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MANAGEMENT INSIGHTS

Will Your Personality Change after Being Promoted to Leadership Position?

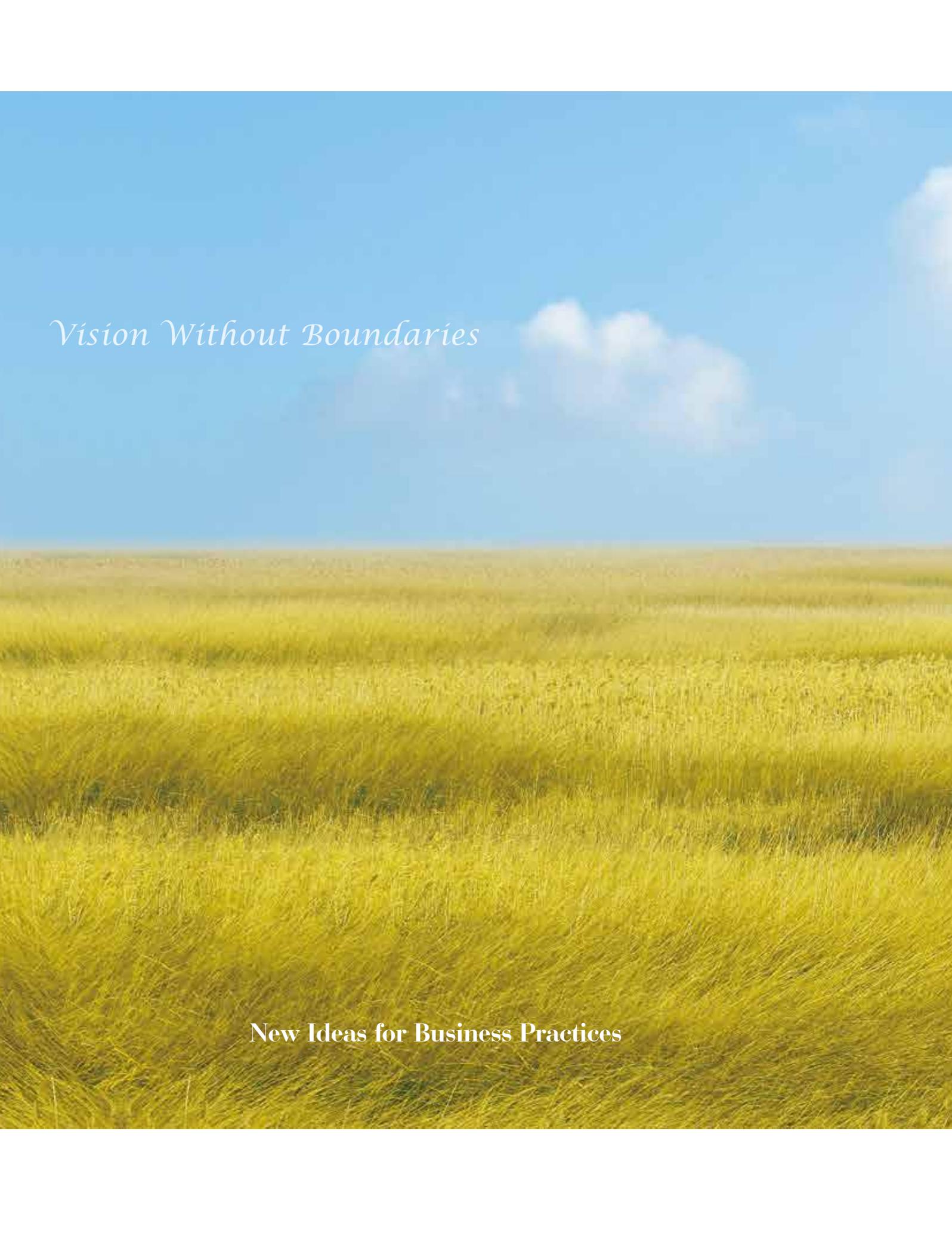
Fraud and Innovation

How Did Costco Succeed in Foreign Markets?

An Interview with James Murphy

JD Group: Progression of the Internet Economy

An Interview with Jianwen Liao

A wide-angle photograph of a vast, flat landscape covered in golden-yellow grass. The horizon is straight and distant, with a clear blue sky above. A few soft, white clouds are scattered in the upper right portion of the sky. The overall scene is bright and open, suggesting a sense of freedom and boundlessness.

Vision Without Boundaries

New Ideas for Business Practices

MANAGEMENT INSIGHTS

Co-published by School of Management, Fudan University
and International Association for Chinese Management Research (IACMR)



Guiding business to succeed in the new economy

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Let Us Be Less Biased and More Honest in the New Year

I am excited to bring you the 2022 annual English issue of Management Insights! Although 2021 was a difficult year for all of us, we were able to work together seamlessly using advanced technologies like Zoom, Microsoft Teams and WeChat, and published four issues of Management Insights in Chinese, in addition to this English issue.

An amazing collection of research highlights is included in this issue. They were rewritten from articles published in top tier academic journals such as ASQ, SMJ, OS, JAP, JPSP, and MOR¹. The insights generated from these articles have important applications for organizations and individuals working in organizations, and I would like to highlight two here. First is to be more inclusive by reducing unconscious bias. For instance, in “Women’s stalled advancement”, Padavic, Ely, and Reid found that although organizations’ work-life balance policies are intended to help women advance their career, the reality is that (a) it is difficult to take advantage of such policy because of the long work hours needed to complete the assigned tasks; and/or (b) often times it is women who use these policies, which make it difficult for them to keep up with their male counterparts, and thus have less opportunity to advance career. Their suggestion is that instead of having these policies, organizations should reduce workload to level the plain field so that all can fulfill their job responsibility within 40-hour/week.

In “How does choice architecture affect judgment and choice”, Li and Hsee demonstrated that when making decisions about two people who have the same qualifications but differ in aspects irrelevant for evaluation, such as gender, ethnicity, or physical appearance, the sequence in presenting the two people generated different decisions. In the case of presenting the ‘more attractive candidate’ first sequence, the ‘less attractive candidate’ received the same favorable treatment, suggesting a “free-riding” effect, whereas in the case of presenting the ‘less attractive candidate’ first sequence, the ‘more attractive candidate’ received the same less favorable treatment, suggesting a “cost-bearing” effect. These findings encourage organizations to adopt

a simultaneous presentation of cases in mitigating the unconsciously biased judgment.

