CHAPTER 1

Principle #1 – Values
Bind people to a common cause, not a central plan

> *People are social beings. They naturally collaborate with one another to learn, experiment, innovate, and optimize their value-added capacities. When companies trust employees, value their expertise, and give them greater flexibility to self-organize, they become energized. When they can also work toward shared goals and visions that affirm their values and beliefs, they become passionate.*[1]
>
> Joseph H. Bragdon *Profit for Life*

The value of values at Southwest Airlines

In the early 1970s Rollin King and Herb Kelleher got together and decided to start a different kind of airline. They began with one simple notion: if you get your passengers to their destinations when they want to get there, on time, at the lowest possible fares, and make sure they have a good time doing it, people will fly your airline. What began as a small Texas airline has grown to become one of the largest in the United States. Today, Southwest Airlines flies over 100 million passengers a year to 72 cities all across the country, and they do it more than 3200 times a day.[2]

Southwest's business model has been copied by all the low-cost airlines that have sprung up around the world over the past 20 years. It focuses on short-haul flights (average distance 653 miles) at convenient times through the day with gate turnaround speeds that continue to amaze competitors. It does not provide meals or in-flight movies and uses inner-city rather than major airports (where feasible). It aims to be easy to deal with as well as offering great value for money, and it meets these customer expectations most of the time. In an industry that has lost billions of dollars in recent years, Southwest has remained profitable. In fact, the performance record of Southwest Airlines is stunning. Not only has it been consistently profitable (a major challenge in the airline industry) and been the most cost efficient airline, but it is usually at the top of the independent customer satisfaction ratings in America. It is also one of the most admired airlines in the world and consistently one of the most admired companies and best "corporate citizens" in America.

A unique corporate culture

The key to Southwest's success is its unique corporate culture, and its architect is former CEO Herb Kelleher. Kelleher is a heroic figure in the American tradition. He fought and won against all the odds to get Southwest off the ground. Since then he has led the Southwest crusade and created and personified the Southwest culture. When asked how he kept this entrepreneurial spirit going, Kelleher replied: "I always felt that our people came first. Some of the business schools regarded that as a conundrum. They would say: Which comes first, your people, your customers, or your shareholders? And I would say, it's not a conundrum. Your people come first, and if you treat them right, they'll treat the customers right, and the customers will come back, and that'll make the shareholders happy. There's no difficulty in visualizing that. We've always tried to be sensitive to the needs of our people and recognize the things that are important to them in their personal lives. At Southwest Airlines, you can't have a baby without being recognized … You can't have a death in your family without hearing from us. If you're out with a serious illness, we're in touch with you once every two weeks to see how you're doing. We have people who have been retired for 10 years, and we keep in touch with them. We want them to know that we value them as individuals, not just as workers. So that's part of the esprit de corps."[3]

After around 30 years at the helm, Herb Kelleher decided to take a back seat (since 2008 he has been Chairman Emeritus). In 2004, former CFO and a Southwest employee for over 20 years Gary Kelly was appointed as CEO (he is also now President and Chairman) and Laura Wright stepped up to become CFO. Between them, they have steered Southwest through some of the stormiest waters the organization has faced in its history. Like Kelleher, Kelly believes in the integrity of people. How the Sarbanes-Oxley Act has been interpreted by some companies is typical of his thinking. "One of my pet peeves," notes Kelly, "is that it is rules-based. Rules create loopholes, and human nature is to exploit those. Ultimately it is all about integrity. You can't legislate integrity. You can't force human behavior."[4]

"Our company has a soul"

Kelly has also inherited Kelleher's passion and pride in the business. "Our company has a soul," said Kelly in a recent interview. "We have a mission that people believe in. We really believe we are giving Americans the freedom to fly. It's a cause and it allows for a sense of pride in our individual employees to be associated with Southwest Airlines. Sports are an overdone analogy, but I'm a University of Texas Longhorn alumni and I couldn't be more proud to be that and to have our team go to the national championship. And that's the way Southwest Airlines employees feel about Southwest … I was talking to my brother last night. He doesn't work for Southwest but people, when they learn that his brother does, they say, 'Hey, that is the greatest company. You know, they're such a strong brand and a wonderful company to work for.' So there is an emotional attachment by our people and it's hard to put your finger on exactly what that is. But more than anything, Herb Kelleher cares about that. I care about it and it is real. And I do think that sets us apart. We have, year in/year out, the strongest brand rankings of most airlines and that's without offering some of the perceived amenities like first class and some of the other frills – just real people working hard to deliver a high-quality product in a very friendly and caring way."[5]

Leaders at Southwest are the cheerleaders of ambition and improvement. They continuously urge their people to think the unthinkable and look for improvements where they do not seem possible at first sight. "Being the best" sums it up. As Gary Kelly said in the March 2008 edition of LUV Lines (the company's internal magazine), "I am most grateful for our unsurpassed culture, a strong culture of love, care, responsibility, accountability and respect. Our culture also is about being the best: the best place to work; the best operations; and the best customer service."

