

CHAPTER ELEVEN

Evolution and Revolution as Organizations Grow

Larry E. Greiner (1998)

Key executives of a retail store chain hold on to an organizational structure long after it has served its purpose because the structure is the source of their power. The company eventually goes into bankruptcy.

A large bank disciplines a “rebellious” manager who is blamed for current control problems, when the underlying causes are centralized procedures that are holding back expansion into new markets. Many young managers subsequently leave the bank, competition moves in, and profits decline.

The problems at these companies are rooted more in past decisions than in present events or market dynamics. Yet management, in its haste to grow, often overlooks such critical developmental questions as, Where has our organization been? Where is it now? and What do the answers to these questions mean for where it is going? Instead, management fixes its gaze outward on the environment and toward the future, as if more precise market projections will provide the organization with a new identity.

In stressing the force of history on an organization, I have drawn from the legacies of European psychologists who argue that the behavior of individuals is determined primarily by past events and experiences, rather than by what lies ahead. Extending that thesis to problems of organizational development, we can identify a series of developmental phases through which companies tend to pass as they grow. Each phase begins with a period of evolution, with steady growth and stability, and ends with a revolutionary period of substantial organizational turmoil and change—for instance, when centralized practices eventually lead to demands for decentralization. The resolution of each revolutionary period determines whether or not a company will move forward into its next stage of evolutionary growth.

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A MODEL OF HOW ORGANIZATIONS DEVELOP

To date, research on organizational development has been largely empirical, and scholars have not attempted to create a model of the overall process. When we analyze the research, however, five key dimensions emerge: an organization's age and size, its stages of evolution and revolution, and the growth rate of its industry. Figure 11.1, How Companies Grow, shows how these elements interact to shape an organization's development.

The most obvious and essential dimension for any model of development is the life span of an organization (represented on the graph as the horizontal axis). History shows that the same organizational practices are not maintained throughout a long life span. This demonstrates a most basic point: management problems and principles are rooted in time. The concept of decentralization, for example, can describe corporate practices at one period but can lose its descriptive power at another.

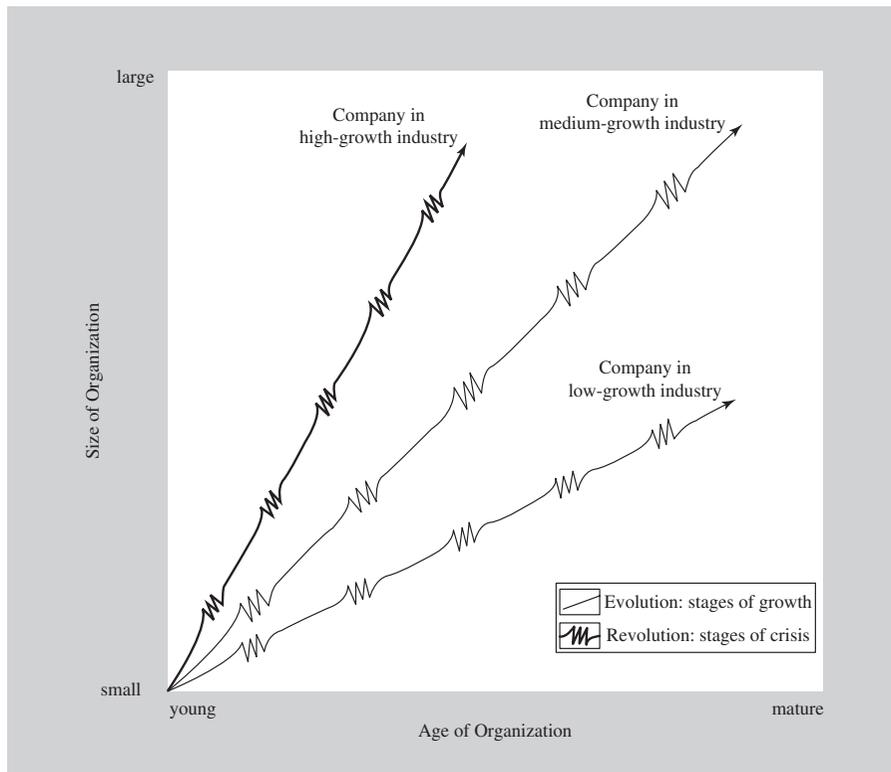


Figure 11.1. How Companies Grow.

