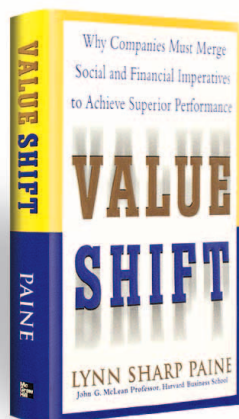


SOUNDVIEW Executive Book Summaries®



By Lynn Sharp Paine

Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance

VALUE SHIFT

THE SUMMARY IN BRIEF

There is an emerging new standard of corporate performance that encompasses both moral and financial dimensions. This book describes the turn to values in the past decades, interprets what is motivating this phenomenon and why it is significant, and explores the implications of this movement for management practice as well as organizational strategy and corporate leadership.

Whereas in the past, companies were measured purely on their financial performance, they are now held to a different standard. How they demonstrate moral intelligence in their dealings with employees, customers and other constituencies is becoming as important as increasing shareholder value. Companies are no longer just convenient devices for pooling capital. In this summary you will learn about the development of the moral personality of the corporation and how it is changing the face of business.

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What You'll Learn In This Summary

- ✓ **Does ethics pay?** You will discover why corporate ethics do provide financial benefits, but that alone is not a good justification for ethics.
- ✓ **The new corporate personality.** You will see how companies have evolved from amoral entities to moral actors in society.
- ✓ **The new definition of outstanding corporate performance.** You will learn that outstanding corporate performance is no longer just a measure of financial performance, but also a measure of investor, employee, customer and community wants.
- ✓ **How much accountability?** You will find out how managers must change their perspective to succeed in the face of the new performance standards.
- ✓ **Achieve the new performance standards.** You will learn how to use the manager's compass to navigate through complex situations and satisfy both ethical and economic standards.
- ✓ **The center-driven company.** You will see examples of companies innovating to become "center-driven" companies that marry NPV (net present value) and MPV (moral point of view).

VALUE SHIFT

by Lynn Sharp Paine

— THE COMPLETE SUMMARY

The Turn to Values

Until recently “business ethics” was considered a contradiction in terms. The market and corporations were amoral, and ethics generally meant corporate philanthropy. In light of recent corporate scandals, ethics has now become an important corporate concern. More than a frill or indulgence, values are becoming an integral part of effective management.

When asked about their interest in values, executive rationales cluster into the following main areas:

- **Risk management.** Values can manage and eliminate risks associated with corporate and individual misconduct.

- **Organizational functioning.** Values build a well-functioning company that encourages cooperation, inspires commitment, nurtures innovation and energizes the organization’s members around a positive self-image.

- **Market positioning.** Values shape a company’s identity and reputation, build its brands, and earn the trust of customers, suppliers and other partners.

- **Civic positioning.** Values establish a company’s standing and reputation in the community as a progressive force for social betterment, or as a solid citizen that obeys laws and pays taxes.

- **A better way.** Values are worthwhile and fundamental principles of responsibility, humanity and citizenship, and need no corporate justification. ■

Does Ethics Pay?

When AES Corporation went public in 1991 its prospectus stated that in a conflict between values and profits, the company would try to adhere to its values, even if that diminished profits. Because of this position — at that time, extraordinary — the SEC insisted that the values be listed in the prospectus under “risk factors.”

Attitudes are changing, and executives are beginning to see that ethics stances can actually have a dollars and cents value.

The Cost of Scandal

Certainly, managing a company without ethical standards can lead to illegal acts and scandals. Allegations trigger customer defections, leading to depressed revenues. Employees doubt the company’s future, and injured parties file lawsuits. Investors demand higher

returns, credit ratings are downgraded, funding costs rise, and the financial pressure is felt throughout the organization. Politicians and lawmakers call for more investigations and hearings, which exacerbate the deterioration.

Rewarding Principles

Avoiding high-profile scandal, however, is not a compelling case for values. What about the low-grade misdoings, such as betrayals of confidence, neglected promises, and evasion of responsibility?

Principles that rule out these behaviors lead to many cost advantages. Workers who are truthful, reliable and conscientious reduce the cost of expensive oversight and monitoring. A high level of trust can lower contracting costs for agreements with prospective customers and suppliers.