Since its inception, Southwest has religiously stuck to a clearly defined purpose: to make a profit, achieve job security for every employee, and make flying affordable for more people. In 2007 Gary Kelly restated the company's purpose in this way:

- Be the safest and most reliable airline in the world
- Be the best place to work, with the best team of people
- Offer customers the greatest air travel value by combining the lowest fares, as enabled by the lowest cost and highest productivity, with the preferred customer service experience
- Be the preferred carrier in the markets we serve in terms of schedule, seat capacity, and customers
- Provide financial and job security for our employees, and excellent financial returns to our shareholders.

Hiring and developing the right people

But most employees are cynical about words on "mission" statements. What does "provide financial and job security for our employees" mean when employees become victims of reorganizations and downsizing as soon as the hard times come around? When Hurricane Katrina devastated New Orleans – Southwest Airline's largest hub – the company's service to the city dramatically dropped from 57 flights a day to just two. But while the City of New Orleans was forced to lay off workers, Southwest was able to offer the option of relocation to all of its 250 New Orleans employees. "This proves we are living up to trust," said Gary Kelly. "You have to have great employees, and you can't do that without trust. Trust isn't about jet engines or airports; it's about people and building relationships with them."[6]

In 2007, Southwest employees received 43,386 customer commendations and 18,140 internal commendations (a 19.5 percent increase over the previous year) for their Positively Outrageous Service (and the ratio of commendations to complaints was 4.6 to 1). Customer service is indeed a way of life at Southwest. "Looking forward," notes President Emeritus Colleen Barrett in a message to employees, "we face some even more difficult challenges, and while we can't control the price of fuel, we can control the way we treat our customers. I ask you to remember that, in this world of instant communications, each of us is constantly on stage, and every customer is a potential reporter. Let's give them something positive to report!"

The key to Southwest's responsibility culture is that it hires the right people – those that have the right attitude. As Kelleher has said, "If you don't have a good attitude, we don't want you, no matter how skilled you are. We can change skill level through training. We can't change attitude."[7]

Communication is a core competence at Southwest. Whether it's in a memo, LUV Lines, other newsletters (from each division such as Ground Operations), a training program, an ad campaign or an awards ceremony, there are multiple ways that guiding principles and other key messages are spread around the organization. Over the years, these have been internalized by employees so they know instinctively what represents good judgment and what makes common sense.

A simple structure for success

Both Kelleher and Kelly recognized that Southwest's strengths lie in its simple structures and systems (for example, no matrix management, few acquisitions and lack of complex budgeting and reporting systems) and always listening to its people. The management focus has always been on improving processes and encouraging the right behavior rather than following the plan and managing budgets. Clarity, simplicity, transparency and trust are the key words that describe Southwest's management approach.

With no more than four layers between a front-line supervisor and the CEO, Southwest is indeed a flat organization largely devoid of micro-management. But it has maintained layers of supervisors that many other ("downsized") organizations have dispensed with. These supervisors often help younger employees grow up. It supports the family atmosphere. There is roughly a ten-to-one employee-to-supervisor ratio.

Local decision-making

One of the reasons why managers are so dedicated to the company is that Southwest has treated them with dignity and respect, even when they've made big mistakes. Senior executives can't of course anticipate all of the situations that will arise at the stations across the organization. But the message is clear. Kelleher put it this way: "Hey, we can't anticipate all these things, you handle them the best way possible. You make a judgment and use your discretion; we trust you'll do the right thing. If we think you've done something erroneous, we'll let you know – without criticism, without backbiting."[8]

While people are trusted to do their jobs to the best of their ability, leaders also know that trust is fragile and reciprocal. How Southwest reacted in the immediate aftermath of 9/11 is a classic Southwest story of maintaining trust with employees. After 9/11, when the federal government shut down the airlines for three days and uncertainty about the future of the industry loomed heavy, Gary Kelly noted that "we were the only airline not to announce layoffs that week and not to use our employees as pawns. We could have downsized and taken that opportunity to wring more profits out or get more costs out of our system. We also didn't go back to our employees and demand pay cuts or cut their benefits or take their retirement plans … When it is all said and done, for me that is that kind of thing I will be most proud of."[9]

While front-line people at Southwest have the scope and authority to make decisions, they are also accountable for the outcomes. It doesn't take five or seven signatures to get things done. Station managers have huge operational responsibilities. Each station (the team that runs operations at each airport) functions like an independent business unit, and managers are responsible for setting the tone of the station and ensuring that Southwest's culture is protected and promoted. Crucially, however, there is a "no blame" culture. There are many stories about managers taking an initiative that cost the company money – in some cases, hundreds of thousands of dollars – only to be told, "You made a decision; it turned out to be the wrong one; but tomorrow is another day. Let's learn from it and push on."

With such a trusting and transparent culture, a financial analyst once asked Kelleher if he was afraid of losing control. Kelleher's reply took the analyst by surprise. He told him that "I've never had control and I never wanted it. If you create an environment where the people truly participate, you don't need control. They know what needs to be done, and they do it. And the more that people will devote themselves to your cause on a voluntary basis, a willing basis, the fewer hierarchies and control mechanisms you need. We're not looking for blind obedience. We're looking for people who on their own initiative want to be doing what they're doing because they consider it to be a worthy objective. I have always believed that the best leader is the best server. And if you're a servant, by definition you're not controlling."[10]

Southwest is one of those rare and special organizations that lives up to its hype. Its management processes enable it to adapt to constantly changing markets and other unpredictable events. There are no fixed performance contracts to drive people toward meeting outdated plans and numbers, to stifle innovation, and to focus on achieving revenue and cost targets at the expense of customer service.

