Business Transformation
A Field Guide for Builders, Social Champions and Changing the World

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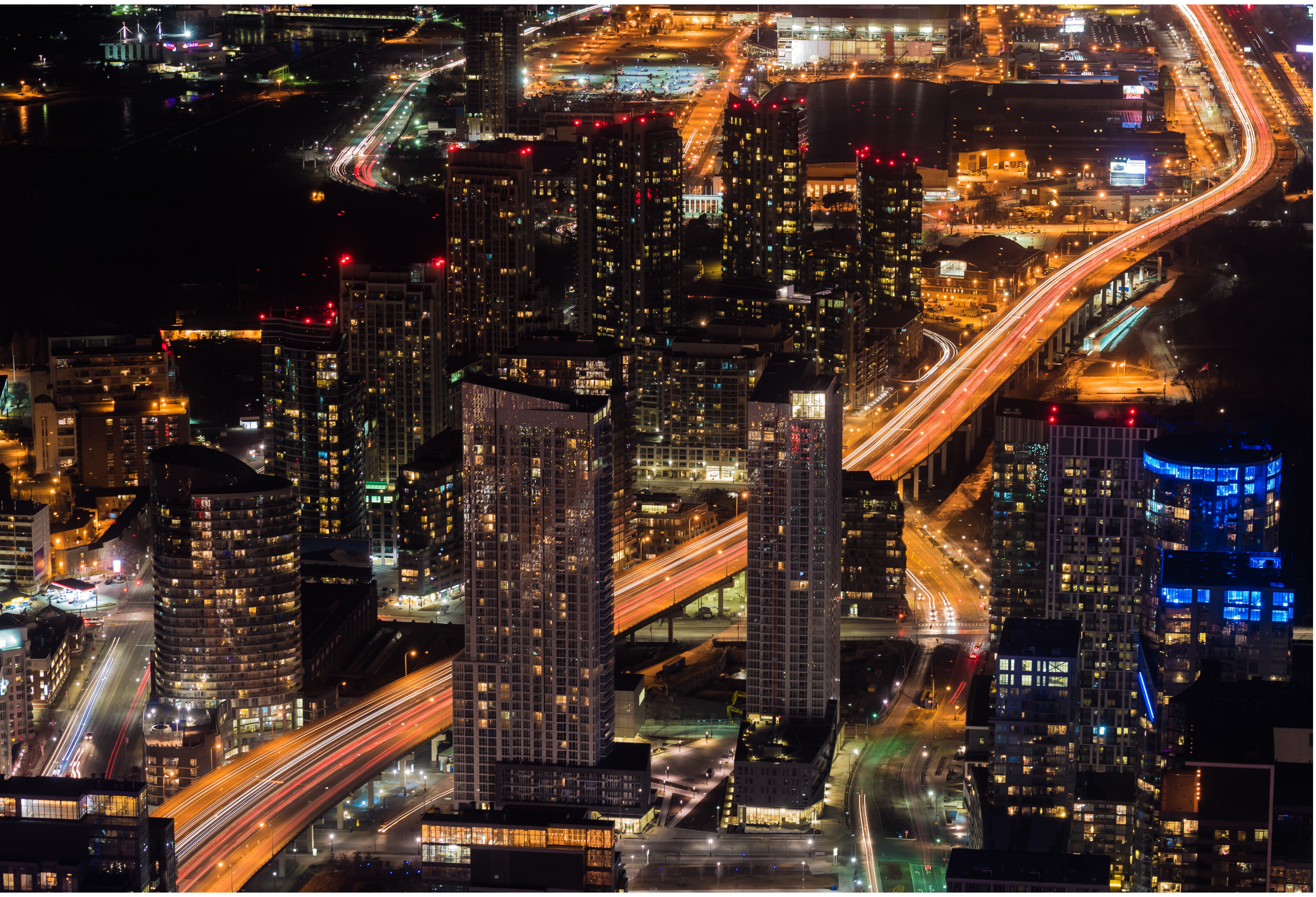

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Business activities that cause significant harm to the public commons—the environment, public health, a well-functioning marketplace, civic life—are not sustainable. Eventually, societies demand that such businesses fully account for and remediate these externalities. Disruptive health, environmental or political crisis precipitate these demands for change. Inevitably, these businesses must transform or perish. Such transformation is hard, but postponing it only makes it harder. This paper catalogs a set of experiences and guidelines for managers to spot such social externalities from their business activities, to respond to them sooner, and to experiment and reinvent their products and business models. The path to such transformation is hard and paved with many false starts, missteps and painful reinvention. Nevertheless, persevering on this path is essential for these businesses to survive.

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II. Introduction

Businesses are living through a time of great uncertainty and radical changes in their operating environment. The recent COVID-19 health crisis (which we are only in the first phases of) illustrates unanticipated phenomena may precipitate uncertainty and change—the unknown unknowns. COVID-19 has added to and accelerated the disruptive forces that have been in motion for the last couple of decades—rapid advances in digital technologies and the unbridled competitive advantage that the mastery of these technologies brings to firms, lowered impediments to the global flows of people, ideas and capital, rapidly changing social mores, and a fast-moving political-economic context.

> *Uncertain times require organizations to build a toolkit to transform in response to a rapidly changing environment. In the face of unanticipated threats like COVID-19, organizations have had to transform their businesses overnight.*

Business models that, for centuries, have been based on social interactions, are finding that their regular operations pose a risk to their customers' health. Others are finding their key activities severely limited due to restrictions on their labor force. Others have become essential services to keep society functional but need to radically scale up their operations in response to the pandemic. Overall, no business has been left untouched, and many businesses will need to radically transform to survive.

