers expect that their friends will provide support. Some employees make a point of doing favors for other individuals within the firm (for example, providing assistance on difficult projects or filling in for other people when they are on vacation) to increase the likelihood that these individuals will support them in the future. Chris is more likely to obtain support for his proposal if he has developed allies within the company.[15] Concerns over inappropriate concentrations of power have led some firms to adopt policies with respect to nepotism.

[14]Andre Shleifer and Robert Vishny argue that managers sometimes choose investment projects that give them an informational advantage and thus make it more costly for shareholders to replace them. A. Shleifer and R. Vishny (1989), "Management Entrenchment: The Case of Manager-Specific Investment," *Journal of Financial Economics* 25, 123–139.

[15]For an economic analysis of gift giving and exchange, see G. Akerlof (1982), "Labor Contracts as Partial Gift Exchange," *Quarterly Journal of Economics* 97, 543–569; and J. Rotemberg (1994), "Human Relations in the Workplace," *Journal of Political Economy* 102, 684–718.

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Logrolling at General Motors

J. L. Pratt, who was chairman of General Motors' Appropriations Committee, noted that there was no corporate headquarters coordinating the company's various divisions before Alfred Sloan became CEO. The Executive Committee was composed of division managers. "When one of them had a project, why he would get the vote of his fellow members; if they would vote for his project, he would vote for theirs. It was a sort of horse trading."

Source: A. Chandler (1962), *Strategy and Structure* (MIT Press: Cambridge, MA), 127.

Tying the Proposal to Another Initiative

Sometimes it is possible to free-ride on the power of other people in the firm to gain support for a proposal. Perhaps, in our example, BCT's CEO has stressed the importance of product quality to the media and to customers through a program entitled "Quality 2006." Chris might claim that his proposal is an integral part of the CEO's vision for the company and fits nicely within the Quality 2006 program. Casting up the proposal in this manner makes it less likely that other employees will raise objections because they will hesitate to argue against an important initiative sponsored by the CEO.

Coalitions and Logrolling[16]

A manager sometimes can increase power through *logrolling*. A logroll consists of a coalition of individuals who are largely indifferent to one another's proposals but agree to support the various requests so that each can get what he or she wants. A classic example is the coalition that forms each year in the United States Congress to pass the Rivers and Harbors Act. This act contains many local projects that individually would receive support from only a few legislators. Yet this act regularly passes by a comfortable majority because legislators band together to provide mutual support for one another's proposals. In our example, Chris might form a logroll with other general managers in the company to support his proposal. He can agree to support proposals by these managers to expand their divisions if they back his quality proposal. In business firms (as in many other settings), these types of agreements virtually always take the form of implicit promises or understandings rather than formal contracts. However, in some cases the scope of the proposal can be expanded so that provisions valued by other managers can be included in the package. As in the case of the Rivers and Harbors Act, any quid pro quos are explicit and potential coalition defections are less troublesome if the issues can be considered simultaneously.

Coalition Obstacles

In trying to form a logroll, Chris should anticipate at least two potential problems. First is the issue of credible promises. Major decisions in firms do not occur simultaneously. He might need immediate support from other managers, whereas proposals from these

[16]This section draws on W. Riker (1962), *The Theory of Political Coalitions* (Yale University Press: New Haven, CT).

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Political Skills and Organizational Productivity

The development and exercise of power in organizations is about getting things accomplished. The very nature of organizations—interdependent, complex systems with many actors and many points of view—means that taking action is often problematic. Failures in implementations are almost invariably failures to build successful coalitions. Although networks of allies can obviously be misused, they are nevertheless essential in order to get things done.

