SECOND EDITION

FIRMS *of* ENDEARMENT

How World-Class Companies **PROFIT** from Passion and Purpose

Raj Sisodia

Jag Sheth

David B. Wolfe

Firms of Endearment

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We dedicate this book to the memory of our dear friend David Wolfe—
a deep thinker, brilliant writer,
and wise and caring human being.
Our lives and those of countless others were greatly enriched by his presence.

—Raj Sisodia and Jag Sheth

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Forewords

Foreword to the First Edition

Television producer and writer Norman Lear once told me, "When I've been most effective, I've listened to my inner voice." Lear's inner voice gave him the courage to transform television's voice with his society-mocking domestic comedy *All in the Family.* Despite a string of impressive television successes, the raw texture of *All in the Family* made it a tough sell. But Lear was driven by a sense of mission on behalf of the entire country. His persistence paid off when CBS finally agreed to run the show.

Confident that one person can bring about big changes, Lear forced us to examine some of the most fetid prejudices that bubbled below the surface of society in the early 1970s. When *All in the Family* debuted, teeming throngs demanding civil rights for all and an end to the war in Vietnam swarmed in the nation's streets and on its college campuses. America's easy-going post–World War II composure was dissolving. Lear thought it was time that we tuned into our inner voices to hear what they had to say about how well we honored our claim to be a just society.

Firms of Endearment brings to mind Lear's respect for the counsel of his inner voice. Judging by recent headlines, corporate America has too few leaders who open their mental ears to their inner voices. Rather, they take cues for their behavior from the external world where pursuit of power over others is the daily priority. Sadly, such ambitions weigh on us with a pervasive presence that extends far beyond the world of business. We are regularly served up headlines calling attention to abuses of power in government, academe, clinical research centers, social service agencies, and religious organizations. We seem overrun these days with people in high positions who compromise their organizations and the general welfare with their propensities for self-aggrandizement, avarice, and other perversions of public and private trust.

Happily, *Firms of Endearment* gives us hope that we are not morally going to hell in a handbasket, a relentless stream of headlines about moral failures in high office notwithstanding. The men and women cited in this book, as exemplars of conscionable leadership, give us reason for optimism about the character of our future leaders in business and other sectors of society.

These executives operate by a guiding vision of service that takes into account all their primary stakeholders: customers, employees, suppliers and partners in the supply chain, the communities in which they operate, and, of course, their investors. Their companies follow a *stakeholder relationship management* business model rather than a traditional stockholder-biased business model. At all levels of operation, these companies exude the passion of their leaders for doing good while doing well. Following Polonius's advice to his son in *Hamlet*, these leaders are true to themselves. They evidence keen self-knowledge and project candor and maturity—three essential elements of integrity—in their interactions with others. In return, stakeholders in every category place uncommon trust in their companies and products. Beyond this, stakeholders develop a real affection for such companies. They literally *love* firms of endearment (FoEs).

It is not too much of a stretch to see that as FoEs proliferate—and they are doing that—the principles of leadership that guide their destinies will be adopted by organizations of every stripe. Indeed, the future well-being of this country could depend more than a little on executive leadership of the caliber and mindset described in this book.

With a title that stands for the empathetic concern of companies that wear their hearts on their sleeves, this book is about the pragmatic role of love in business. However, this is not new ground, as the authors note. Tim Sanders, then chief solutions officer of Yahoo!, lauded the idea of making love a strategic cornerstone of a company's operations in his 2002 book *Love Is the Killer App: How to Win Business and Influence Friends.* He wrote, "I don't think there is anything higher than Love.... Love is so expansive. I had such a difficult time coming up with a definition for Love in my book, but the way I define Love is the selfless promotion of the growth of the other." Three years later, Kevin Roberts, head of one of the world's largest ad agencies, Saatchi & Saatchi, wrote of brands transcending the mundane foundations of branding to reach a higher level of existence calling them "lovemarks." He put forth this idea in a book titled *Lovemarks: The Future Beyond Brands.*

Firms of Endearment is a paean to leaders driven by a strong sense of connectivity to their fellow beings. It celebrates leaders who leverage their humanness by inspiring others to join them in making the world a better place. A few years ago, Timberland CEO Jeffrey Swartz accepted a friend's invitation to spend a half a day in a teen halfway house. His friend promised him that his life would never be the same. After answering a troubled teen's question about what he did ("I'm responsible for the global execution of strategy"), he asked the teen what he did. "I work at getting well." Swartz said later that the teen's answer trumped his own answer.

Swartz's friend was right. His life changed that day. He left his office as a hard-driving executive striving to make Timberland the biggest and best in its category and returned as an inspired leader bent on enlisting his entire company in a campaign to "make the world a better place." That is literally how Jeff Swartz describes his company's mission today. Doubtless, some will charge Swartz with shortchanging his stockholders. However, the stock of this footwear and outdoor apparel company has risen more than 700 percent over the past ten years. It has better than doubled in the past three.

The effectiveness of FoE leadership testifies to something most of us have known for a long time but have generally not felt comfortable talking about it in our organizations: Praiseworthy leaders achieve greatness by inspiring love in others for their vision.

Judging by the stories in this book, Yahoo!'s Tom Sanders is absolutely right: Love is the killer app. Love helped turn FoE Southwest Airlines into the most successful airline in history—33 years of unbroken profitability. Appropriately, its stock symbol is LUV. Co-founder Herb Kelleher consciously developed a culture of love that ironically encompasses his employees' unions. FoE Commerce Bank's founder, Vernon Hill, adapted the "love is the killer app" idea to banking to make Commerce the fastest organically growing bank in America. The culture of love nurtured by FoE Costco co-founder Jim Sinegal protects shareholders against ill-taken management decisions based on the demands of Wall Street analysts who would have Costco pay employees less, pare back their benefits, and charge customers more.

It would be good enough that FoEs simply did well by their non-shareholder stakeholders while modestly rewarding their investors.

However, as the authors show, FoEs have generally rewarded their shareholders to an astonishing degree.

In the end, this book is about leadership and the culture that leaders of FoEs develop and nourish. When asked about their biggest competitive advantage, most CEOs of FoEs say it is their corporate culture. Southwest Airlines so much believes this that it has a 93-member Culture Committee. The committee's job is to ensure continuation of the culture that has made Southwest arguably the most successful airline in history. Committee membership includes employees from every level.

It is hard to imagine the executives we have recently seen led away from their companies in handcuffs spending much time thinking about their corporate cultures. True leaders focus less on their own self-interests than on the interests of the whole. They believe that the full well-being of one depends on the well-being of all. Leaders who focus on their own gains in running a company or other organization are not true leaders. They may be positioned as the head of a global enterprise, a branch of government, a congressional office, a major university, or a local parish, but they are leaders in name only. They command others only by virtue of their positions, not by the content of their character. They are so consumed with self-interest that they are blind to the well-being of others.

All that said, this book makes it easier to imagine that someday not far down the road everyone will demand of leaders in business, corporations, and every other type of organization the kind of impassioned pursuit of a broader purpose found in FoEs. As the authors of this remarkable book observe, two things have happened to make that so. The first is the Internet. As it entered the mainstream of society, it dissolved the information advantage organizations have traditionally had over their constituencies. The Internet has shifted the balance of information power to the masses. This has made it much harder to hide the misdeeds of morally deficient leaders and organizations.

The second event is the aging of the population. For the first time in history, people 40 and older are the adult majority. This is driving deep systemic changes in the moral foundations of culture. Higher levels of psychological maturity mean greater influence on society of what Erik Erikson called "generativity"—the disposition of older people to help incoming generations prepare for their time of stewardship of the common good.

Abraham Maslow spoke of people who operate at the higher reaches of maturity as being concerned about matters beyond their own skins. That sums up the disposition of FoEs. With clear-minded certainty about the correctness of their balance between the pursuit of purpose and profits, the leaders of FoEs involve their companies in matters beyond their immediate boundaries—generally with felicitous results for shareholders.

Warren Bennis
University Professor; Distinguished Professor of
Business Administration
University of Southern California

First Foreword to the Second Edition

I was one of the lucky few who had an opportunity to read the wonderful business book *Firms of Endearment* while it was still in manuscript form prior to publication. A good friend of mine, Kathy Dragon, was on an airplane several years ago and just happened to be seated next to David Wolfe, one of the co-authors of the book. David was excited about the book, and when he described its content he mentioned that Whole Foods Market was one of the companies they had profiled as a "firm of endearment." Kathy became excited when she heard this and told David about her close friendship with me, and that I would no doubt enjoy reading the book. David gave her a copy of the manuscript to pass on to me to read.

Such are the small coincidences that can change people's lives and alter our destinies. To say that I read *Firms of Endearment* would be a gross understatement—I devoured it. Of course I was very happy that Whole Foods was one of the 18 public companies they featured in the book, but that was only the beginning of the impact this book had on me. I was already quite familiar with Stakeholder Theory through my reading of Ed Freeman's original and brilliant work on the subject, but I was unaware that there were several other companies besides Whole Foods Market that were conducting their businesses in such similarly conscious ways. Up until that point, I had believed that Whole Foods was some kind of unusual odd duck that had created a unique business culture based on fulfilling our higher purposes as a business (besides just making a profit) and consciously creating value for all of our major interdependent stakeholders (customers, employees, suppliers, investors, communities, and the environment). I had thought we were virtually alone in the world and I was overjoyed to discover that there were other well-known businesses that thought and acted in much the same way.

