

ROTTERDAM SCHOOL OF MANAGEMENT, ERASMUS UNIVERSITY

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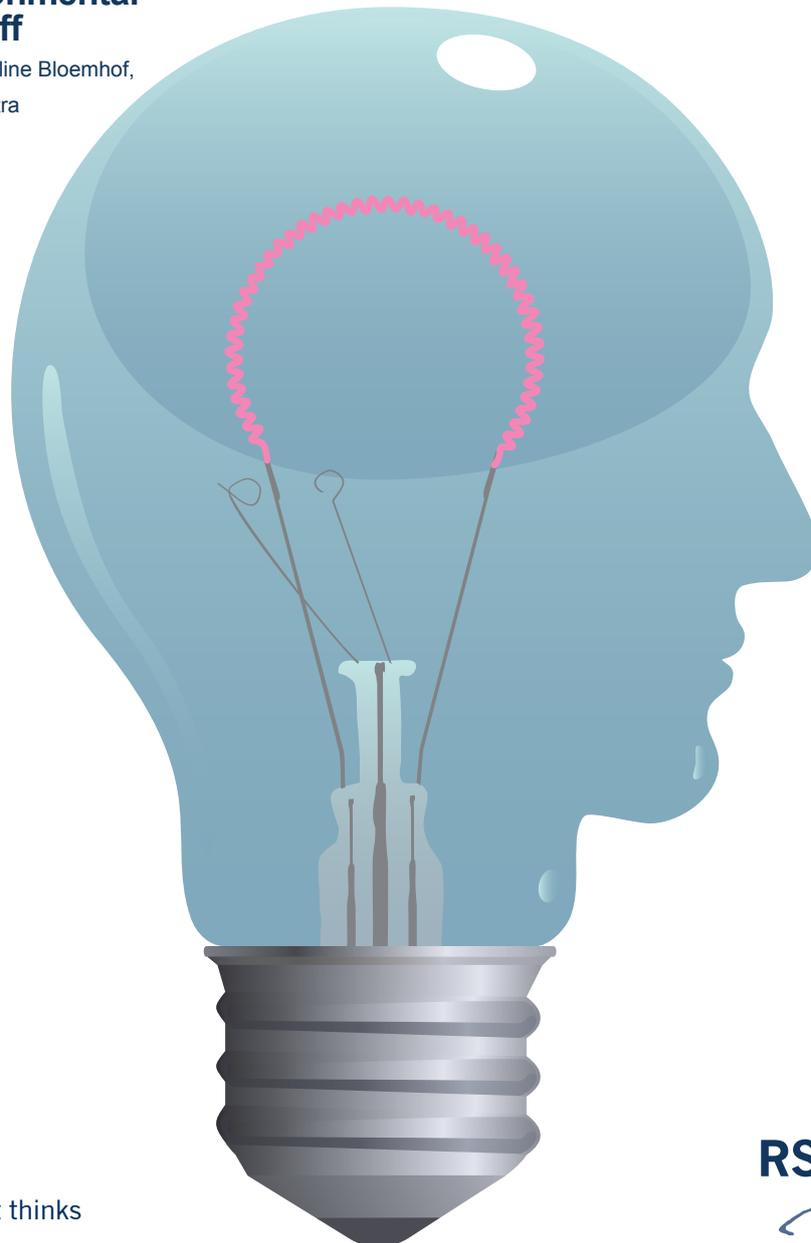
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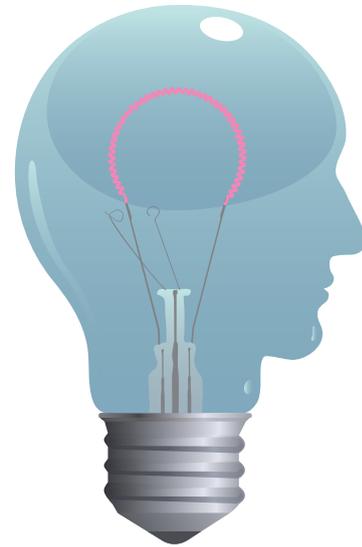
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by Niek Hoogervorst

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## Introduction

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Any hopes that the year 2012 might herald a return to business as normal have long dissipated as global economic growth remains in the doldrums. Whilst there are some signs of better days ahead, there are also warnings of further crises. With such mixed signals, no wonder businesses favour a cautious, risk-averse approach to the future, and opt only for incremental change.

It is clearly a time for a rethink about how we do business. It is a time for new approaches and fresh ideas. Specifically, organisations need innovative first-mover strategies and fundamentally different business models. Through our research, we at RSM strive to produce new knowledge and novel perspectives that enable managers to rejuvenate, transform and evolve their businesses and to succeed no matter how the landscape changes.

*RSM Insight* exists for exactly this reason – to provide information hungry and time scarce managers with easily accessible updates on the most significant research to come out of the school.

The research featured in this issue is wide-ranging and explores: how the recently launched Erasmus Centre for Future Energy Business will provide insights into the dynamics of energy markets; the value of ecological sensemaking in understanding climate change, and why proactive environmental strategies can make a difference.

The changing role of consumers in new product development is explored in two informative articles. Why firms go public is a featured topic that will be of interest to many, and we conclude this issue with a look at how ethical leaders can serve as role models.

It is our hope that the seven articles presented here will provide you with inspiration and ideas that are of genuine benefit and practical value. If you have any comments or suggestions about these articles, I welcome your feedback.