For such a large organization, Southwest is about as simple and straightforward as you can get. There is only one company (no subsidiaries), one market, a strategy that is simple to understand, one interdependent team whose members all get rewarded for success, one set of principles and values that never changes, and only a few measures of success, which everyone understands.

What lessons should we learn from Southwest?

What the Southwest story tells us is that even in the US, where the cult of shareholder value has been at its strongest, a large organization can consistently beat its peers by putting values and ethics before short-term profits and placing its people before customers and shareholders. In other words, values matter, and they can be a source of long-term competitive advantage.

Be open and honest, and trust your people

While most organizations have mission statements that give the impression they are as committed as Southwest to serving their people and their customers, that's where the similarity ends. Their management models, styles and actions follow a different agenda. From the employee perspective, power remains firmly at the corporate center and their actions are strictly governed by detailed rules, targets, budgets, inspections and performance appraisals. "Trust" and "transparency" are empty words as leaders are less than truthful not only with their employees but also with customers, investors and other stakeholders.

Make customer service a way of life

You only have to look at most of the other airlines around the world. Most are trapped inside "command and control" management models. So when hard times come around (as they frequently do in the airline industry) they resort to downsizing, layoffs and mergers and acquisitions. While the Internet has made it easier for customers to book flights, it has also enabled airlines to cut customer service. To change or cancel a flight or obtain a refund is usually a nightmare. Call-center agents have no discretion to make decisions. Leaders of most airlines are constantly under pressure to deliver short-term profits to long-suffering shareholders. British Airways used to have a reputation for excellent customer service. But now its leaders are constantly locking horns with their pilots, cabin crews and baggage handlers and negotiating lower-cost deals with sub-contractors for catering and cleaning.

Involve your people in key changes

No doubt their leaders would say, "What choice do we have? High legacy costs from the days before low-cost competition mean that we need to downsize and cut costs across the board." The reality is that they have the wrong management model.

What would Herb Kelleher do? He would probably say to his employees that "we are all in this together." He would lay great emphasis on the company's purpose and tell his people that they come before customers and shareholders. He would revisit the company's mission statement and tell everyone that the company will now be managed according to an inviolate set of values including trust, transparency, integrity, respect, fun, and even love and care.

But he would not duck the cost problem. He would likely say that "our costs are 40 percent too high and this is why." He would immediately open up the information system to all employees. He would probably start by cutting top management salaries and bonuses and say that from here on there will only be one group-wide profit share that will only pay out if the company performs well against its peers. He would say that "we are also slashing bureaucracy and back office costs and diverting a higher proportion of resources to front-line teams – pilots, cabin crews and ground crews." He would give each team far greater scope and authority to make decisions and tell them that no longer will they need five signatures to get resources or improvement projects approved. In other words, he would bring the whole company together, share its problems and invite ideas for improvement.

Build a culture based on transparency and trust

But this is fiction. While most leaders have responded by cutting budgets and tightening the coils of central control, the evidence suggests that attending to the organization's culture may be a better approach. As we learned from the Southwest story, when leaders build a culture based on transparency and trust people are inspired, become passionate about it, want to live up to it and demand it from others. It involves a deep feeling of satisfaction and even joy. We will hear about many other organizations in this book that have operated with such a management model for decades and have built robust and enduring companies that consistently beat their peers on just about any metric you care to name. They have also built enviable reputations for being great places to work for, buy from and invest in. The public sector is also catching on. A number of US state governors are now placing contracts, minutes of meetings and detailed financial statements on their websites and placing transparency at the core of their management models. Not only does this build trust with taxpayers, who can now readily see how their taxes are being spent, but it also acts as a deterrent against unethical behavior, corruption and fraud.[11]

The success of an adaptive organization depends on front-line teams having the confidence to respond rapidly to unpredictable events without approval from senior people. That's why clarity of purpose and values are so important. Principle #1 represents the foundation stone of the adaptive organization. It takes leaders down a path of "cultural" governance based on purpose and values rather than "compliance" governance based on rules and regulations.

Implementation guidelines

- Agree a noble purpose above and beyond shareholder value.
- Establish clear and inviolate values based on truth, transparency and trust.
- Use a written constitution if this helps to clarify the issues.
- Communicate values at every opportunity.
- Include "values" in the performance evaluation system.
- Place ethics before profit.
- Promote a culture of love and care.

Agree a noble purpose beyond shareholder value

Great leaders believe passionately in the organization's purpose or "reason for being," but this is a far cry from the classic economic model in which the overarching objective of the firm is to maximize shareholder's wealth. Most of their managerial actions (both short-term and long-term) are made with this in mind. This is a model in which individuals are assumed to be self-interested, rational decision-makers driven by economic goals, and economic relationships (with employees, suppliers, customers and external partners) are governed by binding contracts. But above all, it is a mechanistic model subject to mathematical formulae where costs, volumes and profits can be optimized according to market conditions. People lower down the organization don't need to understand its purpose – they simply do what is specified in their job description.