The second insight is that honesty is good for personal emotional well-being and for organization’s innovation. In “I cheated, but only a little”, Peer, Acquisti, and Shalvi revealed that people often make partial confessions of their transgression and think that would make them feel less guilty. However, a series of experiments showed that partial confessions do not eliminate the guilt, rather, it comes at an unexpected emotional cost -- it made people feel worse than not confessing or fully confessing. In “Fraud and innovation”, Wang, Stuart, and Li found that fraudulent firms allocate resources differently than honest companies. They used a longitudinal dataset tracking the personnel recruitment and patenting activities of 467 Chinese high technology firms that applied for state-funded innovation grants and found that relative to honest companies, fraudulent firms are more likely to receive state grants, but are less likely to recruit new employees or produce important inventions in the post-grant period. These findings suggest that honesty may bring you peace as well as predicts firm innovation.

Honesty and inclusion are also deeply engraved in Costco’s “organic growth model”, which explains why the company is so successful in its expansion in foreign markets. In the interview with James Murphy, Executive Vice President and Chief Operating Officer, International Division of Costco, I not only learned about how the company exercises honesty and inclusion in its business practices, but also felt that Mr. Murphy embodies these values in his interaction with everyone. Similarly, Dr. Jianwen Liao, former Chief Strategy Officer of JD Group, also shared with me how honesty and inclusion are two key foundational cultural values the company embraced from the beginning and served the company well in terms of business growth and innovation. JD’s contribution to the Internet economy is truly remarkable.

Hope the following pages will open your mind and bring you knowledge and wisdom. Thank you and happy new year! ☑



1: ASQ = Administrative Science Quarterly; SMJ = Strategic Management Journal; OS = Organization Sciences; JAP = Journal of Applied Psychology; JPSP = Journal of Personality and Social Psychology; MOR = Management and Organization Review

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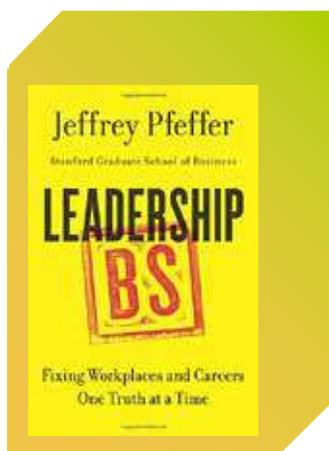
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Idea Scan

Management Scholars' Bookshelf

Book recommendations from top management scholars



Wendong Li
Associate Professor
the Chinese University of Hong Kong

Leadership BS: Fixing Workplaces and Careers One Truth at a Time

Author: Jeffrey Pfeffer Publisher: Harper Business

It is a very sobering book written by the management guru, Jeffrey Pfeffer. It points out the problems that we have in our leadership education, and probably also relevant for our management education including MBA, EMBA and undergraduate programs. This book may help you avoid falling into many leadership traps such as believing in too much the leadership fashions, so-called brand-new ways of leadership advocated by leadership consultants and researchers, and chasing the recent leadership models and theories, and so forth. Dr. Pfeffer provided a great deal of evidence to make his points and suggestions on how we could remedy the current situation.

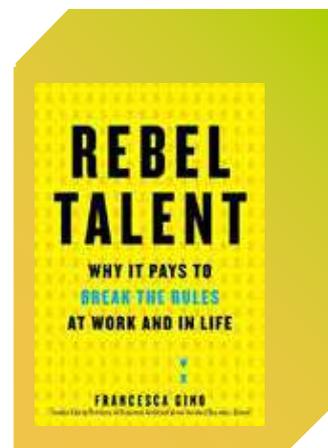


Francesca Gino
Professor
Harvard Business School

Rebel Talent: Why It Pays to Break the Rules at Work and in Life

Author: Francesca Gino Publisher: Dey Street Books

Too often we take the usual ways of working for granted. Rebels, instead, break rules that hold them and others back in a way that is positive and constructive.



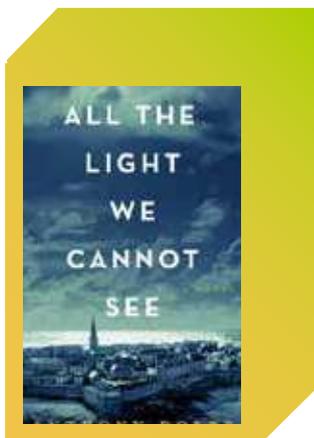


Susan Ashford
Professor
University of Michigan

Never Split the Difference: Negotiating as If Your Life Depended on It

Author: Chris Voss Publisher: Harper Business

Voss is a former hostage negotiator who has been in many life-and-death situations and yet his advice for negotiation is decidedly "soft". Listen well, show empathy, mirror back what you hear and so forth....and great advice for business negotiations as well.



All the Light We Cannot See: A Novel

Author: Anthony Doerr Publisher: Scribner

This is a beautiful novel about a young, blind French girl trying to survive during WWII, and a young German boy also struggling to survive. They have very different challenges, but their lives intersect in ways that make you think about love and bravery in a very different way.