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Managerial problems and practices are rooted in time. They do not last throughout the life of an organization.

The passage of time also contributes to the institutionalization of managerial attitudes. As these attitudes become rigid and eventually outdated, the behavior of employees becomes not only more predictable but also more difficult to change.

Size of the Organization

This dimension is depicted on the chart as the vertical axis. A company's problems and solutions tend to change markedly as the number of its employees and its sales volume increase. Problems of coordination and communication magnify, new functions emerge, levels in the management hierarchy multiply, and jobs become more interrelated. Thus, time is not the only determinant of structure; in fact, organizations that do not become larger can retain many of the same management issues and practices over long periods.

Stages of Evolution

As organizations age and grow, another phenomenon emerges: prolonged growth that we can term the *evolutionary period*. Most growing organizations do not expand for two years and then contract for one; rather, those that survive a crisis usually enjoy four to eight years of continuous growth without a major economic setback or severe internal disruption. The term *evolution* seems appropriate for describing these quiet periods because only modest adjustments appear to be necessary for maintaining growth under the same overall pattern of management.

Stages of Revolution

Smooth evolution is not inevitable or indefinitely sustainable; it cannot be assumed that organizational growth is linear. *Fortune's* "500" list, for example, has had considerable turnover during the last fifty years. In fact, evidence from numerous case histories reveals periods of substantial turbulence interspersed between smoother periods of evolution.

We can term the turbulent times *periods of revolution* because they typically exhibit a serious upheaval of management practices. Traditional management practices that were appropriate for a smaller size and earlier time no longer work and are brought under scrutiny by frustrated top-level managers and disillusioned lower-level managers. During such periods of crisis, a number of companies fall short. Those that are unable to abandon past practices and effect major organizational changes are likely either to fold or to level off in their growth rates.

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The critical task for management in each revolutionary period is to find a new set of organizational practices that will become the basis for managing the next period of evolutionary growth. Interestingly enough, those new practices eventually sow the seeds of their own decay and lead to another period of revolution. Managers therefore experience the irony of seeing a major solution in one period become a major problem in a later period.

Growth Rate of the Industry

The speed at which an organization experiences phases of evolution and revolution is closely related to the market environment of its industry. For example, a company in a rapidly expanding market will have to add employees quickly; hence, the need for new organizational structures to accommodate large staff increases is accelerated. Whereas evolutionary periods tend to be relatively short in fast-growing industries, much longer evolutionary periods occur in mature or slow-growing industries.

Evolution can also be prolonged, and revolutions delayed, when profits come easily. For instance, companies that make grievous errors in a prosperous industry can still look good on their profit-and-loss statements; thus, they can buy time before a crisis forces changes in management practices. The aerospace industry in its highly profitable infancy is an example. Yet revolutionary periods still occur, as one did in aerospace when profit opportunities began to dry up. By contrast, when the market environment is poor, revolutions seem to be much more severe and difficult to resolve.

PHASES OF GROWTH

With the foregoing framework in mind, we can now examine in depth the five specific phases of evolution and revolution. As shown in Figure 11.2, the Five Phases of Growth, each evolutionary period is characterized by the dominant management style used to achieve growth; each revolutionary period is characterized by the dominant management problem that must be solved before growth can continue. The pattern presented in the chart seems to be typical for companies in industries with moderate growth over a long period; companies in faster-growing industries tend to experience all five phases more rapidly, whereas those in slower-growing industries encounter only two or three phases over many years.