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# The future for energy markets

In discussion with Wolfgang Ketter

**Governments, businesses and ordinary citizens alike face an increasingly challenging energy scenario – with rising populations in developing economies, demand is in danger of outstripping supply. To help find real solutions a new research centre, the Erasmus Centre for Future Energy Business, has been established.**

Finite resources of fossil fuels mean that renewables such as wind, wave or solar power will become a bigger and more crucial part of the energy mix, yet these sources are inherently less predictable and harder to manage in terms of balancing supply and demand and ensuring systems that are robust, efficient and reliable.

Against this backdrop, the Erasmus Centre for Future Energy Business was launched last October. But it is no sudden departure: over the past five years the Learning Agents Research Group at Erasmus (LARGE), led by Scientific Director Wolfgang Ketter, has become one of the world's leading research labs in energy markets and their management.

Developing technologies for the smart grid of the future, Ketter and his colleagues are using complex techniques from computing and artificial intelligence to simulate what our future energy markets

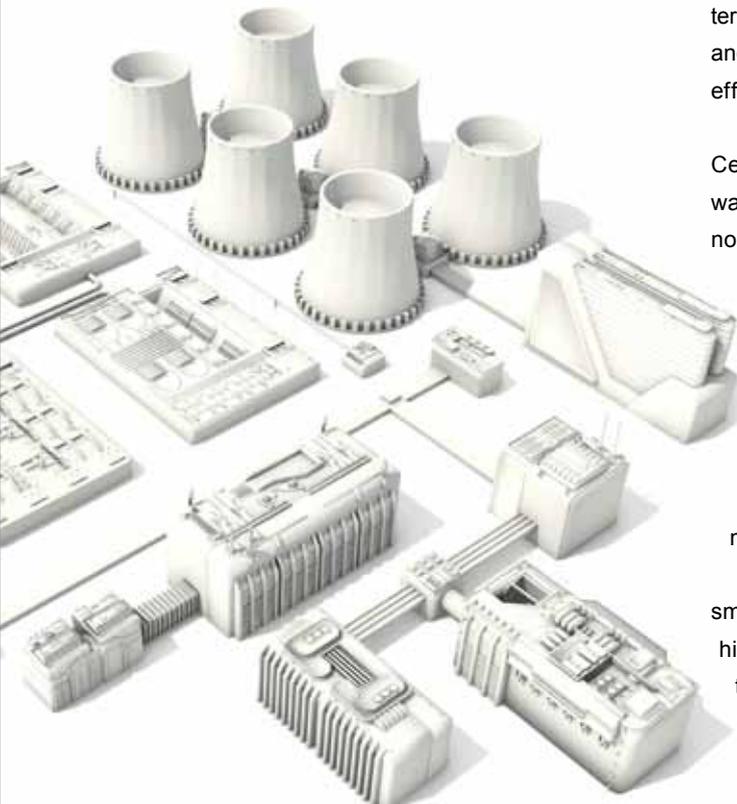
might look like, and understand more about the dynamics involved. They are also examining how domestic, industrial and commercial use of power needs to change, both to reduce overall consumption and to use available resources more efficiently.

The research is generating important insights for industry and for policy makers. 'As the California energy crisis in 2000 demonstrated, failures within the electricity supply system can have enormous consequences for people's lives and livelihoods. This makes policy-makers understandably reluctant to commit to new and untested market designs,' says Ketter.

'With the tools we are developing,' he continues, 'specifically our Power TAC platform, which uses a combination of modelling techniques and real-world data – you can simulate what might happen within the system under various circumstances. We can look, for example, at the effects of policy changes such as taxes and incentives, the impact of external shocks on the system's overall stability, or how rapid technological changes affect the infrastructure.'

## Corporate funding

The work of both LARGE and the new centre has been attracting attention from a growing number of companies within Europe, and at the start of this ▶



# The future for energy markets (continued)

In discussion with Wolfgang Ketter

year came the news that a multinational in the consumer electronics industry is to fund a major programme of work at RSM.

The substantial funding over the next four and a half years will support research and development at RSM in two main areas. A major part will go to the Erasmus Centre for Future Energy Business, financing several collaborative research projects between the company and the centre as well as providing a PhD post and other development costs. Further funding will be invested each year in the Power TAC platform, supporting researchers at both RSM and at the project's six core partner institutions across Europe and North America.

Ketter is very excited about the new possibilities that this collaboration opens up: 'Having this support from industry is a hugely important step forward for us. Our research goes from a fundamental level – into algorithms, information systems, artificial intelligence – right up to applied research, where we can feed back insights into real industry products.'

'Because we have the capability to come up with specific new customer models that we can run, using real-world data from the company, we can generate "what if" scenarios for the future, using insights from that research to come up with solutions,

expose new potential markets and help drive innovation. It's innovation that involves cross-fertilisation between academia and business and tight collaboration – exactly what a research-led school like RSM should be about. We have already received a large grant from the EU, but Sony is the first industry collaborator with whom we want to use our Power TAC environment in this way.'