Source: J. Pfeffer (1992), *Managing with Power* (Harvard Business School: Boston), 108.

managers might not be considered until later. Other managers might be reluctant to support Chris because they fear that he will not follow through on his part of the bargain. Second, identifying potential candidates for the logroll is not always easy. There is likely to be asymmetric information about how the proposal affects other people's welfare. Chris does not know for certain who is indifferent to his proposal. Individuals who are truly indifferent might claim that they would be harmed by the proposal and are unwilling to support him unless he makes many concessions to their wishes. As discussed in Chapter 10, this type of strategic misrepresentation can result in bargaining failures—in this case, the logroll might fail to materialize. Despite these problems, however, effective coalitions often are formed. Indeed, this type of deal making, or "horse trading," is common within organizations.

Proposal Detail and Logrolling

As we discussed, Chris is concerned not only about getting his proposal adopted, but also about incentive problems that could occur after the program is under way. He can reduce these incentive problems by being quite specific about what is expected of each key employee (so he leaves little discretionary decision authority). This strategy, however, entails two potentially significant costs: First, it limits the ability of employees to act on their specific knowledge in the implementation phase. In this sense, Chris faces a basic trade-off in project design that we have emphasized throughout this book—the trade-off between the effective use of specific information and incentive problems. Second, being overly specific in the ratification phase can make it more difficult for Chris to assemble an effective coalition. Logrolling often requires that terms of the proposal be somewhat vague to limit potential conflicts. Specific proposals provide employees with greater opportunities to argue about details.[17]

Is Organizational Power Bad?

We have argued that leaders often use personal power and political skills to motivate change within organizations. Yet words like *power* and *politics* frequently connote negative images to many people. It is easy to conjure up visions of Machiavelli offering insidious advice to the prince on how to increase his power. Similarly, one easily can envision managers becoming completely absorbed in office politics.

[17] J. March (1994), *A Primer on Decision Making* (Free Press: New York), 170–171.

Obviously, attempts to gain power involve costs. For instance, having key employees spend time on logrolling can be expensive. In Chapter 12, we discussed how these influence costs can affect the appropriate architecture of the organization. Firms that survive in the marketplace are likely to be those which effectively limit unproductive uses of employee time. It also is important to recognize that power and political skills can provide important benefits. Organizations involve people working together. Without political skills and power, leaders might fail to implement value-increasing plans and the organization would suffer immensely.

In summary, power and political skills are, in and of themselves, neither good nor bad. They are important attributes that can be used for either productive or unproductive purposes. Managers would be naive to think that they could be effective without such attributes.

The Use of Symbols

Our analysis thus far in this chapter has focused on the formal organizational architecture and strategies for garnering support for proposals. The popular literature often stresses that effective leadership requires the clever use of symbols such as role modeling, formal creeds, stories, and legends. For example, an executive interested in increasing customer service might take the time to talk to customers directly—ensuring that these actions are visible to other employees through media releases and videotapes. The executive might retell stories about employees who have gone out of their way to serve customers. The company also might adopt formal creeds and statements to emphasize the manager's basic vision for the company.

We view such symbols as an aspect of corporate culture that performs a potentially important communication function; the symbols inform employees about what is valued in the company (see Chapters 11 and 22). But again, symbols are unlikely to be effective in motivating employees to take particular actions unless reinforced by the firm's performance-evaluation and reward systems. David Kearns came to realize this and ultimately had to change the reward system at Xerox before he could implement his quality program successfully.

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The Use of Symbols at Nordstrom

Nordstrom is a department store chain that is famous for stressing customer service and satisfaction. The vision of the Nordstrom family (who manage the firm) is to offer the customer the best in service, selection, quality, and value.

The importance of customer service is stressed to employees by the frequent telling of stories about sales clerks who performed such heroics as changing a customer's flat tire in a store parking lot, paying a customer's parking ticket, and lending money to a customer who was short on cash to make a purchase. One particularly interesting story is the one about the sales clerk who refunded money to a customer irate about some newly purchased tires. The clerk cheerfully refunded the money even though the customer did not have a receipt. The fascinating part of the story is that Nordstrom does not sell tires!