This research develops a transformation toolkit, a toolkit that enables organizations to continually observe the environment, process and analyze the early signals in an unbiased and rigorous way, abandon old orthodoxies, cut through the embedded incentive structures and develop new approaches to reinvent themselves in response to the changing environment.

Our particular focus is on organizations that strive to transform themselves in response to new recognition, science and legislation on the negative externalities imposed by their business models on society at large. This can include when new research reveals that the critical components of a product have a harmful environmental impact, or that running a business might create public health risks in the light of new pathogens, or the high adoption and success of a business reduces innovation in the marketplace, etc.

> *Managers' first instinct, when faced with the negative consequences of their business activities, is to avoid change; the business itself might be performing well financially, and in the short run, it might seem that the business can get away with its activities. This is a myopic view. Businesses that impose costs on society are not sustainable.*

Eventually, society catches up, and businesses are forced to transform by legislation, direct consumer actions, employee pressure or by shareholder choices. Obfuscation, avoiding responsibility or manipulating the information environment are not options. The democratization of information recording and dissemination, the ease of organizing and building coalitions using social media, heightened consumer awareness, and a keen sense of purpose among younger individuals sheds light on such activities, and continuing business the old way becomes unsustainable. Thus, businesses that get an early read on these externalities and transform themselves before they are forced to, are likely to be more sustainable and deliver long-term benefits to their shareholders.

The COVID-19 pandemic is likely to further intensify the need for businesses to become responsible citizens that account for and remediate the negative externalities that they impose. The pandemic is highlighting the interconnected nature of the world, in particular, how things that affect any member of society can bring harm to all members of society. The full effects of the economic and social dislocation from the pandemic will take a time to bear out, and there will be many unanticipated effects, but the crisis will likely heighten the responsibility of each member of society to act in ways that do not harm the rest. Societies might further recognize and enhance the role of government and media in policing all errant actors. Overall, businesses that do not become responsible citizens are likely to find an even more challenging operating environment. Thus, building competencies to recognize the businesses' social impact and to remediate it are going to become even more essential to the survival of a business.

1. Highlight the common (known) stimuli for transformation
2. Provide taxonomy of externalities a business model may impose on society
3. Dive into examples of companies and industries that successfully transformed themselves
4. Identify common patterns of behavior from these successful transformations

In this study, we first highlight the common (known) stimuli for transformation. Next, we provide a taxonomy of externalities a business model may impose on society—environmental, public health, market functions, civic life and the social fabric, and on labor laws and human rights—this taxonomy helps organizations audit their societal impact and get an early read on the potential need for transformation. Next, the research delves into some examples of companies and industries that successfully transformed themselves to limit such externalities. Finally, and most importantly, the research identifies some common patterns of behavior from these successful transformations that can serve as a playbook for managers to lead such transformation.

III. Why Transform?

Business is booming. The company is providing excellent returns to its shareholders, sales are growing, employees are thriving, and management is well compensated for delivering results. There are no incentives to change things. Yet, good times are the best opportunity for businesses to proactively look for reasons that might necessitate transformation. When the need for transformation is reflected in the financial statement, or worse, when society forces change, business transformation often is done from a position of financial weakness in a hostile external environment—which leads to lower success rates. In some cases, it might already be too late.

The key to proactively recognize the need to transform is to recognize and understand the externalities that the business exerts on society. In this section, we provide a taxonomy of the social externalities. This provides a checklist that enables early detection of stimuli for business transformation.

SOCIAL EXTERNALITIES

Externalities are side effects or consequences of a firm's regular business activities on unrelated entities that are typically not reflected in the costs, revenues or other items on the financial statements of a company. For example, a business that leads to the development of a region's human capital (experienced workforce, mentors, advisors, etc.) exerts a positive externality on the economy of the region. On the other hand, a business that pollutes the local natural resources exerts a negative externality in its geography.

Social externalities are the externalities that are borne by society at large, as opposed to those borne by a single individual or an organization.

> *Identification and accounting of a firm's social externalities is an essential first step to recognizing the potential need for business transformation.*

Businesses that exert significant negative social externalities are liable to face regulatory attention, deal with employee disengagement and, eventually, face significant restrictions on their business practices.

In the same way, as businesses report their financial progress and sustainability in annual statements, forward-looking business managers must consider regularly auditing and accounting for the externalities that their business imposes. In particular, the following kinds of social externalities are most salient: externalities on the environment, on public health, on market functions, on our civic life and social fabric, and on labor standards and human rights. While annual sustainability reports cover some of these externalities, others, such as those on market functions and public health are rarely well understood.

Externalities on the Environment

Harmful externalities on the natural environment are perhaps the most well-recognized forms of externalities. Typically, these include activities that harm our shared natural resources, including air, water and soil resources. Releasing harmful substances in the air, water or soil are the most evident forms of such externalities as their effects appear and operate in relatively short time horizons. At the same time, the increasing focus and unambiguous science on longer-term environmental impacts,[i] most notably due to the release of carbon in the atmosphere, highlights the need for managers to consider not just the immediate impacts but the potential long-term environmental impacts of their activities. Further, it is important to look at the direct impact of the business activities and the impacts from upstream and downstream in the supply chain. For example, energy companies must look at the environmental impact of their energy production and the impact of how their customers consume energy.

Actionably, managers must regularly list, assess and quantify the environmental impacts of their business activities, the short-term evident impacts and the long-term impacts, the direct impacts from their activities, and the impacts upstream and downstream.

