



# The Institutional Logic of Great Global Firms

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# The Institutional Logic of Great Global Firms

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A classic joke features a scientist pondering an observed phenomenon that he would not have predicted. The joke ends with the punch line that although he sees that it works in practice, he wonders if it can work in theory. That is the dilemma facing management scientists. In practice, the firm is already on a path to humanizing, but theories of the firm have lagged behind.

Theories of the firm have been dominated by a legacy of ideas from early industrialization that pose zero-sum opposition between capital and labor (or capital and nearly everything else), differentiating the economy from society and often posing irreconcilable conflicts.<sup>1</sup> The search for mathematical models has turned the negotiated order of organizational activities, which necessarily include particularistic elements, into abstract generalizations that favor quantifiable variables.<sup>2</sup> An ideal of the primacy of markets and the centrality of finance came to dominate thinking about management, especially in the U.S., where the Ford Foundation helped to create modern business schools and legitimated economic and quantitative knowledge as the core of professional management.<sup>3</sup> Thus, it became inevitable that “shareholder capitalism” would focus on unlocking financial value, and reporting mechanisms would come to hold that the only definition of value creation is economic or financial value.

In this archetypal view, firms are impersonal money-generating machines, operating through bundles of transactions and treating employees in instrumental ways, as disposable costs and controlled by rules, thus leaving a wake of discontent. Discontent is an empirical truth in some contexts. U.S. studies have shown that about half of employees in large firms are disaffected and disengaged.<sup>4</sup> Other studies, from a variety of

countries, point to the negative health consequences of work situations involving long hours, lack of control, work-family conflict, and socially isolating jobs.<sup>5</sup> However, over recent decades, some firms have responded to the discontent by changing their practices – but not always their logic. Sometimes this has been done in the interest of productivity or cost, having been influenced by studies showing that productivity is higher when workers have more control over their work, or that low product quality and high employee turnover increase costs, or that pollution and corruption create financial risks.<sup>6</sup> Thus, often the underlying theories still rested on an economic logic: how to get higher valuations in financial markets.

This paper offers another logic, a social or institutional logic, to let practice provoke the creation of new theory. It provides examples that show how social logic guides the practices of widely-admired, high-performing companies, and why people and society are not an after-thought to be used or discarded, but core to the purpose and definition of the firm. It builds on in-depth, ongoing global field research on admired companies from four continents, followed in over 20 countries, from my book *SuperCorp: How Vanguard Companies Create Innovation, Profits, Growth, and Social Good*, to derive propositions about the role of humanistic institutional logic.<sup>7</sup> (Unattributed information or quotes in this paper are from the author's original research.)

Institutional logic holds that firms are a vehicle for accomplishing societal purposes and providing meaning for those who work in them, which cannot be calculated only in terms of profits or paychecks. Rather than viewing organizational changes as new ways to extract more economic value, these firms have created a framework for guiding decisions that makes it legitimate to use social value or human values as explicit criteria.

The theory-in-practice is that firms have a purpose, as institutions in society that contribute to meeting the needs of all stakeholders through the goods and services they produce, the jobs they create and the quality of work life, how their goods and services impact other aspects of society or are used to provide societal benefits, and their financial viability to provide returns to investors and capital for improvements and innovations. This perspective involves internalizing what had once been externalities and defining a firm around its purpose and values.

This social or societal logic is seen as aligned with economic logic but not subordinate to it. For example, in order to carry out its activities and sustain the institution, firms require capital, but profit is not an end in itself but rather a means to further investment in continuing returns. This view of the firm is no more idealized than profit-maximizing views. There are well-established firm practices such as R&D and marketing that have become conventional, expected, and applauded by stock analysts, which cannot always be tied to profits either in the short or long run.<sup>8</sup> Such investments must be expanded to include employee empowerment, emotional engagement, values-based leadership, and related humanistic contributions.

There are a few caveats that provide a lens for viewing the propositions in this paper.

- Institutional tasks are not easy, and they must be performed beyond all the technical work that is basic and essential to producing and selling goods and services.
- The companies in my study might not be representative of the vast majority of businesses, although I would argue that they represent the vanguard.

- There are no organizational utopias. No one of the companies or their leaders meets the ideal that the skeptical public holds out for perfect conduct in every respect. Each falls short of its own ideals and prefers to frame ideals as aspirations.
- The new practices can have a downside of unintended consequences or pernicious effects. Because size is associated with power, not to mention market domination, large firms are both revered and feared. There is widespread suspicion of the motives of top managers of large entities when they engage in seemingly altruistic activities.
- There are paradoxes and tradeoffs. If firms derive economic benefits from social actions, then their social actions are written off by cause ideologues as cosmetic. But without the financial benefits, the actions written off by economic ideologues as wasting resources that could be put to more profitable ends. You can't please all the people all the time. Perfection is unattainable.

Social or institutional logic will not be unfamiliar to purpose-driven industrialists of earlier eras, such as the Houghton family that built Corning Glass and Corning, New York, or the Tata family of India. But it is certainly even more necessary for non-family-led enterprises operating in today's globalized world. Organizations contend with environments in which many activities outside of the control of top leaders can cause shocks, surprises, and unpredictable change, creating uncertainty and complexity that cannot be contained in an easily-defined structure or by routine processes.

The era of information-driven globalization is characterized by frequent, rapid and sometimes unpredictable change, both done by leaders and done to them by events in the external world. Globalization increases the speed of change, as more competitors

from more places produce surprises. System effects send ripples that spread to more places faster – innovations in one place proving disruptive in others, problems in one economy triggering problems in others. Although geographic diversification is a hedge against local risk, geographic consolidation to gain economies of scope can expose companies to risks that cannot be contained. For example, this is a concern for IBM leaders about consolidating certain data storage or processing functions in fewer places, which increases global vulnerability from local events.