Nordstrom does not rely on these types of stories alone to motivate employees to provide customer service. It has an extensive incentive system that stresses sales and customer service.

Source: H. Weston (1991), *Nordstrom: Dissension in the Ranks,* Harvard Business School Case, N9-191-002.

ANALYZING MANAGERIAL DECISIONS: *Global Insurance*

Global Insurance is a disability insurance company. Traditionally, it has organized its corporate headquarters around functional specialties. After an application for an insurance policy arrives at headquarters from a field agent, it is processed through a series of functional departments. One department checks to see if the application is filled out correctly, another department checks the medical history of the applicant, and so on. Among the final steps is the underwriting decision, where the company agrees to accept the policy. This task is handled by trained underwriters.

One of the more important departments at Global is human resources. The human resources department administers the personnel system (for instance, screening job applicants, reviewing promotion decisions, having key decision rights on salary levels and job classifications, and providing training throughout the organization). Currently, the system includes nearly 2,000 discrete job titles. The director of human resources is viewed by most employees as a key person in the organization.

A major problem at Global is that it takes nearly a month to process an insurance application. Applications can sit for days in in-boxes, as they move from department to department. Global's CEO has decided that the company must reorganize to remain competitive. He has a vision to do away with most of the functional departments. Insurance applications would be handled by *caseworkers* responsible for all the steps from initial inspection of the application through underwriting. These caseworkers would be supported by a computer system that would allow access to medical record databases and other information necessary for processing an application. The management information system manager would be charged with developing the information system. Caseworkers would receive training in underwriting from the existing underwriters in the firm. Entry-level caseworkers would be required to have at least a 2-year degree from a community college. The number of job titles would be reduced significantly. Most of the people would have titles like *associate* or *partner*. Training, promotion, and hiring rights, currently held by human resources, would be decentralized to senior case managers (partners). The human resources department would play an important role in transitioning to the new system (dismantling existing training programs and turning them over to case managers, reducing the size of its staff, and so on). Through similar programs, other insurance companies have been able to reduce their application processing times dramatically. They also have reduced their workforces significantly.

1. Which employees in the organization do you think will oppose the new proposal? Who will support it?
2. What problems can the opponents cause in implementing the plan?
3. What actions should the CEO take to increase the likelihood that his plan will be implemented successfully?

Summary

This chapter uses the framework developed in Part 3 of this book to provide insights into more effective *leadership*. The analysis presents an important example of how this framework can be used to provide a structured discussion of this popular, but not necessarily well-understood, topic.

The leadership literature stresses two important tasks that all leaders must perform—setting goals and motivating employees. To accomplish these tasks, management must design decision-right, performance-evaluation, and reward systems that effectively link relevant specific knowledge with decision-making authority and provide appropriate incentives for decision makers to act on their information. In this sense, much of this book has focused on key components of leadership.

Academic discussions often treat the process of decision ratification as a purely intellectual exercise. In most firms, however, the decision process involves significant incentive problems. As a result, decision making in firms often resembles decision making within political settings.

Effective leadership is facilitated by careful consideration of other employees' perspectives on proposals for change. It is important to recognize that people typically are risk-averse and interested in their own well-being. An important factor to consider is the existing organizational architecture. How will a proposed change affect specific employees in terms of their decision rights and rewards from the organization?

Managers can make two general types of changes in architecture that can assist in gaining support for their proposals. First, they can identify individuals who are potential supporters of their proposals and give them increased decision rights. Second, they can change the performance-evaluation and reward systems so that it is in the self-interest of more employees to support their suggestions.

Developing proposals that can be discontinued at low cost can reduce opposition. Flexibility, however, has costs as well as benefits. Sometimes it is better for managers to demonstrate a greater commitment to a change so that employees take the change more seriously. Managers can analyze the incentives of key decision makers and design proposals that are more likely to be supported.