Externalities on Public Health

The health and well-being of customers, employees, the people in the operating regions and of society at large is critical to the continuing success of a business. Healthier customers live longer, healthier employees are more productive, and a healthier broader ecosystem attracts better talent. These are all important direct financial reasons for businesses to focus on the public health impact of their products. There are also health-related externalities that businesses impose on society. The costs of poor health are often socialized in developed societies; that is, the full burden or cost of poor health is not borne by the company but by society at large. In these cases, myopic management may ignore the socialized health care costs. Yet this is not sustainable, and society will restrict the functioning of businesses that ignore the public health impacts of their products.

The public health impacts of a product arise across three different categories:

CATEGORIES	EXAMPLES
When products directly (and perhaps unknowingly) harm the health of the consumer or individuals around the consumer	Smoking tobacco products, the use of carcinogenic additives in food
The product or the marketing of the product encourages behavior that can cause harm to the individuals or those around him	Marketing and prescription of opioids that may encourage dependency
When the course of production or consumption of products/services leads to contagion and poor public health practices	The cruise industry in a global pandemic

First, when products directly (and perhaps unknowingly) harm the health of the consumer or individuals around the consumer, for example, smoking tobacco products, the use of carcinogenic additives in food, etc.[ii]; Second, the product or the marketing of the product encourages behavior that can cause harm to the individuals or those around him, for example, marketing and prescription of opioids that may encourage dependency (Hadland, Rivera-Aguirre, Marshall, & Cerdá, 2019); And third when the course of production or consumption of products/services leads to contagion and poor public health practices, for example, the cruise industry in a global pandemic.

As with environmental externalities, one must look at the production of the product itself and the upstream and downstream actors in the supply chain.

Externalities on Market Functions

A properly functioning marketplace provides appropriate rewards for innovation, limited barriers to entry of competitors, free access to suppliers and distribution platforms, and fair market interactions. Business strategists advise firms to build sustainable competitive advantage, which, while necessary for breaking into new markets and early growth, if pursued to its logical extreme, can lead to an ill-functioning market. Such dysfunctional markets lead to corporate inertia and decay, low innovation, poor service, high prices for customers, limited mobility for talent, and eventually a ham-fisted regulatory response. In the short-term, being a disruptor of market functions might seem like an advantageous strategy, but sustainable businesses are not built in ill-functioning markets. Eventually, regulatory pressure, customer actions or business missteps catch up.

Managers should account for the impact of their actions on healthy market functions. In particular, firms must watch out for the following potential externalities they might be imposing: First, do the firm's actions block entrant or competitors' access to critical markets (Economides, 2001); Second does your organization routinely thwart entrants by limiting their access to capital, employees, data or other key production inputs? For example, Facebook and other companies that limit customers' data portability, allegedly prevent new entrants with better services.[iii] These actions have already drawn antitrust scrutiny, fines and operating limitations in several markets, and there is more to come; And third does your organization use control of other markets to limit competition in an unrelated market by limiting access, bringing to bear financial resources from the other market? For example, Amazon allegedly used the control of its fulfillment platform to disadvantage sellers that compete with its own branded products, or Amazon allegedly used data generated from its fulfillment platform to compete against rival sellers on the Amazon marketplace.[iv,v,vi] These actions have already led to operating restrictions in some markets in Europe and in India, limiting Amazon's international ambitions and might have effects in the U.S. Independent sellers are also wary of collaborating with Amazon.

Externalities on Civic Life and the Social Fabric.

Businesses thrive in societies with evidence-based health care, education, economic and other policies. Democratic societies arrive at such policies only when the electorate has access to accurate and unbiased information. Further, given the increasing complexities of such policy issues, there are many opportunities for malicious actors to sow confusion and discord. Short-term managers may think that manipulating the information environment to incentivize policies favorable to the business can lead to higher returns.

Yet, such actions merely delay the reckoning, often enhance the downsides, and might lead to the breakdown of civic life that can have unpredictable and unintended consequences. Managers interested in building sustainable businesses, on the other hand, recognize the social externalities that their manipulation of the information environment leads to, and work to proactively identify and limit such effects and to function in a healthy environment.

In particular, businesses should be wary of two such externalities on civic life and the social fabric. First, firms whose products directly limit or confound access to scientifically validated information must recognize the costs such products are imposing on society. For example, a media platform that lets unvalidated medical information flow freely through it, or worse, amplifies false narratives for higher ratings, exerts a negative externality on the social fabric. Second, firms in securing their business interests may invest in manipulating the information for their own gain—information that has a detrimental social impact—and must recognize such social externalities. For example, when a firm invests in lobbying for looser regulation on a critical component, this component has an alternate nefarious use.

Smart managers must continuously review their business activities and those of players upstream and downstream in the supply chain to identify such social externalities, assess their importance and significance and estimate the costs associated with them.

IV. The Transformation Journey

Transformation is hard and often needs to happen in the face of sustained internal opposition. In particular, transformation requires fundamentally changing the products, business models, culture and leadership that made the organization successful in the first place. Nevertheless, some organizations successfully transformed in the face of these challenges. In this section, we highlight a few of our favorite examples.

The following examples are not intended to be blow-by-blow accounts of transformations; instead, they are provided to serve as illustrations of the kinds of transformations that this study documents. Further, the examples here are not intended to suggest that these transformations were ideal executions or came at the right times; in fact, most of these organizations would have been served better by starting these transformations sooner. Overall, the following cases should be thought of as illustrations of what is possible once organizations put their heart into the business of transformation.

To provide a complete view of the transformation journey, we provide two cases of companies that have successfully completed their transformations, one industry that is in the middle of several promising initiatives, and one organization that we hope is starting on the path of transformation.