It is important to note that each phase is at once a result of the previous phase and a cause for the next phase. For example, the evolutionary management style in Phase Three is delegation, which grows out of and becomes the solution to demands for greater autonomy in the preceding Phase Two

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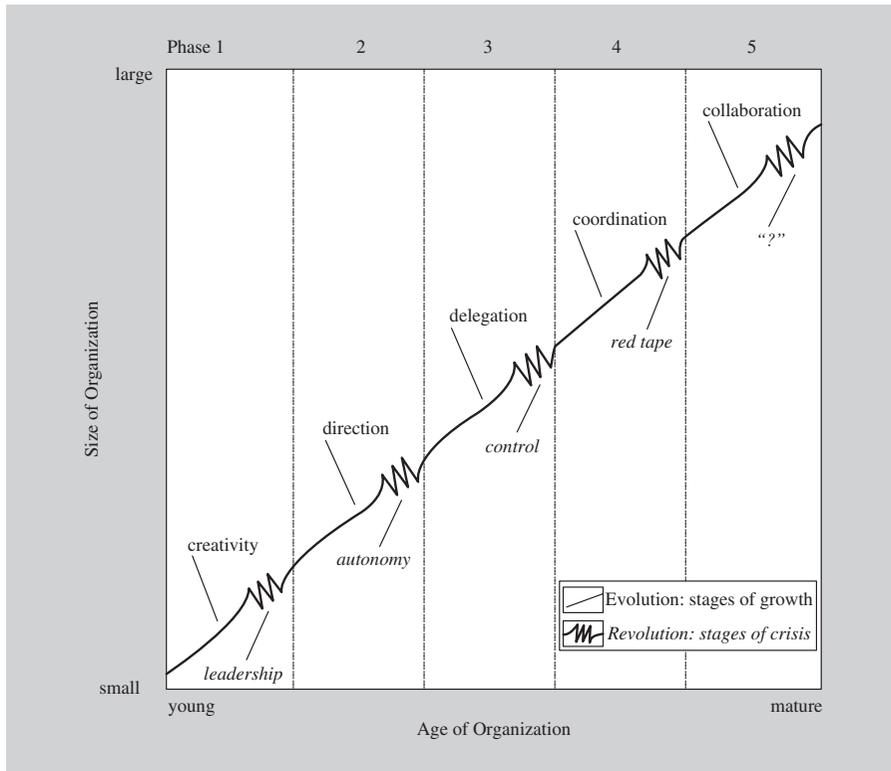


Figure 11.2. The Five Phases of Growth.

revolution. The style of delegation, used in Phase Three, however, eventually provokes a revolutionary crisis that is characterized by attempts to regain control over the diversity created through increased delegation.

For each phase, managers are limited in what they can do if growth is to occur. For example, a company experiencing an autonomy crisis in Phase Two cannot return to directive management for a solution; it must adopt a new style—delegation—in order to move forward.

Phase One: Creativity

In the birth stage of an organization, the emphasis is on creating both a product and a market. The following are the characteristics of the period of creative evolution:

- The founders of the company are usually technically or entrepreneurially oriented, and they generally disdain management activities; their physical and mental energies are absorbed entirely by making and selling a new product.

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- Communication among employees is frequent and informal.
- Long hours of work are rewarded by modest salaries and the promise of ownership benefits.
- Decisions and motivation are highly sensitive to marketplace feedback; management acts as customers react.

All the foregoing individualistic and creative activities are essential for a company to get off the ground. But as the company grows, those very activities become the problem. Larger production runs require knowledge about the efficiencies of manufacturing. Increased numbers of employees cannot be managed exclusively through informal communication, and new employees are not motivated by an intense dedication to the product or organization. Additional capital must be secured, and new accounting procedures are needed for financial control. The company's founders find themselves burdened with unwanted management responsibilities. They long for the "good old days" and try to act as they did in the past. Conflicts among harried leaders emerge and grow more intense.

Creative activities are essential for a company to get off the ground. But as the company grows, those very activities become the problem.

At this point, a *crisis of leadership* occurs, which is the onset of the first revolution. Who will lead the company out of confusion and solve the managerial problems confronting it? Obviously, a strong manager is needed—one who has the necessary knowledge and skills to introduce new business techniques. But finding that manager

is easier said than done. The founders often resist stepping aside, even though they are probably temperamentally unsuited to the job. So here is the first critical choice in an organization's development: to locate and install a strong business manager who is acceptable to the founders and who can pull the organization together.

Phase Two: Direction

Those companies that survive the first phase by installing a capable business manager usually embark on a period of sustained growth under able, directive leadership. Here are the characteristics of this evolutionary period:

- A functional organizational structure is introduced to separate manufacturing from marketing activities, and job assignments become increasingly specialized.
- Accounting systems for inventory and purchasing are introduced.