Globalization brings more moving parts, more variables in play simultaneously, and more dimensions of interest. There is a rapid flow of people, money, and ideas in and around the organization.<sup>9</sup> An intensely competitive global information economy places a high premium on innovation, the faster the better, as well as the ability to continuously upgrade products and processes. Both rely on tapping brainpower of knowledge workers and also on their collaborations, because innovation relies on new connections among previously unrelated elements or entities that now require further integration.<sup>10</sup> Information has a short half-life -- “use it or lose it.” So there is more need to get ideas connected to tangible products and services, and to connect innovations with applications and users. Mergers and acquisitions add further complexity, and their success rests on the effectiveness of integration among the previously unconnected organizations. The important challenges and opportunities lie across boundaries.

Furthermore, seeking legitimacy or public approval by aligning with social values has become not just a basic license to operate but a business imperative.<sup>11</sup> Firms that cross borders face questions of cultural fit and local appropriateness; they must gain

approval with authorizers and opinion leaders. Their employees are both internal actors and external agents who represent the company to the community.

## PROPOSITIONS

Proposition 1: Conceiving of the firm as a social institution is a buffer against uncertainty and change.

As companies acquire, divest, or are acquired; the business mix of globalizing companies changes frequently; and jobs levels fluctuate across countries. So what exactly is the same that makes us say this is the same company? Bank of America is the surviving name after numerous mergers, but the underlying surviving bank is Nation's Bank, which gave up its name but not its headquarters, management cadre, or culture. And where are the sources of certainty that permit people to take action in an uncertain world? "Management is temporary, and returns are cyclical. The only enduring thing is our values," IBM CEO Sam Palmisano said, explaining to me why he puts so much emphasis on values and culture.

The answer to the question of the identity of an organization in the future is that it is not the current widgets, but it is the purpose and values, and that can help find the right new widgets to serve society. For example, Mahindra, a US\$11.1 multi-business firm based in India, with 117,000 employees in 100 countries, proclaims that it is "many companies united by a common purpose – to enable people to Rise. We operate in the key industries that drive economic growth..." including finance, IT, vehicles, and several dozen others. This kind of reasoning (or rationalization) is characteristic of



conglomerates in emerging markets; although most do not create a common purpose-based culture, it can be argued that the ones that can be counted among great global firms have created an institutional logic for their business investment choices.

Globalization seemingly detaches organizations from particular societies only to require the internalizing of society and its needs (many societies) in organizations. Institutional certainty can balance business uncertainty. For example, in the choice to identify health as a central purpose, with nutrition, environmental responsibility, and talent sustainability as pillars supporting the slogan Performance with Purpose, PepsiCo provides direction and motivation for diverse lines of business, some of them more globalized than others, in multiple countries. This is certainly strategic. It guides a gradual shift of resources from “fun-for-you” to “better-for-you” to “good-for-you,” in PepsiCo parlance. It provides a rationale for acquisitions and divestitures. It guides a quest for ways to eliminate sugar and sodium in foods and beverages. But it also provides an identity for the people who work in the company.

Thus, leaders can compensate for uncertainty by institutional grounding – identifying something larger than transactions or today’s portfolio to provide purpose and meaning. Institutional frameworks permit diverse, self-organizing people to gain coherence. Joel Podolny and Rakesh Khurana have argued that meaning-making is the central function of leaders.<sup>12</sup> Institution-building involves active efforts to build and reinforce aspects of what is loosely-called organizational culture – but it is also much more than that. Culture, as generally used, is often a by-product of past actions, a passively-experienced outgrowth of history.<sup>13</sup> Institutional work is an investment in activities and relationships that do not yet have an instrumental purpose or a direct road

to business results but that instead show what the institution stands for and how it will endure.<sup>14</sup>

Institutional work is a survival strategy. Globalization increases the likelihood of shorter organizational life cycles, as a result of mergers and acquisitions, industry consolidation, and intensified competition driving out weaker competitors. It is plausible to hypothesize that the extent and depth of institutional work can divide the survivors from those subsumed by global change, equivalent to the difference between long-lived and short-lived utopian communities in my earlier research about commitment and survival.<sup>15</sup> A sense of purpose beyond instrumentalism infuses meaning into an organization, “institutionalizing” it as a fixture in society with continuity between past and future. The name can change but the identity lives on.

For example, Banco Real, the Brazilian subsidiary of a European bank, was a high-performer growing in size, reputation, and financial performance. This was widely attributed to institutional work by CEO Fabio Barbosa and other top leaders to infuse the bank with values of environmental and social responsibility that became the core of the bank’s business strategy and the key point of differentiation. These values gave larger purpose to daily work and stimulate innovation to serve customers and society with practices that meet high standards. In 2006, when the European parent, ABN AMRO, was on the auction block, producing enormous uncertainty and anxiety in Brazil, Barbosa turned again to the Banco Real’s culture. He reminded managers that the best protection was high performance stemming from intensified efforts to showcase institutional values. He told them at smaller meetings and larger conferences that certainty came from their knowledge that they were “doing the right things the right way every day” (a slogan he

often repeated). In April 2007, a consortium bought ABN AMRO, and ownership of Banco Real shifted from the Netherlands to Spain's Santander, which bought the Brazilian assets to add to the branches they already operated in Brazil. But the spirit of Banco Real involved so much more than the assets. Fabio Barbosa was named CEO of the combined entity, and the Banco Real culture and values were to be infused throughout Santander Brazil, combined with Santander's emphasis on financial efficiency. Although Santander Brazil was pressed to increase branch profitability, the parent bank adopted Banco Real's concern for social and environmental responsibility along with its private banking model.

Proposition 2: An emphasis on the firm as a social institution generates a longer-term perspective. Short-term financial sacrifice becomes permissible in the interest of positioning the firm for sustainable success.

Sustaining the institution requires resource attraction, so financial performance matters, but great companies are willing to sacrifice short-term financial opportunities if those are incompatible with institutional values. Institutional values guide matters central to firm identity and reputation, such as the quality of products, the nature of the customers being served, or attention to by-products of the production process. There is increasing pressure on firms to attend to and report on these matters as well as on financial performance.<sup>16</sup> Banco Real was willing to restrict its market in the interests of signaling and acting on its values. The bank created a screening process for project lending, as well as a way to help customers meet higher standards, but it walked away from customers that did not meet tests of environmental and social responsibility.