MICROSOFT

Microsoft was founded in 1975 by Paul Allen and Bill Gates to make software for microcomputers. Over the next decade, Microsoft developed software that was bundled with the most popular personal computers. As a result, by the early 1990s, Microsoft had become the dominant provider of operating systems and productivity software, with an over 90% market share in most categories.

The Challenge

Microsoft's antitrust woes began in 1990 when the Federal Trade Commission (FTC) launched an investigation of the company. On July 15, 1994, the U.S. Department of Justice brought a complaint alleging that Microsoft entered into volume-driven licensing contracts with personal computer manufacturers that leveraged its high market share to limit market access of competing operating systems. The low marginal cost of software coupled with these licensing arrangements allegedly helped Microsoft maintain an unlawful monopoly of personal computer operating systems. Simultaneous with the filing of the complaint, Microsoft and the Department of Justice entered into a consent decree in which Microsoft agreed to abide by certain restrictions on its licensing arrangements (Gilbert & Katz, 2001).

The restrictions did not engender a serious transformation, and the battles with regulators continued. On May 18, 1998, the government (the U.S. Department of Justice, 19 state attorneys general, and the attorney general of the District of Columbia that brought the case) brought an antitrust case against Microsoft alleging that Microsoft compelled computer manufacturers to license and install Internet Explorer, and entered into contracts that excluded rivals, and engaged in various forms of predatory conduct. Of particular concern was the role of the browser and related technologies (e.g., Java). The Netscape browser could run applications written in Java and effectively render the underlying operating system as a commoditized backend layer. Further, the browser could itself become a substantial competitor to the operating system. Microsoft's use of its control of the operating system market to block the growth of the Netscape browser was intended to limit such innovations and preserve the value of its existing products.

Microsoft contended that it was a vigorous competitor that was trying to provide the best services to its competitors. While the legality of Microsoft's action was decided following the prevalent statutes, it was widely understood that Microsoft's actions increased its market power and created negative social externality by limiting access to an alternate choice for consumers, which made at least some consumers worse off. One may argue that this made other consumers better off, leading to overall better outcomes for customers, but the existence of a negative social externality for some part of society is less contested (Gilbert & Katz, 2001).

While the government argued for a structural remedy—the breakup of the company—the associated costs of such a breakup were high. Instead, conduct-based remedies such as the required unbundling of complementary products were put in place. See Economides, 2001, for a full accounting of the remedies. On November 1, 2002, Microsoft reached an agreement with the U.S. Department of Justice to settle the case, leading to conduct-based remedies.

Well before the effects of the legal remedies bore out, Microsoft's business was affected significantly. As early as August 2000, Microsoft's stock price was down about 40% because of the antitrust actions. Even more substantial and long-lasting was the loss of trust from the developer community, a stakeholder group key to the continued vitality of the Microsoft ecosystem.

By not recognizing the negative social externalities of its actions and continuing to defend its behavior, Microsoft was distracted from new markets that were opening up, in particular for operating software for personal devices (assistants, music players) and eventually mobile phones.

These distractions provided an opening for much smaller competitors (e.g., Apple) to enter and dominate these markets, which eventually ended up being bigger than the personal computer operating system market. As of 2004, its two core products—Windows and Office—had been experiencing anemic growth in revenues and profits. Moreover, competing software such as the Linux operating system, piracy in the fast-growing emerging markets, and the rising popularity of search engines like Google were threatening Microsoft's traditional franchises (Rukstad & Yoffie, 2004).

The Transformation

Analysts hoped that Microsoft's transition would start with the leadership transition from Bill Gates to Steve Ballmer in January 2000. The early years of the transition were notable for a change in the public face of the company and a less combative legal posture. Yet, little changed in the culture at Microsoft. Bill Gates continued to be heavily involved in the organization.

In the decade that followed, a culture that crippled innovation flourished at Microsoft. A wave of external competition crashed down on the firm, causing talent to jump ship. By 2004, thanks to the rapid growth of upstart firms such as Google, some of Microsoft's most talented employees were leaving faster than they could be replaced.

> *"Instead of a culture that said, 'Let's experiment and see which ideas work,' the culture is one of, 'Let's kiss enough ass so maybe they'll approve of our product,'"*

said one Microsoft executive who eventually quit in 2009 to work for Google. A former engineer said it was like "designing software by committee" (Ibarra, Rattan, & Johnston, 2018).

Microsoft's product development process lagged: Bing failed to extinguish Google search, and Zune could not compete with Apple's iPod. Ballmer aggressively opposed open-source innovation, calling Linux a "cancer that attaches itself in an intellectual property sense to everything it touches." The industry labeled him "shortsighted." Morale plummeted. By 2011, Ballmer's Glassdoor rating among his own employees was just 29%. Despite climbing to 46% the following year, it still lagged behind others at that time: Google CEO Larry Page's approval rating was 94% and Mark Zuckerberg's was 99% (Ibarra, Rattan, & Johnston, 2018).

Substantial transformation started only after yet another change in leadership when Satya Nadella took over in early 2014. Nadella, a consummate insider, grew up professionally in the Microsoft that Gates and Ballmer created. He had worked at Microsoft since 1992. Yet, right after taking over, Nadella made it clear that there was a need to change Microsoft in very substantial ways.