Trustworthy companies usually have an easier time dealing with non-corrupt politicians and regulatory agencies. They are more likely to be believed when making an argument. Self-imposed commitments can also reduce compliance costs by reducing the need for restrictive laws and regulations.

Commitments to truth, reliability, fairness and respect enhance management and efficiency. Without them unnecessary time and money go toward evaluating proposals, resolving disputes and mobilizing teams, because nothing can be taken at face value.

Reputation is key. A good reputation attracts customers, employees and investors, which leads to increased revenue, market share, access to talent, and premium prices for the company’s goods or for the company itself.

Though the links between values and economic value can be difficult to track, because they are often indirect or remote in time, they are numerous. ■

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Reality Check

Despite all the positive arguments for ethics, it is unrealistic to ignore the tensions that inevitably arise between profits and values. Moral indifference has rewards too.

Very often it is advantageous for companies to break the law or be dishonest. Using child labor, exploiting the morally lax desires of consumers, and offering bribes in an industry where all competitors do so are situations where the relationship between ethics and economics falls apart.

When economic concerns trump ethical choices, “ethics pays” proponents often point out the long-term perspective. Decisions made ethically can show immediate economic losses, but long-term gains. Decisions based on poor values, such as cutting corners or altering books, can show short-term gains, but later discovery of the deception can obviate the gains overnight.

However, how long is the long term? Is it right to do what is good for the long term if it makes staying competitive in the short term impossible?

The relationship between ethics and economics is dependent on the values in question.

Values, Reward and Penalties

The chart above right shows the difference between the basic standards of values dealing with justice and humanity and full commitment to these values.

The financial case for values is generally accepted in the lower-left quadrant and is usually backed up by law. Companies that do not respect these values can easily lose customers, incur fines, and lose their reputations. In the lower-right and upper-left quadrants, financial gains depend more on the extent of the rewards from adherence to those values — or the penalties from breaching them.

In the upper-right quadrant, the financial benefits become tenuous. These diffuse values are not easily measurable and do not help anyone in particular, therefore neglecting them illicit few complaints or specific negative consequences. In addition, these values have no limit, and chasing them endlessly would lead to bankruptcy. The gains in this quadrant are more in terms of employee commitment and reputation gains, which indirectly lead to financial gains.

The Ladder of Commitment

This view of commitment to values leads to a “ladder of commitment.”

First level: Based on adherence to a minimum set of standards. Cost and risk driven.

Second level: More far-reaching commitments including consideration and positive mutuality. Based on a combination of penalties, rewards and risk management.

Third level: Striving toward leadership and self-

		Domains of Commitment	
		Justice	Humanity
Scope of Commitment	Full	<ul style="list-style-type: none"> • Do right • Be honest • Be fair • Keep promises • Obey spirit of law 	<ul style="list-style-type: none"> • Develop self • Help others • Improve the community • Promote human dignity • Be courageous
	Basic	<ul style="list-style-type: none"> • Avoid wrong • Avoid fraud • Avoid theft • Fulfill contracts • Obey letter of law 	<ul style="list-style-type: none"> • Maintain self • Avoid harming others • Avoid injury to community • Respect human rights • Be considerate
		Justice	Humanity
		Values	

improvement, even contributing to community problems you did not create. Driven mainly by rewards.

Context is key to the idea that “ethics pays.” Economic gains described in this matrix assume economic and political freedom, free-flowing information, an educated population, and a functioning legal system. The absence of these conditions make injustice and fraud quite profitable, and the economic benefit of values disappears. ■

The Corporation’s Evolving Personality

The recent value shift in international companies needs more explanation than financial benefits. It also comes from subtle developments in the “personality” of the corporation that affect how companies are perceived, what is expected of them, and how they are evaluated.

From Fictional Entities to Moral Personalities

For centuries, companies were fictional, soulless entities that were not expected to act as moral agents.

In the mid-19th century, corporations became umbrellas for shareholders, and as corporate capital and influence grew in the early 20th century, academics began to view them as real entities. As the role of the shareholders diminished and the corporation developed a legal personality — it could sue, be sued, and was responsible for its own debts — it became harder to think of the corporation as a fiction.