## Modelling future markets

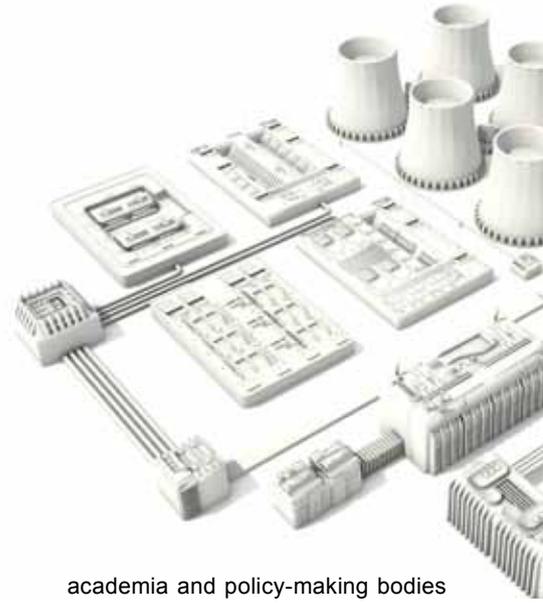
Power TAC (Trading Agents Competition) is central to the work of LARGE and the project has been developed in partnership with research groups at leading schools around the world. The major partner within the project is the University of Minnesota, where John Collins, one of Ketter's long-term collaborators, leads the work.

The trading agents are pieces of intelligent software capable of autonomous decision-making. They are also known as learning agents because they have the capacity to learn and adapt to situations. Complex algorithms built in enable the agents to judge situations and reach decisions completely autonomously – in this instance, buying, selling and acting as brokers competing against one another within an energy market in order to derive maximum profits.

'They can do everything you would expect in a market: submitting bids, requesting quotes, negotiating deals and accepting offers,' says Ketter. 'They process information far faster than humans do, and their reactive capacity enables them to constantly monitor prices, set prices, and react instantaneously to market changes. They can function as a kind of personal assistant, helping us make better decisions – particularly in scenarios where information changes very rapidly.'

One such usage for these software agents will be employed in the next generation of home energy management systems. More sophisticated than the current smart meters, these devices will enable certain appliances to be switched on when energy prices – determined by how much supply is available within the system – are most advantageous for the consumer.

'The idea of the smart grid is to expose energy users to the real costs of electricity,' explains Ketter. 'Currently most tariffs are either flat or two-part tariffs where people have little incentive to change their behaviour. But with dynamic pricing, there's a chance to incentivise people to become more efficient in how they use energy – and ideally to shift their pattern of usage to when those renewable resources are available.'



The Power TAC platform offers a great deal of flexibility – with the potential to incorporate many different types of consumer or producer models in the future, and play through different scenarios. Moreover, although Power TAC's explicit focus is on energy management, the fundamental techniques being developed have many other potential applications, Ketter says. 'Many of the ideas are not necessarily domain-dependent. The best algorithms can also apply outside energy management.'

Some algorithms from a similar agent-based simulation, this one focusing on supply chain management,

This summer, at the International Joint Conference of Autonomous Agents and Multi-Agent Systems (AMAAS) in Valencia in early June, the Power TAC competition will run for the first time on a completely open basis. Some 30-40 international teams from industry and academia will pit their agents against one another, then share results so that all can learn from the process and the underlying algorithms can be refined. Team-based competitions of this kind are, Ketter believes, a huge spur to creativity – advancing thinking in ways that could never be achieved within a single research lab.

*“Trading agents process information far faster than humans do, and their reactive capacity enables them to constantly monitor prices, set prices, and react instantaneously to market changes.”*

have already been adopted by companies such as SAP, Ford and Daimler for use in their own operations. Flora Holland is also funding work by the LARGE group in which intelligent agents are used to support improved decision-making at the international auction centres it operates in Aalsmeer.

The initial findings and insights from the competition will be shared with a wider audience as part of the first Erasmus Energy Market Forum to be held in Rotterdam on 15 June. At this special event, designed to become an important annual forum for networking, leaders from industry,

academia and policy-making bodies will come together to debate the opportunities and challenges offered by smart energy. ■

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**More information** about the work of the Erasmus Centre for Future Energy Business is available at the Centre's website: [www.erim.nl/energy](http://www.erim.nl/energy)  
For further details of Power TAC, see the project website: [www.powertac.org/](http://www.powertac.org/)  
Information about the LARGE group is available at: [www.large.rsm.nl](http://www.large.rsm.nl).

# Ecological sensemaking and climate change

by Gail Whiteman

**There is not enough understanding of the issues affecting our environment and climate system. This raises the crucial question: are modern managers prepared to ‘embed’ themselves in our natural world to monitor and make sense of local variability in the natural environment?**

The impacts of climate change are already apparent and are having profound implications for the way we manage and organise our societies. In a complex environment, people need to pay attention to subtle cues, overcome barriers, and collectively develop ‘sensemaking’ across organisations. If people do not pay sufficient attention, they will encounter a ‘predictable surprise’ – a crisis that could be avoided but isn’t because of existing social and economic structures.

Sensemaking is an interpretive theory in organisation and management research. The basic idea is that before we can manage something, we have to make sense of the situation. We make sense of situations by noticing certain things, ignoring others, and by attaching meanings to what we’ve noticed until we develop a plausible story. We keep this plausible story to help guide us in future sensemaking. The first step – noticing – is the most basic and most important because what we don’t notice can hurt us.

Management scholars are interested in this because the ability to make sense of complex, ambiguous or uncertain situations improves the performance of teams and organisations over time. In particular, research has shown that individuals and groups bounce back after surprise when they are able to effectively make sense of weak cues arising from a situation, and share this across actors.