The journey of Microsoft's transformation over the next five years had several twists and turns. Yet, four key pillars drove the transformation:

I. Innovate and No Holy Cows.

One of the most significant barriers to innovation was a culture of fiefdoms and internal teams battling each other, effectively stifling innovation by other teams to keep one's own group dominant. In a way, the same aggressive competitive practices that Microsoft employed in its competition with other firms had become part of its internal culture and teams engaged in the same "vigorous competition," but now to compete against other internal teams, rather than new entrants. This is not a strange or surprising occurrence; company values have a way of becoming business-unit and internal team values and seeping in through the organization, which can lead to unexpected counterproductive effects.

Nadella declared that we are one company, one Microsoft—not a confederation of fiefdoms. Innovation and competition do not respect our silos, so we have to learn to transcend those barriers (Nadella, Shaw, & Nichols, 2017). To effectuate this mindset, several changes, small and big, were made. Most attention grabbing was a change to the notorious stacked-ranking-based performance review system, yet the cultural transformation happened as much due to many other smaller changes such as publishing a list of desired behaviors. Most importantly, senior management made sure to publicly act in ways consistent with these values, even when these led to significant personal or professional costs.

II. Focus on the Customer.

Microsoft had become successful by virtue of having a dominant market position and using that dominant position to attract developers and computer makers to its platform. As such, establishing a dominant position in a market and using it to encourage the adoption of complementary products was part of the organization's DNA. This included making its most popular products, such as the Office suite of products, only available on its platforms, even though this limited choice for Office customers who might have wanted to use the product on a different platform. This strategy had served Microsoft well in the personal computer era as customers had little choice. But, in the mobile era, despite multiple attempts, Microsoft did not have any dominant product. Apple and Google controlled the dominant platforms. In the spring of 2014, despite a contentious historical rivalry with Apple and a lack of traction with their own Windows phones, Microsoft made Office available on all iOS devices, including the iPhone and iPad. This action was a far contrast from Microsoft's earlier attempts to exclude customers who would use products from rivals.

More broadly, these actions were part of a renewed focus on doing what is right for the customer rather than what was in the narrow, myopic interest of the business. It also involved listening a lot more to the customers, retraining its entire frontline sales staff to become much more empathetic to the customer's business processes.

From pushing packaged products, Microsoft trained its sales leaders to become partners in customers' digital transformation enabled by Microsoft technologies.

III. From Know-It-Alls to Learn-It-Alls.

Any business transformation involves much uncertainty. No organization can figure out all that the transformation will involve and produce a perfect plan for execution. Operating in such environments of uncertainty requires firms to experiment and learn.

Nadella highlighted to his management team that people who operate with a fixed mindset are more likely to stick to activities that utilize skills they have already mastered rather than risk embarrassment by failing at something new. People focused on growth make it their mission to learn new things, understanding that they will not succeed at all of them at first. Nadella declared that management at Microsoft would need to shift from being "know-it-alls" to "learn-it-alls."

IV. Acknowledge Mistakes, Learn from Them, and Make Changes.

The last pillar of this transformation involved acknowledging mistakes. Whenever an organization operates in an uncertain environment and learns by experimenting, there are bound to be several missteps, false starts and setbacks. It is essential to acknowledge these missteps, apologize for the harm done, investigate the root causes, and fix them.

Microsoft's transformation involved many missteps. The most public ones included launching an artificial intelligence (AI)-based chatbot, Tay, which turned out not to have adequate protections against learning racist, sexist and other hateful discourse from its training datasets. Microsoft acknowledged the mistakes, investigated the root causes in an unbiased way, and improved the product. Nine months later, Microsoft launched Zo, a bot similar to Tay but designed to be more troll resistant (Ibarra, Rattan, & Johnston, 2018).

Four years after Microsoft started its transformation journey, it is once again a magnet for top engineering talent, rated as one of five best AI companies for

> employees, and Nadella has a Glassdoor employee approval rating of 95%. Microsoft was able to shift from its legacy business of selling packaged productivity software to selling software as a service and, more importantly, to compete effectively with Amazon for cloud-based services. Today, over 95% of Fortune 500 companies choose Azure, Microsoft's cloud computing service. Azure has announced 50 regions globally, with 40 generally available today—more than any other major cloud vendor. The company has embraced Linux, the open-source Windows rival "rather than clinging to Windows like a security blanket."
>
> As of early 2020, Microsoft's share price had quadrupled under Nadella's leadership.

NIKE

Nike was founded in 1964 by Phil Knight and Bill Bowerman as a reseller of imported Japanese athletic footwear. A few years later, the company began designing its own sneakers.[vii]

Nike's business is based on developing research-based high-performance athletic wear. Designers at Nike work closely with top athletes and material science researchers to develop products that use the latest technologies to improve performance, convenience and durability (Hsieh, Toffel, & Hull, 2019).

In the 1960s, only 4% of the footwear bought in the U.S. was made overseas.[viii] Knight's strategy was to produce shoes overseas at a much lower cost than other U.S.-based manufacturers or European competitors. Nike retained control over design and marketing but outsourced nearly all of its manufacturing to lower-cost Asian suppliers.

By the mid-1990s, Nike was sourcing from suppliers in Japan, South Korea, Taiwan, China, Indonesia and Vietnam.[ix] The *Far Eastern Economic Review* wrote in 1992, "Nike may look like an all-American enterprise, but its success relies on its ability to harness Asia's spectacular manufacturing enterprise."[x] A few years later, *The Washington Post* wrote that "Its 30-year history in Asia is as close as any one company's story can be to the history of globalization, to the spread of dollars—and marks and yen—into the poor corners of the earth"[xi] (Hsieh, Toffel, & Hull, 2019).