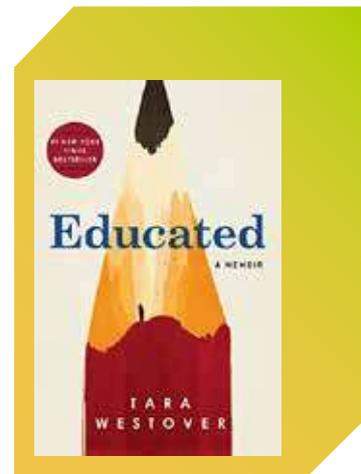


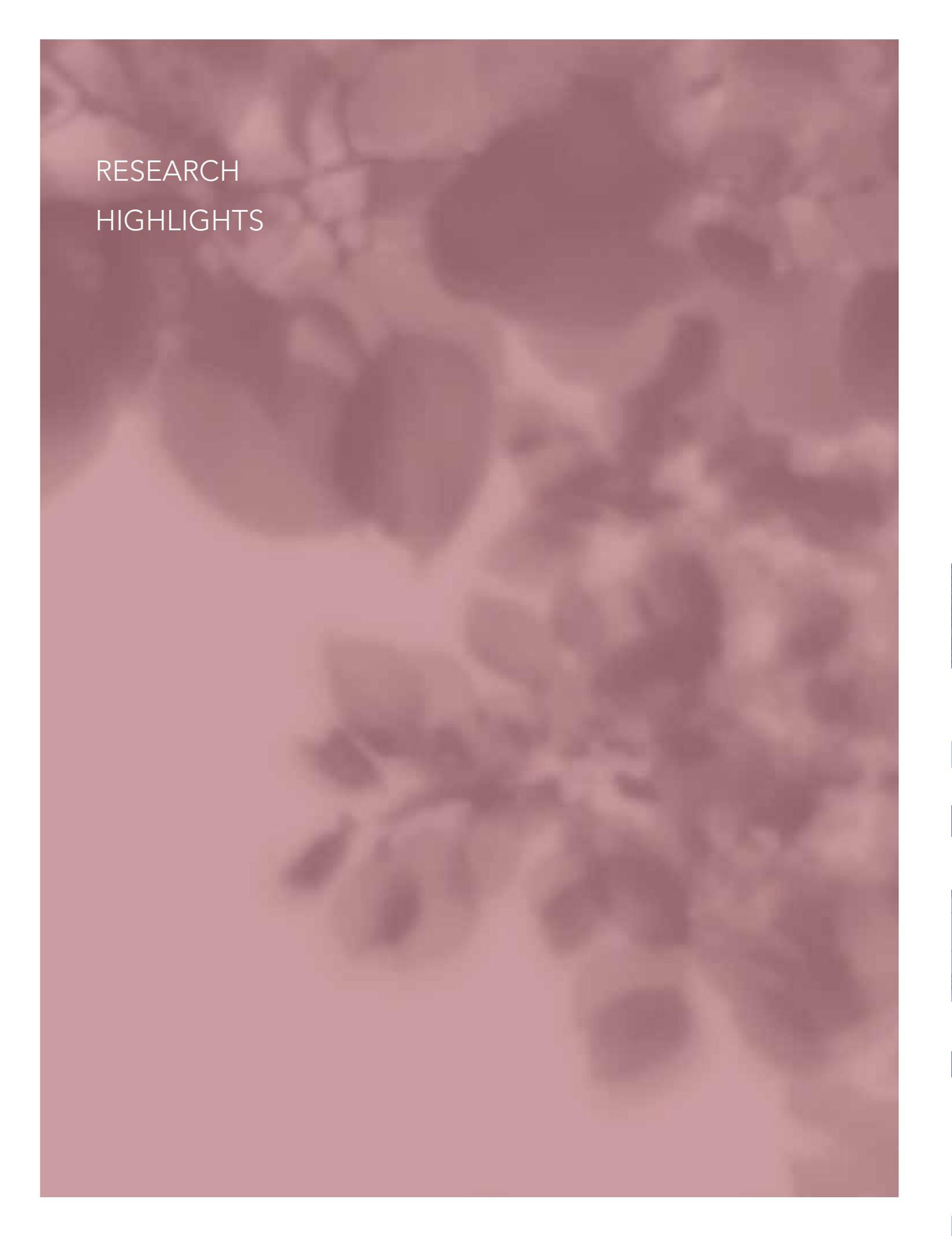
Ray Friedman
Professor
Vanderbilt University

Educated: A Memoir

Author: Tara Westover Publisher: Random House

This is an autobiography of a woman who grew up in a home that was cut off from the world – history, science, literature, friends – by a fundamentalist family that thought formal education was evil. It is astonishing to realize that some people – like Westover’s parents – choose to be uneducated, and impose that on their children. The memoir shows how Westover was torn between truth and love of family as she leans about the wider world. You get a greater sense of the value and impact of learning.





RESEARCH
HIGHLIGHTS

Women's Stalled Advancement: A Work-Family or A Work-Hours Problem?



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Women remain remarkably underrepresented in the partner ranks in professional service firms—as lawyers, accountants, and consultants—despite having gained parity with men at the associate level long ago.

This stalled advancement is surprising in light of companies' efforts to improve the situation, often by means of well-intentioned work-life accommodation policies. Time and again, however, researchers document how taking accommodations has the unintended effect of derailing women's careers. Yet these remain the go-to solutions, and women's careers continue to languish.

Meanwhile, another problem, whose solution could arguably improve women's advancement and the work lives of both men and women professionals is unaddressed: the long-hours work culture. This "24/7" culture pits home against work in the battle over limited hours and creates discontent for women and men alike. Moreover, the link between long hours and productivity is tenuous at best. Considering the costs, why do we continue to trod the same work-life balance path and disregard the possibility of instituting more humane work hours?

A new look at data we gathered from interviews with 110 women and men partners and associates in a mid-sized consulting firm considers how firm members thought about women's and men's roles. A pervasive story—we call it the "work-family narrative"—describes women's stalled advancement as stemming from conflict between women's family obligations and professional jobs' long hours. The narrative makes no mention of men's dissatisfaction with work-family conflict,

which we found to be at least as strong as women's, nor whether such long hours were necessary.

Why was the focus on women's near-absence in the partnership rather than on the taxing work hours, which averaged 60-65 per week? Our analysis leads us to conclude that facing the sadness of the sacrifice women and men both make in meeting the demands of long-hours' jobs is more painful than confronting the problem of a lack of women in top positions.

So the less distressing problem substitutes for the more distressing one. An elaborate—but unconscious—deflection of the problem away from the profound problem of overwork and onto women's balancing act can help assuage these distressing feeling and maintain the firm's equilibrium. All parties have an emotional stake in keeping the focus off the painful notion that men and women both suffer.

In the case of men, our interviews revealed feelings of guilt at neglecting family life, and in the case of women, they revealed an unsettling ambivalence about the extent of their career commitment and how much the firm values their contributions.

This situation sets the stage for protective measures to kick in. At the employee level, they appear as unconscious psychological defense mechanisms. Men tended to split off their feelings of guilt and project them onto the firm's women. Instead of directly feeling guilt, they identify with women and empathize with the guilt they believe

they experience. This reduces, but does not completely alleviate, the emotional fallout of the hours spent away from their own families.

The dilemma women faced was more complex and less readily resolved. They had to confront the firm's expectations that, as good mothers, they should ratchet down their hours regardless of whether they wanted to, and that, as women, their leadership abilities were sub-par. The result for women was a mix of ambivalence about being away from their families and concerns about competence that were not easily resolved at a psychological level.

At the organizational level, the protective measures appeared as the universally-held belief in the work-family narrative as the explanation for women's near-absence in the partnership ranks and policies like the availability of accommodations (taken mostly by women) that removed women from the path to partnership.



These protective mechanisms worked together to encourage women to see themselves as needing to put family first and thus to cut back at work and encouraged men to see themselves as breadwinners and to be willing to step up to the 24/7 time demands. ❏

Managerial Implications

As a result, two strongly-held ideologies that support the status quo remain in place: long work-hours are necessary and women's stalled advancement is inevitable. When companies address work-life balance instead of the long-hours culture, we end up with solutions that leave the partner ranks depleted of some of their brightest female stars and also leave many men continually torn between the pulls of home and work.