After reading *Firms of Endearment,* I soon met with David and Raj. We discovered that we shared many ideas and had a commitment to "evangelize" our ideas to the larger world. We began a dialog discussing the ideas outlined in *Firms of Endearment*—ideas that I had been calling "Conscious Capitalism." We believed that these ideas deserved a much larger audience, and we began to plan our first Conscious Capitalism conference to bring together like-minded people into dialog.

With an initial modest gathering of about 20 people, we launched an initiative to spread the ideas of Conscious Capitalism throughout the world. Many much larger and hugely successful conferences have followed over the past six years. It was at one of these conferences in Boston that I was able to meet the third author of *Firms of Endearment*, the renowned marketing scholar Jag Sheth. Jag has been a prolific author of dozens of books, including the classic *The Theory of Buyer Behavior* and *Clients for Life*. For many years, Jag served as Raj's mentor, and in that role alone his contribution to the Conscious Capitalism movement has been immense.

Business is by far the greatest value creator in the world. As Raj and I state it in our book *Conscious Capitalism* (Harvard Business Review Publishing, 2013), "We believe that business is good because it creates value, it is ethical because it is based on voluntary exchange, it is noble because it can elevate our existence, and it is heroic because it lifts people out of poverty and creates prosperity." Business has such enormous potential to do good in the world. Much of the good is currently being done "unconsciously" simply by creating products and services that people value, providing jobs, and generating profits. However, business can also be done much more consciously, with higher purpose and optimal value creation for all of the major stakeholders while creating cultures that optimize human flourishing. As people, particularly leaders, become more conscious, we are able to create new types of entrepreneurial enterprises that will help solve our most serious problems and will evolve humanity upward to fulfill our unlimited potential as a species. *Firms of Endearment* is a very important and ground-breaking book because it points the way that all businesses should aspire to emulate and ultimately transcend. I am grateful to the authors for their landmark contribution to elevating business practice and thereby benefiting humanity.

John Mackey
Co-founder and Co-CEO of Whole Foods Market

Second Foreword to the Second Edition

This new edition of *Firms of Endearment* continues to break important new ground in understanding the power of capitalism to transform our world for the better. In the first edition the authors suggested that firms that pay attention to how they create value for stakeholders might perform better. They gave us an introductory quantitative analysis and a set of rich stories that made the analysis make some sense.

In this new edition they take a giant step forward. They give us a "proof of possibility," thereby grounding a new story of business in solid economic analysis and practical management thinking. The role of passion and purpose is not well understood in a world where the dominant story of business that we read everyday suggests that only money and profits count. Furthermore, this dominant story suggests that businesspeople are greedy and self-interested. We see this played out everyday in the press, in government responses to crises, and sometimes we see executives themselves making the same attributions.

It's time to stop this nonsense, and the authors give us a roadmap.

Every business always has and always will create value for customers, employees, communities, suppliers, and the financiers who put up the investment. Firms of endearment are those companies that realize this principle of stakeholder value creation and orient themselves around it. These are the companies we love to do business with. They are the brands we recommend to our friends, and if we are smart, they are the investments we have in our portfolios, 401(k) plans, and so on.

None of what this book says should be surprising. What is surprising is the resistance that can be encountered. Many narrow-minded economists, as well as many critics of business, just "know" that business is really about the money. They then make the logical error of inferring that the purpose of business is to make as much money as possible. That's like saying that because we need red blood cells to live, the purpose of life is to make red blood cells.

Our great companies, including the ones in this book, but in the past as well, are fueled by passion and by a sense of purpose. Great business leaders channel their employees' desires to be a part of something bigger than themselves and to be a part of making the world a better place for their children into the overall purpose of their business. Profit is an outcome. And, of course, there are no guarantees here. Sometimes companies do their best around a purpose and indeed fail, or they fail to keep that purpose in front of them, or conditions simply change.

The twenty-first century requires a new way of thinking about business. Thankfully that story is beginning to emerge with books like *Firms of Endearment*. It will repay close study, seeing how your company is both like and unlike the examples in the book. And, hopefully it will cause you to ask questions about your own purpose, both in terms of your company and your individual situations.

This is not the end of the new story of business, but it is a good beginning. Hopefully it will inspire others to "critique by creating something better." I urge you to see it not as the definitive word on how to run a business, but as a proof of possibility that creating value for stakeholders with purpose and passion is an idea that works and whose time has come. It offers hope that we can be the generation that makes business better and leaves a better world for our children.

R. Edward Freeman
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Raj Sisodia is the F.W. Olin Distinguished Professor of Global Business and Whole Foods Market Research Scholar in Conscious Capitalism at Babson College in Wellesley, MA. He is also co-founder and co-chairman of Conscious Capitalism, Inc. He has a Ph.D. in marketing from Columbia University. Raj is the co-author of *The New York Times* bestseller *Conscious Capitalism: Liberating the Heroic Spirit of Business* (Harvard Business Review Publishing, 2013). In 2003, he was cited as one of "50 Leading Marketing Thinkers" by the Chartered Institute of Marketing. He was named one of "Ten Outstanding Trailblazers of 2010" by Good Business International, and one of the "Top 100 Thought Leaders in Trustworthy Business Behavior" by Trust Across America for 2010 and 2011. Raj has published seven books and more than 100 academic articles. He has consulted with and taught executive programs for numerous companies, including AT&T, Nokia, LG, DPDHL, POSCO, Kraft Foods, Whole Foods Market, Tata, Siemens, Sprint, Volvo, IBM, Walmart, Rabobank, McDonalds, and Southern California Edison. He is on the Board of Directors of The Container Store and Mastek, Ltd., and is a trustee of Conscious Capitalism, Inc. For more details, see www.rajsisodia.com.

Jag Sheth is the Charles H. Kellstadt Professor of Marketing in the Gouizeta Business School at Emory University. He has published 26 books, more than 400 articles, and is nationally and internationally known for his scholarly contributions in consumer behavior, relationship marketing, competitive strategy, and geopolitical analysis. His book *The Rule of Three* (Free Press, 2002), coauthored with Raj Sisodia, has altered current notions on competition in business. This book has been translated into five languages and was the subject of a seven-part television series by CNBC Asia. Jag's list of consulting clients around the world is long and impressive, including AT&T, GE, Motorola, Whirlpool, and 3M, to name just a few. He is frequently quoted and interviewed by *The Wall Street Journal*, *The New York Times*, *Fortune*, *Financial Times*, and radio shows and television networks such as CNN, Lou Dobbs, and more. He is also on the Board of Directors of several public companies. In 2004, he was honored with the two highest awards bestowed by the American Marketing Association: the Richard D. Irwin Distinguished Marketing Educator Award and the Charles Coolidge Parlin Award. For more details, see www.jagsheth.net.

The late **David B. Wolfe** was an internationally recognized customer behavior expert in middle-age and older markets. He was the author of *Serving the Ageless Market* (McGraw-Hill, 1990) and *Ageless Marketing: Strategies for Connecting with the Hearts and Minds of the New Customer Majority* (Dearborn Publishing, 2003). David's consulting assignments took him to Asia, Africa, Europe, and throughout North America. He was widely published in publications in the U.S. and abroad. He also consulted to numerous Fortune 100 companies, including American Express, AT&T, Coca-Cola, General Motors, Hartford Insurance, Marriott, MetLife, Prudential Securities, and Textron.

Prologue

A Whole New World

The future is disorder. A door like this has opened up only five or six times since we got up on our hind legs. It's the best possible time to be alive, when almost everything you thought you knew is wrong.

The mathematician Valentine, in Tom Stoppard's play *Arcadia*

This book reaches the public eye at the dawn of a new era in human history—perhaps more so than any previous era that inspired historians to give it a name signifying its import. Looking back hundreds of years—thousands of years, say some[1]—this new era may be unmatched in the scale of its effect on humankind. Numerous credible authors have testified in their writings that something this big is happening. Francis Fukuyama declared the end of a major cultural era in his famous and controversial essay "The End of History" (1989). A little later, *Science* magazine editor David Lindley foretold the demise of the Holy Grail of physics—the General Unified Theory—in *The End of Physics* (1993). The next year, British economist David Simpson claimed that macroeconomics had outlived its usefulness in *The End of Macro-Economics* (1994). Then, science writer John Horgan ticked off legions of scientists with his provocative book *The End of Science* (1997). That same year, Nobel Laureate chemist Ilya Prigogine told us in *The End of Uncertainty* (1997) of an imminent broad-reaching shift in scientific worldview that would make much of what stands as scientific truth today scientific myth tomorrow.

So many endings must mean so many new beginnings. Around the start of the 1990s, virtually no major field of human endeavor was spared from predictions of its ending—not literally, but certainly in terms of past conceptualizations of its nature. The world of business is no exception. It is experiencing far-reaching changes in our understanding of its fundamental purposes and how companies should operate. Indeed, looking at the magnitude of change in the business world, it is not overreaching to suggest that an historic *social transformation of capitalism* is underway.

Twenty or so years ago, just as the Internet was going mainstream, few could have credibly predicted the scale of this transformation. In this book, we provide some measure of that scale by profiling companies that have broadened their purpose beyond the creation of shareholder wealth to act as agents for the larger good. We view these companies not as outliers but as the vanguard of a new business mainstream.