The Challenge

In the early 1990s, several influential media outlets published critical accounts of how Nike's products were made. Labor activists accused Nike of tolerating human rights abuses and exploiting underpaid workers in overseas factories. In 1992, *Harper's* magazine printed an Indonesian worker's payslip showing she earned $0.14 per hour.[xii] In a highly-publicized 1997 incident in Vietnam, workers fainted and were hospitalized after a manager made them run laps because they were not wearing regulation shoes.[xiii] A particularly damning article in *LIFE* magazine in 1996 showed young Pakistani children sewing Nike soccer balls.[xiv] Though not the only brand to be accused of exploiting workers, Nike's size, profitability and brand recognition made it a target. Outraged U.S. college students pressured their universities to cancel collegiate sportswear contracts with Nike.

When labor issues first surfaced in 1991, Nike defended itself. "They are our subcontractors," said Nike's general manager in Indonesia. "It's not within our scope to investigate [allegations of labor violations].[xv] Knight's response was initially defensive. He accused the U.S. media of not understanding how global sourcing works and continued for years to highlight Nike's social initiatives and how the conditions at Nike's factories were much better than on farmlands in the countries where the products were made. Nike did not accept the premise of the articles that compared the conditions in Nike's factories with those in the markets where Nike was selling its products.

The Transformation and Continuing Challenges

After years of prevarication, in 1998, Knight addressed the situation publicly in a speech at the National Press Club: "The Nike product has become synonymous with slave wages, forced overtime and arbitrary abuse." Responding to a reporter's question, he added: "I truly believe that the American consumer does not want to buy products made in abusive conditions."[xvi]

After the speech, the company set up a corporate responsibility and compliance division. However, unfortunately, this division reported to its public relations unit, confirming suspicions that Nike still viewed its labor practices primarily as a public relations challenge, or a marketing challenge, rather than a moral challenge. A few years later, Nike eventually changed tack, and the organizational structure shifted with the senior director of corporate responsibility reporting to the company president.

In 2001, Nike finally put in place processes and systems for continuous monitoring of conditions at all its supplier factories.[xvii] At this point, it was clear that Nike needed to go beyond every other apparel company to remedy the situation. The first steps were to create a framework for detailed supplier audits. While the audit frameworks clarified Nike's expectations, they did not automatically lead to full compliance, nor did they increase Nike's ability to actually monitor what was going on in its factories. Getting a number of distributed factories to actually live up to Nike's goals was easier said than done.

Nike eventually realized that by itself, it could never monitor all the factories and, in a significant departure from its past, decided to work with labor activists, the press and civil society to expose the extent of the problems. Notably, these were the original entities to have highlighted labor conditions at Nike factories. In 2005, Nike became one of the first companies to disclose the locations of Nike's contract factory suppliers voluntarily, [xviii] contrary to conventional wisdom in the industry that sharing this information would give competitors an advantage. "We believe disclosure of supply chains is a step toward greater efficiencies in monitoring and remediation and shared knowledge in capacity building that will elevate overall conditions in the industry," said Hannah Jones at the time, then Nike's corporate responsibility vice president.[xix] "No one company can solve these issues that are endemic to our industry. We know the future demands more collaboration among stakeholders, not less," she added.[xx]

Still, like others in the industry, Nike continued to face difficulties in increasing compliance. Some factories improved immediately following audits and were able to sustain those improvements. Others corrected behaviors after an audit revealed violations, only to fall back into noncompliance. In an acute violation of the code of conduct, in 2008, an Australian television network reported that a Nike supplier factory in Malaysia was engaging in "human trafficking on a major scale."[xxi] In this instance, Nike found that migrant workers were subjected to substandard housing, charged employment fees and denied access to their passports while sewing apparel for Nike and other brands.[xxii] In another incident, in 2010, a Nike supplier in Honduras subcontracted an order—without Nike's permission—to two factories that closed suddenly and failed to pay their 1,800 workers more than $2 million in legally mandated severance.[xxiii] These incidents exposed a weakness in Nike's monitoring system—and monitoring in general—that some suppliers engaged unauthorized subcontractors, especially during periods of high demand, often to continue to receive orders after surpassing their production capacity. Nike updated its code of conduct to officially prohibit the practice.

In early 2020, Nike has almost $40 billion in revenues and is the largest sportswear brand in the world.

Key Aspects of the Transformation

Overall, Nike's transformations, like those of Microsoft, did not happen in one go.

> *Even after a full-throated acknowledgment of the need to change, there were a number of false starts, mistakes and continuing issues. Perhaps the most important learnings here are the importance of an early start and the need to continuously work on the business of transformation.*

STARTING THE TRANSFORMATION JOURNEY?

While the transformations of Microsoft and Nike have largely been successful, success in such ventures is hardly a given. In this section, we mention industries that are *perhaps* on the road to transformation. This section highlights some nascent steps and calls for continued action on the path to transformation.

> *The business of transformation is hard, long and requires persistence; starting a transformation does not mean that these transformations will be successful. Further, as in the case of Microsoft and Nike, there are many missteps, and it is easy for leadership to fall in old patterns of obfuscation, denial and resistance, rather than continue the hard path of change and transformation.*

Social Media

Social media platforms have been accused of imposing several negative externalities. Most notable are the roles of social media in magnifying misinformation and social discord, causing psychological harm to some users, and prioritizing financial gain over respecting user privacy. There is a growing body of evidence that documents each of these negative externalities.[xxiv] The root cause of many of these harmful effects is the business model, which relies on monetizing user engagement via targeted advertising. As such, the platforms are incentivized to maximize engagement even if it is unhealthy for the individual or society and then use all the data generated on the engaged users in the service of their primary product, targeted advertising.