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- Incentives, budgets, and work standards are adopted.
- Communication becomes more formal and impersonal as a hierarchy of titles and positions grows.
- The new manager and his or her key supervisors assume most of the responsibility for instituting direction; lower-level supervisors are treated more as functional specialists than as autonomous decision-making managers.

Although the new directive techniques channel employees' energy more efficiently into growth, they eventually become inappropriate for controlling a more diverse and complex organization. Lower-level employees find themselves restricted by a cumbersome and centralized hierarchy. They have come to possess more direct knowledge about markets and machinery than do their leaders at the top; consequently, they feel torn between following procedures and taking initiative on their own.

Thus, the second revolution emerges from a *crisis of autonomy*. The solution adopted by most companies is to move toward more delegation. Yet it is difficult for top-level managers who previously were successful at being directive to give up responsibility to lower-level managers. Moreover, the lower-level managers are not accustomed to making decisions for themselves. As a result, numerous companies founder during this revolutionary period by adhering to centralized methods, while lower-level employees become disenchanting and leave the organization.

Phase Three: Delegation

The next era of growth evolves from the successful application of a decentralized organizational structure. It exhibits these characteristics:

- Much greater responsibility is given to the managers of plants and market territories.
- Profit centers and bonuses are used to motivate employees.
- Top-level executives at headquarters limit themselves to managing by exception based on periodic reports from the field.
- Management often concentrates on acquiring outside enterprises that can be lined up with other decentralized units.
- Communication from the top is infrequent and usually occurs by correspondence, telephone, or brief visits to field locations.

The delegation phase allows companies to expand by means of the heightened motivation of managers at lower levels. Managers in decentralized organizations, who have greater authority and incentives, are able to penetrate larger markets, respond faster to customers, and develop new products.

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A serious problem eventually emerges, however, as top-level executives sense that they are losing control over a highly diversified field operation. Autonomous field managers prefer to run their own shows without coordinating plans, money, technology, and personnel with the rest of the organization. Freedom breeds a parochial attitude.

The delegation phase brings a new period of growth, but freedom eventually breeds a parochial attitude.

Soon, the organization falls into a *crisis of control*. The Phase Three revolution is under way when top management seeks to regain control over the company as a whole. Some top-management teams attempt a return to centralized management, which usually fails

because of the organization's newly vast scope of operations. Those companies that move ahead find a new solution in the use of special coordination techniques.

Phase Four: Coordination

The evolutionary period of the coordination phase is characterized by the use of formal systems for achieving greater coordination and by top-level executives taking responsibility for the initiation and administration of these new systems. For example:

- Decentralized units are merged into product groups.
- Formal planning procedures are established and intensively reviewed.
- Numerous staff members are hired and located at headquarters to initiate companywide programs of control and review for line managers.
- Capital expenditures are carefully weighed and parceled out across the organization.
- Each product group is treated as an investment center where return on invested capital is an important criterion used in allocating funds.
- Certain technical functions, such as data processing, are centralized at headquarters, while daily operating decisions remain decentralized.
- Stock options and companywide profit sharing are used to encourage employees to identify with the organization as a whole.

All these new coordination systems prove useful for achieving growth through the more efficient allocation of a company's limited resources. The systems prompt field managers to look beyond the needs of their local units. Although these managers still have a great deal of decision-making responsibility, they learn to justify their actions more carefully to a watchdog audience at headquarters.

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A lack of confidence, however, gradually builds between line and staff, and between headquarters and the field. The many systems and programs introduced begin to exceed their usefulness. A *red-tape crisis* is in full swing. Line managers, for example, increasingly resent direction from those who are not familiar with local conditions. And staff people, for their part, complain about uncooperative and uninformed line managers. Together, both groups criticize the bureaucratic system that has evolved. Procedures take precedence over problem solving, and innovation dims. In short, the organization has become too large and complex to be managed through formal programs and rigid systems. The Phase Four revolution is under way.