There is a way forward. As individual families and employees push back against overwork, and as more research shows the productivity advantage of reasonable work hours, some employers are reconsidering 24/7 work demands. If these forces gain traction, neither women nor men will feel impelled to sacrifice the home or the work domain, and women may begin to gain workplace equality with men.

This summary is based on the full article, "Explaining the Persistence of Gender Inequality: The Work-family Narrative as a Social Defense against the 24/7 Work Culture" in *Administrative Science Quarterly* 2019, DOI: 10.1177/0001839219832310 journals.sagepub.com/home/asq. Irene Padavic (ipadavic@fiu.edu) is a Professor at Florida International University. Robin J. Ely (rely@hbs.edu) is a Professor at Harvard Business School, Harvard University. Erin M. Reid (reidem@mcmaster.ca) is an Associate Professor at DeGroote School of Business, McMaster University.

Will Your Personality Change after Being Promoted to Leadership Position?



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This study has shown that moving into leadership roles leads to an increase in a person's conscientiousness but no significant change in emotional stability.

Aadults' personality traits have been traditionally assumed to be stable. However, recent studies have examined influences of major life events (e.g., first job, marriage, unemployment) on personality development. A recent study further extends this emerging line of research by examining personality development after becoming a leader and, more importantly, a change in job demands.

Wendong Li, Associate Professor at the Department of Management at The Chinese University of Hong Kong, has teamed up with a few other academics to examine whether taking on a leadership role—along with the added job responsibilities—can actually change people's personality traits. Their study, recently published in *Journal of Applied Psychology*, has found that, after being promoted to leadership positions, individuals enhanced their levels of conscientiousness and became more dependable, organized, and efficient.

The authors suggest that one of the crucial factors in driving adult personality development is taking on new roles at work. As individuals take on wider responsibilities and play more important roles in organizations, novice leaders are expected to be more conscientious than when they were employees—more efficient, organized, vigilant, achievement-oriented, and dependable to subordinates. Fulfilling the expectations and responsibilities required by leadership roles also means leaders must deal effectively with uncertainties and changes. Therefore,

leaders need to be able to remain calm, and handle negative emotions in response to stress.

This study has focused on two of the so-called "Big Five" personality traits: conscientiousness and emotional stability, using two publicly available U.S. and Australian databases, to compare the personality development of individuals at different stages. One study consisted of 61 people in the becoming leader group and 128 in the non-leader group and used U.S. data selected from three different time periods: first between 1995 and 1996, then after 10 years and finally after 20 years. The other study comprised 342 people in the leader group and 675 in the non-leader group, and used Australian data selected at four-year intervals from 2005, 2009 and 2012. The results of the two studies supported the hypotheses regarding the relationship between becoming a leader and the subsequent small, but substantial increase in the level of conscientiousness over time as well as the mediating effect of changes of job demands. The results have also shown that becoming a leader did not significantly change individuals' extraversion, agreeableness, or openness.

The majority of extant organizational personality research has taken the position that personality traits influence work experiences, not vice versa. Although this view seems parsimonious, it cannot account for the accumulating empirical evidence that adults' personality traits continue to develop as people adapt to new life/work roles. A role-



based perspective of personality development helps explain the changes in personality traits when people transition into leadership roles from employees.

This study has adopted a quasi-experimental design and several robustness check methods to strengthen the reliability of the study and validate the conclusions. Despite the strengths and convergent findings from the two sets of data, the authors have pointed out that this study is still limited in several ways, which point to directions for future research. The first limitation is related to the abbreviated measure of the broad Big Five personality traits. If feasible, future research should use more fine-grained scales to capture more delicate and nuanced personality changes. Second, although using self-report measures of personality has been considered as a dominant approach in personality research, it raises concerns of whether social desirability may potentially account for the significant findings. Third, conducting secondary analyses of public data might still limit the capability to test the role-based theorization of personality change. Although this study has shown that job role demands serve as an underlying mechanism for personality change during leadership emergence, assuming leadership

roles may also change other aspects of work, such as job control. Fourth, transitioning from the role of employees to that of leaders is a crude form of leadership experiences, yet leadership is multifaceted and may include various leadership styles. Future research should investigate influences of specific leadership behaviors at multiple organizational levels (e.g., first line leaders and CEOs) on the changes in individual characteristics in the long run. Lastly, although such two-wave or three-wave research is still valuable to advance this line of research, the selection of time lags might not be optimal.

The authors also suggest that caution should be taken when interpreting the results. The effect sizes observed in this research for change of conscientiousness seem small according to conventional rules of thumb. This suggests that becoming a leader might not change an unconscientious person into a highly conscientious one. Yet, small effect sizes do not necessarily mean that such research findings have no practical significance. Personality changes are often not dramatic because of other mechanisms that may promote personality stability. For example, people may actively avoid novel environments or are simply unable

to adapt to them. Moreover, not all people react to the same change in the same manner and what has been discovered in this paper is a general trend. Future research can examine individual differences in the speed, timing, and magnitude of personality changes. It should also be noted that this research does not provide a definite answer to the question whether the classic dispositional perspective of personality traits or

a role-based transactional perspective of personality development is more accurate in accounting for personality development. In fact, there seems still an ongoing debate on the major determinants of personality trait development in the state-of-the-art research in personality psychology. More research endeavors should be devoted to this intriguing and fruitful line of inquiry in organizational research. ■

Managerial Implications

Insights gained from this research will help organizations to plan leadership succession and guide individuals to better manage their career. Given the importance of conscientiousness for leadership, promoting an employee into a leadership position may have the potential to induce a virtuous cycle: becoming a leader may enhance one's level of conscientiousness, which in turn may further enhance his or her leadership effectiveness. The authors suggest that organizations should consider assigning staff with informal leadership roles as a way to encourage them to continuously develop the types of behavior and traits associated with conscientiousness and prepare them for their future tasks. This study also encourages organizations to broaden the scope and content of training to include more holistic forms of leadership development as well as personality development. This study has also highlighted two additional concerns. Firstly, highly conscientious staff may not be able to adapt well to new environments and will lack necessary creativity. Secondly, companies may need to provide training to leaders to help them balance the benefits and possible disadvantages—such as a more volatile working environment and reduced flexibility—associated with

increases in conscientiousness.