Sometimes this is justified in risk reduction terms, but it is a signal that the interests of the institution in the long-term transcend short-term transactions. Firms are known for the company they keep, and reputation of customers and partners is an asset.<sup>17</sup>

Using a social logic, firms are also willing to make investments in the human side of the organization that cannot be justified by immediate financial returns but that help produce a sustainable institution. In South Korea, after the Asian financial crisis of the late 1990s, Shinhan Bank set out to acquire Chohung Bank, a much larger and older bank that had been bailed out by the government. Announcement of the acquisition was met by a dramatic protest: 3500 men from Chohung Bank, members of a union that extended into management, shaved their heads and piled the hair in front of Shinhan's headquarters in downtown Seoul. Customers are often lost in the turmoil of changes around mergers and acquisitions anyway; this widely-reported event was certain to do much more damage. Shinhan had to decide whether to go ahead with the acquisition, and then, if it did proceed, how to treat the protestors and what to do about Chohung employees – whether to retaliate against this hostile action.

Shinhan, a relatively new bank, had been guided by humanistic values, and those prevailed. Shinhan negotiated an agreement with the Chohung union that involved deferring formal integration for three years, providing equal representation of both Shinhan and Chohung managers on a new holding company management committee and internal committees, and increasing the salary of Chohung employees to match the higher wages of Shinhan employees. (Shinhan also provided 3500 caps to cover the heads of the protestors.) In short, Shinhan increased the cost of the acquisition and appeared to defer returns from it for several years. Moreover, Shinhan decided to invest the equivalent of

tens of millions in U.S. dollars in a process the bank called “emotional integration” – a series of retreats and conferences that would not only spread strategic and operational information but would also be explicitly designed to produce social bonding and a feeling of being “one bank.” The first retreat involved taking 1500 top managers, the entire top layers, to a historic city where they climbed a mountain at a famous shrine together and sang a company song. According to a financial logic, the new Shinhan Financial Group was wasting money and jeopardizing shareholder value. According to the institutional logic Shinhan used, these investments were considered the only course of action that would keep the two banks running with continuity from knowledgeable employees who had ongoing relationships with customers.

Here is what happened next. Within 18 months, Shinhan had retained and grown its customer base and neutralized the union, which was having a hard time rallying protest against the benign bank. Although no formal merger could occur, Shinhan and Chohung employees were working together on task forces discussing best practices, and ideas were spreading that began to make the branches more similar. Branches of one bank often displayed a sign for the other bank. Employees were, in essence, self-organizing. By the third year, when formal integration could occur, Shinhan was outperforming not only the banking industry in South Korea but the entire Korean stock market.

To carry out their activities, firms requires labor of a knowledgeable kind, who are trained, committed, and can understand what needs to be done when rules are vague or unspecified. Companies can pass up short-term cost-savings in order to motivate

performance, retain and attract employees and managers. When part of a coherent strategy, this can produce superior financial results in the longer-term.

Proposition 3: Articulation and transmission of institutional values can evoke positive emotions, stimulate intrinsic motivation, and propel self- or peer-regulation as a type of control system.

Instrumental, utilitarian rationality is not the only force governing firm performance and behavior within firms.<sup>18</sup> Emotions play a strong positive or negative role. Moods are contagious, and they can determine such issues as absenteeism, levels of effort, and energy or health.<sup>19</sup> People influence one another and either increase or decrease the level of performance, as was shown in my study of teams and organizations on winning or losing streaks.<sup>20</sup> Well-understood shared values and principles can be a source of emotional appeal and help people reinforce their implementation, which in turn can help determine how well a firm succeeds over time.

Having a statement of values has become common, so the issue is not whether a set of words called “values” exists somewhere in the company. An institutional logic makes the regular articulation of the values core to the work of the company, on a regular basis. CEOs of companies in my project headquartered in the U.S., Mexico, the U.K., and Japan all allocated considerable resources to breathing new life into long-standing values statements, engaging multiple levels of junior leaders in this institutional task of identifying and communicating values. The point was not the exact words themselves but the living process: to begin a dialogue that would keep the sense of social purpose in the forefront of everyone’s mind and use that as a guidance mechanism for business

decisions. That was how Procter & Gamble leaders saw the company's PVP (statement of purpose, values, and principles); CEO AG Lafley and Vice Chairman Bob McDonald spent much of their time teaching about and discussing the PVP in formal programs and in visits to locations around the world, beginning with the purpose: "to improve the lives of the world's consumers, now and for generations to come." As Chairman and CEO succeeding Lafley, McDonald built P&G's purpose central to the new strategy in 2009: "improving more lives in more places more completely" and made it central to his meetings everywhere, pointing to the need to reach emerging markets and the bottom of the pyramid.<sup>21</sup>

Omron's new CEO, Sakuta-san, led a restructuring of this Japanese global electronic sensors company from 2002-2006. But in an interview with the author for the research for the book *SuperCorp*, he said that he considers something beyond rearranging the business portfolio or technical engineering prowess more important to the long-term endurance of Omron: Omron's Principles. The Principles, which had been created many years earlier, were rewritten in 2002 and then transmitted through a massive communication process that could have seemed a distraction from the managerial work of restructuring. It proved instead the glue that helped Omron through business ups and downs. Today, groups of employees begin each work day by reciting the core slogan, sales people start conversations with customers by talking about the Omron Principles, and representatives invoke the Principles first when meeting with companies they are vetting and courting for acquisition. (The analogy with religious ritual is apparent.) CEO Sakuta-san fully expects that 35,000 people in Omron might have different interpretations – maybe 35,000 different ones -- but that the engagement and discussion is the important

thing. He said, “Whenever I speak with employees, I tell them your answer should not be a set answer. Please tell what you understood, and how you can express it using the language of the Principles. I also promote discussion among peers, colleagues, and teams to share these understandings with each other.” He puts this in terms of a very long time horizon: “No matter how different the workplaces are in terms of race, value sets, geographical locations, etc., as long as we can continue this debate and discussion, we are able to maintain our attractive and strong work environment and Principles with a flexible attitude to respond to any changes to come in 50, 100, 200, 300 years. And I believe we will be able to refine the Principles by doing so.”