Phase Five: Collaboration

The last observable phase emphasizes strong interpersonal collaboration in an attempt to overcome the red-tape crisis. Where Phase Four was managed through formal systems and procedures, Phase Five emphasizes spontaneity in management action through teams and the skillful confrontation of interpersonal differences. Social control and self-discipline replace formal control. This transition is especially difficult for the experts who created the coordination systems as well as for the line managers who relied on formal methods for answers.

The Phase Five evolution, then, builds around a more flexible and behavioral approach to management. Here are its characteristics:

- The focus is on solving problems quickly through team action.
- Teams are combined across functions to handle specific tasks.
- Staff experts at headquarters are reduced in number, reassigned, and combined into interdisciplinary teams that consult with, not direct, field units.
- A matrix-type structure is frequently used to assemble the right teams for the appropriate problems.
- Formal control systems are simplified and combined into single multi-purpose systems.
- Conferences of key managers are held frequently to focus on major problems.
- Educational programs are used to train managers in behavioral skills for achieving better teamwork and conflict resolution.
- Real-time information systems are integrated into daily decision-making processes.
- Economic rewards are geared more to team performance than to individual achievement.

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- Experimenting with new practices is encouraged throughout the organization.

What will be the revolution in response to this stage of evolution? Many large U.S. companies are now in the Phase Five evolutionary stage, so the answer is critical. Although there is little clear evidence regarding the outcome, I imagine that the revolution arising from the “?” *crisis* will center around the psychological saturation of employees who grow emotionally and physically exhausted from the intensity of teamwork and the heavy pressure for innovative solutions.

My hunch is that the Phase Five revolution will be solved through new structures and programs that allow employees to periodically rest, reflect, and revitalize themselves. We may even see companies with dual organizational structures: a *habit structure* for getting the daily work done and a *reflective structure* for stimulating new perspective and personal enrichment. Employees could move back and forth between the two structures as their energies dissipate and are refueled.

One European organization has implemented just such a structure. Five reflective groups have been established outside the company’s usual structure for the purpose of continuously evaluating five task activities basic to the organization. The groups report directly to the managing director, although their findings are made public throughout the organization. Membership in each group includes all levels and functions in the company, and employees are rotated through the groups every six months.

Other concrete examples now in practice include providing sabbaticals for employees, moving managers in and out of hot-spot jobs, establishing a four-day workweek, ensuring job security, building physical facilities for relaxation during the workday, making jobs more interchangeable, creating an extra team on the assembly line so that one team is always off for reeducation, and switching to longer vacations and more flexible work hours.

The Chinese practice of requiring executives to spend time periodically on lower-level jobs may also be worth a nonideological evaluation. For too long, U.S. management has assumed that career progress should be equated with an upward path toward title, salary, and power. Could it be that some vice presidents of marketing might just long for, and even benefit from, temporary duty in field sales?

IMPLICATIONS OF HISTORY

Let me now summarize some important implications for practicing managers. The main features of this discussion are depicted in Table 11.1, Organizational Practices in the Five Phases of Growth, which shows the specific management

Table 11.1. Organizational Practices in the Five Phases of Growth

<i>Category</i>	<i>Phase 1</i>	<i>Phase 2</i>	<i>Phase 3</i>	<i>Phase 4</i>	<i>Phase 5</i>
Management focus	Make and sell	Efficiency of operations	Expansion of market	Consolidation of organization	Problem solving and innovation
Organizational structure	Informal	Centralized and functional	Decentralized and geographical	Line staff and product groups	Matrix of teams
Top-management style	Individualistic and entrepreneurial	Directive	Delegative	Watchdog	Participative
Control system	Market results	Standards and cost centers	Reports and profit centers	Plans and investment centers	Mutual goal setting
Management reward emphasis	Ownership	Salary and merit increases	Individual bonus	Profit sharing and stock options	Team bonus

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actions that characterize each growth phase. These actions are also the solutions that ended each preceding revolutionary period.

In one sense, I hope that many readers will react to my model by seeing it as obvious and natural for depicting the growth of an organization. To me, this type of reaction is a useful test of the model's validity.

But at a more reflective level, I imagine some of these reactions come more from hindsight than from foresight. Experienced managers who have been through a developmental sequence can identify that sequence now, but how did they react when in the midst of a stage of evolution or revolution? They can probably recall the limits of their own developmental understanding at that time. Perhaps they resisted desirable changes or were even swept emotionally into a revolution without being able to propose constructive solutions. So let me offer some explicit guidelines for managers of growing organizations to keep in mind.