For individuals, given that becoming a leader represents a milestone for one's career development, assuming leadership roles seems a natural step for employees to climb up the corporate ladder. In this regard, findings of this study provide employees another perspective to consider and evaluate their career development decisions. This study suggests that successfully carrying out leadership roles over time may lead them to become more adaptive to such behaviors and then ingrain these characteristics as personality traits. Meanwhile, people need to weigh up the benefits and costs of taking on a management role. Although promotion may lead to higher level of conscientiousness at work, it can also lead to less adaptation and creativity. Taking on extra job demands may also result in increased stress levels and worsened wellbeing.

Lastly, as the quote “it's not who I am underneath, it's what I do that defines me” from the 2005 blockbuster *Batman Begins*, starring Christian Bale as the billionaire caped crusader, implies: although personality traits are relatively stable, they may also be prone to change—even if the transformation is not always dramatic.

This summary is based on the full article, “Can becoming a leader change your personality? An investigation with two longitudinal studies from a role-based perspective”, *Journal of Applied Psychology*, DOI: <https://doi.org/10.1037/apl0000808>. Wendong Li (wendong@cuhk.edu.hk) is an Associate Professor at Chinese University of Hong Kong. Shuping Li (shu-ping.li@polyu.edu.hk) is an Assistant Professor at Hong Kong Polytechnic University. Jie Feng (jie.feng@rutgers.edu) is an Assistant Professor at Rutgers University. Mo Wang (mo.wang@warrington.ufl.edu) is a Professor at University of Florida. Hong Zhang (zhanghong@link.cuhk.edu.hk) is a Ph.D. student at Chinese University of Hong Kong. Michael Frese (blzmf@nus.edu.sg) is a Professor at National University of Singapore. Chia-Huei Wu (C.Wu4@leeds.ac.uk) is a Professor at University of Leeds.

“I Cheated, but Only a Little” : The Hidden Costs of Partial Confessions



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Confessions can help us redeem ourselves by coming clean about our unethical transgressions. Traditionally, confessions are treated in behavioral research as categorical—one either comes clean or not - but that is hardly the case in everyday behavior. Using a novel experimental design, the authors of this paper debunk the idea of binary (all or nothing) confessions and provide evidence of a high frequency of “partial” confessions. They demonstrate that admitting to only part of the

transgression is a common practice, particularly among those who cheat to the greatest extent possible. While these partial disclosures allow people to relieve their guilt without owning up to the full consequences of the transgression, they come at an unexpected emotional cost. Through several studies, the authors found that partial confessions made people feel worse than not confessing or fully confessing! This paper provides a nuanced view of this phenomenon by uncovering specific situations in which partial confessions are likely to occur and sheds light on the repercussions of such a strategy.

Tell the truth... the Whole truth...

People who engage in ethical transgressions or illegal actions may sometimes consider admitting their transgressions, for one reason or another. For example, people may tell the truth of their wrongdoings because they believe it may help absolve themselves of the guilt or to minimize shame. But do confessors always tell the whole truth? As it turns out, many of us fall short of revealing the entire story and provide only partial confessions.

The authors of this paper took a deep look at the psychological underpinnings of partial confessions and uncover when and why people choose to confess partially. They explored the occurrence, antecedents, consequences, and everyday prevalence of partial confessions through five studies. The results indicate that people find partial confessions attractive because they are more believable than denials, but they fail to anticipate the emotional costs associated with partially confessing. Before we delve into the interesting findings and unique research designs of this paper, let us first understand the phenomenon of partial confessions.

Partial Confessions

People use confessions as a way to come clean about their unethical acts. In general, confessions have been considered dichotomous, “all-or-nothing”

decisions - people either confess fully or not at all. In reality, however, people often partially confess by owning up to only part of their transgression. To understand the implications of admitting to only part of one’s transgressions, it is crucial to recognize the distinction between full and partial confessions. The difference between full and partial confessions lies in the extent to which a person assumes responsibility for all or part of the transgressions. The authors provide some examples to clarify this nuance. If a person stole \$100, admitting to stealing \$100 would constitute a full confession. In contrast, claiming to have stolen only \$50 would constitute a partial confession. Many of us may relate to such instances of the latter where we reveal only partial truth about our misdeeds. Other examples include a driver accused of speeding who may tell the officer, “I was only driving ten mph above the limit”. Similarly, a person following a diet regimen may confess to only eating one piece of chocolate instead of the larger amount they actually consumed. At work, a sexist employee may admit to telling “only one dirty joke”, while at home, an unfaithful partner may say that it happened only once.

One might wonder why a person would bother to offer a partial confession. The authors assert that partial confessions could be attractive for various reasons. They may serve the instrumental purpose of allowing offenders to benefit from their bad behaviors without getting the full punishment for doing so.

They can also be a neutralization or minimization technique designed to reduce or avoid the severe social consequences of full confessions. While a full confession entails assuming full responsibility for one's offenses, partial confessions allow people to relieve their guilt, without having to own up to the full consequences of the transgression. Through partial confessions, people can strike a personal compromise by satisfying the desire to confess while minimizing the feeling of shame or social costs of the transgressions.

If you think this might be a good strategy, you are not alone. The evidence from the studies conducted by authors indicates that making a partial confession is a common practice. But before you consider telling your boss or your partner half the truth about your past transgressions, hit the pause button and read on. Based on their findings from a series of studies conducted for this paper, the authors caution that while this approach may seem attractive at first glance, it comes with a substantial emotional cost. To help us understand how partial confessions can lead to good or bad outcomes, the authors first demonstrate the prevalence of partial confessions and illustrate the underlying motives.

Is this really happening and who is doing it?

While investigating an under-studied phenomenon such as partial confessions, it is critical to identify the type of individuals who are likely to engage in such behaviors and understand the extent of their confessions. Towards this end, in their first study the authors investigated the relationship between the degree of cheating and the likelihood of following up with a partial or full confession. Participants of this study were asked to predict the outcome of ten coin tosses, report how many of their predictions were correct, and earn money accordingly. Because participants were paid according to their self-reported number of correct guesses, they had an opportunity to lie by overreporting. Afterward, participants were given the opportunity to confess and could do so

by admitting all, some, or none of their cheating. The authors assessed the prevalence of partial confessions—admitting to inflating the actual outcome but not to the full extent—and its relation with the extent of cheating. The extent to which participants could have cheated was measured using a 'cheating ratio,' which was computed by dividing the number of over-reports made by the number of over-reports possible. Confessions were computed using a 'confession ratio,' or "the extent to which participants confessed out of the maximum extent that was available for them to do so." The results demonstrate the prevalence of partial confessions and indicate that the more people cheated, the more likely they were to confess. Interestingly, different types of confession patterns were found among participants who cheated to a high versus full extent. People who cheated to the full extent were more likely to partially confess, whereas people who cheated to a high extent were more likely to fully confess.