The sponsor often will have information that can affect other employees' assessments of a proposal. The sponsor might be able to convince other employees of the merits of the proposal through careful analysis and groundwork, relying on a reputation for good decision making, and/or emphasizing a crisis.

Some managers have more personal *power* than others to affect the payoffs to other employees. Power within organizations generally does not come from the ability to force others to follow commands. Rather, power comes from other people who *voluntarily agree* to comply with a leader's proposals. For this voluntary action to occur, it must be in the interests of these other people to cooperate with the leader. Sources of power include formal authority derived from the position in their firm, control over important physical or budgetary resources, control over information, and friends/allies. Sometimes it is possible to use the power of another employee by tying the proposal to a program backed by the powerful employee.

Employees can gain support for proposals by *logrolling*. A logroll consists of a coalition of individuals who are largely indifferent to one another's proposals but agree to support the various requests so that each can get what he or she wants.

Words like *power* and *politics* often conjure up negative images. Our view is that power and political skills are neither universally good nor bad. Rather, they are important attributes that can be used for either productive or unproductive purposes. Managers are naive if they think that they can be effective without such attributes.

Symbols such as role modeling, formal creeds, stories, and legends can play an important role in communicating a manager's vision to employees. However, they are unlikely to be effective in motivating employees to take particular actions unless they are reinforced by the firm's performance-evaluation and reward systems.

Appendix

Strategic Value of Commitment and Crisis

In this chapter we discussed how a crisis and a leader's demonstrated commitment to change sometimes help motivate change within an organization. In this appendix we use a simple game-theoretic example to illustrate these ideas.

Figure 20.4 Strategic Value of Commitment

Tomoka Hayashi is CFO of the GSA Company, and Simon Lewellen is the general manager of the company's largest division. At the next board meeting Tomoka will recommend the degree of leverage; Simon will recommend whether his division should invest in a new technology. If they both wait until the board meeting to announce their policy choices, the Nash equilibrium is low leverage and no investment. Tomoka may be able to achieve a preferred outcome—high leverage and investment—by effectively *committing* to recommend high leverage prior to the meeting.

	Simon—Invest	Simon—Not invest
Tomoka—High leverage	$90 / $85	$0 / $0
Tomoka—Low leverage	$100 / $80	$80 / $100

Tomoka Hayashi is chief financial officer of the GSA Company. Simon Lewellen is the general manager of the company's largest division. The board of directors is scheduled to meet next week. Tomoka will recommend the firm's leverage ratio for the next year. She will recommend either high leverage, where the firm will borrow money to repurchase common stock, or low leverage, where the company maintains its current low debt-to-equity ratio. Simon will recommend whether his division should invest in a major new technology. The board is expected to accept Tomoka's and Simon's recommendations.

Figure 20.4 displays the personal payoffs to Tomoka and Simon for the four possible combinations of leverage and investment. Tomoka prefers low leverage and investment in the new technology, whereas Simon prefers low leverage and not investing in the new technology.[18] Tomoka, however, prefers high leverage and investing to low leverage and not investing. Currently both are scheduled to make their first public disclosures of their recommendations at the board meeting. This schedule effectively requires them to make simultaneous announcements. Each must prepare extensive presentations supporting their recommendations. It is unlikely that either person will want to change his or her recommendation in the middle of the board meeting: Board members might view such a change as troublesome evidence with respect to that person's abilities. The Nash equilibrium is for Tomoka to propose low leverage and for Simon to propose no new investment.[19]

[18] Tomoka anticipates that the new technology will increase the firm's value. As CFO she is evaluated based on the stock-price performance of the company. She favors low leverage because of its lower likelihood of bankruptcy. Simon, on the other hand, views the investment as more work for him, with little direct personal benefit. Also, the new investment will reduce his division's reported profits for a few years (there are initial start-up expenses, and it will take some time to build sales) and thus the size of his annual bonus. He expects to retire in 3 years and will not be with the firm when the division begins reporting higher profits.