In the second half of the 20th century it has been the "mission statement" that has been increasingly used to define purpose and values. But such statements are often too bland to convey deep meaning and end up being ignored by employees. Jeffrey Abrahams reviewed 301 corporate mission statements from America's top companies and noted that the words most frequently used were: service (230 times); customers (211); quality (194); value (183); employees (157); growth (118); environment (117); profit (114); shareholders (114); leader (104); best (102).[12] Author Stephan Haeckel invites us to consider this hypothetical mission statement: "We will strive to provide the highest return to shareholders and offer the highest quality products and services, while achieving the highest customer loyalty and the highest employee satisfaction." As Haeckel notes, this company intends to be all things to all people, and its statement offers no clues to employees about ordering priorities. When the need to compromise and make choices arises, as it inevitably will, the statement will give employees no clear basis for making decisions and no help in determining how to make the necessary trade-offs.[13]

Pursuing the wrong goal

Moving away from the organization's purpose can have serious consequences. When UK chemicals company ICI – Imperial Chemical Industries as it was known in its more illustrious days – saw its job as practicing the "responsible application of chemistry," it became phenomenally successful. Later, under pressure from fractious investors, it declared its mission to be: "the industry leader in creating value for customers and shareholders through market leadership, technological edge and a world competitive cost base." It then proceeded to go on a disastrous buying spree, which culminated in ICI falling into the hands of the Dutch firm Akzo Nobel a few years ago.[14]

When Citicorp merged with Travelers in 1999 to create the sprawling bank conglomerate Citigroup, the joint CEOs held a press conference. John Reed, Citicorp's CEO, declared: "The model I have is of a global consumer company that really helps the middle class with something they haven't been served well by historically. That's my vision. That's my dream." His joint CEO, Travelers' Sandy Weill, rapidly interjected and stated that, "My goal is increasing shareholder value." Reed, with his old-fashioned, oblique way of running a business, was sidelined.

Just a few years later, Citigroup was in trouble and Weill was forced out. Within a decade, Citigroup was forced into the arms of the US government.[15]

What these stories tell us is that by pandering to rapacious shareholders, firms are not just trying to come up with the results too quickly – they're actually pursuing the wrong goal. It's not just about numbers and targets and synergies – it's about great products, happy customers and loyal staff. As economist John Kay says, no one will be buried with the epitaph "He maximized shareholder value."[16]

Despite what they might say, few people are able to fully commit themselves to a mission statement, plan or even their job. To engage people in the process of stretching performance and taking risks has to involve something more than "doing their job." It must involve their emotional commitment. Management guru Henry Mintzberg explains why plans do not, by themselves, build commitment: "The problem is that planning represents a *calculating* style of management, not a *commitment* style. Managers with a committing style engage people in a journey. They lead in such a way that everyone on the journey helps shape its course. As a result, enthusiasm inevitably builds along the way. Those with a calculating style fix on a destination and calculate what the group must do to get there, with no concern for the members' preferences."[17]

A purpose that "grabs" people

An organization's purpose should be expressed in terms that "grab" people. It should make them proud to tell their family and friends who they work for and what the organization produces. These "soft" or emotional bonds make all the difference between people giving 40–50 percent or 80–90 percent of their effort and creativity.

Take Whole Foods Market, whose CEO John Mackey regularly speaks at college campuses across the US trying to persuade young people that business, profits and capitalism aren't forces of evil. He calls his concept "conscious capitalism." "Whole Foods has a deeper purpose," he says. "Most of the companies I most admire in the world I think have a deeper purpose." He continues, "I've met a lot of successful entrepreneurs. They all started their businesses not to maximize shareholder value or money but because they were pursuing a dream. It's not that there's anything wrong with making money," notes Mackey, "it's one of the important things that business contributes to society. But it's not the sole reason that businesses exist. Just like every other profession, business serves society. They produce goods and services that make people's lives better. Doctors heal the sick. Teachers educate people. Architects design buildings. Lawyers promote justice. Whole Foods puts food on people's tables and we improve people's health. And we provide jobs. And we provide capital through profits that spur improvements in the world. And we're good citizens in our communities, and we take our citizenship very seriously at Whole Foods."[18]

Like Mackey at Whole Foods, the founders of UK optical retailer Specsavers also believe in "conscious capitalism." Founders Doug and Mary Perkins had a goal of providing "affordable fashionable eye care for all." They never saw making money as their primary objective; they established the business to make it possible for everyone in the UK to have easy access to quality eye care. They deliberately built their business model in such a way that their business partners – the store owners – took the lion's share of the profits. Now Specsavers has 1400 stores in 10 countries and they have never closed a store.[19]

Performance: more than the bottom line

The problem that many leaders have is that investors want to talk about the bottom line. But what if we lived in a world where companies didn't measure their performance only in terms of revenue and profitability? What if pharmaceutical companies reported on their bottom lines, along with the familiar figures, the number of lives saved by their drugs every quarter, and food companies reported the number of children rescued from malnutrition? What if companies issued separate stock based on social returns, and people could buy the shares of those that saved more lives than others, or sell the shares of energy companies that polluted more than their competitors? What if, by raising "social capital" and investing it in sustainable businesses without a profit motive, companies could reach into new markets, expanding their core businesses at the same time they improved lives? That's the world that Muhammad Yunus, the winner of the 2006 Nobel Peace Prize, envisions.[20] Maybe this is a glimpse into the future of corporate accountability and measurement.