By mid-century the corporation became an institution rather than a private business device. This implied the corporation had responsibilities beyond its shareholders — a moral personality.

Society’s Dominant Institution

Managers deal with moral decisions every day, and

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The Corporation's Evolving Personality

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corporations are routinely dealt with, discussed, and judged as moral agents. When people protest a company's environmental policies, boycott an unethical company, or employees feel gratitude to a corporation for treating them fairly, they assume that companies are objects of moral assessment and concern. Even the business media covers stories of moral controversies, misconduct and safety concerns with as much zeal as it reports profits, economics and corporate mergers. Some economists still feel it is absurd to ask corporations and their managers to behave in a morally defensible manner, but practice has outpaced theory.

Every day people work for corporations, invest in them, buy from them, provide services for them, and regulate them. Corporations provide most of our food, transportation, utilities and entertainment. They guide our behavior through marketing, employee policies and campaign donations. Of 1997's \$18 trillion in U.S. business revenue, 88% went to corporations. In 1998 approximately half of Americans owned stock. Corporations are society's dominant institution, and if we granted them exemption from morality, we would exempt morality from 80-90% of our lives.

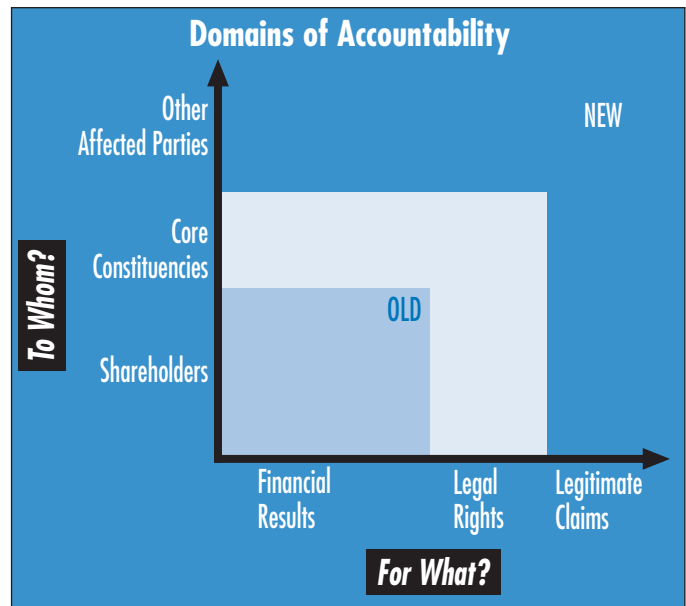
In the last 30 years, discussing company values, commitments, and responsibilities — attributes of moral actors — has become commonplace, and recent legal findings and decisions have encouraged and even required more moral behavior. The growing acceptance of this turn to corporate morality is the key to understanding the recent turn to values. ■

A Higher Standard

Companies are being evaluated as if they were responsible human beings. A new yardstick is emerging

Moral Questions at Shell and Nike

Questions about nonfinancial issues affected both Shell and Nike in the 1990s. Their environmental and human rights decisions had serious effects on their financial performance, but also caused both companies to focus on these issues. Shell not only had lower sales after the Brent Spar and Nigeria controversies, but their employees and shareholders wanted clarification on the company's stance. After Nike was attacked for the poor labor practices of its suppliers abroad and the decline of its market share and share price, the company did an about face and concentrated on improved worker conditions and social responsibility.



for assessing corporate performance that holds them to both moral and financial standards. A high-performance company that competes unfairly, mistreats employees, or neglects its civic role is becoming an oxymoron. This is reflected in the growing number of “most admired” and “most respected” company surveys.

Whether people are deciding where to work, buy, or invest or what companies they want in their communities, they are including moral considerations with financial ones.

Employee Perspectives: Employees want to be respected, treated fairly, and recognized for their contributions. They appreciate honesty in colleagues and managers, consideration for their health and safety, and opportunities for learning as well as making a positive difference in the world.