[19] Simon knows that Tomoka will recommend low leverage regardless of what she expects him to do. (Holding Simon's recommendation fixed, she always receives a higher payoff by recommending low leverage.) Thus, Simon's optimal strategy is to recommend not to invest in the new technology.

Tomoka potentially can affect Simon's choice by *committing* to propose high leverage. Simon views high leverage as placing the firm in a financial *crisis.* If the company does not invest in the new technology, the firm will not generate sufficient cash flow to service the debt, the firm will go bankrupt, and both will lose their jobs. The new technology, on the other hand, is likely to generate enough cash flow to avoid this outcome. If Simon were convinced that Tomoka would recommend high leverage, he would propose investing in the new technology. She might effectively commit to high leverage by announcing to the financial press that she intends to make this recommendation. Simon will realize that Tomoka has "backed herself into a corner"; surely she would not alter her recommendation—it would ruin her reputation as a decisive CFO. To affect his choice, it is important that Tomoka's commitment is binding. If he is not convinced, he is more likely to recommend not to invest, expecting that she will recommend low leverage to the board. Simon also might be able to influence the outcome in his favor by being the first to commit to a specific recommendation—in this case, to reject the new technology.

Appendix Question

The analysis in this appendix suggests that a leader can sometimes motivate desired change by making a strong commitment to a particular action. Do you think it is always in the leader's interest to make this type of commitment? Explain.

Suggested Readings

J. Gardner (1990), *On Leadership* (Free Press: New York).

D. Kearns and D. Nadler (1992), *Prophets in the Dark* (Harper Business Press: New York).

D. Kreps (1990), "Corporate Culture and Economic Theory," in J. Alt and K. Shepsle (Eds.), *Perspectives on Positive Political Economy* (Cambridge University Press: Cambridge).

J. March (1994), *A Primer on Decision Making* (Free Press: New York).

J. Pfeffer (1992), *Managing with Power* (Harvard Business School: Boston).

Review Questions

20–1. What is leadership?

20–2. It is frequently claimed that meaningful change is difficult to achieve in large companies. Why do you think this might be the case?

20–3. What does leadership have to do with organizational architecture?

20–4. What is organizational power, and where does it come from?

20–5. The PPP Company recently purchased a large chain of supermarkets (over 1,000 stores). Following this acquisition, PPP's management announced its plan to cut labor costs dramatically so that the stores could remain competitive. Labor unions responded by saying that they would not agree to large wage cuts. After negotiating with a labor union for a short time, PPP announced that it was closing several of its most profitable stores because labor would not agree to wage cuts. On the surface, this seemed like a silly move, given that the stores were profitable. Why do you think PPP made this move?

20–6. The TRF Company has not fared well with recent increases in foreign competition. Management indicates that it must substantially cut costs to survive. Cost cutting entails dramatic change for the company. TRF had been an all-equity firm. Recently, the company borrowed nearly 90 percent of its value and used the money to repurchase shares. The required annual debt payments exceed the company's realized earnings over the past few years. What might have motivated management to make this dramatic increase in leverage, given that it placed the firm in a near "financial crisis"?

20–7. Alex Cohen is the general manager of the textile division in a large diversified company. Recently, Alex argued strongly to the CEO that an expansion request by the drug division be approved. On the surface, Alex's actions seem strange, given that Alex is not affected by this decision (it does not affect his budget or his compensation). Further, Alex spent substantial time developing his presentation for the CEO.

a. Why do you think Alex took such an active role in supporting the drug division's request?

b. Since Alex is not affected by the decision, should the CEO consider Alex as an unbiased observer who is focused on trying to maximize company value? Explain.

20–8. Poorly performing employees in Japanese firms are sometimes punished by being sent to remote locations or placed at desks away from their colleagues. Discuss the effects that such a penalty will have on the leadership effectiveness of the punished employees.