Why are they doing it?

The first study provides substantive proof that partial confessions are indeed prevalent, but it is unclear why partial confessions seem attractive to people. The authors conjectured that if one engaged in wrongdoing, such as cheated (by overstating performance) but then confessed to (some of) the cheating, other people would find the performance report more credible than when a person claimed high performance and did not confess to cheating at all. Thus, confessing partially might be preferable to confessing fully because one can reap part of the benefits of lying (which is not possible when fully confessing) but still appear more credible to others than when not confessing at all. In addition, from an emotional standpoint, when one does not confess, one is likely to feel guilty about not taking responsibility for one's wrongdoing. Study 2 was conducted to investigate the psychological mechanism leading people to choose not to confess versus to choose to partially versus fully confess. Using hypothetical

scenarios, participants were asked to forecast two things: (a) how believable would their confession seem to others and (b) how they anticipated feeling after they made such a full, partial, or no confession. The results indicate that people anticipated that partial, as well as full, confessions would be perceived as more credible compared with not confessing. They did not anticipate, however, that confessing would make them feel different than not confessing. Thus, partial confessions seem like an optimal option because of the relative gain in credibility compared with not confessing, as well as the relative gain in not having to face the consequences of admitting to a major wrongdoing compared with fully confessing.

What is actual impact?

The evidence thus far establishes that people opt for partial confessions based on expectations of benefits associated with it. Whether it is advisable to partially confess depends on the degree of negative post-confession feelings that people may be unable to anticipate and its effect on credibility. Accordingly,

in the third study, the authors looked at negative feelings after confessing to cheating in the same activity used in Study 1. They found that people who partially confessed actually experienced the worst emotional outcome. Partial confessors experienced more negative feelings than non-confessors and full confessors. In the fourth study, the authors explored whether the credibility of partial confessions functions as expected. Using a hypothetical scenario, they demonstrated that partial confessions are judged to be more credible than not confessing at all.

The authors designed a final study to assess whether the findings related to the prevalence and emotional consequences of partial confessions flesh out in daily circumstances as well. Participants were asked to recall a partial versus a full confession they made in real life, their reasons for confessing, and how they subsequently felt. The results confirmed that partial confessions were prevalent in many real-life situations and circumstances, and suggested that full confessors were more content and feel less negatively about their confessions, relative to people engaging in partial confessions. 

Managerial Implications

Through a series of rigorous studies, the authors demonstrate that people tend to restrict their honesty about their dishonesty. They engage in partial confessions based on the correct intuition that such confessions would be more credible than not confessing at all. Paradoxically, partial confessions maybe attractive due to their relative high credibility (compared to not confessing) and low cost in terms of facing up to the admitted offence (compared to fully confessing), but can lead people to experience

more negative feelings compared with others who do not confess or confess to the full. Thus, partial confessions can be a double-edged sword. While they may help with gaining some credibility, they come at an emotional cost. Before we opt for a partial confession for reputational benefits, we need to remember the findings of this paper and consider the affective implications. If you seek guilt relief then best tell the truth... the WHOLE truth.

This summary is based on the full article, "I Cheated, But Only a Little – Partial Confessions to Unethical Behavior", Journal of Personality and Social Psychology, 106(2), 202. Eyal Peer (eyal.peer@mail.huji.ac.il) is an Associate Professor at the Federmann School of Public Policy, the Hebrew University of Jerusalem. Alessandro Acquisti (acquisti @ andrew.cmu.edu) is a Professor of Information Technology and Public Policy at the Heinz College, Carnegie Mellon University. Shaul Shalvi (S.Shalvi@uva.nl) is a Professor of Behavioural Ethics at the Center for Research in Experimental Economics and Political Decision Making (CREED), Amsterdam School of Economics. Misha Mariam is an Assistant Professor at University of Washington, Bothell, and she is also an associate editor for Research Highlights of Management Insights.

Business Model Innovation in Transforming Economies: A Co-evolutionary Perspective for a Global and Digital World

We develop a co-evolutionary framework in which we consider what type of business model innovation occurs in transforming economies (adoption, adaptation, or creation) and who the central players are (indigenous firms or MNEs). We show how, through business model innovation, indigenous firms have begun to challenge global industry leaders, despite not having the same resource advantages, proprietary technology, or market power. We highlight the consequences of this for the domestic and global environment.



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The desire of the BRICS countries (Brazil, Russia, India, China, and South Africa) and those in Eastern Europe to transform their economies into innovation economies has stimulated a push for entrepreneurship and experimentation with new business models. A business model is a holistic concept that “explains” how firms create and capture value, a “way of doing business”, or a “business concept”. In a way, the business model describes the structure of the value chain that is needed to create and distribute a value proposition, as well as the extra assets required for this process. The value proposition describes how value is realized for specific target groups and markets. For example, it can provide cost advantages, meet previously unmet needs with new products and services, offer greater information and choice, or confer status associated with a brand.

In this article, we develop a co-evolutionary framework of business model innovation in developing economies, the process through which firms react to the idiosyncrasies of their local environment as nested within the global context to develop new ways of doing business. This process not only improves the firms’ local and global competitiveness but also, because of their the social and competitive implications of the new models, has the potential to alter the local and global environment.

Who Innovates the Business Model: Indigenous Firms vs. MNEs?

The transforming economies provide an important arena for experimentation for both indigenous firms and foreign multinationals, and each have their own advantages when it comes to developing new business models. Indigenous firms are particularly attuned to customer needs and are well-positioned to tap into local resources. They can leverage their knowledge of the market and relationships with

local stakeholders to introduce business models designed around a deep understanding of their potential customers and the country’s context. In contrast, foreign MNEs can devise new ways of creating and capturing value by experimenting with novel combinations of firm-specific advantages and the transforming economy’s particular context. However, while the transforming economies might provide opportunities for business model innovation, MNEs, being embedded in multiple contexts, need to develop capabilities that enable them to overcome the challenges of managing multiple business models.

What Form of Business Model Innovation is Being Used in Transforming Economies: Adoption, Adaptation, or Creation?

Depending on the degree and type of newness, there can be three types of business model innovation in transforming economies. The first is adoption, which is when firms implement new ways of creating and capturing value but simply copy these from other firms, either in developed or transforming economies, and use off-the-shelf solutions (i.e., without significant modification). In this literal geographical replication, an existing business model is applied in a different country or region.