Customer Perspectives: Customers want to deal with companies that are reliable and treat them fairly. They want products that provide quality and performance, but they are also interested in the health, safety and environmental risks of what they buy.

Community Perspectives: Communities want companies to clean up their messes, minimize negative impacts of their activities, obey local laws, protect the environment, and help solve community problems.

Investor Perspectives: Shareholders want transparency, timely information, reliable forecasting, fair treatment, and opportunities to be heard.

An expanded sphere of accountability is hard for managers to accept when previously they were only accountable for financial results.

Though it seems more demanding, the higher standard only asks companies to do the same as all moral actors — respect the legitimate claims of others as they conduct their business. ■

The New Value Proposition

After thoroughly examining the issue of “ethics pays,” it is clear that the phrase “ethics counts” is more appropriate.

Using the *financial* argument for ethics has a dangerous underside. If you can make more money by lying, exploiting workers, or falsifying financial records, then ethics only pays when the risk of getting caught is too high. Using a purely financial argument for ethics undermines the idea that ethics have innate value, which is unwise in a world where companies are increasingly judged by a composite “ethico-nomic” yardstick. Superior companies must excel in both areas.

Measuring Moral Performance

There are myriad ways to assess financial performance, but measuring moral performance is inherently more difficult. Referring back to the “ladder of commitment” here are three levels of assessment (see chart).

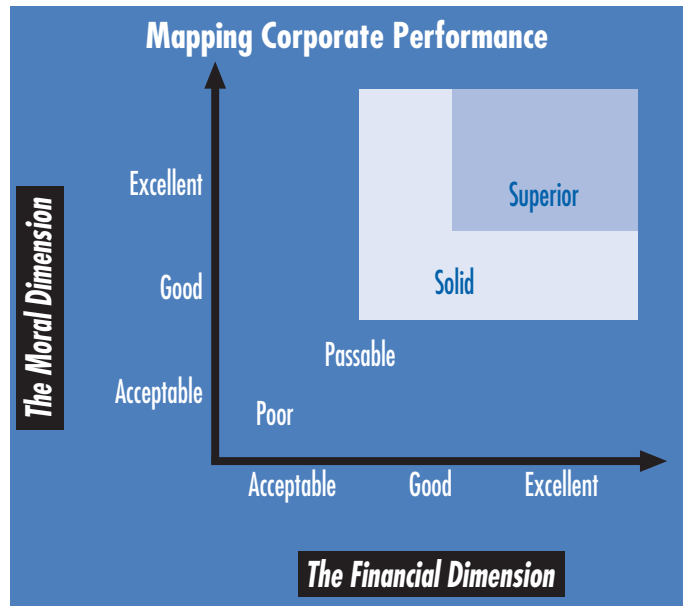
- **First level/Acceptable:** Companies adhere to the law and avoid gross wrongdoing and offenses against basic justice.
- **Second level/Good:** Companies comply with the law, observe norms of fairness and responsibility, seek mutual gain in dealings with others.
- **Third level/Excellent:** Companies comply with the law, observe norms of fairness, seek opportunities to make additional contributions. ■

Ethics Counts

It is difficult to match *values*-based measures with *financially* based measures. Responsibility, dignity, citizenship have no obvious correlation with revenues, costs and profits. After a helicopter crash in an airfield, an investor thinks of production losses, and a social service provider thinks of safety and security. Both are valid, but they cannot be collapsed into each other. Companies must find a way to engage both points of view and speak both languages fluently. The phrase “ethics pays” is inappropriate, because values are not a component of the ultimate goal of financial success. “Ethics counts” casts values as a full partner with economics in a quest for outstanding performance.

When moral and financial considerations have their own standing, conflict will inevitably arise. Though there is no standard way to choose between them, acknowledging the conflicts honestly will allow clearer trade-offs and creative solutions.

Ethics counts also has value-added in the truth, loyalty, gratitude and reciprocal respect it engenders among stakeholders. Though impossible to measure in monetary terms, this value-added that comes from the energy



produced when values are respected is very important for companies. ■

For Additional Information on criticisms of corporate values, go to: <http://my.summary.com>

Performing at a Higher Level

Many companies believe “having values” means having a list of values, and “implementing values” is a discreet staff activity unrelated to line management. Companies create specialized programs in diversity, environmentalism and ethics as they receive external pressure to do so. In actuality, meeting the new performance standard is a more comprehensive and fundamental process.