Now, through management and organisation studies, we have a pretty good idea about how people make sense of our social world. However, there is less understanding of how we make sense of changes to our physical and natural world.

This is rather surprising because all organisations and societies are dependent, to some degree, upon earth systems. Making sense of physical changes to the earth, such as those occurring within our climate system, is one of the most important challenges facing humankind.

A variety of studies now consider how organisations and organising processes are influenced by physical artefacts, such as tools, technology, buildings, infrastructure, and the like, as well as through language and other social processes. Some of us would extend this to the natural environment. We would argue that materiality also arises from nature – for example, extreme weather, rain, volcanoes, fire, trees, animals and virus outbreaks, are not human inventions.

Furthermore, under certain conditions, ‘ecologic materiality’ – the interaction of dynamic biological and biophysical processes and organic and inorganic matter over space and time – becomes an important constraint for society to manage within. This kind of materiality has not been previously addressed by management theory. It may seem like an obvious point – the earth is material and we should pay attention to changes over time – but management studies have historically operated as if organisations lack biophysical foundations.

Social and organisational processes are logical areas for our field to study – managing and organising are human endeavours. But a singular reliance on this kind of expertise only makes sense under certain conditions, like when the natural environment is stable and therefore relatively benign.



## Acting sensibly

In our research, we examine these and other issues by studying two events. The first is the rather straightforward but nevertheless surprising fall down a rock-face in subarctic Canada by one of the authors, who could not make sense of the subarctic landscape, and as a consequence almost died when she fell near a large set of rapids. This is an example of meeting one's own material limits.

The second case is a reassessment of a famous historic event – the extremely volatile Mann Gulch wildland fire in Montana, which was studied originally by Karl E. Weick, the father of sensemaking theory. Significantly, we identified something that Weick missed: fire-fighters who survived the blaze were the ones able to make sense of the natural world – and the complex interaction between fire, wind, vegetation, climate and landscape.

This may also seem obvious: people need to be able to make sense of the natural environment under changing conditions. The point of our paper is that many people (including managers) are no longer able to do

*“People can’t pay attention to everything, so they need to narrow their focus.”*

this. Big cities, especially those lying in coastal areas or those at risk of drought and flood, are particularly vulnerable to the effects of climate change. We might not need to be able to make sense of the environment today, but we may need to do so tomorrow.

We find evidence that actors who are ecologically embedded – those who are deeply rooted in the land in a physical and cultural sense – are

better attuned to changes in ecological conditions and more actively interpret material cues across landscapes and time. Furthermore, the individual and organisational ability to make sense of a changing ecosystem reduces vulnerability and increases the chance of survival.

People can't pay attention to everything, so they need to narrow their focus. When things appear to be different, sometimes we just ignore them, or if we do notice them, we find ourselves unable to connect the dots. This leads to misinterpretations and vulnerability. As our climate warms, the ability to adapt and manage relies upon our ability to make sense of

changes in the natural environment. We call this the process of 'ecological sensemaking'. You could also call it the ability to listen to the canary in the coal mine.

Unfortunately, making sense of climate change using natural science data is not easy for the non-expert. However, many indigenous people, who spend so much time out on the land, are keenly aware of changes to their local natural environment. ▶

# Ecological sensemaking and climate change (continued)

by Gail Whiteman

While indigenous people are not the typical subject for business management studies, their ecological expertise makes them an increasingly relevant (albeit unusual) role model for managers of climate change.

In addition, we need to listen to the experts: scientists and local people, both of whom routinely pay attention to fluctuations in the natural environment. We also need to share information across a wide selection of actors and locations. This requires a paradigm shift within organisation and management theory: from a corporate orientation to a system orientation.

## Key lessons

To summarise: over the last two decades, management studies on sustainability have grown considerably, including a recent surge of research on climate change. However, environmental problems have not been resolved, and most of the top management journals remain focused on the firm, not the system. This is the paradox, and the opportunity. In addition, there are four key management lessons to be learned.

**1. Focus on the system, not just the firm:** we need more management studies that take a systemic perspective, and analyse cross-scale linkages between

firm behaviour and ecosystem functioning.

**2. Make better sense of climate change:** we need to collaborate more deeply with experts from the natural sciences. We also need to learn how to incorporate local knowledge of climate change into our information networks. Managers should also be paying more attention to weak or subtle cues in distant places, and geographic hot spots.

**3. Share ecological sensemaking across organisations:** the material impacts of climate change will affect organisations and individuals from all areas of society. Managers therefore need to learn how to make sense of our changing climate and share this across organisations.

**4. Anticipate predictable surprises and be ready to adapt:** the incidence of extreme weather events will increase alongside global warming. We need to be ready to adapt to a new system.

In conclusion, remember what we need most of all is to make better sense of climate change. This requires managers and academics to take more of a systemic approach and collaborate

with the natural sciences and local people. At the very heart of this solution is ecological sensemaking, the way people make sense of a changing environment. And before they try to make sense of it, they have to know that it is changing. ■

This article draws its inspiration from Gail Whiteman's Inaugural Lecture: *Making sense of climate change: how to avoid the next big flood*. A transcript of this lecture is available at: <http://repub.eur.nl/res/pub/22952/> It is also inspired by the paper *Ecological Sensemaking*, which was written by Gail Whiteman and William H. Cooper and published in the *Academy of Management Journal* 2011, Vol. 54, No 5, 889-911.