We call this era of epochal change the "Age of Transcendence." The dictionary defines *transcendence* as a "state of excelling or surpassing or going beyond usual limits."[2] We're not the first to speak of a transcendent shift in the *zeitgeist* of contemporary society; Columbia University humanities professor Andrew Delbanco says, "The most striking feature of contemporary culture is the unslaked craving for transcendence."[3] This craving for transcendence could be playing a strong role in the erosion of the dominance of scientifically grounded certainty, which has characterized worldviews in western societies since the dawn of modern science. Subjective perspectives based on how people *feel* have gained greater acceptance in recent times.

Others have taken note of the rising subjectivity of worldviews. One is French philosopher Pierre Lévy, who has devoted his professional life to studying the cultural and cognitive impacts of digital technologies. He believes that the shift toward subjectivity may prove to be one of the most important considerations in business in this century.[4] Lévy also believes that Ayn Rand–style objectivism, firmly embraced by Milton Friedman and his protégés, is passing into history as feelings and intuition have risen in stature in the common mind. Malcolm Gladwell's bestselling book on intuition, *Blink*, is a testament to that, as is James Surowiecki's *The Wisdom of Crowds.*

The dramatic upsurge of interest in spirituality in the U.S. that has helped spawn stadium-sized "mega churches" is another indication that something big is happening in the bedrock of culture.

Numerous consumer surveys report that people are looking less to "things" and more to experiences to achieve satisfaction with their lives.[5] For many, the experiences they most covet transcend a world that is materialistically defined by science, and for that matter most of traditional business enterprise.

People who lead companies are not insulated from the influences of culture. After all, they drink from the same cultural waters as the customers they serve and the employees they lead. The executives we write about as exemplars in this book reflect in their managerial philosophies the changes in culture we've been talking about. They are champions of a new, humanistic vision of capitalism's role in society. It is a vision that transcends the narrower perspectives of most companies in the past, rising to embrace the common welfare in its concerns. Former Timberland CEO Jeffrey Swartz (whose company has been acquired by VF Corp.) unabashedly said that his company's primary mission was "Make the world a better place." But Swartz and the other executives we hold up as role models in this book are not starry-eyed do-gooders. They are resolute and highly successful business professionals who augment their human-centered company vision with sound management skills and an unswerving commitment to do good by all who are touched by their companies. We call their companies "firms of endearment" because they strive through their words and deeds to endear themselves to all their primary stakeholders—customers, employees, suppliers, communities, and shareholders—by aligning the interests of all in such a way that no stakeholder group gains *at the expense of* other stakeholder groups; rather, they all prosper together. These executives are driven as much by what they believe to be right (subjectively grounded morality) as by what others might more objectively claim to be right.

Ponder for a moment what the results of a Conference Board survey say about the moral outlook in executive suites across the country. Seven hundred executives were asked why their companies engaged in social or citizenship initiatives. Only 12 percent mentioned business strategy. Three percent mentioned customer attraction and retention, and one percent cited public expectations. The remaining 84 percent said they were driven by motivations such as improving society, company traditions, and their personal values.[6] We don't think members of this 84 percent all sat down and calculated in rational fashion the direct payoff of carrying out their duties according to high moral standards. More likely, we believe, most simply feel in their gut what they should be doing. This is how movements and revolutions unfold: as much from the heart as from the mind. What we write about in this book is a powerful movement if not altogether a revolution.

We are poised precariously at what physicists call a bifurcation point—an interregnum of normalcy between the poles of death and birth (or rebirth), when an old order faces its end and a new order struggles to emerge from its fetal state. At such times, the future becomes more uncertain than usual because events within the time and space boundaries of a bifurcation point have infinite possible outcomes. This is why Valentine declared, "The future is disorder" but challenges us to join efforts to bring forth a new order with the yeasty lure: "It's the best possible time to be alive when almost everything you thought you knew is wrong."

Humankind is entering a realm where no one has gone before. Its landscape is as unfamiliar to us as the world that we've known until now would be to a time traveler from the eighteenth century. Let's travel back in time to better appreciate the evolutionary nature of culture through brief reflections on the antecedent two cultural ages in U.S. history from which the Age of Transcendence is emerging.

The Age of Empowerment

We call the first cultural era in America the "Age of Empowerment." The signing of the Declaration of Independence and publication of Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* in 1776 marked its beginning. That these two epochal events in human history occurred in the same year is an extraordinary historic coincidence. The former event was about a free society, the latter about free markets. Joined at the hip, democracy and capitalism marched into the future to bring forth a whole new world, one that would elevate the lot of the common man to heights never experienced or imagined before in human history.

For the first time in history, ordinary people were empowered by codified law to shape their own destinies. People born without social distinction could raise themselves from abject poverty to the highest public and private offices. A free market economy aided their efforts. Liberal education and laws that rewarded industry supported America's determination to become a great nation. As decades went on, millions of families rose out of subsistence existence. The aristocratic culture of Europe may have generated great philosophic thinking in the Age of Enlightenment, but common folk in America generated great material accomplishment in the Age of Empowerment. By the end of the Age of Empowerment, which we mark around 1880, America was connected coast-to-coast by telegraph lines, railroads, a single currency, and a national banking system that the Lincoln presidency had established. Another great accomplishment of the Lincoln administration was the establishment of the land grant college program that increasingly brought the benefits of higher education to the masses. The nation was primed for its next great cultural era.

The Age of Knowledge

The intellectual and economic liberation of the masses paved the way for the Age of Knowledge. Within a half-dozen years of 1880, Alexander Graham Bell invented the telephone, and Thomas Edison invented the phonograph, the first practical incandescent light bulb, and the first central electrical power system.

During the Age of Knowledge, the U.S. transitioned rapidly from an agrarian to an industrial society. Science exploded into daily life. The time from laboratory prototype to the marketplace came to be often measured in months instead of decades. Great scientific breakthroughs spawned great industries. And great industries created the modern consumer economy. Economic gains across society raised living standards to previously unimaginable heights. Childbirth and childhood deaths became rarities. Life expectancy in the U.S. shot up from 47 years at birth in 1900 to 76 years at birth by 1990.

Business management took a seeming leap forward in the early years of the twentieth century when Frederick Winslow Taylor introduced scientific discipline to the practice of management in *Scientific Management* (1911). Alfred P. Sloan invented the modern corporation after becoming president of General Motors in 1923. In 1921 John Watson, head of Johns Hopkins' psychology department and founder of the behaviorist school of psychology, joined the J. Walter Thompson advertising agency to establish the first consumer research center in the nation. Science now undergirded the full spectrum of business—from product design and organizational management, to consumer research and marketing.

Ever since Ransom E. Olds established the first assembly line (no, it wasn't Henry Ford; he just mechanized Olds' assembly line), the operating focus of business has been on constant improvements in productivity—getting more and more from less and less. For a long time, this served society well. Quality of life steadily rose while the cost of living steadily fell. The material wellbeing of ordinary people reached astonishing levels. Materialism became the bedrock of business, society, and culture.

In time, however, preoccupation with productivity and cost cutting to improve bottom lines began to take a toll on communities, workers, their families, and the environment. Scores of communities fell into economic disrepair as companies abandoned them for venues promising lower operating costs. Legions of families endured abject suffering as their breadwinners struggled to find new jobs. Life was sucked out of villages, towns, and center cities across the nation. Sprawling slums filled with the carcasses of abandoned factories became unwelcoming neighborhoods. Apologists justified business decisions that wreaked havoc on individuals and their families and neighborhoods by invoking the Darwinian "survival of the fittest" theme. The pro-business argument was simple: To reap the benefits of capitalism, society must tolerate the pain it sometimes causes people on the lower rungs of society.

But growing numbers are now wondering, "How much more pain do we have to live with?" Ordinary citizens increasingly view commerce as lacking a human heart. They feel that most companies see them as just numbers to be controlled, manipulated, and exploited. They know that to many companies they have little flesh-and-blood realness—that they have the same abstract quality as people on the ground have for pilots dropping bombs from 40,000 feet.

But the times they are a-changing, as Bob Dylan sang in the 1960s.

New Republic senior editor Gregg Easterbrook has observed, "A transition from material want to *meaning want* is in progress on an historically unprecedented scale—involving hundreds of millions of people—and may eventually be recognized as the principle cultural development of our age."[7] (Italics added.)

Welcome to the Age of Transcendence, the highest pinnacle that humanity has yet ascended to.

The Age of Transcendence

The point of tracing America's cultural evolution since its founding is to focus attention on the idea that free societies continuously progress through processes of cultural evolution, the equivalent of a person's evolutionary progress in what psychologists call "personality development." Societies, like people, are driven to strive for being more today than they were yesterday, and more tomorrow than they are today. Indeed, Steve McIntosh suggests that this is the very purpose of evolution:

> The evolutionary story of our origins has tremendous cultural power that transcends the boundaries of science; it shapes the view of who we are and why we are here. Yet many of the scientific luminaries responsible for educating the public about evolution tell us that it is an essentially random or accidental process with no larger meaning. However, as the scientific facts of evolution have increasingly come to light, these very facts demonstrate that the process of evolution is unmistakably progressive. As we come to see how evolution progresses, this reveals evolution's purpose—to grow toward ever-widening realizations of beauty, truth, and goodness.[8]

While scientific discovery and technological development have been the primary catalysts in the evolution of culture, recent demographic changes have played quite a large role in reshaping culture. Aging populations are altering the course of humankind. But this is not the first time demography has reset the directions of humankind.