IBM CEO Sam Palmisano’s process for refreshing IBM’s values for the 21<sup>st</sup> century was itself a dialogue on a scale beyond anything any company had ever done. By 2000, IBM had outlived others prominent in the industry 25 years earlier but what hardly the same company from a business perspective. It has downsized or sold manufacturing (later selling the ThinkPad, grown in software and services, emphasized the Internet over mainframes, had nearly as many employees in India as in the U.S., and was targeting growth in all the BRIC nations. So what was IBM? One of the early leadership actions that Sam Palmisano took when he became Chairman and CEO in 2002 was to refresh the IBM values through a unique participative process involving web chats open to over 350,000 IBMers in 270 countries.

When Palmisano presented the plan to the IBM board, one of the directors, a former CEO, questioned him about whether this was “socialism.” He explained that this was the only way to build an enduring institution in which IBMers embraced and owned the values. “It wouldn’t do to create values from the top, like Watson did; today people



are too sophisticated, global, and cynical. We want people to connect to the entity in a way that's relevant to them." He wanted people to have pride in IBM as an institution, not to be following a leader: "The values are the connective tissue that has longevity." An IBM sector direction in Latin America concurred: "When you are working for the same company for 20 years, you need to be proud of it. The reason I wake up early every day to come to IBM is because this company has values that we really believe in. This is the reason I'm here, because I really believe in this company. I know we are doing good things for society. Of course we are a business, and we have our targets, but we can give other things. And we do it."

Although I am mentioning CEOs by name, institutional logic suggests that firms cannot operate through a cult of personality, because that is not enduring.<sup>22</sup> Thus, while top leaders must exemplify and communicate the values, codified statements of purpose and values reduce vulnerability to the choice of top leaders and dependence on a single charismatic figure. In effect, they routinize charisma so that it spreads throughout the organization. With many people performing institutional work, the entire organization holds emotional appeal, and successors can convey the founding ethos and take it in new directions. Leaders must continue to fuel the passion at the heart of institutional work while remaining aware of the distinction between organization and person. They must convey that the institution is larger than any one person, so that people are not following a leader; they are following the values and principles of the institution. Thus, values and purpose represent an alternative, non-bureaucratic mechanism for de-personalizing work relationships.

When institutional work is done well, the ultimate results might not be apparent for years; survival and longevity can't be known in the short-term of financial reporting periods. But the emotional impact can be immediate and powerful, and that can be measured by loyalty and commitment in the face of alternative choices, recruitment of others to join, expressions of belief, and efforts by individuals to volunteer for institutional tasks, above and beyond their jobs. Institutional grounding in purpose and values might attract and hold customers that are not solely transaction-oriented. And if the institution has coherence and an enduring purpose, then the inevitable change of an uncertain world should be less threatening.

Proposition 4: The need for cross-border and cross-sector engagement to tap new opportunities requires concern for public issues beyond the boundaries of the firm and the formation of public-private partnerships in which the public interest is weighed along with the business interest.

The thrust of financial logic is to maximize the returns to capital – shareholder or owner value. The thrust of institutional or social logical is to balance returns to capital with considerations of impact outside the boundaries of the firm, internalizing public interests and undertaking new kinds of partnerships.

One paradox of globalization is that it is accompanied by a greater need for deep national and local connections in plural public spheres.<sup>23</sup> To thrive in diverse geographies and political jurisdictions, companies must build a base of relationships with government officials, public intermediaries, and customers that can ensure alignment of agendas even as circumstances (and public officials) change. In some places, these

external stakeholders are interested in the quality and sustainability of the institution as a local contributor as much as the transactional capabilities of the organization. The global organizations themselves want both an extended family of relationships that can endure and a seat at the policy table for matters affecting their ability to do business in the future. So the institutional work of leaders extends outside the enterprise.

Converting arms-length transactions across the supply chain into deeper partnerships as part of an extended family in the business ecosystem has been an increasing emphasis of major companies in recent decades. Public-private partnerships to address societal needs in which the firm might have an interest are somewhat newer but growing in importance. A wide range of services can be performed at various levels, from international activities in collaboration with the United Nations (Procter & Gamble's Children's Safe Drinking Water partnership with UNICEF and other global and national NGOs), large national projects in collaboration with government ministries, products addressing unmet societal needs, or leading employees and/or other stakeholders in short-term volunteer efforts (IBM's response to the Asian tsunami, or Cemex's engagement of small distributors in Latin America in community service days). PepsiCo attracted Derek Yach from the World Health Organization as its first Chief Health Officer in part because the company appeared to be heeding the criticisms that WHO had leveled against unhealthful properties of its beverages and snack foods and was now in active conversations about working together. PepsiCo also created partnerships with development agencies to finance new facilities in poor rural areas that would create jobs.

Under an institutional logic, top executives cultivate relationships with top public officials, but not as a quid pro quo nor for the sake of particular business transactions.

They seek to understand and contribute to the public agenda, even while influencing it.

IBM's CEO Palmisano circumnavigates the globe 6 or 7 times a year to meet with national and regional officials, bringing regional leaders with him, discussing how to help the country achieve its goals. This is not sales, not even marketing, but rather a high level conversation to indicate IBM's interest in being an enduring institution contributing to that country. Such contacts help other IBM leaders get seats at the table discussing the country's future. That certainly provides an opening for discussion of the company's policy agenda (which is more technical than political). But any instrumental goal would not be achievable without first contributing to efforts clearly benefiting the country.

Institution-building requires effort by many people. Top leaders involve others in leading diplomacy, such as representing the company to the community at conferences and civic or charitable dinners and serving communities directly through service projects. I hypothesize, based on the companies in my research, that the more interested top leaders are in institution-building for the long term, the more likely they are to involve more people in institutional work and reward it with recognition and resources. A Cemex manager in his first country manager post expressed surprise to the chairman, Lorenzo Zambrano, at how much time he had to spend making relationships with government officials and wondered if he should be doing it. "Welcome to top management," Zambrano told me he replied.