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# Proactive environmental strategies pay off

by Melek Akin Ates, Jacqueline Bloemhof, Erik van Raaij & Finn Wynstra

**Although there is contradicting evidence on the impact of a company's proactive environmental strategy on its environmental performance, recent research shows such an approach can indeed make a difference.**

Increasing awareness of environmental problems has created a new competitive environment for firms forced to include stakeholders' concerns in their corporate plans. Whether it be from "green consumers", business customers, suppliers or shareholders, external pressures are motivating firms to adopt a more proactive environmental strategy – environmental objectives, plans and procedures that go beyond mere compliance with laws and regulations.

Moreover, internal pressures also drive this process, and forward-thinking firms increasingly invest in proactive strategies, not just to improve their environmental performance – defined as the reduction of environmental impact by minimising waste, material and energy usage – but also to gain and maintain competitive advantage. We define environmental investments as the combination of internal investments (made in areas of environmental design, production and logistics), and external investments (made in collaboration with suppliers and related to these same areas).

All of this underscores the strategic importance and implications of environmental issues to business.

## Testing key hypotheses

The objective of our recent research has been to investigate the impact a proactive environmental strategy has on environmental performance, what is needed for it to work, and its business implications. Based on a study of past literature on environmental strategy adoption, we arrived at five hypotheses:

1. **Environmental investments** have a positive effect on environmental performance.
2. **Proactive environmental strategy** has a positive effect on environmental investments.
3. **Customer pressure** has a positive effect on environmental investments.
4. **Customer pressure** has a positive effect on proactive environmental strategy.
5. **Organisational commitment** has a positive effect on proactive environmental strategy.

We also identified three possible influencing factors: the role of the customer and especially customer pressure; organisational commitment; and the role of supply-chain partners. To test these hypotheses, we surveyed 97 medium and large enterprises from the chemicals and plastics, food and beverages and machinery sectors in Turkey, one of the biggest emerging economies.

## Companies, take note

Our results confirm that a proactive environmental strategy does lead to higher environmental investments, internally and externally. The results also show that these investments are required to achieve this performance, underscoring the need for firms to invest both in their internal processes and in their collaboration with suppliers. Surprisingly, the latter investments did not play as significant a role as we had assumed. In fact, the importance of internal investments was twice as large as that of external investments. We had envisioned at least an equal role, if not a slightly larger one than internal investments. Of course, the relative importance of internal versus external investments may differ from country to country.

In addition, the findings support our hypothesis that environmental investments act as a mediating variable



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between proactive environmental strategy and environmental performance, and that without environmental investments there would be no environmental performance. The results also show that customer pressure and, particularly, organisational commitment, positively impact the extent to which firms adopt a proactive environmental strategy.

Our conclusions are equally striking. Results suggest that proactive environmental strategies with internal and external environmental investments do pay off. Furthermore, organisational commitment and customer pressure are key factors. Organisational commitment seems to play a major role in pro-activeness, which is in line with our expectations.

implications. For example, just formulating proactive strategies is not sufficient to achieve a higher performance. This should be followed by actual environmental investments. If the company and its suppliers do not make the necessary investments, there is hardly any gain from proactive environmental strategies. Moreover, even though internal investments impact environmental performance more than external investments, this impact is not negligible.

In particular, firms that outsource large parts of their production should involve suppliers more in their strategies by jointly setting environmental goals and sharing environmentally related personnel and equipment, and establishing joint environmental

*“...proactive environmental strategies with internal and external environment investments do pay off.”*

We found companies without a proactive strategy were making environmental investments purely as a reaction to customer pressure. This reactive approach has a significantly weaker effect on performance than the proactive one.

Importantly, our results highlight some significant managerial

programmes. Finally, managers need to remember that a successful proactive strategy needs organisational commitment, from both top management and employees. To this end, firms might consider encouraging cross-functional co-operation between departments, and offering employees environmental training. ■

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This article is based on the paper *Proactive environmental strategy in a supply chain context: the mediating role of investments*, which was published in the *International Journal of Production Research*.

# The age of the consumer innovator

by Jeroen de Jong

**Consumers increasingly generate product innovations themselves, a fact that has important consequences for companies and how they organise their R&D. It also highlights the need for a new perspective on the role played by customers in product development.**

Thousands of creative and skilful consumers are engaged in their own personal product design and development, making new products and adapting existing ones to meet their individual needs. They're doing this in their free time, investing their own resources, tapping into the many sources and tools available online.

There are entire communities of innovators, freely sharing knowledge and information about their novel and functional products. They represent an untapped resource for companies, generating valuable ideas, designs, and even physical prototypes that could simplify and ultimately improve the matchmaking process between new product developers and customers' needs.

## Fast-moving trend

We have known about this trend in consumer behaviour from scientific research for several decades. However, recent studies carried out among users aged 18 upwards in the UK, Japan and the USA show that

the trend is far more extensive than expected. It relates to a wide variety of industries, from high-tech machinery, scientific instruments and information technology to household, sports, and health equipment. Most importantly, knowledgeable innovators are producing prototypes of products for themselves that are finding acceptance among other users.

Consumer-innovators often cooperate with like-minded enthusiasts to develop and enhance their designs. They make their designs available to others at no cost. And the majority are not motivated by commercial interests: according to one study of consumers in the Netherlands, only about 10 per cent are interested in starting their own company.