Recent findings by anthropologists indicate a sudden increase in longevity 30,000 years ago that changed human culture dramatically. The longevity gains created a population explosion among grandparents. For the first time in human history, relatively large numbers of postmenopausal women were available to support their daughters and granddaughters and to begin refining domestic life. More grandfathers were available to instruct young males in "the old ways," thus strengthening generational continuity. Many anthropologists regard the "grandparent phenomenon" as a major turning point in the cultural evolution of humankind. Among other benefits, the sharp increase in the grandparent population led to a moderation of the aggressive behavior of youth. This reduced tribal warfare, freeing tribal attention and energy to move toward higher states of cultural development.[9]

Something similar could be happening today—that is, the rapid growth of an aging population is altering the *zeitgeist* of society, driving humankind toward higher states of cultural development. We can cite 1989 as the formal start of this new course because starting that year, most adults in the U.S. were 40 or older for the first time in history (the median age of adults now exceeds 45 across the American population and is more than 50 for Caucasians). Like an echo of the moderating influences brought about by an explosion in the grandparent population 30,000 years ago, the aging of the population in the vast majority of nations in the world today raises the prospects for a "kinder and gentler society"—to use Peggy Noonan's words in a campaign speech she wrote for George H. W. Bush in 1988.

But another development occurring around the time the new "mature adult" majority came into being has also played a major role in catalyzing quantum changes in the bedrock of culture. Also in 1989, British software engineer Tim Berners-Lee invented the World Wide Web. Within a few short years, the Internet went from being an arcane communications tool used mostly by an elite few to a mainstream artifact used by tens of millions. The World Wide Web shifted the balance of information power to the masses. It dramatically changed how people interact with each other, democratized information flow, and forced companies to operate with far greater transparency.

The Age of Transcendence bears similarities to what author Daniel Pink calls the "Conceptual Age" in his book *A Whole New Mind*. Pink defines the Conceptual Age as an "economy and a society built on the inventive, empathetic, big-picture capabilities of what's rising."[10] He describes the Conceptual Age as the successor to the Information Age. We define our term for the same era a bit differently. The Age of Transcendence signifies a cultural watershed in which the physical (materialistic) influences that dominated culture in the twentieth century ebb while metaphysical (experiential) influences become stronger. This is helping to drive a shift in the foundations of culture from an objective base to a subjective base: people are increasingly relying on their own counsel to decide their course of action. This trait is typically present among people in midlife and older who are generally less subject to the "herd" behavior that is so prevalent among youth. That shift acknowledges a long suppressed idea in a world largely guided by the Newtonian certainty that Ilya Prigogine says is scattering to the winds: *Ultimately, everything is personal.*

Pink wrote enthusiastically about society moving from the more rational perspectives commonly associated with the left brain to the more emotional, intuitive perspectives usually associated with the right brain. He argued that companies in the U.S. need to move more toward right brain values to work an advantage over companies abroad who want to build relationships with American consumers. As he sees it, this means that U.S. companies must connect with what he calls the six senses of the Conceptual Age in product design, marketing, and customer relations. These six senses are design, story, symphony, empathy, play, and meaning.[11] They all have deep roots in the brain's right hemisphere.

However, the issue of change in the foundations of culture is not as simple as a matter of left brain versus right brain. We see the marketplace generally favoring companies that integrate both right and left brain perspectives to yield what Austrian neurologist Wolf Singer calls "unitive thinking," which is a distinct third kind of thinking in Singer's mind that he claims is the ultimate source of creativity.

In the wake of René Descartes' formulation of the scientific method, the Western mind came to be dominated by "either/or" constructs that are largely moderated in the analytical left brain. That side of the brain tends to rank things hierarchically in categories. It routinely excludes from serious consideration what doesn't fall into a clearly defined category. To put this in a business context, in exclusionary left brain thinking, stakeholders are relegated to categories. Connections between stakeholders in differing categories are incidental and accidental. The picture is quite different among firms of endearment (FoEs). Their leaders think in unitive fashion, approaching their tasks with holistic vision in which all players in the game of commerce are interconnected and significant.

Welcome, again, to the Age of Transcendence. Settle down, get comfortable, and read on. There are many new rules to learn, because *almost everything you thought you knew could be wrong*. We are going to be in this age for quite a while—probably for the rest of your life, and longer.

Overview of Chapters

Here is a preview of the journey you have just embarked on:

- In Chapter 1, "Building Business on Love and Care," we introduce the firms of endearment business philosophy and summarize its astonishing performance in today's challenging business environment.
- Chapter 2, "New Age, New Rules, New Capitalism," discusses the new rules for business in the Age of Transcendence and offers the unconventional idea that an increasing number of companies are behaving in ways that mirror the increasing influence of self-actualization needs and processes that derive from our aging society.
- Chapter 3, "Dealing with Disorder," discusses how and why the social transformation of capitalism that is underway is happening.
- We now start looking at how FoEs manage their relationships with each stakeholder group. In Chapter 4, "Employees: From

Resource to Source," we look at how these companies deal with their employees, creating happy and productive work environments in which employees are highly motivated, valued, and well rewarded.

- Chapter 5, "Customers: Healing vs. Hucksterism," addresses customer relationships, describing the new marketing paradigm that is emerging in the Age of Transcendence. This includes honoring the legal as well as the unspoken emotional contract that companies have with their customers—and, indeed, with all stakeholders.
- In Chapter 6, "Investors: Reaping What FoEs Sow," we show how companies can and must relate to their investors in financial as well as emotional terms.
- Chapter 7, "Partners: Elegant Harmonies," addresses business partners, including suppliers, distributors, retailers, and others. As companies outsource more and more value creation, business partners are becoming increasingly crucial to success. This chapter shows how FoEs manage these vital relationships in a symbiotic and mutually beneficial way.
- Chapter 8, "Society: The Ultimate Stakeholder," deals with how FoEs relate to the world at large, including the communities within which they operate, competitors, governments at all levels, and nongovernmental organizations. We view society as the ultimate stakeholder because it subsumes each of the other stakeholders within it. The key message here is that FoEs are enthusiastically welcomed into the communities where they operate, and view governments as partners in value creation rather than adversaries.
- Chapter 9, "Culture: The Secret Ingredient," addresses issues of leadership and corporate culture.
- Chapter 10, "What We Have Learned," summarizes what we have learned about the FoE way of doing business.

- Chapter 11, "The Other Side of Complexity," concludes the book with a vision of the "simplicity on the other side of complexity" that describes the FoE management philosophy.
- Appendix A, "Brief Company Profiles," provides thumbnail sketches of each FoE featured in the book, highlighting what makes the company unique and what we can learn from it.
- Appendix B features an interview with Rick Frazier, Founding Partner of Concinnity Advisors, LP. This interview elaborates on the empirical basis for selecting the publicly traded U.S. companies in our analysis.

Endnotes

1. *Washington Post* Reporter Joel Garreau asserts in his book *Radical Evolution: The Promise and Peril of Enhancing Our Minds, Our Bodies—and What it Means to Be Human*, Doubleday, 2004, pg. 3: "(The) gulf between what engineers are actually creating today and what ordinary readers might find believable is significant. It is the first challenge to making sense of this world unfolding before us, in which we face the biggest change in tens of thousands of years in what it means to be human."
2. http://www.wordreference.com/.
3. Andrew Delbanco, *The Real American Dream: A Mediation on Hope,* Harvard University Press, 1999, pg. 113.
4. Pierre Lévy, *Collective Intelligence,* Perseus Book Group, 2000, p. 4.
5. Marita Wesely-Clough, trends expert at Hallmark Cards, Inc., says, "Watch for people of all ages to scale down and simplify, to insure they have time to invest in what matters—friends, family, giving back, their legacy. Boomers approaching retirement will lead this trend." (http://retailindustry.about.com/od/retail_trends/a/bl_trends2005.htm). This is a common refrain among consumer trend watchers, including the Yankelovich Monitor, which issued a report in 2002 stating that consumers were striving to simplify their lives by relying less on "stuff" to make them happy (David B. Wolfe with Robert Snyder, *Ageless Marketing*: *Strategies for Reaching the*

Hearts and Minds of the New Customer Majority, Dearborn Trade publishing, 2004, pg. 20.)

6. Sophia A. Muirhead, Charles J. Bennett, Ronald E. Berenbeim, Amy Kao, and David Vidal, *Corporate Citizenship in the New Century: Accountability, Transparency and Global Stakeholder Engagement*, R-1314-02-RR, New York: Conference Board, 2002.
7. Gregg Easterbrook, *The Progress Paradox: How Life Gets Better While People Feel Worse,* Random House, 2003, pg. 317.
8. Steve McIntosh, *Evolution's Purpose: An Integral Interpretation of the Scientific Story of Our Origins*, Select Books, 2012; quote drawn from http://www.stevemcintosh.com/books/evolutions-purpose/.
9. Lee Bowman, "The dawn of grandparents proved positive for humans," *Seattle Post-Intelligencer,* July 6, 2004. (http://seattlepi.nwsource.com/national/180825_wisdom06.html).
10. Daniel H. Pink, *A Whole New Mind: Moving from the Information Age to the Conceptual Age*, Riverhead Books division of Penguin, New York, 2005.
11. *Design:* paying attention to aesthetics when carrying out any task. *Story:* conveyance of information to consumers, employees, and others through storytelling techniques. *Symphony:* the ability to put together pieces to create a holistic picture; synthesis is a good synonym. *Empathy:* identifying with and understanding another person's circumstances, feelings, and motives. *Play:* putting fun into every activity to enhance both pleasure and creativity. *Meaning:* Extending the value of an activity beyond the moment and self.