Know where you are in the developmental sequence. Every organization and its component parts are at different stages of development. The task of top management is to be aware of the stages; otherwise, it may not recognize when the time for change has come, or it may act to impose the wrong solution.

Leaders at the top should be ready to work with the flow of the tide rather than against it; yet they should be cautious because it is tempting to skip phases out of impatience. Each phase produces certain strengths and learning experiences in the organization that will be essential for success in subsequent phases. A child prodigy, for example, may be able to read like a teenager but cannot behave like one until he or she matures through a sequence of experiences.

I also doubt that managers can or should act to avoid revolutions. Rather, these periods of tension provide the pressure, ideas, and awareness that afford a platform for change and the introduction of new practices.

Recognize the limited range of solutions. In each revolutionary stage, it becomes evident that the stage can come to a close only by means of certain specific solutions; moreover, these solutions are different from those that were applied to the problems of the preceding revolution. Too often, it is tempting to choose solutions that were tried before but that actually make it impossible for the new phase of growth to evolve.

Management must be prepared to dismantle current structures before the revolutionary stage becomes too turbulent. Top-level managers, realizing that their own managerial styles are no longer appropriate, may even have to take themselves out of leadership positions. A good Phase Two manager facing Phase Three might be wise to find

Too often, it is tempting to choose solutions that were tried before but that actually make it impossible for the new phase to emerge.

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a position at another Phase Two organization that better fits his or her talents, either outside the company or with one of its newer subsidiaries.

Finally, evolution is not an automatic affair; it is a contest for survival. To move ahead, companies must consciously introduce planned structures that not only solve a current crisis but also fit the next phase of growth. That requires considerable self-awareness on the part of top management as well as great interpersonal skills in persuading other managers that change is needed.

Realize that solutions breed new problems. Managers often fail to recognize that organizational solutions create problems for the future, such as when a decision to delegate eventually causes a problem of control. Actions in the past determine much of what will happen to a company in the future.

An awareness of this effect should help managers evaluate company problems with a historical understanding instead of pinning the blame on a current development. Better yet, it should place managers in a position to predict problems and thereby to prepare solutions and coping strategies before a revolution gets out of hand.

Top management that is aware of the problems ahead could well decide not to expand the organization. Managers may, for instance, prefer to retain the informal practices of a small company, knowing that this way of life is inherent in the organization's limited size, not in their congenial personalities. If they choose to grow, they may actually grow themselves out of a job and a way of life they enjoy.

And what about very large organizations? Can they find new solutions for continued evolution? Or are they reaching a stage when the government will act to break them up because they are too large?

Clearly, there is still much to learn about processes of development in organizations. The phases outlined here are merely five in number and are still only approximations. Researchers are just beginning to study the specific developmental problems of structure, control, rewards, and management style in different industries and in a variety of cultures.

One should not, however, wait for conclusive evidence before educating managers to think and act from a developmental perspective. The critical dimension of time has been missing for too long from our management theories and practices. The intriguing paradox is that by learning more about history, we may do a better job in the future.

Revolution Is Still Inevitable

I wrote the first draft of this chapter while I was felled by a bad leg during a ski vacation in Switzerland. At the time, the business world was buzzing with numerous faddish techniques. Perhaps it was the size and height

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of the mountains that made me feel that there were deeper and more powerful forces at work in organizations.

Four basic points still seem valid about the model. First, we continue to observe major phases of development in the life of growing companies, lasting anywhere from three to fifteen years each. Although scholars debate the precise length and nature of these phases, everyone agrees that each phase contains its own unique structure, systems, and leadership. The growth rate of the industry seems to determine the phases' length.

Second, transitions between developmental phases still do not occur naturally or smoothly, regardless of the strength of top management. All organizations appear to experience revolutionary difficulty and upheaval, and many of these organizations falter, plateau, fail, or get acquired rather than grow further. IBM before Lou Gerstner and General Electric before Jack Welch both suffered badly at the end of the fourth phase of coordination, when sophisticated management systems evolved into rigid bureaucracies.