The technology to limit discord, misinformation, psychological harm and preserve user privacy exists and would be relatively easy for the platforms to incorporate into their products. Yet, it will come at some short-term costs of diminished growth and revenues, and myopic executives have so far been unwilling to fully embrace these changes and limit the businesses' negative social externalities.

The recent ongoing health care crisis shows some evidence of a shift—for the first time, platforms have taken aggressive steps to police medical misinformation and prioritize showing information from more reliable sources, even if it leads to lower engagement. This shows the technological ability of platforms to control misinformation.[xxv] Admittedly, information on policy issues is harder to police than medical guidance, yet this is potentially a first step in a long-needed transformation.

> *The four biggest technology companies—Facebook, Google, Apple and Microsoft—have long developed products that create "walled gardens" or closed ecosystems.*

These ecosystems function in ways that make these companies' products well with each other and less well when used in combination with products from a competitor. For example, Apple's messaging and video calling platforms do not work on mobile phones powered by Google's software or on computers running Microsoft software. These restrictions limit customer convenience and choice, competition, and inhibit innovation. The COVID-19 crisis has brought some changes in these firms' long-standing refusals to create interoperable systems.

Google and Apple are collaborating to help governments and health agencies track and reduce the spread of the virus, with user privacy and security central to the design. The firms plan to launch a comprehensive solution that includes application programming interfaces (APIs) and operating system-level technology to assist in enabling contact tracing. The firms will release APIs that enable interoperability between Android and iOS devices using apps from public health authorities. These official apps will be available for users to download via their respective app stores. Apple and Google also intend to work to enable a broader Bluetooth-based contact tracing platform by building this functionality into the underlying platforms. This is a more robust solution than an API and would allow more individuals to participate, if they choose to opt in, as well as enable interaction with a broader ecosystem of apps and government health authorities.

The technology companies claim that privacy, transparency and consent are of utmost importance in this effort, and they are committing to publish information about their work for others to analyze.[xxvi] The companies' adherence to these promises remains to be seen.

Tobacco

While the transformation of social media is only in its very nascent stages, the transformation is probably further along for the tobacco industry. However, the challenge facing the tobacco industry is harder—the history and context give one more reason to be skeptical and the transformation here requires not just a commitment to move away from the most harmful business products, but also make significant investments in research, development and transparency to truly deliver and develop products with reduced public health externalities compared to smoking.

Smoking tobacco is addictive and is one of the biggest causes of preventable death globally.[xxvii] The public health externalities from smoking tobacco are unambiguous and relate not just to the harm to the individual but potentially to other individuals in their vicinity; the overall burden on health systems, and the costs are socialized. As such, finding better alternatives—products with reduced exposure to consumers and non-consumers—is a necessary condition for continuing to operate in this industry. Further, the history of the resistance to change and transformation makes the business of transformation even more challenging.

Some tobacco companies are finding ways to transform. Leading players are working on and investing in the research and development of smoke-free products that are potentially much less harmful than smoking. Fully acknowledging and believing the need to transform is a key first step, yet in this context, the challenge is as much technological as it is managerial.

Nicotine, while addictive and not without risk, is not the primary cause of smoking-related diseases. Instead, the burning of tobacco and other materials produces thousands of chemicals, many of which are widely recognized as being associated with the development of smoking-related diseases. Smoke-free products that are designed to significantly reduce or eliminate the formation of these chemicals can limit the health impact while approaching the taste and ritual characteristics of cigarettes.

The industry must invest heavily in research and development, be very transparent with the science, and get independent, audited and peer-reviewed rigorous scientific assessments of the short-term and long-term effects of its products, and use these actions to win back society's trust. Despite the long history of business and public health conflicts in this industry, some firms are attempting to move beyond the history and are charting a future that is guided by science and innovation while intending to demonstrate their commitments to these principles by doing all of these.

The path is still long, and persevering on this path is necessary for a successful transformation.

Meat Packing Plants

As of May 2020, meatpacking plants are one of the key hotspots of the COVID-19 outbreak in the United States. This has highlighted the "generally awful conditions and low wages that these plants have offered workers, even before the virus." [xxviii] Meatpacking factories are organized as highly labor-intensive assembly lines where employees are packed together to maximize production. These plants primarily employ low-wage workers with few job opportunities and limited political representation, often from disenfranchised immigrant communities. The industry is highly consolidated with a few powerful players that control most of the nation's meat supply. The unequal legal status of its workers is an important point of leverage for the major players.

> *Meatpacking was declared an essential business and production continued during the early days of the pandemic with no significant changes in the operating procedure, and limited disclosure to employees and the communities these operations were based in. Not surprisingly, this led to significant major outbreaks that continue unabated as of the writing of this report. The industry's response has unfortunately been to deny the issues and limit information.*

While the companies themselves refuse to reveal the extent of the disease in their populations, the nonprofit group Food & Environment Reporting Network estimated that as of mid-May 2020, there are at least 17,000 COVID-19 cases and 66 deaths among meat plant workers. There are likely many more cases and deaths in the communities that host these facilities.[xxix]

The industry can do well to learn from the Nike case discussed in this report. The initial response of Nike to obfuscate the issue and not commit to transforming did not serve the company well. As such, these businesses should think of ways to transform their operating conditions to make their operations safe for the workers and communities.

Fortunately, the business of transformation in this industry is more straightforward than that for Nike, which relied mainly on international contracted facilities. The big meatpacking companies all fully control these facilities. Further, solutions based on improving worker conditions, allowing for worker representation, allowing more transparency in their operations, allowing workers to share their information are all practices that other industries routinely follow, including meatpacking outside the United States. Automation may provide a technical solution, once the management commits to a transformation. As is often the case, the transformation might appear to limit the short-run profitability, but it is necessary for the post-COVID-19 survival of these operations.