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1

Building Business on Love and Care

This book is not about corporate social responsibility. It is about enlightened business management.

This book owes much to the ideas of R. Edward Freeman, who in 1984 made a strong case for a stakeholder-based business model in his book *Strategic Management: A Stakeholder Approach* (Pittman Publishing). As management professor Ronald W. Clement wrote in an article examining stakeholder management theory, "Freeman was the first management writer to so clearly identify the strategic importance of groups and individuals beyond not only the firm's stockholders, but also its employees, customers, and suppliers. Indeed, he saw such widely disparate groups as local community organizations, environmentalists, consumer advocates, governments, special interest groups, and even competitors and the media as legitimate stakeholders."[1]

Firms of Endearment had its origins in discussions among the authors about writing a book on the topic of how marketing has lost its way, consuming ever-more resources but delivering less in terms of customer satisfaction, loyalty, and especially trust. Our initial working title was *In Search of Marketing Excellence.* However, as we continued exploring the topic and identifying companies that spent less on marketing than their industry peers but achieved far more, we uncovered a more holistic truth: that customers are best served by companies that create superior value and have close relationships with *all* their stakeholders—employees, suppliers, the communities in which they operate, and, of course, their stockholders. This realization led us to the work of R. Edward Freeman, who among other distinctions, heads the Center for Applied Ethics at University of Virginia's Darden School of Business.

Since the publication of Freeman's seminal book on stakeholder-based business models, a flood of articles and books have examined and argued for and against the stakeholder approach to business management. In this book, we present evidence that supports Freeman's ideas about the interconnected and interdependent nature of stakeholders.

This book is a clarion call for companies—indeed, organizations of every stripe—to reorganize and become vehicles of service to every stakeholder group. We offer a substantial volume of case-based evidence that companies that hew to a stakeholder relationship management (SRM) business model develop a distinctive and lasting competitive advantage and outperform their peers along multiple dimensions, including financial.

We believe that SRM business models will increasingly be seen as the most efficacious way to achieve *sustained* superior business performance. To understand why, we need to reflect on the profound changes taking place in the cultural bedrock of U.S. society as well as in every other developed nation. The aging of developed societies is a major factor in these changes. With the majority of adults now 45 and older, the worldviews, values, and needs of the young no longer have the influence on society they once did. The worldviews and values associated with midlife and beyond have become more influential on culture than ever. Surveys by consumer trend watchers such as the Yankelovich Monitor bear this out. Myra Stark of the global ad agency Saatchi & Saatchi stated the following in an essay titled "The State of the U.S. Consumer 2002:"

> In the face of threats to our safety, our way of life and our economic stability, Americans have pulled back from many of the things that seemed to matter in the '90s—materialism, career, the celebrity culture, the affluent attitude—and are rethinking how they want to live and work. Daniel Pink, author of *Free Agent Nation,* calls this new seriousness "the flight to meaning." "In turbulent times," he says, "people get serious about finding meaning."[2]

The meaning of life—and the meaning of one's own life in particular—is a perennial issue in midlife and beyond whose influence on society as a whole was less pronounced when the young were the majority. But with the adult majority now consisting of people over the age of 45, the search for meaning has a major influence on the ethos of society at large, including on corporate cultures everywhere.

It is common for people nearing or beyond the career-building and family-raising years to ask, "What am I going to do with the rest of my life?" This self-query arises from a sense that one should be doing more than serving just one's self; one should begin thinking about serving the larger collective "self." We discovered many business leaders who have asked themselves a similar question: "How are we going to make this company an instrument of service to society even as we fulfill our obligation to build shareholder wealth?"

As we said in the Prologue, we are in the early stages of a new era that we call the Age of Transcendence. Numerous consumer surveys reveal that people are increasingly looking for higher meaning in their lives than simply adding to the store of things they own. This is a signature trait of people in midlife and older who are not battling basic survival issues, either materially or emotionally. The search for meaning is changing expectations in the marketplace and in the workplace. Indeed, *we believe it is changing the very soul of capitalism*.

Many have long regarded capitalism as an economic concept without a soul; it is all about business and markets. However, as we see it, the edifice of capitalism is undergoing its farthest-reaching transformation since Adam Smith published *The Wealth of Nations* in 1776. The nature of the transformation can be summed up in one short statement: Companies are increasingly motivated by and being held accountable for humanistic as well as economic performance.

A *humanistic company* is run in such a way that its stakeholders—customers, employees, suppliers, business partners, society, and many investors—develop an emotional connection with it, an affectionate regard not unlike the way many people feel about their favorite athletic teams. Humanistic companies—or *firms of endearment*—seek to maximize their value to society as a whole, not just to their shareholders. They are the ultimate value creators: They create emotional, spiritual, social, cultural, intellectual, ecological, and, of course, financial value. People who interact with such companies feel safe, secure, and fulfilled in their dealings. They enjoy working with or for the company, buying from it, investing in it, and having it as a neighbor.

Numerous companies are successful and admirable in many ways but lack a strong emotive dimension. We argue that for the best prospects of success in the future, companies will need to combine an emotive dimension with operational efficacy. Some have called the emotive dimension the "soul of a company." Companies without a soul face a doubtful future.

Of course, millions of customers routinely buy from companies to which they feel no emotional attachment. Customers can be loyal in *behavior* to a company without being loyal in *attitude*. Attitudinal loyalty comes from emotional attachment. It is attitudinal loyalty that matters most in sustaining the long term survival and success of a business, especially in today's rapidly evolving marketplace.

The social transformation of capitalism is being driven by cultural changes of tectonic proportions that corporations, governments, and business schools ignore at their peril. This book examines the nature of this transformation, why it is happening now, and what it will take for companies to succeed in this new environment. Companies that do not understand capitalism's evolving identity—what many are now calling "Conscious Capitalism"—could have a short life expectancy because the forces driving this makeover are essentially unstoppable. They have become part of who we are in these times. Every company has the choice of going with the flow of these forces and being lifted to new heights or being drawn under by the churning rip tides of historic change.

The Power of Love

Most Wall Street analysts and corporate bean counters haven't caught on to the idea that there is much profit to be gained by bringing love into business operations. However, they and any others whose eyes roll at hearing the words *love* and *management* joined together would do well to read James Autry's *Love and Profit*. First published in 1991, the book followed Autry's retirement as chief executive officer of Meredith Corporation Magazine Group. Meredith publishes *Better Homes & Garden, Ladies Home Journal,* and *Country Life,* among other titles. *Town and Country* editor-in-chief Pamela Fiori called *Love and Profit* "the most enlightening book about management written in the last twenty-five years."[3] *Love and Profit* is a book of poetry about business with inspired prose between poems.

How can a book of poetry be considered the "most enlightening book about management in the last twenty-five years?" Easy. Autry focuses on strategically crucial dimensions of human behavior that relatively few companies acknowledge in their policies and operations. Most business leaders think in terms of numbers and profit. *Love* and *profit* is an alien conjunction of words that is quantitatively murky. What's the payoff? Well, as that sage of sages Albert Einstein said, "Not everything that can be counted counts, and not everything that counts can be counted." It is attention to the *immeasurable* qualitative dimensions of life that gives FoE companies their crucial competitive differences from their competitors.

In his book *A Whole New Mind,* Daniel Pink in effect endorses Einstein's counsel on the limitations of measuring what counts. He posits that America's continued economic vitality depends on "...supplement(ing) well-developed high-tech abilities with abilities that are high concept and high touch"[4] (echoes of John Naisbitt's *Megatrends* from a quarter century ago). Pink elaborates:

> High concept involves the ability to create artistic and emotional beauty, to detect patterns and opportunities, to craft a satisfying narrative, and to combine seemingly unrelated ideas into novel invention. High touch involves the ability to empathize, to understand the subtleties of human interaction, to find joy in one's self and to elicit it in others, and to stretch beyond the quotidian, in pursuit of purpose and meaning.[5]

Pink's words capture the essence of the cultural foundations of FoE companies. However, the prevailing view still is that business survival is mostly a numbers game. But according to Pink, we are in a new era in which company survival and growth will depend less on *quantitative* factors and more on *qualitative* factors. Perhaps the most powerful qualitative factor present in the culture of FoEs we've examined is love—a deep, tender, ineffable feeling of affection[6] that runs from company to stakeholder and back again to the company.

James Autry wrote in *Love and Profit*, "Good management is largely a matter of love." He elaborates:

> Management is, in fact, a sacred trust in which the well-being of other people is put in your care during most of their working hours. It is a trust placed upon you first by those who put you in the job, but more important than that, it is a trust placed upon you *after you get the job* by those whom you are to manage.[7]

Tim Sanders, former Chief Solutions Officer of Yahoo!, sings from the same sheet of music in his book, *Love Is the Killer App: How to Win Business and Influence Friends*:

> I don't think there is anything higher than Love.... Love is so expansive. I had such a difficult time coming up with a definition for Love in my book, but the way I define Love is the selfless promotion of the growth of the other.[8]

Kevin Roberts, CEO of one of the world's largest ad agencies, Saatchi & Saatchi, proposes in his book *Lovemarks: The Future Beyond Brands* that love should be the foundation of all marketing:

> At Saatchi & Saatchi our pursuit of Love and what it could mean for business has been focused and intense. Human beings need Love. Without it they die. Love is about responding, about delicate, intuitive sensing. Love is always two-way. When it is not, it cannot live up to the name Love. Love cannot be commanded or demanded. It can only be given.[9]

Copyrights, trademarks, servicemarks, and now lovemarks, says Roberts. That's how the strongest brands will institutionalize their uncopyable distinction from competing brands. This is more than a sea change. It is a planetary change. A cosmic change. It is as far removed from marketing theory of the past as instant messaging is from Victorian-era letter writing.