In the early 1990s Sears attempted to increase its lagging performance by setting quotas for its car mechanics. The mechanics began lying to customers — exaggerating problems and the work done to fix them. The plan was to align the employees’ financial interests with those of the shareholders, but Sears incorrectly assumed financial performance was the only component to superior performance. By 1992 the company was under investigation by 44 states for misconduct. Similar problems caused downfalls at Columbia/HCA, Sunbeam Corporation and Enron. The problem was not the concepts of alignment of performance-based incentive, but how the concepts were applied.

In addition to incentive and compensation systems, all other systems — hiring and development, planning and coordination work, measuring and reporting performance — must be aligned to allow the company as a whole to behave as a moral actor. There should be a fit

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Performing at a Higher Level

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or correspondence between a company's guidance systems and the expectations of the new performance standard. Additionally the company's organizational design must support the trust and information transfer that is necessary to meet the new standards. Rolling out a new values statement is not enough.

A Company That Made It Work

A prime example of a company that organized itself to be a moral actor from the beginning is the energy company AES. The founders, Roger Sant and Dennis Bakke aimed to create a new form of business that would be socially responsible and profitable. They believed power companies should do more to protect the environment, and that companies should approach social responsibility in an integrative way. In their company, all people would be treated as adults, defined as:

- **Thinking, creative and capable of making hard decisions.**
- **Willing and able to assume accountability and responsibility.**
- **Unique and deserving of special treatment.**
- **Positively disposed to work in groups.**
- **Eager to make a contribution or join a cause.**
- **Fallible, even intentionally so at times.**

An Organized Framework

Sant and Bakke recognized the importance of strong financials, but as a by-product of fulfilling a legitimate corporate purpose. They started AES in 1981 and crystallized their core beliefs as a way for their employees to carry out the company's purpose. The values were integrity, fairness, fun and social responsibility. When AES experienced financial difficulties in 2001, it had a framework in place to review its operations and identify ways to improve its economic performance, strengthen its values, and tighten accountability mechanisms.

Having an organizational framework in place worked better than the piecemeal approach used by so many companies that causes initiative-fatigue, confusion and cynicism. AES has no diversity initiative or empowerment program. These concerns are embedded in the company's basic management systems. When we accept that companies are moral actors, these values become an inherent part of management's job. It turns economic functions into economic responsibilities that management has to answer for and includes them in the same category as all of their other responsibilities. Ethics are part of the structure along with finances and not perceived as add-ons. ■

For Additional Information on how AES integrated values into its structure, go to: <http://my.summary.com>

A Moral Center

Values implementation is not a task that should be delegated. Executives define and shape values through everything they do, and at the same time everyone in a company does values implementation every day. The approach must be comprehensive, management-led and oriented toward a moral center that recognizes social and economic responsibilities. A moral center is defined by the answers to these questions:

- **Purpose:** What is the company's purpose? Besides creating wealth and using resources efficiently, what is the company's contributions to society? How do its products and services add value to people's lives?
- **Principles:** What are the company's guiding principles? What precepts guide the conduct of its people in carrying out its purpose? What are its nonnegotiable standards? Its ideals and aspirations?
- **People:** What is the company's concept of the person? Who counts as a member of its moral community? Whose interests are considered in its decision-making?
- **Power:** What is the scope of the company's power and authority? To whom and for what is the company accountable? How is decision-making authority to be allocated within the organization? ■

The Decision-Making Compass

No matter how well a company's organization and systems are set up to achieve the new performance standards, a company's success comes down to the quality of its decision making. Moral scrutiny from stakeholders will only increase as the pressure to perform financially increases as well. All employees will have to become more sensitive to the moral aspects of their dealings and more skilled at identifying ethical issues and making decisions that are morally and financially sound.

The Right Questions

Companies need a structured management decision process to identify and evaluate moral concerns. This book's framework exploits the power of asking questions, which is essential to many business processes including strategy formulation or evaluating an investment.