They are passionate about their field of interest, and want to put their knowledge and skills into practice. If a commercial enterprise adopts their idea or prototype, the consumer-innovator is mainly content with public recognition of the part they played in its invention.

## The mother of invention

A well-known example of a consumer-innovation is the Jacuzzi, originally a hydrotherapy bathtub developed by Candido Jacuzzi in the 1960s as a treatment for his son's skin disease. Often, scientists and technicians will design, adapt or make their own instruments for a specific purpose, in the absence of one that is commercially available. The same is true of individuals who improve and adapt products of all kinds for their own use. If identified and adopted by the manufacturers, these modifications can lead to the resolution of problems for other customers, and to improved, streamlined new products that more fully meet the needs of an existing market segment.

Necessity is not the only "mother of invention": there are many examples from a wide variety of markets, such as sports equipment, where user-innovators have been the first to invent completely new products. Users first built novel kayaking equipment for white-water rafting; creative enthusiasts started the now widespread kite surfing trend.

In the field of sports, companies already see the wisdom of mining for innovation among their customers; witness Nike, who implemented at least seven of the designs for basketball shoes submitted by thousands of



customers who responded to the company's invitation to contribute their ideas.

### Engaging innovation

The bottom line is that companies need to learn to ask their customers smart questions. A change of perspective on users who make frequent contact with customer support could result in their experience and expertise being harnessed. When their calls are seen as potential sources of solutions to problems, rather than annoying complaints, lead customers or "outliers" can be identified, ie, homogenous groups of customers with similar needs, for whom a standardised product could be developed.

Lead users have needs that are well ahead of a trend: even before the "early adopters". They need a new product, so tend to create solutions. Lead customers are rare, but can be found. The American company 3M has developed and implemented an entire development process methodology based on engaging lead users.

A second possibility is crowd sourcing through the web: several platforms such as Innocentive (USA) and Battle of Concepts (the Netherlands) carry challenges and calls for ideas and prototypes for new products or solutions. Companies can also develop their own user

communities. With a focus on getting closer to customers and exploring their experiences, a web-based user community can not only bring important insights to light, but may also result in the fruitful possibility of co-developing products to meet customers' actual needs.

Companies need to engage customers in a different way to leverage the potential of the growing trend in user-innovation. The role of companies continues to be one of providing consistently reliable and safe products to their customers, and companies have the resources for volume testing, quality control, production and other functions that are beyond the scope of individuals.

However, companies need customers and should seek to engage them right at the beginning of the production cycle. Rather than identifying a need and then focusing on inventing a product to fill it, companies can engage with consumers to see what innovations are already emerging, and help bring these new products into the world. ■

This article is based on the research paper *The age of the consumer-innovator*, which was published in *MIT Sloan Management Review*, 53(1), Fall 2011, p 27-35.

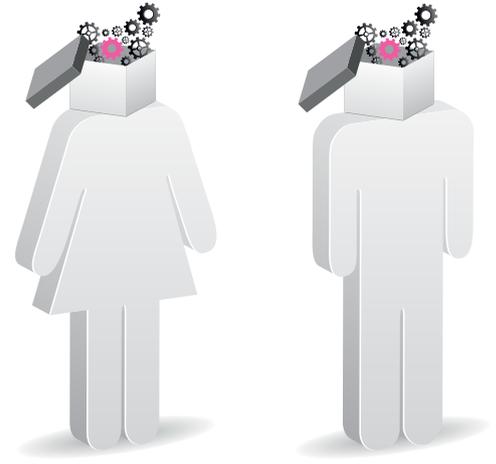
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# Customer empowerment in new product development

by Christoph Fuchs & Martin Schreier

**Companies have traditionally taken responsibility for deciding what products and product innovations are offered to customers. However, a growing number of companies are turning this relationship on its head by asking customers not only for help in creating new products, but also in deciding which ones should be produced.**

In the 1970s, Eric von Hippel, Professor of Technological Innovation at MIT Sloan School of Management, asked companies to identify from where their ideas for product innovations came. Engineers were the wellspring of new product ideas, they told him. However, this was not entirely true. When asked, the engineers admitted that in fact, end users were often their source of inspiration: the engineers had seen products used in novel ways by customers and they had adapted these innovations commercially.

Today, McDonalds encourage its customers to “design” new burgers. Threadless, a successful American company that prints and sells t-shirts, asks its sizeable online community of registered users to provide the designs for its product range. Further, the Threadless community also gets to decide which designs the company should sell.

Muji, the “no brand quality goods” retailer, asks customers to select which product concepts it should produce.

In each of these three examples, the company gives significant responsibility for new product development to its customer base.

These companies are not unique in their endeavours to encourage customer-driven innovation and product selection. There is plenty of research to confirm that the objective qualities of products can be improved by the input of what are defined as lead users, those customers or consumers who are not only ahead of any trending patterns, but may be responsible for starting them.

## A peripheral view

Looking to add to the body of knowledge about customer empowerment in new product development, we chose a unique approach: to find out what customers, and specifically those on the periphery, ie, users who choose not to participate in development or selection activities, think about companies and products that engage and empower them in this way. For example, does it make any

difference to peripheral customers if the design of a product stems directly from user involvement, or whether other customers are responsible for influencing the company’s decision to develop, launch and market any given product?

What we find is that for these customers, knowing other users are involved in the development or selection (or both) of a product has a positive effect on their purchasing intentions. Additionally, they think of these companies as being highly customer oriented.