What Is a Firm of Endearment?

Consider the words *affection, love, joy, authenticity, empathy, compassion, soulfulness,* and other terms of endearment. Until recently, such words had no place in business. That is changing. Today, a growing number of companies comfortably embrace such terms. That is why we coined the phrase "firms of endearment," or FoE. Quite simply, an FoE is a company that *endears* itself to stakeholders by bringing the interests of all stakeholder groups into strategic alignment. No stakeholder group benefits at the expense of any other stakeholder group, and each prospers as the others do. These companies meet the functional and psychological needs of their stakeholders in ways that delight them and engender affection for and loyalty to the company.

During the 1990s, the phrase "share of wallet" became popular among marketers. It became the primary focus of the marketing approach called customer relationship management (CRM). However, the term signified an emotionally barren, largely impersonal and quantitative view of customers. For the vast majority of companies, CRM was more about better targeting and deeper exploitation of customers through data management than about empathetically attending to their needs. Instead of customer relationship management, it would have been more accurate to call it customer *data* management.

FoEs have bought into a different idea; they strive for *share of heart*. Earn a place in the customer's heart and she will gladly offer you a bigger share of her wallet. Do the same for an employee and the employee will give back with a quantum leap in productivity and work quality. *Emotionally* bond with your suppliers and reap the benefits of superior offerings and responsiveness. Give communities in which you operate reasons to feel pride in your presence, and enjoy a fertile source of customers and employees. (Of course, the phrase "share of heart" suggests that there is a fixed amount of love and care to be divided among claimants. In reality, there is no such limit, as the expression "Love is not a pie" suggests.)

And what about shareholders? Except perhaps among day traders and other short-term speculators, most shareholders probably enjoy feeling good about the companies in which they invest. They want good returns, but they also take delight in investing in companies they truly admire. Most do not want support companies that are morally deficient. Of no little importance, institutional investors such as university endowment funds and pension funds have grown increasingly conscious of the moral character of companies they invest in; witness the rapidly growing trend toward sustainable, responsible, and impact investing.

Unfortunately, the vast majority of companies today cannot be described as firms of endearment. Many have enjoyed success in the past, but find themselves increasingly vulnerable and criticized from all sides. Such companies are under growing pressure today, while their FoE competitors stand tall with all their stakeholder groups while acquitting themselves with distinction in investment markets. The message of this book is clear and simple: Provided that sound management is in place (no amount of moral correctness can save a badly managed company), *endearing companies tend to be enduring companies*.

FoEs share a distinctive set of core values, policies, and operating attributes. Here is a sampling:

- They subscribe to a purpose for being that is different from and goes beyond making money.
- They actively *align* the interests of all stakeholder groups, not just balance them. Instead of trading off the interests of one group versus those of another (for example, higher wages for employees versus higher profits for investors or lower prices for customers), they craft business models in which the objectives of each stakeholder can be met simultaneously and are in fact strengthened by other stakeholders. The key to this "concinnity" is that the activities of FoEs are executed within a system that allows for the active alignment of stakeholder interests. For example Whole Foods Market captures this idea in its formal "Declaration of Interdependence," which acknowledges the idea that stakeholder groups constitute a family whose members depend on one another.
- Their executive salaries are relatively modest. In a typical year, Costco co-founder and former CEO Jim Senegal's salary was $350,000, accompanied by a bonus of $200,000. By contrast, the average CEO of a comparable public company received $14.2 million in total compensation in 2012.

- They operate at the executive level with an open door policy. For example, when Honda has a big problem, it implements *waigaya*—temporary suspension of social protocols based on rank, thus making it possible for workers on the lowest rungs to personally present a proposed solution to the highest executives involved. Harley-Davidson has a similar policy, except less ceremonial: Any employee on any day has access to the highest offices in the company.
- Their employee compensation and benefits are significantly greater than the standard for the company's category. For example, Trader Joe's pay and benefits in the first year for full-time employees are double the U.S. average for retail employees.
- They devote considerably more time than their competitors to employee training. For example, The Container Store's first-year employees get an average of 263 hours of training versus the retail industry's average of eight hours.
- Their employee turnover is far lower than the industry average. For example, Southwest Airlines' employee turnover is half that of other major airlines.
- They empower employees to make sure customers leave every transaction experience fully satisfied. For example, a Wegmans Food Markets employee once sent a chef to a customer's home to overcome a customer's mistake and cook the Thanksgiving meal. (Yes, Wegmans employs chefs, some from five-star restaurants.)
- They make a conscious effort to hire people who are passionate about the company and its products. For example, Patagonia tries to only hire people who are passionate about nature. Whole Foods Market tries to draw as many employees as possible from the ranks of "foodies."
- They consciously humanize the company experience for customers and employees, as well as creating a nurturing work environment. For example, Google provides free gourmet meals around the clock for all employees.
- They project a genuine passion for customers, and emotionally connect with them at a deep level. By earning a larger share of customers' hearts, they earn a larger share of customers'

wallets. Nordstrom, for example, is legendary for its commitment to outstanding customer service.

- Their marketing costs are far lower than those of their industry peers, while customer satisfaction and retention are far higher. For example, Jordan's Furniture spends less than one-third the industry norm on marketing and advertising, while generating industry-leading sales per square foot that are more than five times the industry norm. Google has built one of the world's most valuable brands without any advertising.
- They view their suppliers as true partners and collaborate with them to move both their companies forward. They help suppliers reach higher levels of productivity, quality, and profitability. Suppliers, in turn, function as true partners, not as beleaguered indentured servants. For example, Honda is said to "marry suppliers for life." Once a supplier has gained admittance to the Honda family of suppliers, the company does everything it can to help the supplier improve quality and become more profitable.
- They honor the spirit of laws rather than merely following the letter of the law. They apply uniformly high operating standards across the world, regardless of local requirements that may be considerably less stringent. For example, IKEA's policy is that if strict laws concerning chemicals and other substances are imposed in a country where it does business, all suppliers in all countries must conform to such laws.
- They consider their corporate culture to be their greatest asset and primary source of competitive advantage. For example, Southwest Airlines has an elected "Culture Committee" charged with sustaining and strengthening the company's unique culture.
- Their cultures are resistant to short-term, incidental pressures, but also prove able to quickly adapt when needed. As a result, they are typically the innovators and breakers of conventional rules within their industries. Stonyfield Yogurt shuns traditional advertising, for example, relying instead on creative social media campaigns.

While financial data surely is important in analyzing a company's strength and past performance, qualitative indicators are even more important in assessing a company's future prospects. In fact, we would go so far as to say that in many instances, qualitative factors may be more revealing in drawing the picture of a company's future performance than quantitative factors.

FoE Stakeholders

This book is organized around the five major stakeholders of modern corporations. As a memory tool, we have listed them in Table 1.1 in a way that creates the acronym "SPICE."

Table 1.1 The five major stakeholders of modern corporations

Stakeholder	Definition
Society	Local and broader communities as well as governments and other societal institutions, especially non-governmental organizations (NGOs); we also include the environment as part of this stakeholder
Partners	Upstream partners such as suppliers, horizontal partners, and downstream partners such as retailers
Investors	Individual and institutional shareholders as well as lenders
Customers	Individual and organizational customers
Employees	Current, future, and past employees and their families

As Figure 1.1 shows, each stakeholder is linked to all of the others. As in any good recipe, the individual ingredients come together to form something completely new; the whole is greater than the sum of the parts.

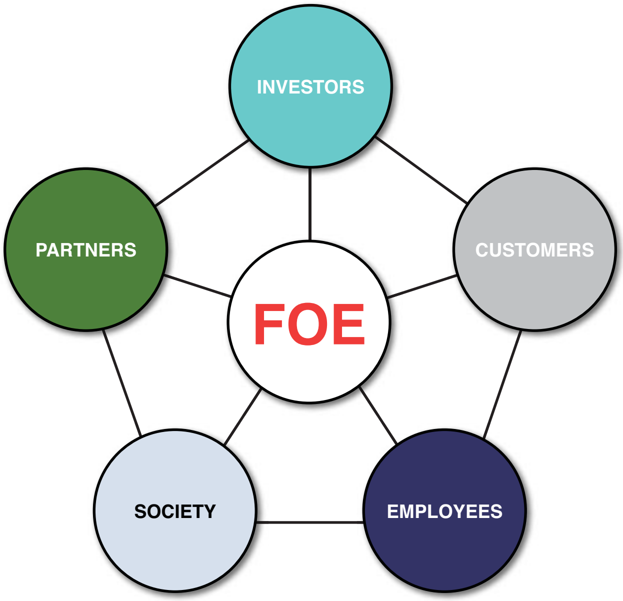

Figure 1.1 The SPICE stakeholder model

Each of these relationships is an essential piece of the puzzle, and each must be managed in the following ways:

- There is a two-way flow of value between both parties to the relationship.
- The interests of all parties are aligned.

This is the essence of great management. It is what all corporations should strive for. It is the way to maximize the returns to society of all the investments that flow into every organization. It is the *Firms of Endearment* way.