There is evidence to suggest that when the CEO makes it a priority to balance the concerns of customers, employees and the community while also taking environmental impact into account, employees perceive him or her as visionary and participatory. They report being more willing to exert extra effort, and corporate results improve. This finding is based on recent survey data gathered from 520 business organizations in 17 countries, many of them emerging markets.[21]

Establish clear and inviolate values

When global banking group HSBC decided to charge UK students a monthly fee for "free" overdrafts, there was a rebellion orchestrated by the National Union of Students who created a "protest site" on Facebook. When over 5000 students joined the protest within days, HSBC was forced to retract the action it had taken. With the meteoric rise of the blogging and Facebook generation, someone, somewhere can see a problem and tell the whole world in an instant. The punishment now meted out to offenders ranges from being "named and shamed" as an unethical company to jail sentences of up to 25 years for people who commit outright fraud. The result is always bad and sometimes catastrophic.

As this story tells us, it is increasingly costly and difficult for leaders to take decisions that are not supported by other stakeholders. That's why establishing a set of values that will govern how an organization is managed and what it regards as inviolate is a critical step in rethinking the management model. The best organizations have only a few core values. These rarely, if ever, change. They use values to send clear messages to all employees that unethical behavior and poor standards will not be tolerated. "By putting our values first, business success will follow. Without these values, there is no success at all," said Paul O'Neill, Chairman and CEO of US aluminum company Alcoa.[22]

There is little doubt that establishing a set of values that govern how an organization is managed and what it regards as inviolate is a critical step in recruiting the right people and tightening up governance standards. In 2003 researchers from the Stanford Business School and the University of California published a survey of more than 800 people with MBA degrees from 11 leading North American and European business schools. Ninety-seven percent of respondents said they would take a 14 percent pay cut to work for an "ethical" company – a contradiction of the traditional culture's supposition that money is what ultimately counts. Intellectual challenge topped the list as the most important attribute for MBAs in accepting a job. The financial package was only 80 percent as important as intellectual challenge.[23]

Core values at Handelsbanken

At Swedish bank Handelsbanken all new employees learn its seven core values:

- *Profits come from customers, not products.* There is no emphasis on marketing and/or selling products. The emphasis is finding and keeping satisfied, profitable customers. Branches "own" customers whatever their size. The selection of the right customers determines the productivity and profitability of the branch. One of the key factors in maintaining low costs is the selection of the right customers.

- *Managers have responsibility with accountability*. Managers have no excuses. The branch is responsible for its profitability and has the power to change what needs to be changed. Managers know if they are performing well or not so well.
- *People are honest and open.* There is no scope for sweet-talking away bad results. The figures speak, and speak clearly for themselves.
- *Stick to the knitting*. Many banks aim to become financial supermarkets. At Handelsbanken the aim is to develop supreme banking professionals offering good sound up-to-date advice to their customers.
- *Identify and eliminate unnecessary costs.* While the bank maintains some of the traditions associated with the sector (such as private dining rooms), it is anything but ostentatious. Modest living and value-for-money pervade the bank and promote a favorable image to customers. The sense of cost consciousness is apparent everywhere.
- *Promote from within.* The bank develops its own leaders. It takes a long time to become a good banker and understand the corporate culture in all its facets. Handelsbanken aims to recruit the right people and keep them forever.
- *Don't copy others.* In a fast-changing marketplace there is a temptation to copy what others are doing – a process of cross-pollination often promoted by the consulting community. Handelsbanken is not afraid to be different. In fact, it sees being different as a major virtue.

These values were a key element in the company's decision not to engage in the so-called "casino banking" that enabled many other banks to generate huge (but, as it turned out, illusory) profits and led up to the 2008 crash. The view of Handelsbanken's leaders was that these activities did not fit with the company's values or provide any benefit to its customers.

But no matter how many words are written in codes of practice, value statements and strategic plans, it is how people are recognized and rewarded and how an organization spends its money that tell you most about its culture. If it rewards and promotes managers who will do anything to meet their numbers (as at Enron), then getting people to work together in teams will be hard to achieve. If it spends money on limousines, lavish head offices and executive perks (as at WorldCom), then asking people to increase their effort will likely fall on deaf ears. Operating teams across the organization need standards and guidelines within which they can operate and make decisions that are consistent and coherent with the company's strategy and direction. In command and control organizations this is done through the annual plan and budget. But in adaptive organizations it is clarity of purpose, strong values and sound judgment that enable leaders to strike a fair balance between freedom and control.