Relatively few people hold formal responsibility for these external interfaces as their primary jobs, and indeed, institutional work is less effective in terms of impact on external stakeholders when it appears to be "just a job." So instead, many others perform institutional work as volunteers, giving meetings and community service projects a ring

of authentic motivation. This is not a hard sell for people either native to the area or long-term residents, because there is an emotional pull of place that makes institutional work desirable, so they are willing to volunteer personal time to do it, sometimes initiating efforts and taking others in the company with them. For others whose careers take them across geographies, institutional work is a way to connect their internal roles with the place they now live, making them feel less rootless and more at home.

Leaders from global companies operating in developing countries are often asked to advise on emerging issues where global experience could be useful. That requires special diplomatic skill: being able to appear neutral and interested in the host country, rather than company or home country-interested. A leader in India was typical in presenting the company's agenda to the Minister of Commerce as a slate of future-oriented issues that would help ensure India's competitiveness.

Corporate diplomacy is particularly important where country interests differ or there is active conflict (or long historical memories – for example, U.S.-headquartered companies in the Middle East, or Japanese companies in China). Add to that challenge suspicion of foreigners and concerns about their hidden agendas. Leaders must find ways to show that they act or advise in the interests of society, beyond politics, as a company that is not tied to a specific government or interest group but serves humanity. If the values are real, then leaders are willing to invest in ways that reflect them, not as a quid pro quo but as a sign that they will be locally involved. An Indian company entering Europe faced hostility from some government officials. Company leaders, who could draw from a long tradition of social responsibility, chose to make community investments

that heralded their high standards, and leaders spoke with officials primarily about their values and how, once in a country, they would remain committed to its prosperity.

When leaders come to see themselves in terms of societal purpose, even across countries, they choose to perform institutional work, including self-initiated unofficial international diplomacy. In May 2007, the chairman of IBM Greater China organized his own diplomatic mission to Washington, DC, meeting with Senators, Members of Congress, and White House officials on both sides of the China issue to build bridges and find areas of collaboration, such as environmental issues, because of his conviction that his role in a global company gave him a unique perspective on both countries and a desire to see both thrive as allies.

Proposition 5: When institutions internalize society, actions to produce societal value are undertaken whether or not they are tied to core functions of producing and selling goods and services, and actors consider externalities as part of their internal decision-making.

Claims of serving society are made credible and tangible when leaders allocate time, talent, and resources to national or community projects without seeking immediate returns, and when they encourage people from one country to serve another. Articulating an institutional purpose broader than making money can guide strategies and actions, open new sources for innovation, and help people express firm values and their own.<sup>24</sup>

“Corporate citizenship” is a relatively new term to connote embeddedness in society and the obligations that accrue.<sup>25</sup> It might encompass corporate philanthropy but ranges far beyond it into core business strategies and operations. For example, IBM’s approach to corporate citizenship is closely connected to its business competence -- to

harness the power of technology-enabled innovation to meet social and educational goals of the broader society. IBM employees are expected to look at those broader goals while carrying out their particular tasks. A Latin American executive responsible for the small-and-mid-sized business sector felt that IBMers were increasingly using an external or societal lens to view IBM: “I see a change in the way we think about social responsibility. Twenty years ago, I think the focus was, do the right thing internally. Before, it’s like I see a problem in the society, in the community, and I don’t care, because this is not inside IBM, so I have nothing to do with it. The change right now is to leverage the size of IBM and do the right thing outside our organization, into the whole supply chain with providers and customers.”

Attention to social needs in particular places can generate ideas that lead to significant innovations. For Cemex, operating by this institutional logic and considering unmet societal needs produced innovations such as anti-bacterial concrete, which was particularly important for hospitals and farms; water-resistant concrete helpful in flood-prone areas; or used tires converted to road surface for countries with rapid growth in road construction. An idea from Egypt for salt water-resistant concrete, helpful for harbor and marine applications, became a product launched in the Philippines.

Institution-building connects an extended family of partners across an ecosystem. Cemex started Construrama, a distribution program for small hardware stores, in 2001 in response to competition from Home Depot and Lowes, U.S. construction product companies that were then entering Latin America. Cemex drew on its values to seek dealers with integrity who were trusted in their communities; the company rejected high growth/high margin candidates whose business tactics didn’t meet Cemex ethical

standards. Construrama offers training, support, brand recognition, and easy access to products for small hardware stores, including sometimes the first computers and Internet access for these small enterprises. By the mid 2000s this network in Mexico and Venezuela was the equivalent of the largest retail chain in Latin America, and it was expanding to other developing countries. Cemex owns the Construrama brand and handles promotion but doesn't charge distributors, operate stores, or have decision-making authority, although service standards must be met. About a third of the Construrama management team at headquarters spends 6-8 months working at the stores. Partners participate in councils on a rotating basis. Among the Cemex values that are disseminated to partners is participation in community-building philanthropic endeavors, for example, contributing people and materials to expand an orphanage or improve a school. A Cemex executive referred to the societal sensitivity that produced Construrama as "understanding the last link in the value chain."

Widespread opportunities for individuals to use company resources to serve society further institution-building goals. In 2003, when IBM's business emphasis had shifted to On Demand Computing, the company launched On Demand Community, an intranet site for technology tools designed to improve schools and community organizations. Three years later, 75,000 employees (over 20% of the population) had performed nearly 3.5 million hours of service, and the number continued to rise in subsequent years. IBMers could clock their community service time and at 50 hours get a certificate of recognition from their country head and be eligible to apply for a grant for that organization based on IBM worldwide standards. According to IBM officials, many people love the service for its own sake and forget to clock their hours.



Proposition 6: People can be treated as self-determining professionals, coordinating and integrating activities and producing innovation through self-organizing in addition to formal assignments.

Coordination and integration of activities can be more efficiently and effectively accomplished through human relationships and self-organizing.<sup>26</sup> Formal structures or technical systems create pathways for employees to connect information, share or exchange resources and develop innovations. Although employees have formal assignments which require minimum compliance, higher levels of performance stem from the voluntary component – not only which ideas to surface and how much effort to put in but also on going beyond the job to contribute to additional activities. In addition, resource allocation is determined not only by formal strategies and budget processes top-down but also by informal relationships, spontaneous actions, and preferences of people at all levels.<sup>27</sup> Consider the Shinhan case described earlier; the two predecessor banks self-integrated over a period of years through social bonds and cross-cutting relationships, far in advance of formal integration.