The core question in ethics is "How should we live?" It breaks down into subsidiary questions: "What should we aim for?" "How should we conduct ourselves?" "What do we owe others?" "What rights do we have?" Each of these questions suggests a mode of moral analysis that can be used for decision-making.

- **Purpose:** Will this action serve a worthwhile purpose?

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The Decision-Making Compass

(continued from page 6)

- **Principle:** Is this action consistent with relevant principles?
- **People:** Does this action respect the legitimate claims of the people likely to be affected?
- **Power:** Do we have the power to take this action?

Once an issue is identified, the four kinds of questions explicate different features of the situation so they can be inspected and compared with other features, and then evaluated and addressed.

Together the four lenses create a compass for the manager that helps to chart a reasonable course through conflicting demands. Hopefully in the end, the course of action will satisfy all four criteria.

Product Failure: A Case Study

In the early 1990s Lotus Development Corp. and Equifax Inc. combined their core competencies to develop Lotus Marketplace: Households, a database that included information on 80 million households, allowing small businesses and nonprofits to effectively target their mailings.

There was an enormous outcry when the companies announced their product. Concerns focused on whether people had consented to be included in the database, how people could have their names removed, and how the data would be secured from falling into the hands of criminal elements.

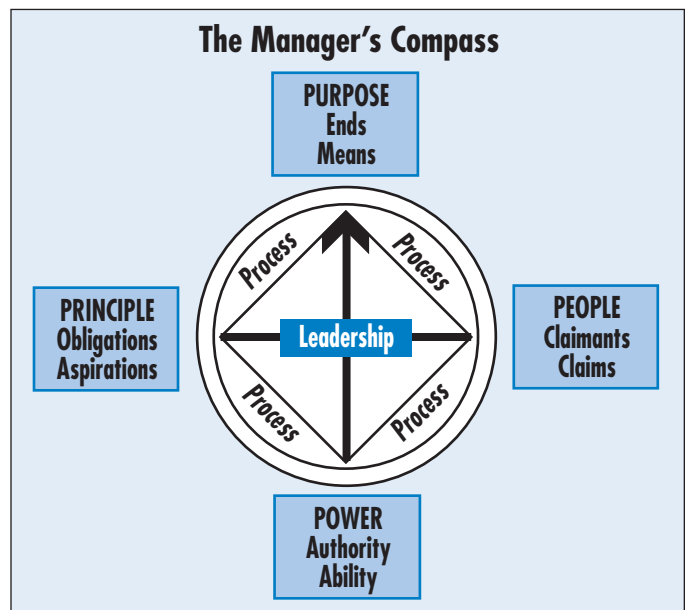
After a review by the Direct Marketing Association, it was determined that the new product needed an effective way to opt out and a strict screening mechanism for buyers. The makers would also need to educate the public, which erroneously believed the database included detailed records of actual purchases rather than general buying propensities.

The extra precautions and changes made the cost of continuing with production prohibitive, and Lotus and Equifax cancelled plans to ship the product.

How the Compass Would Have Helped

If Equifax and Lotus had used the manager's compass in the early stages of development, they could have avoided such great costs. Marketplace could have been designed or marketed differently, or perhaps not even pursued.

An analysis of principles would have shown that Equifax's own statement of fair information practices included at least two relevant principles about use of data and privacy. The DMA's ethics handbook advised that customers whose data might be rented, sold or exchanged for direct marketing purposes should be periodically informed of the potential. The U.S. Fair Credit



Reporting Act laid out specific directives for the proper use of credit and other consumer information. Even generally accepted ethical principles would have raised many of the same issues.

Similarly, conducting a stakeholder analysis of the people involved would have directed the team's attention beyond the small business consumers for whom the product was designed. They would have considered the other parties with interests at stake, such as the data subjects, government regulators and lawmakers, and even public advocacy groups such as the ACLU Project on Privacy and Technology, which eventually helped spearhead the campaign against Marketplace.

Correcting for Blind Spots

Without a systematic process of moral analysis to inject the moral point of view into deliberations, decision makers are vulnerable to the blind spots and biases in most frameworks.