Use a written constitution if this helps to clarify the issues

Following on from a clear purpose and inviolate values, there usually needs to be some form of written constitution that sets out the company's operating principles. These principles govern relationships, behavior and the interaction between managers at different organizational levels. Shared values are not only important: the success of an adaptive organization depends on them. These are the universal principles of fairness, justice, honesty, integrity and trust. Haeckel lists the following guidelines for building clear, robust principles:

- They should establish boundaries for permissible behavior, governing (not dictating) decisions, activities and accountabilities
- They must be unambiguous and can therefore be formulated in statements beginning with "we will never" or "we will always."
- They are usually qualitative rather than quantitative
- They apply to all groups and units under the authority of the issuing agent
- They lend themselves to objective tests for compliance
- They are likely to endure for at least a few years
- They are devised (rather than just approved) by policy-making executives
- Violating them results in serious system consequences.[24]

A written constitution at John Lewis Partnership

In 2010 the John Lewis Partnership, one of the UK's most respected and successful retailers, employed 72,000 people and had revenues of £7.4bn. Though John Lewis is a partnership owned by its partners/employees, it is totally open with financial information. You can even see its current weekly sales figures on its website. The partnership has a strong employee-centric culture. It also has a written constitution. The foreword to this constitution (last updated in July 2009) is revealing:

"Not many companies have a written constitution. Ours does, for two reasons. The first is historical. The Partnership exists today because of the extraordinary vision and ideals of its Founder, John Spedan Lewis. He believed an "industrial democracy" where employees shared knowledge, power and profit was a better form of business. That vision was set out in a written Constitution – a framework to define the Partnership's principles and the way it should operate. The Constitution has been revised on a number of occasions since then, in order to keep it fresh and up to date. Nonetheless, this latest edition is a direct connection to his original inspiration – it defines what we are. The second looks forward. The challenge for Partners today is to prove that a business which is not driven by the demands of outside shareholders and which sets high standards of behavior can flourish in the competitive conditions facing a modern retailing business. The Constitution provides the Principles and Rules within which we aim to demonstrate, through Partners, customers and profit, that we are a better form of business.

This Constitution identifies that the "happiness of all its members" relies on their "worthwhile and satisfying employment in a successful business." To achieve this we aim to give all Partners a relevant, consistent and rewarding experience during their career. This experience is based on the Partnership and Partners themselves delivering three commitments: taking responsibility for our business success, building relationships Powered by our Principles and creating real influence over our working lives. These commitments place on us all the obligation to improve our business in the knowledge that we share the rewards of success.

The Constitution also addresses the role of the Partnership in society, defining our responsibilities to customers, suppliers and to the environment. The Partnership must change constantly to fulfill its ultimate purpose. The Constitution ensures these changes remain true to our principles and will allow us to pass on to our successors a business they too will be proud to work in."[25]

To illustrate the scope of the constitution we have set out its contents page below:

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Communicate values at every opportunity

It is not sufficient just to agree and write about values. They must also be communicated in every possible way. Whole Foods CEO John Mackey explains what this means: "It doesn't matter if an organization has a higher purpose if the leadership doesn't understand it and seek to serve it. The various stakeholders of an organization, especially employees and customers, look to the leadership to 'walk the talk' – to serve the purpose and mission of the organization and to lead by example. It is especially important that the CEO and other senior leadership embody the higher purpose of the organization."

"As the co-founder and CEO of Whole Foods Market, I'm the most visible person in the company. One of the most important parts of my job is touring our stores and talking to our team members, customers and suppliers. I know that in virtually everything that I say and do, our team members are always studying me, trying to determine whether they can trust me and the mission of the company. I'm always on stage. So walking the talk is very important. I try to communicate the mission and values of Whole Foods Market at every opportunity and I try to live those core values myself with complete fidelity. Fidelity to the mission and values builds trust, while any deviation from these ideals undermines trust. High-trust organizations and hypocritical leadership are mutually exclusive."[26]

Employee health and safety constitute a vitally important indicator of caring, particularly in manufacturing where there is often exposure to injury and harmful substances. When Paul O'Neill became CEO of Alcoa in 1987 he decided to make this issue the company's highest priority – one that would be addressed in top-level meetings even ahead of profit. So embedded has this objective become that today Alcoa reports its lost workday accident rate to all employees and stakeholders in real time. The rate hovers near 0.2 – significantly better than the national average for all manufacturers of 2.2.[27] In more recent times, Alcoa has gone even further. "We have to go beyond zero injuries," noted William J. O'Rourke in the Environment, Health & Safety Audit Report 2002. "We have to send employees home healthier than they came to work. We do that through wellness and fitness programs that give them physical, emotional and work-life support."[28]

Nucor Steel serves employees by giving them a sense of empowerment over their work lives, creating a team environment in which people freely exchange ideas and coaching, and maintaining an open-door policy to division leaders. At Nucor steel mills there are no employee time clocks – there is only a work ethic that arises from within each individual team as it strives to surpass its production goals. Employees write their own job descriptions and are given wide latitude to self-organize around tasks as they see fit. The presumption behind this system is that plant workers closest to the action care about collective welfare of their teams, are intelligent and can therefore be trusted to do the right thing. What makes the system work is a culture of accountability. People understand that their teams and divisions will stand or fall on their own merits. In the words of former CEO Ken Iverson, "There's no cavalry waiting to ride to the rescue … There's just you and the people working with you."[29]

Include values in performance evaluation

Replacing old values with new ones, no matter how well crafted and prepared, will have little effect unless leaders champion and constantly reinforce them.