Thus, to fully understand a firm requires knowledge of its social life, and to optimize performance requires social investments. Perhaps network analysis will one day prove capable of predicting firm performance through quantitative methods, but it is also clear that there is an emergent, open-ended quality to the actions of great global companies – one reason that the idea of strategy-as-plan has been redefined as strategic intent. This idea was summarized by IBM's CEO, who wrote that IBM cannot be optimized through organizational structure or by management dictate but requires

empowering people while ensuring that they're making the right calls the right way that give support and life to the strategy and brand, concluding "That's why values, for us, aren't soft. They're the basis of what we do, our mission as a company." Procter & Gamble's PVP (purpose, values, and principles) also proved central to the turnaround of the business in Brazil, which had fallen behind the competition. Managers motivated to save the business developed a new model for conceiving of change to lower costs and reach a mass audience of lower-income consumers (that later became adopted worldwide), then applied it to a leading product category with the involvement of cross-functional teams and external customers, using open innovation to look outside the company for special ink for new packages and using customer partnerships to create major new displays that enabled effective promotion without expensive media. Empowerment was the result of trust that stemmed from clear belief in company values.

Formal structures are too general and rigid to reflect the many multi-directional pathways for resource or idea flows in the best firms. Informal, self-organizing, shape-changing and temporary networks are more flexible and can make connections or connect bundles of resources more quickly.<sup>28</sup> Formal positions come to resemble a home base from which people are continuously mobile, in terms of daily tasks, projects, work relationships, group membership, and physical location. Matrix organizations, in which individuals report to two bosses representing two dimensions of their tasks (e.g., reporting to a functional head and an industry head or a geographic head), become what I dub a "matrix on steroids." In a multi-dimensional matrix, people are accountable along many dimensions simultaneously and consecutively, with multiple projects and with multiple interfaces that enable them to assemble resources for those projects.

There are large numbers of people around the world who still work under exploitative, low-engagement conditions. Even without counting the abuses, such as exploited unskilled immigrants or illegal sweatshops, there is still a drudgery and confinement component to some jobs, including in vanguard companies. Cemex runs cement factories, Publicis Groupe has mass production software programming shops, and every company has office support staff who must sit in place for certain hours no matter what.

But information technology facilitates direct access and rewards those who seek and spread information. Open access and communication irrespective of levels are phenomena increasingly apparent everywhere in the world, even in countries with more authoritarian traditions (as evidenced by recent rebellions in the Middle East). Some of this is generational; younger employees, even in elder-revering countries, are less hesitant than older employees to email the CEO directly. Thus, leaders tend not to stand “above” on a vertical dimension in practice, regardless of formal structures; they lead by facilitating horizontal, diagonal, or multi-directional connections. The decisions that top leaders retain involve choices about which potential pathways to endow with resources to start them moving – i.e., which broad initiatives to fund or which pieces of the organization to combine formally in order to facilitate closer connections between related parts.

Firms can add to the voluntary component of paid work by entrusting people with choices, including where, when, and with whom they work. Any cost-savings by having fewer offices are offset by the risks of unmonitored action, and thus trust and empowerment are key. For example, on any given day, nearly 40 percent of IBMers do

not go to an IBM office. Mobile employees are working at home or at customer sites, moving between locations, or taking personal leave at a time of their choice. “Giving people more control over how, when, and where they do their work is the core of flexibility,” Ted Childs, former vice president for diversity said at a meeting in my Harvard office reviewing evidence of the changes at IBM. “I’m not saying we solved anything (pointing to the 35% of participants in an IBM global survey who report some work-life difficulty), but people feel we are responding.” IBM’s work at home programs, such as the one started in Japan in 2001, have caught the attention of government officials interested in keeping women with technical degrees in the work force. In some cases, there are allowances to support infrastructure in the home.

“At the end of the day, IBM is more worried about the work being done and how well you do it than, did you work for eight hours or did you work for 20 hours to do your job,” declared a manager in Bangalore, India. He claimed that even if a person in Bangalore turned down a temporary assignment with a client in Mumbai, the manager would work it out with someone else or offer flexibility, “but no way that the person, because he or she didn’t go for the project, would be relegated or ignored. We understand the reasons why he or she is not able to go for the project.” A woman professional in China, project director for a high-profile initiative to digitize the treasures of Beijing’s Forbidden City, praised her manager for providing deadlines and then leaving her alone, saying, “Then you know when you need to work overtime, and when you can sleep. I like this very much. I hate people telling me to work overtime. But if people don’t ask me to work overtime, I might be working overtime anyway.”

Job descriptions hardly document what people do every day, nor do official performance reviews and salary bands capture the activities through which people might add the most value for the company, because sometimes those “side” efforts are not even itemized in any official data base or system. In some cases, professionals are formally encouraged to spend 15 or 20 percent of their time on projects of their own choosing, as a stimulus to innovation.

Some of the most important voluntary activity, in terms of the impact on company strategy and direction, occurs outside of any formal responsibility, when people come together to share information. Communities of practice link people with a similar technical expertise. Communities of kind link people from particular groups, such as women or minorities. Communities of interest connect people who want to explore particular ideas. Technology enables them to cut across wide swaths of the organization, to grow virally, to cull the best ideas, to build support for action, and to become powerful forces for change. The driving force for self-organized groups is curiosity and interest on the part of the people themselves. The company can try to facilitate them, but they flourish when they involve volunteers.

Self-organizing communities give their members voice. They are also a potent force for change, propelling companies in directions they might not have taken without the unanticipated voluntary actions of people with no formal mandate to contribute. But for such self-forming networks, IBM might have lagged or missed out on two very big business ideas. One is a virtual worlds community that got IBM involved in this new technology area, which burst on the scene in 2003 with Second Life and has grown exponentially since. The other is “green computing,” which helps IBM meet

environmental commitments for the company and clients. Both of these were among IBM's top strategic priorities that were crystallized following an Innovation Jam in July 2006, modeled after the Values Jam of a few years earlier. The Innovation Jam was IBM's second global Web-based chat open to everyone in the IBM world. Over 140,000 people contributed ideas, confirming what self-organizing communities were already doing.