Identifying the Original Firms of Endearment

Most studies of corporate exceptionalism (or "greatness," to use Jim Collins' term) start with financial performance and work backward to identify the causes or covariates. We started with humanistic performance—meeting the needs of stakeholders other than shareholders—and worked forward.

We described the process for identifying firms for the first edition of this book as "organic and analog." We were interested in identifying a representative sample of firms that met our humanistic criteria. We did not simply conduct a statistical analysis of a plethora of companies in search of those whose financial performance supported the FoE hypothesis that companies can do well while doing good. Also, we did not want to exclude private companies from our analysis, as we believe that some of the best-managed companies from a stakeholder perspective are privately owned.

What we did was ask people, "Tell us about some companies you love. Not just like, but *love*." This process generated hundreds of candidate companies, many that are household names and many that we had never heard of. We then put them through a screening process that assessed the quantitative and qualitative performance of each company for each of the SPICE stakeholders. We also probed for vulnerabilities, asking questions such as the following: Would most people say that the world is a better place because this company exists? How extensive a track record have they built? Do they have intensely loyal customers? How well do they treat their part-time employees? How high is their employee turnover? Do they have a reputation for squeezing their suppliers? Do communities welcome them or oppose them when they try to enter or expand? Do they have a record of environmental violations? Do they follow uniformly high standards of conduct worldwide? How have they responded to industry downturns or crises of confidence?

We picked the most promising 60 or so of the companies that bubbled up through our exploratory research and assigned teams of MBA students to research them. We directed the teams to conduct secondary and primary research (through interviews with executives, employees, customers, and others) on the companies, covering all major stakeholder groups: customers, employees, suppliers, communities, governments, and investors. When each project was completed by its assigned team, the results were assessed by the other research teams to gauge the extent to which a company qualified as a company loved by its stakeholders (that is, was qualified to be called a firm of endearment). The projects were completed over a two-year period. Some companies were investigated multiple times. In the end, we picked 28 companies, of which 18 were publicly traded.

We understood, of course, that none of these companies is perfect; each has areas in which it is relatively weak or somewhat vulnerable. Generally, these weaknesses are confined to one or at most two stakeholder groups. On the whole, however, we judged these companies to be quite exemplary in significant ways. Once we had selected the 28 companies we felt best manifested a high standard of humanistic performance, we then conducted a detailed comparative analysis of the firms from an investor viewpoint. Our hypothesis at this stage was that these companies probably performed better than the "average" company, but generally not by a huge amount. After all, they pay their employees exceptionally well, do not squeeze their suppliers, deliver great products and experiences at fair prices to customers, are conscious of their environmental impact, and spend significant resources in the community—surely, all this should lead to a reduction in profits and thus the stock price. As we are constantly reminded, there is no free lunch, certainly not in the corporate world.

Imagine our surprise, then, when we completed our investor analysis. These widely loved companies (those that are publicly traded) outperformed the S&P 500 by huge margins, over ten-, five-, and three-year time horizons. In fact, **the public FoEs returned 1,026 percent for investors over the ten years ending June 30, 2006, compared to 122 percent for the S&P 500; that's more than an 8-to-1 ratio**!

If this is not a "feel good" story, we don't know what is. In fact, it is far more than a feel good story—it is a deeply inspirational one. Apparently, these companies have figured out that not only can you have your cake and eat it too, you can also give some to your friends, donate some to a soup kitchen, and help support the local culinary school. How is it that these companies can be so generous to everyone who costs them money (customers, employees, suppliers, communities) and still deliver superior (some would say spectacular) returns to investors? **The answer to that important question is what this book is all about.**

Firms of Endearment vs. Good to Great Companies

We were interested in one more comparison. Jim Collins' best-selling book *Good to Great* identified 11 companies that it described as going from "good" to "great" by virtue of their having delivered superior returns to investors over an extended period of time (the companies had each delivered cumulative returns at least three times greater than the market over a 15-year period). We compared our set of publicly traded FoEs with the 11 *Good to Great* companies. This is what we discovered:

- Over a ten-year horizon, the 13 FoEs outperformed the *Good to Great* companies 1,026 percent to 331 percent (a 3-to-1 ratio).
- Over five years, the 17 FoEs outperformed the *Good to Great* companies 128 percent to 77 percent (a 1.7-to-1 ratio).
- Over three years, the 18 FoEs performed on par with the *Good to Great* companies: 73 percent to 75 percent.

Note that none of the *Good to Great* companies made our cut, though one (Gillette, which was acquired by Procter & Gamble) did come close. We also have a semantic disagreement with that book when it comes to defining "great." To us, a great company is one that spreads joy and fulfillment and makes the world a better place because it exists, not simply a company that outperforms the market by a certain percentage over a certain period of time. By our criteria, then, a company such as Altria (formerly Philip Morris and one of the companies in *Good to Great*) cannot be considered "great" even though it may have performed handsomely for investors. With a broader, society-level accounting, Altria's value is considerably diminished, perhaps even rendered negative.

Great companies sustain their superior performance over time for investors, but equally important in our view, for their employees, customers, suppliers, and society in general. We are confident that the companies you will read about in this book will stand the test of time. If you are looking for a meaningful and deeply satisfying career, take a look at the opportunities these companies offer. If you are a potential customer, compare their offerings to others. If you run a business, consider partnering with them. If you represent a community, try to attract them to your neighborhood. If you are a business professor, get this affirming message out to your students. We don't think you will be disappointed.

Selecting Companies for the Second Edition

The first edition of *Firms of Endearment* utilized what we acknowledged was a somewhat subjective process for identifying companies that we believe to be good representatives of this way of being. This time around, we wanted to bring greater rigor to the selection process. We also wanted to widen our lens to include more companies outside of the retail and consumer products sectors, as well as more international companies. Our search for how we could accomplish this came full circle, leading us back to friends who have been with us on this journey from the beginning, including Rick Frazier, Jeff Cherry, and Peter Derby. Inspired by the vision and the stories in the book, Rick, Jeff, and Peter began work on an investment research process soon after the book was published in 2007. After investing a great deal of time, energy, and money over the past six years, they have produced what it is arguably the most comprehensive data-driven process for identifying U.S. companies that are guided by a multi-stakeholder operating system. (Appendix B includes additional information on the research process as part of an interview we conducted with Rick Frazier, Founding Partner at Concinnity Advisors, LP.)

As a first step, we asked Concinnity Advisors, LP to provide us with a list of companies that have consistently scored well enough with all stakeholders to be considered investment candidates *each* of the last five years. We believe it is important for companies to demonstrate consistency and stability over time in their approach to stakeholders. This yielded a set of 64 publicly traded U.S. companies. We also selectively looked at some companies that had made the cut four out of the last five years, especially if they had made it for the most recent four.

Next, we applied additional qualitative screens to the shortlisted companies. First, we looked at purpose. A company received a high score on this if it has a well-articulated and authentically lived purpose that goes beyond profit maximization. Companies received lower scores if the purpose was unarticulated but still lived, or if the purpose was articulated but not clearly manifested. Companies that did not have an articulated higher purpose and did not manifest one were rejected based on this criterion.

We used a similar approach to look at the company's leadership. The company received a high score if it has a purpose-driven, service-minded, and reasonably paid CEO. Companies with autocratic and excessively highly paid leaders were rejected based on this criterion. Lastly, we looked for evidence that the companies had cultures that were rooted in trust, caring, and authenticity. Companies with overtly competitive, fear-based, and non-collaborative cultures were rejected.

This combined quantitative and qualitative approach yielded a set of 28 U.S. publicly traded companies that we deem to be firms of endearment.

Of course, an important caveat applies to all of these companies. Just as there are no perfect human beings, there are no perfect companies. Every one of the companies can be criticized by some for a perceived deficiency in certain areas. But all things considered, we feel very confident in the set of companies we've identified, and anticipate that their strong caring cultures will enable them to continue to operate in this manner for a long time to come. It is also important to point out that our stakeholder data on these companies spans the years 2008–2012. That provides a long enough time span for us to be able to assert with some confidence that these companies are likely to continue operating in this way into the future. But it does not guarantee that all of these companies did operate with a stakeholder orientation prior to 2008, though we do believe that was the case for most of them.

Although we used case studies and some personal interviews to qualitatively screen the U.S. public companies that had been identified through Concinnity Advisors' scoring system, we had to rely entirely on the case study approach in order to identify a set of privately owned firms of endearment. This is because we did not have access to a similar database for private companies. In addition, the universe of private companies is much larger than that of public companies, making the challenge of identifying a small set of such companies even greater. Our approach was to identify a set of companies that appear to embody these virtues, without claiming that they are the only such companies or even that they are the *best* such companies. We have included 29 such companies in our list. In most cases, we have direct experience with these exemplary firms, and can attest to their deep commitment to the principles underlying this way of doing business and being in the world.

We followed a similar process to identify a set of 15 non-U.S. companies, which includes 13 publicly traded companies and two private ones. Our goal here was to point to a diverse set of companies from multiple geographies that all share a commitment to this philosophy of business. The list includes companies from Japan, South Korea, India, Denmark, France, Spain, Sweden, and Mexico.

Table 1.2 lists all the companies that are included in these various categories.