The litmus test of any set of values is that senior executives promote those that live the values and discipline those that don't. Jack Welch did this in spectacular fashion at GE when he dismissed managers who made their financial targets but failed to live up to GE's values. He surprised his audience when, at one celebratory meeting of senior managers, he said, "Look around you: there are five fewer officers here than there were last year. One was fired for the numbers, four were fired for [lack of] values."[30] Former Handelsbanken CEO Arne Mårtensson was asked was what his role in the devolved organization. He replied, "To constantly talk to our people and reinforce our principles and values. There is a constant need to resist the forces of centralization."

Norwegian oil and gas company Statoil made it clear that abiding by its values would form a key element of the performance appraisal process. As Beyond Budgeting project leader Bjarte Bogsnes explains, "These are the beliefs that guide the company's operations and the foundation on which it is building its future. The key to effective devolution is crystal-clear values and principles. The new management style can only operate effectively if there is high trust (and open information), but if this trust is breached, then the sanctions are clear – people will not survive. We are ruthless on policy violations that usually lead to dismissal. We have a simple 'ethics test' so that people know whether or not their action is acceptable. They just need to ask the following question: Is it acceptable if the results of their actions appear on the front page of the newspaper? If yes, go ahead. If no, don't do it."

To support these changes, Statoil changed its performance appraisal system. Whereas previously managers were assessed on how well they met their financial targets, now 50 percent of the bonus is based on meeting a range of key performance indicators and 50 percent on meeting the company's values using a peer review process.

Place ethics before profit

For years, Dell's seemingly magical power to squeeze efficiencies out of its supply chain and drive down costs made it a darling of the financial markets. Now it appears that the magic was at least partly the result of a huge financial illusion. In July 2010 Dell agreed to pay a $100m penalty to settle allegations by America's Securities and Exchange Commission (SEC) that, in the SEC's words, the company had "manipulated its accounting over an extended period to project financial results that the company wished it had achieved."

According to the commission, Dell would have missed analysts' earnings expectations in every quarter between 2002 and 2006 were it not for accounting shenanigans. This involved a deal with Intel, a big microchip-maker, under which Dell agreed to use Intel's central processing unit chips exclusively in its computers in return for a series of undisclosed payments, locking out Advanced Micro Devices, a big rival. The SEC's complaint said Dell had maintained "cookie-jar reserves" using Intel's money that it could dip into to cover any shortfalls in its operating results.

The SEC says that the company should have disclosed to investors that it was drawing on these reserves, but did not. And it claims that, at their peak, the exclusivity payments from Intel represented 76 percent of Dell's quarterly operating income, which is a breathtaking figure. Small wonder, then, that Dell found itself in a pickle when its quarterly earnings fell sharply in 2007 after it ended the arrangement with Intel. The SEC alleges that Dell attributed the drop to an aggressive product-pricing strategy and higher than expected component prices, when the real reason was that the payments from Intel had dried up.[31]

Ethical reporting was also far from the minds of Lehman executives as they struggled to maintain credibility in the market in the years leading up to the company's demise in 2008. From 2001 onwards the company resorted to a piece of accounting trickery known as "repo 105" ("repo" is short for repurchase). This enabled leaders to book short-term loans from other banks as "sales," temporarily removing about $50 billion of assets from its balance sheet (usually at the end of each quarter), helping to make it look better than it really was. What is so strange about this affair is that it was only the UK arm of Lehman that had permission (via its lawyers and thus its auditors) to carry it out: its US lawyers and auditors ruled against it. As the following email (later discovered by examiners) showed, Lehman executives knew this was unethical:

> *"It's basically window-dressing."*
>
> *"I see … so it's legally do-able but doesn't look good when we actually do it? Does the rest of the street do it? Also, is that why we have so much BS [balance sheet] to Rates in Europe?"*
>
> *"Yes, no and yes."*[32]

It is hardly surprising that few investors have much confidence in the numbers that most public companies produce. Nor are these problems confined to external reporting. "Gaming" and unethical reporting are pervasive within many organizations today. Selling products on sale-or-return; shifting funds between accounts to avoid budget overruns; showing normal expenditure as an "exceptional" (non-recurring) cost; and using contract labor to avoid exceeding headcount limits are just a few of the popular "games" played by managers at every level of the organization.

Many accountants see the "sexing up" of accounts as a perfectly legitimate practice (provided they stay within some defensible interpretation of generally accepted accounting principles). Indeed, it is one of their most prized skills. As most experienced accountants are aware, you can make profit statements and balance sheets sing and dance to different tunes at different times depending on your purposes. The effects of fudging, manipulating and spinning the numbers, like an addictive drug, can give managers a temporary fix – they can even be convinced that they change reality – but the problems quickly return as the next reporting period comes around.

Aggressive performance contracts reinforced by financial incentives are probably the number-one cause of over-zealous risk-taking and unethical financial reporting in organizations today. One accounting professor described the Fannie Mae debacle as "the kind of thing that shakes your confidence in financial statements."[33] The lesson is that setting unrealistic earnings targets and then resorting to every conceivable means (whether fair or foul) to meet them is likely to end badly, as it has done for thousands of shareholders and employees in companies that have been destroyed by these actions.