The virtualization initiative came together outside of any formal structure at IBM, participants reported. Nearly 200 engineers and professionals who were early adopters of Second Life found each other through company chat spaces and created an ad hoc community. They used their free time and acted bottom-up like free-lancers, communicating informally through avatars on new virtual platforms and through weekly phone calls, with the line also open on the virtual world. After about a year, they found an IBM executive to support them as a more official activity. This activity was then designated an emerging business opportunity with official funding for three years.

A different kind of self-organizing group, focused on the environment, drew on worldwide virtual discussions about environmental sustainability but had a more local face-to-face dimension as IBM employees in the U.K. began to take initiative, first by "talking around the water cooler," an executive said, about how to make the IBM more environmentally friendly. Personal values coincided with corporate responsibility and a perception of a big business opportunity. It ballooned through word-of-mouth (or word-of-screen), and soon there were regular meetings of several dozen people drawn from different business areas, many of whom had not previously met one another despite sharing the building, and a steering committee with representation from every business

unit, setting guidelines and identifying tasks. Eventually, a project manager was assigned. Successful ideas spread worldwide. What started spontaneously, organized by volunteers, became business, central to IBM's signature "smart planet" campaign.

## TOWARD JOINT LOGICS

Social or institutional logic should take its place alongside economic or financial logic in research, analysis, education, regulation, and managerial decision-making. Six propositions have been put forth to advance this direction for theories of the firm, and for changes in firm leadership and behavior:

- Proposition 1: Conceiving of the firm as a social institution is a buffer against uncertainty and change.
- Proposition 2: An emphasis on the firm as a social institution generates a longer-term perspective. Short-term financial sacrifice becomes permissible in the interest of positioning the firm for sustainable success.
- Proposition 3: Articulation and transmission of institutional values can evoke positive emotions, stimulate intrinsic motivation, and propel self- or peer-regulation as a type of control system.
- Proposition 4: The need for cross-border and cross-sector engagement to tap new opportunities requires concern for public issues beyond the boundaries of the firm and the formation of public-private partnerships in which the public interest is weighed along with the business interest.

- Proposition 5: When institutions internalize society, actions to produce societal value are undertaken whether or not they are tied to core functions of producing and selling goods and services, and actors consider externalities as part of their internal decision-making.
- Proposition 6: People can be treated as self-determining professionals, coordinating and integrating activities and producing innovation through self-organizing in addition to formal assignments.

As a starting point for theory that catches up with practice, this paper is both descriptive and normative. Examples have been drawn from the field, and the concepts derived from them have a normative flavor, reflecting a sense of possibility for running organizations in ways that increase engagement, both internally in terms of the behavior of organization members and externally in terms of contributing to societal progress.

In some ways, this paper has come full circle. A logic that justifies treating employees as self-determining volunteers – in essence, as professionals – makes it more important to have a motivating purpose and values to provide coherence and common identity. The first proposition enables the last one. Throughout, the connections between the propositions make it difficult to turn the examples into discrete practices that illustrate only one proposition. In the world of practice, and perhaps most especially for great global companies, institution-building is not the result of tallying a set of specific items but rather a coherent, holistic pursuit in which elements reinforce one another, are inextricably intertwined, and reflect a logic and a style of leadership that permeates the firm as a whole.



Skeptics abound, and firms that present themselves as institutions concerned with serving society often get more scrutiny than others and must withstand criticism about the gap between their stated aspirations and their performance, financially or socially. As stated at the beginning, if they make money while doing good, they are criticized for manipulation; if they do some good but not enough to solve complex problems, they are criticized for lack of courage or commitment.<sup>29</sup> Despite the formation of a small bandwagon of advocates of a new kind of capitalism that finds win-win opportunities for creating value for both the business and society, there is still controversy about the obligations of business. But this paper does not try to tackle the question of the proper role of business in society. It simply presents propositions about the ways in which great global firms already use and institutional or social logic to supplement economic or financial logic in guiding and growing their enterprises. The form that logic takes, and how it is presented and justified to various stakeholders, can vary across firms, industries, and countries.

Economists can certainly try to reduce these propositions to the language of economizing. But they would miss nuances and subtleties. They would miss the role played by emotions and the search for meaning as human motivations. They would miss the normative elements that inspire action to improve the nature of the firm – to humanize it. Finally they would miss the mechanisms through which change takes place in all social institutions, such as peer group effects. When firms see that the theory they act under is humanistic and gains social approval, they reinforce one another in pursuit of these ends, and new models for action are produced.

## NOTES

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<sup>1</sup> Consider, for example, the classic work of that era, Frederick W. Taylor, *The Principles of Scientific Management* (New York: Norton, 1967).

<sup>2</sup> This quantitative drive was present in numerous schools of organizational studies, including systems theory and organizational economics.

<sup>3</sup> Gerald F. Davis, "The rise and fall of finance and the end of the society of organizations," *Academy of Management Perspectives* 23 (2008): 27-44, and Davis, *Managed by the Markets: How Finance Re-Shaped America* (Oxford, England: Oxford University press, 2009). For the Ford Foundation role, see Rakesh Khurana, "How foundations think: the Ford Foundation as a dominating institution in the field of American schools of management," Harvard Business School working paper, 2011.

<sup>4</sup> Ellen Galinsky, James T. Bond, Stacy S. Kim, Lois Backon, Erin Bownfield, and Kelly Sekai, *Overwork in America: When the Way We Work Becomes Too Much* (New York: Families and Work Institute, 2005).

<sup>5</sup> Evidence is reviewed in Jeffrey Pfeffer, "Building sustainable organizations: the human factor," *Academy of Management Perspectives* (February 2010): 34-45. Pfeffer suggests that even the focus on job satisfaction or work-family conflict evolved over time to largely consider the implications for organizational performance (profits, costs, productivity), rather than human well-being.

<sup>6</sup> The effect of control on worker productivity was demonstrated as early as the 1970s. See J.R. Hackman and G.R. Oldham, "Motivation through the design of work," *Organizational Behavior and Decision Processes* 16 (2) (1976): 250-279 and R. A. Karesk, "Job demands, job decision latitude, and mental strain: Implications for job redesign," *Administrative Science Quarterly* 24 (1979): 285-308.