V. A Guidebook for Managers

Examining the successful journeys highlights some common patterns. Further, with the benefit of hindsight, we can identify facets where even these successful transformations might have done better. In this section, we highlight what we have learned from these transformations.

AWARENESS.

In all cases examined, the organizations in question were surprised by the reactions of civil society to the problems highlighted. Even when there were years of history and evidence suggesting the clear negative impacts of the firms' actions, the firms tended to either ignore the evidence or enter into a sort of internal, almost delusional confidence in their actions. While it is easy to dismiss this as willful ignorance, such groupthink is not atypical of organizations, particularly those with charismatic founders and a record of success. Unfortunately, such a lack of self-awareness makes it much harder for organizations to transform.

> *A key first step for all organizations is to be aware of their societal impact.*

In particular, organizations must do an honest accounting of the negative social externalities imposed by their business activities. Organizations need to be ahead of the curve and have a good understanding of the potential impacts of their business activities before external actors call them out. The framework provided in Section I can serve as a useful guide, that is, organizations should regularly account for the externalities imposed by their business activities on the environment, on public health, on market functions, and on our civic life and the social fabric. Social media, the democratization of information recording and sharing, and inexpensive sensor technologies give companies highly effective tools to get advance information on the impact of their activities and how these activities are perceived by society at large. Cheap sensors and widely available cameras have empowered individuals to record and share information on business activities. New artificial intelligence-based information aggregation platforms can scour millions of foreign language news reports, research publications, trade journals and chatter on forums to identify activities in the supply chain that lead to societal harm. Such platforms are proving to be highly effective in predicting the evolution of the COVID-19 pandemic, giving companies more time to assess the public health impact of their activities.[xxx] AI-based sentiment analysis tools can help a firm see when its actions are perceived negatively, when its products are reviewed less favorably or when its business practices are being questioned, in real-time. In today's information-rich environment, it is inexcusable for organizations to be caught unaware of these impacts, in the way Microsoft and Nike were years ago.

START SOONER

Organizations that exert significant social externalities can postpone the need for change, but in functioning societies, the externalities eventually catch up, and organizations inevitably have to change. A business that continues to impose negative social externalities is simply not sustainable.

Thus, if change is inevitable, then the question is—how to minimize the costs of change?

> *The best way to minimize these costs is to start on the path of transformation as soon as possible, and well before there is any external pressure. In general, once there is external pressure, the costs are much higher, the path much less clear, and the odds of success are lower.*

A FULL-THROATED COMMITMENT TO CHANGE

All transformation exercises must confront substantial resistance. Transformations of the nature studied in this report are even harder as they must be done at a time that the organization is doing well by traditional financial metrics, and there is no shareholder or other pressure to change. Yet as discussed above, such times are the best times to use the available resources to change.

Successful leaders need to recognize the need to change and must marshal the organization, shareholders and external stakeholders, leading them to the need to change.

> *This requires a clear, unambiguous acknowledgment of the issues by the leadership and a path to transformation. Any lip-service or half-actions are particularly ineffective at marshaling organizations into action and are against their immediate self-interest.*

EXPERIMENT AND LEARN

The path of transformation is rarely clear and never certain. The business of transformation is all about operating in extreme uncertainty. No one knows what lies on the path ahead and where the transformation will lead one. Often transformation requires developing a new strategy, processes, business model or product—all highly uncertain endeavors. Despite the uncertainty, there is a tendency for leaders to pretend that they know the path ahead. While this seems comfortable, the uncertain twists and turns on the road can lead such leadership to soon lose its credibility.

An alternate approach is to acknowledge the uncertainty on the path ahead, and instead of committing to outcomes, to commit to a path of rigorous experimentation and continuous learning.

ACKNOWLEDGE MISTAKES AND MISSTEPS

No transformation proceeds as per a plan, and there are often many setbacks. When these inevitable setbacks strike, the organization needs to make an honest admission of the mistakes, identify the root causes of these mistakes, and make amends.

VI. Conclusion

Businesses are living through a time of great uncertainty and changes arising out of the COVID-19 pandemic, rapid digitization, and a fast-changing political environment. Uncertain times require organizations to build a toolkit to transform in response to a rapidly changing environment.

> *Managers' first instinct, when faced with an environment that will make as-usual unsustainable, is to deny the stimuli for change—often by managing the informational environment or ignoring key constituencies.*

Numerous case studies show this never works out in the long run. Eventually, all businesses must learn to engage in the hard work of transformation or face extinction. Businesses that transform sooner have a better chance of survival.

Transformation is hard, yet several successful transformations guide us in developing a playbook for transformation. The characteristic patterns of successful transformation involve a regular audit and heightened awareness of the externalities from business operations on the commons, starting early, a full-throated commitment to transformation, experimentation and learning, and the ability to acknowledge and learn from the inevitable missteps and mistakes along the way.

Companies that follow these principles can transform and sustain their leadership.

DISCLAIMER: I, Karan Girotra, was asked by Handshake and PMI to write a white paper considering the question of "Business Transformation" in a corporate context, drawing on publicly available literature. This project and preliminary white paper is not about any specific organization; rather, it is written for any institution interested in fresh ways to think about the business disruption and innovation. Nor is it prescriptive in nature; each organization's context, history, and approach will vary. The research methodology and subsequent findings and views represented in this white paper are the author's only and were not influenced by nor do they necessarily reflect the views of Handshake or PMI. Nor do they necessarily represent the views of Cornell University, where I serve on the faculty.

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