Promote a culture of love and care

Of course "love and care" are not the first qualities you associate with large commercial organizations. In fact, many organizations would be described in diametrically opposite terms. But as organizations make the transition from cold and efficient "command and control" organizations to ones built on "empower and adapt," love and care are exactly the qualities that need to come to the fore. Both words appear on Southwest Airlines' list of values. Whole Foods CEO John Mackey is passionate about these qualities. This is what he said in a recent essay on *Creating the High Trust Organization:*

"Ultimately we cannot create high trust organizations without creating cultures based on love and care. The people we usually trust the most are the people that we also believe genuinely love and care for us. All too often, love and care are not qualities that we associate with organizations. We tend to look for love and friendship with our families and friends, but not from our work. Why is this? Many people believe that love and care in the organizational setting interfere with efficiency and get in the way of making the 'tough but necessary' decisions that the organization requires for success. This type of thinking reflects our own lack of integration of love and care in our own lives. We have created an artificial barrier that is holding back our own personal growth and the full potential of our organizations."

He goes on: "Fear is the opposite of love. When fear predominates in the organization, love and care cannot flourish. The opposite is also true – love and care banish fear." Mackey provides some suggestions that will hopefully stimulate further thinking on this incredibly important goal of creating more love and care in our organizations:

- The leadership must embody genuine love and care. This cannot be faked. If the leadership doesn't express love and care in their actions, then love and care will not flourish in the organization. As Gandhi said: "We must be the change that we wish to see in the world."
- We must "give permission" for love and care to be expressed in the organization. Many organizations are afraid of love and care and force them to remain hidden. Love and care will flow naturally when we give them permission and encourage them.
- We should consider the virtues of love and care in all of our leadership promotion decisions. We shouldn't just promote the most competent, but also the most loving and caring leaders. Our organizations need both and we should promote leaders who embody both.
- We must cultivate forgiveness rather than judgment and condemnation. Too many organizations believe that judgment of others and criticizing failures are essential for creating excellence. While striving for excellence is important for all organizations, this can be done at a higher level of consciousness – without condemnation. Forgiveness doesn't mean condoning mistakes and failures. It simply means that we help the other person to learn from their mistakes through non-judgmental feedback and encouragement.
- Consider ending all your organizational meetings with "appreciations." This is something that Whole Foods Market has been doing for 25 years with wonderful results for spreading love and care. Give everyone participating in the meeting the opportunity to voluntarily appreciate and thank other members in the group for services they have contributed or qualities that are admired.

This one simple cultural practice of appreciating our fellow Team Members moves us out of judgment and fear into the consciousness of love."[34]

Conclusions

Some of the strongest words to be heard at the World Economic Forum's annual meeting in Davos, Switzerland, in January 2010 came at the start of the global event when French president Nicolas Sarkozy called for a fundamental rethink of capitalism in the aftermath of the financial crisis. "We need deep, profound change," he said in his keynote speech, adding that he wished to see a "moral dimension" restored to free trade. "Were we not to change, we would be showing tremendous irresponsibility," he stated. It was a powerful opening to the meeting, in tune with its theme: "Improve the State of the World: Rethink, Redesign, Rebuild."[35]

The primary work of leaders is to release the energy and unleash the knowledge that often lies fallow within their people. This demands a governance framework that strikes the right balance between central compliance and control and local enterprise and freedom. Few organizations have achieved this balance. There is much more work to be done.

KEY POINTS

- Frame the organization's purpose in teams of social or community benefits that provide real meaning to employees and other stakeholders. Explain to people that consistent profitability (better than peers') is essential to grow and sustain the business, but this is not the purpose of the organization. Once agreed, communicate the purpose on all the company's printed materials and websites.
- The best organizations have only a few core values. These rarely, if ever, change. Use values to send clear messages to all employees that unethical behavior and poor standards will not be tolerated.
- Consider a written constitution. Frame the company's values in terms of "always" and "never." Make it clear that abusing values has serious consequences. Agree clear operating boundaries within which teams can operate autonomously (e.g. territories, markets, channels).
- It is not sufficient just to agree and write about values. They must also be communicated in every possible way. It doesn't matter if an organization has a noble purpose if leaders ignore it and fail to serve it. Leaders need to "walk the talk" of purpose and values and constantly reinforce the message at every opportunity.
- Consider including values in the performance evaluation system (for example, in peer reviews). This is particularly appropriate in the transitional phase of implementing the new model.
- Place ethics and reputation before profit. Actions that (sometimes unwittingly) damage a company's reputation can undo years of work patiently building governance and control systems and leave a trail of devastation that can last for many years. The reality is that the (temporary) rewards are never worth the risks. Educate everyone that a company's "license to operate" must be protected at all costs. Anyone breaking this rule should face dismissal.
- Promote a culture of love and care. Of course love and care are not the first qualities you associate with large organizations. In fact, many organizations would be described in diametrically opposite terms. But as organizations make the transition from "command and control" to "empower and adapt," love and care are exactly the qualities that rise in importance.