Third, the logic of paradox underlying the model continues to ring true, although it often haunts and confuses the managerial psyche. Managers have difficulty in understanding that an organizational solution introduced by them personally in one phase eventually sows the seeds of revolution.

Fourth, the greatest resistance to change appears at the top because revolution often means that units under each senior executive will be eliminated or transformed. That is why we so often see new chief executives recruited from the outside and why senior managers frequently leave companies. Executives depart not because they are "bad" managers but because they just don't fit with where the company needs to go.

As for the differences that I have observed since the chapter's original publication, there is obviously much more "death" in the life of organizations today. Few organizations make it through all the phases of growth. If they don't fail, as most do in the initial phase of creativity and entrepreneurship, they often get acquired by companies, that are in a later phase.

The phases are not as cleanly marked off as I depicted them. The vestiges of one phase remain as new approaches are introduced. Such overlaps are most notable in the case of the first-phase entrepreneur hanging on when professional management is added in the second phase of direction.

There are also miniphases within each evolutionary stage. The delegation phase, for example, does, not typically begin with the complete decentralization of the entire organization into multiple product units, as

(Continued)

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the chapter implies. Usually one product group is launched, and then others are added over time. Also, as delegation—or *decentralization*, as I now prefer to call this phase—advances, senior managers at the corporate office are not as hands-off as I depicted them. The addition of multiple product or geographic units over time requires a sophisticated level of involvement by senior management to review strategies, evaluate results, and communicate the organization's values—but not to micro-manage the units under them.

I would change some of the things I said about the fifth phase of collaboration. My original description of this phase suggests that the entire organization is turned into a matrix of teams. I now see the matrix as confined largely to senior management, where the heads of geographic areas, product lines, and functional disciplines collaborate as a team in order to ensure that their decisions are coordinated and implemented across global markets. The most significant change in this phase occurs when the previously bureaucratic Phase Four control-oriented staff and systems are replaced by a smaller number of consulting staff experts who help facilitate, rather than control, decisions.

My speculation that “psychological saturation” is the crisis ending Phase Five now seems wrong. Instead, I think the crisis is one of realizing that there is no internal solution, such as new products, for stimulating further growth. Rather, the organization begins to look outside for partners or for opportunities to sell itself to a bigger company.

A sixth phase may be evolving in which growth depends on the design of extra-organizational solutions, such as creating a holding company or a network organization composed of alliances and cross-ownership. GE may have developed a similar model in which a periphery of companies is built around a core “money” company or bank [GE Capital] that attracts capital, earns high returns, and feeds the growth of other units.

I doubt that the advancement of information technology has made much of a difference in the basic aspects of the model. Information technology appears useful as a tool that evolves in different forms to fit each phase. For example, the Phase Two functional organizational structure requires data that reflect revenue and cost centers, whereas Phase Three decentralization needs data that measure profit center performance.

I wrote the chapter mainly about industrial and consumer goods companies, not about knowledge organizations or service businesses, which had yet to come into prominence. After recently studying a number of consulting, law, and investment firms, our research team found that those organizations also experience evolution and revolution as they grow.

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In the first, entrepreneurial phase, the professional service firm pursues and tests a variety of market paths. The phase ends with the partners arguing about whether or not to stay together to concentrate on one partner's vision for the future. In the second phase, the firm focuses on one major service and eventually finds itself with a debate among the partners about whether to continue focusing on the current practice or to open another office or add additional services. A third phase of geographic or service expansion typically ends with a struggle over ownership: how much equity are the original partners willing to share with the younger partners who led the expansion and brought in new clients? The fourth phase involves institutionalizing the firm's name, reputation, and its standard way of operating, and ends in a crisis of cultural conformity in the face of which the firm must restore innovation and flexibility.

Finally, as a strong caveat, I always remind myself and others that the "ev and rev" model depicted in this chapter provides only a simple outline of the broad challenges facing a management concerned with growth. It is not a cookie-cutter solution or panacea. The rate of growth, the effective resolution of revolutions, and the performance of the company within phases still depend on the fundamentals of good management skillful leadership, a winning strategy, the heightened motivation of employees, and a deep concern for customers.