What is interesting here is that although customers might choose not to participate in the product or design selection process, they nonetheless feel very positively about the company, and specifically so because the option to participate and influence is there. They also express a higher level of attachment to companies that involve them in this way. This is because they feel that as customers, the company understands them, cares about their needs and values their opinion.

Given a scenario where two companies offer very similar products, our research shows the purchasing decision of a customer is not influenced by the perception that one product is better than the other, but that one is user- or community-designed/ influenced whilst the other is not.

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## Empowering benefits

Developing a strong level of engagement is of particular benefit for web-based start-up companies. This is because the online community and the customer or user community are one and the same. For larger, established companies with a substantial customer base, there is a concern that online community engagement might not necessarily reflect the views of the target market as a whole. This is to say, that established “bricks and mortar” businesses with online operations could well have considerably more customers who do not engage in the online community than do participate in it.

If there is an imbalance between the two, then community decisions may be at odds with the preferences of the customer base as a whole. Newly established web-based companies, on the other hand, will have a customer base that comes exclusively from the online community.

Another benefit for companies is that developing, engaging and empowering its community brings forth a diversity of ideas. In addition, the user community is not constrained by company thinking and has unparalleled experience of the product. Indeed, it is from already loyal customers that companies may find the next great product innovation comes.

## The value of integrity

As they gain more influence, a time may come when the balance of power tips in favour of customers. User communities may guide companies in their corporate decision making in ways that we do not yet understand.

Social media already enables people to unite into communities that perceive themselves as being consumer guardians and moral watchdogs with the power to influence or reproach corporate deeds.

Being under such scrutiny, and exactly as it is not possible to hide from their corporate social responsibilities, companies cannot afford to pay mere lip service to their empowered users. Using customer empowerment as a marketing gimmick to enhance customer reputation is unlikely to succeed in the long term. Just as people can easily sense when someone is being disingenuous, so customers can easily detect a lack of integrity from companies.

As a final observation, managers should be aware that customer empowerment is not limited to products alone. In the Netherlands, financial services provider Rabobank allows customers to decide which projects it invests in as part of its corporate social responsibility strategy.

Elsewhere, companies have let customers decide on the messages

used in advertising campaigns. These examples show us that customer empowerment is an innovative strategic tool and its potential applications are many. ■

This article draws its inspiration from the research paper *Customer Empowerment in New Product Development*, written by Christoph Fuchs and Martin Schreier and published in *Journal of Product Innovation Management*, 28 (1), 17-32, January 2011.

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# Why do firms go public?

by Abe de Jong, Carel Huijgen, Teye Marra & Peter Roosenboom

**Ambitious chief executives considering the possibility of floating their company on a major stock exchange should be careful what they wish for. They need to be sure that they are making the decision for the right reasons, at the right time, and that the initial public offering (IPO) is made in the right location.**

The reasons most often provided for going public will be familiar to most people with even a passing awareness of modern business. One, the most important benefit, is the access to public capital markets to raise finance to invest and drive further growth. Two, it offers a simple exit route to existing shareholders who want to monetise their investment. Three, the diversification of the shareholder base can enable the newly listed company to take a higher level of risk in its core activities, further driving growth. Four, it can help a company improve its name recognition and visibility. Five, a company that is listed can use its shares to pay for acquisitions; in effect, it creates a company's very own acquisition currency.

The downside is arguably less familiar, as it is brushed under the carpet in the heady excitement of the listing process. Nevertheless, the various trade-offs inherent in a public listing need to be fully taken

into account before the green light is finally given.

One, the newly listed company will need to comply with the rules and regulations issued by the stock exchange, or stock exchanges, on which it has chosen to list.

Two, it will need to become more transparent than in its private incarnation, and publish more information on its finances, strategies, tactics and plans for innovation, to satisfy the insatiable curiosity of stock exchanges, investors and the national and international media. Annual reports, press conferences and analyst visits are just some of the obligations imposed upon listed companies.

Three, the listing process is complex, and expensive. The investment banks, law firms, accountants and public relations firms that will need to be hired to ensure a successful IPO do not come cheap. These expenses typically consume seven to 10 per cent of a new issue's headline proceeds.

Four, an often overlooked consequence is that the inevitable loss of confidentiality enforced by the disclosure requirements of a public listing results in previously private information becoming available to existing or potential competitors.

Companies that make the private to public transition successfully, though, can transform their prospects, strengthen their market position by aggressively driving up market share and raising the barriers of entry to dissuade would-be competitors from entering the fray.

In the writing of our paper - *Why do firms go public? The role of the product market* - we put under the microscope the underlying reasons behind the decision to go public, one of the most important decisions a company might ever take.

The paper investigates the effect of product market characteristics on the decision to go public. Our results show that UK firms are more likely to go public when they operate in a more profitable industry and in an industry with lower barriers to entry. These firms are more likely to go public in order to improve their position in the product market and to deter new entrants into the industry. However, firms from more competitive industries and firms with smaller market share are less likely to go public. For these firms the loss



of confidential information to rivals outweighs the benefits of going public.

The decision to go public itself signals higher product quality to competitors. The decision to go public therefore depends on product market characteristics, and the position of the firm within the product market.

We further examine the product market related effects of going public in the years directly following the IPO. Firms that go public increase their market share and operational risk in the post-IPO period to the year before the IPO.

We also find that firms increase their scale of operations in the post-IPO years. IPO-firms significantly increase their capital expenditures, fixed assets, total assets, sales and profitability in comparison to the year before the IPO.