<sup>7</sup> Rosabeth Moss Kanter, *SuperCorp: How Vanguard Companies Create Innovation, Profits, Growth, and Social Good* (New York: Crown Business, 2009). See also, Kanter, "Leadership in a Globalizing World," in Nitin Nohria and Rakesh Khurana (eds.), *Handbook of Leadership Theory and Practice* (Boston: Harvard Business School Press, 2010): 569-609.

<sup>8</sup> On the difficulty in measuring the returns of R&D, see Zvi Griliches, *R&D and Productivity: The Econometric Evidence* (Chicago: University of Chicago, 1998).

<sup>9</sup> Rosabeth Moss Kanter, *World Class: Thriving Locally in the Global Economy* (New York: Simon & Schuster, 1995).

<sup>10</sup> Rosabeth Moss Kanter, "Innovation: The Classic Traps," *Harvard Business Review* 84(1) (November 2006): 72-83. See also Michael Tushman and Charles O'Reilly, *Winning Through Innovation: A Practical Guide to Leading Organizational Change and Renewal* (Boston: Harvard Business School Press, 2006)

<sup>11</sup> David Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Washington, DC: Brookings Institution Press, 2006).

<sup>12</sup> Joel Podolny, Rakesh Khurana, and Marya Lisl Hill-Popper, "Revisiting the Meaning of Leadership," *Research in Organizational Behavior* 26 (2004): 1-36.

<sup>13</sup> See, for example, the classic definition of organizational culture given in Edgar Schein, *Organizational Culture and Leadership* (San Francisco: Jossey-Bass Publishers, 1985).

<sup>14</sup> Thomas Lawrence and Roy Suddaby, "Institutions and Institutional Work," in S. Clegg, C. Hardy, T.B. Lawrence, and W.R. Nord (eds.), *Handbook of Organizational Studies* (London: Sage, 2006): 215-254. See also Thomas Lawrence, Roy Suddaby, and Bernard Leca (eds.), *Institutional Work: Actors and Agency in Institutional Studies of Organizations* (Cambridge: Cambridge University Press, 2009).

<sup>15</sup> Rosabeth Moss Kanter, *Commitment and Community* (Cambridge, MA: Harvard University Press, 1972).

<sup>16</sup> See, for example, Robert Eccles and Michael Krzus, *One Report: Integrated Reporting for a Sustainable Strategy* (New York: Wiley, 2010). Another example is the work of CERES to change reporting requirements for companies to include sustainability measures, as outlined in its report "The 21<sup>st</sup> Century Corporation: The CERES Roadmap to Sustainability" (CERES, 2010). A coalition of advocates of new metrics for companies formed the Global Reporting Initiative.

<sup>17</sup> Vogel, *The Market for Virtue*, 52-53, 106-107.

<sup>18</sup> This humanist insight was provided, initially, by the human resources approach to organizations. See, for example, Douglas McGregor, *The Human Side of Enterprise* (New York: McGraw Hill, 1960)

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<sup>19</sup> Social psychology has returned to the study of emotion, and the idea is reaching companies. There are numerous studies of mood contagion; for example, Elaine Hatfield, John T. Cacioppo, and Richard L. Rapson, *Emotional Contagion* (Cambridge, England: Cambridge University Press, 1994); Sigal G. Barsade, "The Ripple Effect: Emotional Contagion and Its Influence on Group Behavior," *Administrative Science Quarterly* 47 (2002): 644-75/

<sup>20</sup> Rosabeth Moss Kanter, *Confidence: How Winning Streaks and Losing Streaks Begin and End* (New York: Three Rivers Press, 2006)

<sup>21</sup> The emphasis on the bottom of the pyramid represents a current effort to tie values and the need to serve society with profit-making opportunities that might stem from providing goods and services to the underserved, i.e., the world's poor, thereby improving their lives. The late C.K. Prahalad crystallized this emphasis in his book, *The Fortune at the Bottom of the Pyramid* (Philadelphia, Pennsylvania: Wharton School Publishing, 2004). See also V. Kasturi Rangan, John Quelch, Gustavo Hererro, and Brooke Barton (eds.), *Business Solutions for the Global Poor: Creating Social and Economic Value* (San Francisco: Jossey-Bass, 2007).

<sup>22</sup> Rakesh Khurana, *Searching for the Corporate Savior: The Irrational Quest for Charismatic CEOs* (Princeton: Princeton University Press, 2002)

<sup>23</sup> Kanter, *World Class*. See also Pankaj Ghemawat, *Redefining Global Strategy* (Boston: Harvard Business School Press, 2007)

<sup>24</sup> For a distinct but related argument on the benefits of open innovation, see Henry Chesbrough, *Open Innovation: The New Imperative for Creating and Profiting from Technology* (Boston: Harvard Business School Press, 2003)

<sup>25</sup> For a general overview of the concept of corporate citizenship, see Andrew Crane, Dirk Matten, and Jeremy Moon, *Corporations and Citizenship* (Cambridge: Cambridge University Press, 2008)

<sup>26</sup> See, for example, the literature on teams and effectiveness, J.R. Hackman, R. Wageman, T. Ruddy, and C.R. Ray, "Team Effectiveness in Theory and in Practice," in C. Cooper and E. Locke (eds.), *Industrial and Organizational Psychology: Linking Theory with Practice* (London: Blackwell Publishing, 2000).

<sup>27</sup> Joseph Bower and Clark Gilbert (eds.), *From Resource Allocation to Strategy* (Oxford: Oxford University Press, 2006)

<sup>28</sup> Ronald Burt, *Structural Holes: The Social Structure of Competition* (Cambridge: Harvard University Press, 1995); *ibid.*, *Brokerage and Closure: An Introduction to Social Capital* (Oxford: Oxford University Press, 2007); and *ibid.* *Neighbor Networks: Competitive Advantages Local and Personal* (Oxford: Oxford University Press,

<sup>29</sup> See Chapter 9, "Unfinished Business: Confronting the Dark Side of Globalization," in Kanter, *SuperCorp*, *ibid.*