The second type is adaptation, when firms also copy a business model from another firm but make significant changes to it to leverage their own resources and competencies more effectively or to create a fit with the environment in which they are operating. Adaptation involves reconstructing a system of activities and processes that are often imperfectly understood, causally ambiguous, complex, and interdependent. It is a dynamic and evolving process that requires the right balance between learning, change, and precise replication.

The third type of business model innovation is the creation of new models in-house that are sufficiently different from existing ones to be classed as new to the industry or to the world. Business model creation involves radically appraising a firm's current business model in order to arrive at a new or more sustainable competitive position for the firm. For instance, Haier Group, a Chinese multinational in the home appliances and consumer electronics industry, leveraged its strong reach into rural China to create value by renting out its distribution and service channels to foreign competitors. As another example, TikTok creates value by combining elements of social networking and video-sharing platforms with a proprietary artificial intelligence algorithm and experiments with novel ways of capturing value such as advertisements, in-app purchases, and collaborations with various brands.

How and Why Can Resource-Constrained Firms in Transforming Economies Develop New Business Models?

The environment shapes business model innovation as it affects opportunities and resources available due to idiosyncrasies in customer and institutional factors. In turn, through their business model innovation firms shape the environment, because the models used affect the firms' competitiveness, create social value, and alter institutions. There are three processes of co-evolution: variation, selection, and retention.

Variation – Environmental drivers. In transforming economies, the environment plays a particularly prominent role in stimulating business model innovation. Since the transforming economies are growing rapidly and striving to become innovation economies, firms are encountering changing customer needs and increasing purchasing power, new technologies, volatile regulatory systems, and varied government support programs. These conditions provide ample opportunities for business model innovation. Indigenous firms

are particularly well positioned to identify these opportunities. For foreign MNEs doing business in transforming economies, they might need to change their value proposition accordingly based on market conditions, and may also need to change their business model when doing business in emerging markets in order to gain legitimacy as there may be different regulative, normative, and cognitive legitimacy needs associated with different regulatory bodies, customers, and partners.

Variation – Firm drivers. Why do some firms engage in business model innovation but not others, even though they all operate in the same environment? Since firms have their own particular characteristics and resources, there are significant differences in how they identify and tackle problems and opportunities that lead to new business models. Research points to several firm characteristics and capabilities that are important in stimulating business model innovation, such as exploratory orientation, which increases a firm's ability to recognize opportunities and to engage in entrepreneurial bricolage. In addition to capabilities, studies also indicate that firms' resources, such as networks with customers, financial investors, and collaborators are particularly important for business model innovation, as they play a key role not only in developing new business models but also in implementing them successfully.

Variation – Managerial drivers. Variation in business models also arises because of differences in managers' characteristics and behaviors. For example, extroversion, agreeableness, and openness of top managers have a positive effect on business model innovation, whereas neuroticism has an adverse effect. Also important are top managers' managerial skills, which help them coordinate and configure resources; entrepreneurial skills such as alertness, which help them sense and seize opportunities; and professional ties, which allow them not only to collect information from clients and suppliers but also to redefine the value network. Similarly, the boundary-spanning behavior of top management teams can stimulate business model

innovation as it leads to increased bricolage.

Selection. Business model innovation is no guarantee of success—not all new models will survive. In other words, variation is followed by selection. Models that are not appropriate for the transforming economy will not perform well and unless they are transformed in some way to address deficiencies in performance, they will fall out of use. Whereas variation is born out of perceived needs in the environment, selection processes test the appropriateness of firms' responses to those needs. Factors such as strategic choices, firm resources, or the characteristics of the managers concerned may all influence whether the business model can improve performance and survive.

Retention. At this stage, successful business models will diffuse within the economy as other firms try to adopt and adapt those models that appear to be working well. Diffusion can take place within the transforming economy; it can be outside-in when business models are identified outside of the

transforming economy (predominantly from developed economies). This process is driven both by MNEs who attempt to compete in transforming economies by transferring their existing models to them and by indigenous firms who look abroad for new business model ideas. An example of this type of business model diffusion is that of food delivery platforms from firms such as GrubHub, JustEat, or Takeaway.com in developed economies to firms in transforming economies (e.g., hipMenu in Romania). The diffusion can also be inside-out when new models from within the transforming economy spread to other countries. For example, as TikTok expanded and became successful outside of China, its business model spread to other countries as firms tried to emulate its success. One example is the Chingari app launched in India, which provides similar functions to TikTok after TikTok was banned from operating there. TikTok's business model also spread to developed economies such as the US, where Instagram developed the Reels app based on the TikTok model. 

Managerial Implications

First, business model innovation can change the competitive dynamics in the domestic environment, because it can lead to improved business and to new ways of interacting with customers, suppliers, and local institutions. Second, business model innovation affects the environment of the transforming economy as it can create social value by providing needed services and addressing institutional voids. In addition, business model innovation can also have implications far beyond the borders of the transforming economy in which it originated as it can affect global competitive

dynamics. Again using TikTok as the example, this business model not only led to a new category of apps as Western developers started to adopt it, but also extended its influences beyond the digital realm, changing the competitive dynamics in the retail sector. This is evident when the mostly bricks-and-mortar retailer Walmart expressed intent to invest in TikTok, hoping to gain a competitive advantage in the retail sector by using TikTok as a market research tool, as a new way to engage with consumers, and as a new channel through which to sell its products.

This summary is based on the full article, "Business Model Innovation in Transforming Economies: A Co-evolutionary Perspective for a Global and Digital World", *Management and Organization Review*, 17:2, May 2021, 202–225, DOI: 10.1017/mor.2021.142021. Oli Mihalache (r.o.mihalache@vu.nl) is an Associate Professor of Strategy and International Business at Vrije Universiteit Amsterdam. Henk W. Volberda (h.w.volberda@uva.nl) is a Professor of Strategy & Innovation at Amsterdam Business School of the University of Amsterdam. Moreover, and he is Director of the Amsterdam Centre for Business Innovation. The rewriter Isabelle Yi Ren (reny@montclair.edu) is an Assistant Professor of Management at Feliciano School of Business, Montclair State University.

How Does Choice Architecture Affect Judgment and Choice?





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Individuals and organizations make choices almost all the time. For instance, individuals make decisions on what to wear for work in the morning, what to pick up from the supermarket shelf, which job to select, and whether to engage in a relationship. Organizations make decisions on suppliers, distribution channels, organizational structure design and so on. Classic theories on decision making propose that decision makers make optimal decisions based on rational and objective analysis and evaluation of information and options. However, many real-life examples show that our decisions are often irrational or biased. For instance, a hiring manager may make a different decision when having two candidates with highly similar qualifications but different genders versus when having only one of them at hand.