Competitive analysis does not consider stakeholder impact, social contribution or conformity to legal and ethical norms. Cost-benefit analysis often necessitates assigning monetary value to things that cannot be measured in money, like human lives. Difficulties can also arise because it does not clarify what is a cost and a benefit and for whom.

Today's companies need a methodology for integrating the moral point of view into decision-making. Where companies are expected to create wealth while conducting themselves as moral actors, managers will need to practice "center-driven" decision-making, the target zone of acceptability in the overlap of values and economics. ■

The Center-Driven Company

As the corporation becomes moralized and the new performance standard sets in for the foreseeable future, companies will need leaders who can meld high moral standards with outstanding financial results.

To become center-driven, companies must make fundamental and comprehensive changes in their operating systems. Though there is no specific model for a center-driven company, Royal Dutch/Shell, which has been implementing their sustainability model since 1988, is a good example.

- **People are committed to both moral and financial excellence.**
- **Guidance systems are aligned with financial and nonfinancial accountabilities.**
- **People use decision frameworks that integrate social and financial considerations.**
- **People assess its performance along moral and financial dimensions.**
- **People engage each other and external parties as moral actors.**
- **Company as a whole displays the competencies expected of a moral actor.**

A center-driven company defies traditional methods of operation and develops creative innovations to satisfy both moral and financial obligations, as demonstrated by the two case studies below.

Workforce Restructuring at Telia

In 1995, Sweden's Telia Group, an Internet and communications company, found that it needed to lay off 5,000-7,000 employees because it was overstaffed, and the current employees did not have the skills for the rapidly growing industry. Instead of a traditional layoff, Telia's redeployment team worked with unions to provide training, vocational guidance, study grants, business support and job placement support to the employees. As a result, 2,800 employees were given new positions with their improved skills, and the rest moved to other jobs, started businesses, went back to school, or retired. Fewer than 1.5 percent were given notice. The program saved the government \$135 million, the affected employees \$85 million, and benefitted Telia by \$310 million.

Irrational Managers?

Telia's efforts, as well as the efforts at Manville (see above right) were a foregone conclusion, though they seem no more than common sense. These innovative thinkers waged uphill battles against the status quo. Conventional wisdom said that these managers were thinking about the wrong things.

Minimizing negative effects of restructuring on Telia

Managing Safety at Manville

Bill Sells was head of Manville Corp.'s Fiber Glass Product Group in 1986 just four years after the company declared bankruptcy because of a liability disaster involving their asbestos production. A study came out announcing that fiberglass could cause cancer. Sells quickly mobilized his colleagues to have several weeks of discussion on what to do.

After discussing possibilities from doing nothing to exiting the fiberglass business, Sells' team decided on an aggressive communications and relabeling campaign to disclose the potential risk to employees, distributors and customers, and they agreed to indemnify their customers against cost incurred from end-user injury claims. Manville did not lose very much business, and ended up gaining goodwill from thankful customers.

Groups' employees was considered the work of government, families and communities. Manville's Bill Sells was breaching his fiduciary obligation to shareholders by putting the interests of employees and customer ahead of shareholders when the law didn't require him to. From an orthodox perspective these managers acted irrationally, but from a center-driven outlook they were normal and rational.

As moral actors they discovered a practical path that enabled the company to remain competitive while respecting the rights of others and minimizing the collateral harm caused by their activities. They still satisfied the orthodox, even though traditional managers many never have envisioned the path or experience the concerns that led to it.

A Philosophy of Management

Center-driven management is not a technique or collection of best practices, but a philosophy of management grounded in assumptions about business that challenge key tenets of traditional management.

These assumptions include the premise of a corporate personality; that superior corporate performance consists of moral and financial excellence; that corporate accountability extends beyond shareholders; that corporate conduct consists of all actions taken by its members or representatives on its behalf; that human behavior is multifaceted and can express mixed motives and varied aspirations; that rationality means using reason to enhance life; and that progress is not inevitable and needs to be fought for continuously. Companies looking to achieve the new performance standards will need to cultivate leaders who understand these broader accountabilities. ■