Table 1.2 The FoE companies

US Public Companies	US Private Companies	Non-US Companies
3M	Barry-Wehmiller	BMW (Germany)
Adobe Systems	Bon Appetit Management Co.*	Cipla (India)
Amazon.com	Clif Bar	fabIndia (India - private)
Autodesk	Driscoll's	FEMSA (Mexico)
Boston Beer Company	GSD&M Idea City	Gemalto (France)
CarMax	Honest Tea*	Honda (Japan)
Chipotle	IDEO	IKEA (Sweden - private)
Chubb	Interstate Batteries	Inditex (Spain)
Cognizant	Jordan's Furniture*	Mahindra & Mahindra (India)
Colgate-Palmolive	L.L. Bean	Marico (India)
Costco	Method	Novo Nordisk (Denmark)
FedEx	Millennium Oncology*	POSCO (South Korea)
Google	New Balance	TCS (India)
Harley-Davidson	Patagonia	Toyota (Japan)
IBM	Prana	Unilever (UK)
J.M. Smucker	REI	
Marriott International	SAS Institute	
MasterCard Worldwide	SC Johnson	
Nordstrom	Stonyfield Yogurt*	
Panera	TDIndustries	
Qualcomm	The Container Store	
Schlumberger	The Motley Fool	
Southwest Airlines	Timberland*	
Starbucks	TOMS	
T. Rowe Price	Trader Joe's*	
United Parcel Service	Union Square Hospitality Group	
Walt Disney	USAA	
Whole Foods Market	Wegmans	
	WL Gore	

* These companies are stand-alone subsidiaries of other companies, and operate essentially as private companies.

Finally, it is important to point out that all of these companies are at different points in their evolution toward becoming firms of endearment. Some of them have been on this path from the beginning, which in several cases was more than 100 years ago. Others have only recently discovered this approach to business and are now consciously moving toward it. A third subset of companies were born this way, lost their bearings for a while after becoming publicly traded, and at some point reconnected with their roots, rediscovered their soul, and became firms of endearment or conscious companies once again.

Appendix A provides thumbnail sketches of all the companies included in the preceding table. Examples of practices from many of them are included throughout the book.

As Table 1.3 indicates, firms of endearment have significantly outperformed the market over all time frames, ranging from three years to 15 years. They have also greatly outperformed the companies cited in the book *Good to Great* over the last 10 and 15 years.

Table 1.3 Financial performance

Cumulative Performance	15 Years	10 Years	5 Years	3 Years
US FoEs	1681.11%	409.66%	151.34%	83.37%
International FoEs	1180.17%	512.04%	153.83%	47.00%
Good to Great Companies	262.91%	175.80%	158.45%	221.81%
S&P 500	117.64%	107.03%	60.87%	57.00%

The Unspoken Contract That FoEs Honor

In an earlier career, one of us (Wolfe) owned a company that managed communities with mandatory membership homeowner associations. One day a disturbing fact hit us between the eyes: Our most technically proficient community managers were not always as successful in getting management contracts renewed as managers with less well-developed technical skills. We conducted a survey of association boards of directors in hopes of solving this mystery. The survey team came back with a startling insight: We had *two* contracts with every board—a *legal* contract and an *emotional* contract. The survey team told us, "You can be completely faithful to the legal contract but it's not likely to be renewed if you haven't satisfied the emotional contract. On the other hand, if you satisfy the emotional contract, the boards will cut you some slack on the legal contract."

From customers and employees to suppliers, partners, shareholders, and the community, the full spectrum of a company's stakeholders is bound up with a company via these two contracts:

- **Legal contract**—This contract is mostly explicit and is based on *quantitative* performance criteria established by jurisprudence as well as representations by a company and its agents in writing, oral communications, and actions.
- **Emotional contract**—This contract is mostly implicit or unspoken and is based on *qualitative* performance criteria established by stakeholders in the form of expectations that reflect their moral and ethical values and their experiential desires—what they want to experience, and what they want to avoid experiencing.

Former MIT Sloan School of Management professor Edgar H. Schein writing about the explicit or legal contract and the implicit or emotional contract (which he called the "psychological contract") suggested that unless the terms of the psychological contract are intuitively understood by all, long-term relationships are not possible and friction is likely in the short term.[10]

Quite likely one of the most common causes of corporate mortality is breaches of the emotional contract. When the emotional contract is egregiously breached, customers stop buying, worker productivity ebbs, suppliers become less responsive, partners bail out, shareholders put in sell orders, and community support evaporates.

Companies spend vast sums fortifying and defending themselves against legal challenges by various stakeholders, while apparently not realizing that the roots of a claim might lie in a breach of the emotional contract. People don't sue people or organizations for whom they feel affection—or as Kevin Roberts would say, "that they love."

Toro, the giant lawn mower and snow blower maker, discovered that by delivering better on the emotional contract it could decrease personal injury litigation. Toro's leadership once believed personal injury litigation was inevitable given the nature of its products. But in the mid-1990s, that belief was abandoned. Company representatives began making personal contact with injured customers. They apologetically extended the company's sympathy and suggested that if an immediate settlement could not be arranged, arbitration might be better and less of a hassle than going to court. The company used nonthreatening paralegals, experienced settlement counselors, and mediators familiar with Toro's preference for early case resolution. By mid-2005, Toro estimated that it had saved $100 million in litigation costs since it kicked off its nonaggressive and emotionally sensitive approach to avoiding litigation in 1994. It had not been in court for a single personal injury case—a truly amazing record for a company that builds dangerous equipment that falls into countless careless hands every weekend of the year.[11]

Amul Dairy Products, one of the best-known brands in India, is a widely loved company that understands the unspoken contract it has with customers. Dr. Varghese Kurien, Chairman of the National Cooperative Dairy Federation of India, observed at Amul's 50th anniversary celebration, "If Amul has become a successful brand... then it is because we have honored our contract with consumers for close to 50 years. If we had failed to do so, then Amul would have been consigned to the dustbin of history, along with thousands of other brands."

FoEs understand that their business operations are shaped by both spoken and unspoken contracts. Like partners in a successful marriage, they know that failure to honor the emotional contract with a customer means the end of customer loyalty.

The FoE Way

FoEs take an expansive worldview. Instead of seeing the world in narrow, constricted terms, they see its infinite positive possibilities. They believe deeply in the possibility of a rising tide that raises all boats. Faced with a competitive threat, they don't look to cut prices and costs and employees, but to add greater value.

FoEs are bathed in the glow of timeless wisdom. Their "softness" in a hard world comes not because they are weak or lack courage, but from their leaders' knowledge of self, psychological maturity, and magnanimity of the soul. These companies are forceful and resolute in standing up for their principles. FoE leaders have the courage to defend and act decisively on their convictions: Jeff Bezos at Amazon, Jim Sinegal at Costco, Jim Goodnight at SAS Institute, Sergey Brin and Larry Page at Google, Barry and Eliot Tatelman at Jordan's Furniture, Jim and Anne Davis at New Balance, Herb Kelleher at Southwest, Jeff Swartz at Timberland, John Mackey and Walter Robb at Whole Foods, Kip Tindell at The Container Store, Ron Shaich at Panera, Bob Chapman at Barry-Wehmiller, Danny Meyer at Union Square Hospitality Group, Yusuf Hamied at Cipla, Terri Kelly at W.L. Gore—the list goes on and on. These FoE leaders have built extraordinary, industry-transforming companies despite carping from some Wall Street critics who reflexively view their "capitalism with a human face" as a threat to shareholders' interests. The view that competitive advantage can be gained through a business model whereby all stakeholders add value and benefit from gains in value simply runs counter to the views of many analysts. Such critics are fundamentally myopic; they tend to view any stakeholders other than stockholders as net drainers of value, rather than a broader and deeper set of resources that can be leveraged to create even greater value than a company could otherwise create when it treats them merely as a means to the ultimate end of maximizing shareholder returns.

To be best prepared for doing business in the twenty-first century, business executives, especially those of companies that are leaders in their categories, would do well to ask themselves the ultimate existential question: "What are we here for?" They should ponder such nontraditional (in business) propositions as, "We are not here just to enrich investors; we have no culturally legitimized license to corrupt minds, bodies, and the environment; we cannot justify under the rubric of capitalism actions that are intended to tempt, seduce, and mislead customers into doing what can harm them; we have no right under any legitimate credo to dehumanize employees or to squeeze the financial life out of suppliers with unreasonable demands." As leaders of FoEs do, companies of every type and size should consciously shape their cultures around the idea that we are here to help others live their lives with greater satisfaction, to spread joy and well-being, to elevate and educate, and to help employees and customers fulfill their natural potential. As leaders in companies—and other institutions of public purpose—is it too much to accept as one's mandate the obligation to listen and to see, to open eyes and minds, to help people focus on what matters most? These sentiments are captured in our own words, but they are the sentiments of the leadership in every truly great business.

If FoEs can be described by any one characteristic, it is that they possess a humanistic soul. It is from the depths of this soul that their determination to render uncommon service to all stakeholders flows. These companies are imbued with the joy of service—to the community, to society, to the environment, to customers, to colleagues. The leaders of these great companies, as we define "greatness," intuitively recognize the inherent need that most people above subsistence level have to serve others. These companies—their leaders, their people—have the courage to buck hallowed traditions in capitalistic theory. They are succeeding, indeed thriving, against long odds in the face of often ill-conceived, onerous regulations and unscrupulous competitors. They are holding on to their humanity in the face of overwhelming short-term pressures. We should rejoice in their success, and spread their message of caring for their fellow beings and their bottomless optimism far and wide. We have written this book to do precisely that.

Endnotes

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