Overall, our results suggest that firms go public at a peak in their sales growth and continue to expand their

scale of operations directly following the IPO. After the IPO, firms show higher volatility in profitability, which is consistent with firms being able to pursue more aggressive product market strategies.

The increase in market share by the median IPO firm in the two years after the flotation suggests that the effect of having access to lower-cost equity financing for increasing the scale of operations at least initially dominates the effect of having to disclose sensitive information to product market competitors.

Going public involves a trade-off between competitive benefits and costs. Our results show that both confidential information theories and more recent theories that focus on product market benefits of obtaining a public listing are relevant for explaining the complex decision to go public. ■

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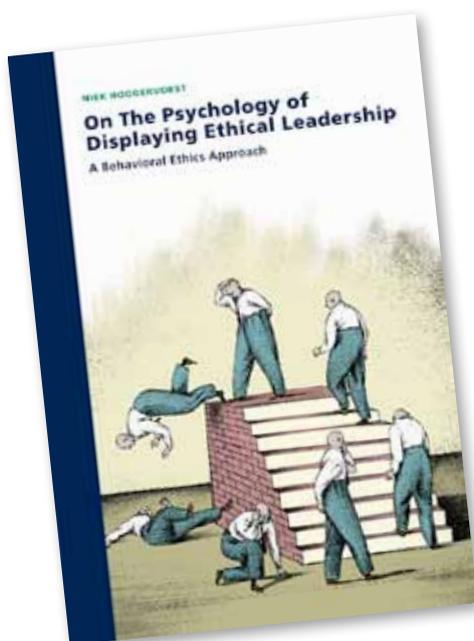
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# The psychology of ethical leaders

by Niek Hoogervorst

**The collateral damage to companies caused by unethical behaviour can be enormous, especially when it is perceived to be systemic within an organisation. We look to leaders to set an example. So how can they be encouraged to set aside self-interest and provide an ethical role model for those they lead?**



The Occupy movement is perhaps a sign of our times: we live in a climate in which ethics increasingly matter. The scandals of the past decade have triggered growing media interest in how organisations behave – or misbehave – and society is becoming less tolerant of unethical behaviour wherever it happens – whether in business, sport, government or religious organisations.

As evidenced by the case of Dirk Scheringa and the failed DSB Bank, unethical practices are costly not just in terms of the reputation of individual leaders. Research has already shown what good leaders *should* do, and the positive impact that can have on motivating others – but what we also need to know is, *when* do leaders actually display such behaviours? What are the psychological factors underlying ethical leadership? Moreover, what can those reveal about how organisations can encourage ethical behaviour?

In a series of experimental studies and surveys conducted with leaders from middle and senior levels of

management in a wide range of Dutch and American organisations, I set out to explore these important questions.

Most people would probably agree that leaders should do what is *right*, irrespective of whether that will make them liked by their team. What I found is that leaders are more inclined to act as role models, making personal sacrifices for their group and putting the needs of their followers and organisation first, when they feel part of that group, not excluded from it.

That feeling of *belonging*, of being liked and accepted by others, is a key motivator for most of us – and leaders, I discovered, are not exempt from that kind of influence. Interestingly, those that feel more powerful and certain of their own influence within a group are not susceptible to this need to belong. So long as they see it as a key part of their leadership role, they will typically act as a role model, irrespective of whether they are liked or not.

It is important, therefore, for organisations to stimulate positive relationships between leaders and their followers through team-building exercises, for example. They also need to find ways of increasing their leaders' sense of power, by allowing them more autonomy and freedom to make decisions. Given that leaders who feel powerful will act more in line with role requirements, organisations ▶

# The psychology of ethical leaders (continued)

by Niek Hoogervorst

should communicate to leaders the importance of being an ethical role model. However, arguably within leadership training, and more broadly in business education, leaders also need to be made aware that they may be susceptible to the influence of how they are liked by their employees. This awareness raising can act as a first stage in helping them guard against it.

## Reacting to unethical behaviour

One of my studies showed that when an employee behaves unethically, but the leader stands to benefit in some way, that leader becomes less likely to take disciplinary action against the

interest factor in the leader is so strong and so automatic, it takes precedence. Whenever self-interest surfaces, we unconsciously start to engage in a form of self-deception. Therefore, when leaders start to profit from an unethical act, they no longer see it as being that immoral.

A disturbing finding was that followers seem to predict quite accurately when leaders are most likely to disapprove of their unethical behaviour. Therefore, if the climate within the organisation is lax, they may be tempted to do morally dubious things when they feel they can *get away with it*. That is of course highly dangerous for the organisation,

*“When leaders start to profit from an unethical act, they no longer see it as being that immoral.”*

offender. Even if action is taken, the chances are it will be less severe. This is borne out by other research showing, for example, that sales managers crack down less hard on unethical sales behaviour by top-selling agents than when similar actions are performed by less successful agents.

In such situations, holding the leader accountable only works up to a point. Despite the social pressure to do the right thing and expectation to explain his or her actions, the self-

potentially creating a vicious circle of unethical behaviour.

For companies, this brings home the importance of making ethics a central part of organisational culture. Ethics needs to be talked about and invested in. For the long-term good of the organisation, creating a culture in which moral values are truly important through all strata of the organisation can have really positive effects, not only on the behaviour of leaders, but also those who follow them. ■

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