Researchers have found that one of the most important reasons for biased decision-making is choice architecture. It is concerned with the impact of factors such as evaluation mode, temporal positions of options, framing of options, and attributes that differentiate alternatives for decision makers, decision recipients, and decision outcomes. Richard Thaler, the behavioral economist who won the Nobel Prize in economics in 2017, proposes that choice architecture design can help people make better choices without changing the alternatives or depriving people's freedom of choice, which he calls "nudge".

Xilin Li and Christopher Hsee, researchers from Booth School of Business at the University

of Chicago, have conducted a series of studies to examine the impact of two elements of choice architecture, namely evaluation sequence and evaluation mode, on decision-making.

01 Option Sequence and Treatment Discrimination

Sometimes the alternatives we have differ in certain aspects but the differences are not relevant to our evaluation. For example, when multiple candidates are evaluated for faculty promotion, their gender, ethnicity, and physical appearance should not affect the committee members' evaluation of their research capability. However, we may consciously or unconsciously consider these unjustifiable factors and make biased judgment, which Li and Hsee called "discrimination". Li and Hsee were interested in whether the sequence of presenting different options would influence discrimination.

Study 1: Do attractive customers enjoy lower prices?

Li and Hsee conducted a field experiment at a large clothing market in China to test the discrimination due to physical appearance in the price negotiation context. Two confederates were highly similar except that one was considered more attractive (the advantaged person) in the pretest than the other (the disadvantaged person).

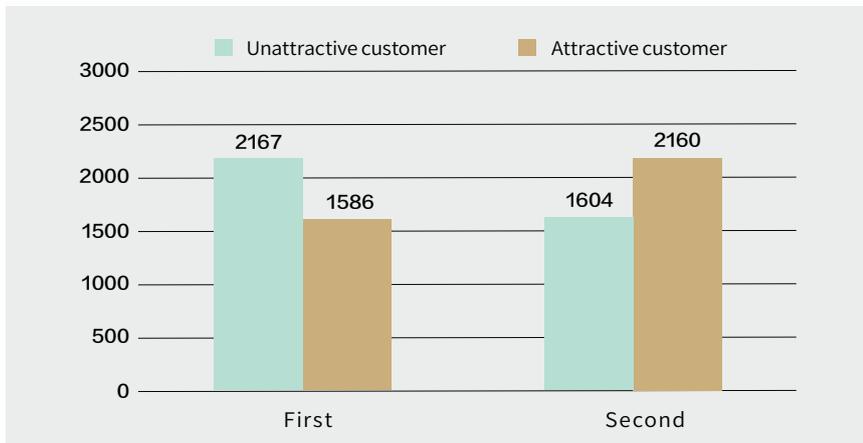


Fig 1. Price in Chinese Yuan.

For half of the stores, the attractive confederate walked into the store first, asked the store owner the price of a leather jacket, and negotiated a lower price; then the unattractive confederate followed, asked the price and bargained on the same leather jacket. For the other half of the stores, the sequence of the two confederates was reversed.

The results showed that when inquiring first, the unattractive person received worse prices (RMB 2176 on average) than the attractive person (RMB 1586). In particular, the unattractive person received better prices when inquiring second (1604) than inquiring first (2167), suggesting a free-riding effect. In contrast, the attractive person received worse prices when inquiring second (2160) than inquiring first (1586), suggesting a cost-bearing effect.

Study 2: Does nationality affect rent?

The researchers conducted another study to test the influence of sequence on discrimination due to nationality in a rental context. 400 American participants were asked to imagine that they had a basement apartment for rent and could rent it at a price ranging from \$400 to \$1000 per month. These participants were randomly assigned to four conditions. In two conditions, the two tenants differed in nationality (a factor of low justifiability) but were the same in terms of noise level (a factor of high justifiability). They found that when visiting first, the Saudi tenant (the disadvantaged group)

received a worse rent (\$744) than the Canadian tenant (the advantaged group) (\$656). However, when visiting second, this discrimination disappeared (\$692 versus \$688), suggesting a free-riding effect. In contrast, the Canadian tenant received a worse rent when visiting second (\$688) than visiting first (\$656), suggesting a cost-bearing effect.

In the other two conditions, the two tenants have the same nationality, with both being Australian (the advantaged group), but one of them was noisy and the other was quiet. As shown in Figure 2(B), regardless of the sequence, the noisy tenant always received a worse rent than the quiet tenant.

Study 3: Does the wrongdoer's gender affect tolerance of sexual harassment?

To further test the effects of sequence on discrimination, the researchers conducted another study focusing on discrimination due to gender in sexual harassment cases.

603 participants were randomly assigned to four conditions. Participants in condition 1 and 2 read two sexual harassment cases sequentially. Participants in condition 1 read the case with a male offender first and then the case with a female offender. In condition 2, the order was reversed. Participants in condition 3 and 4 did the same as those in condition 1 and 2 respectively, except that they also read some evidence supporting the justifiability of gender to be considered in sexual harassment and suggesting

more severe punishment against male wrongdoers. Participants were asked to recommend punishment against the offender in each case on a 4-point scale in which bigger numbers meant harsher punishment.

When gender was an unjustifiable factor, the sequence led to discriminatory treatment of the disadvantaged person, the male wrongdoer. Specifically, the male wrongdoer was supposed to receive harsher punishment when evaluated first (2.31) than evaluated second (1.97). However, the male wrongdoer was supposed to receive more lenient punishment when evaluated after the female wrongdoer (1.97) than before her (2.31), suggesting a free-riding effect, whereas the female wrongdoer was supposed to receive harsher punishment when evaluated after the male wrongdoer (2.29) than before him (1.75), suggesting a cost-bearing effect. When gender was a justifiable factor, regardless of the sequence, the male wrongdoer was always supposed to receive harsher punishment than the female wrongdoer.

02 Joint Evaluation vs. Single Evaluation

The decisions above all involve two targets to evaluate. What if the decision maker only has one target to evaluate? Li and Hsee proposed that this depended on the (1) evaluability and (2) justifiability of the attribute that differentiated the targets. Evaluability refers to whether people can evaluate the given value of the attribute without comparing with other

values. Justifiability refers to whether people think the attribute should be considered in their decision.

Study 1: An overseas military operation

The researchers prepared two scenarios describing a US fighter pilot mistakenly fired a missile and killed either 10 or 20 Japanese civilian in a recent military operation. 258 American participants were randomly assigned to three conditions. Participants in condition 1 saw both scenarios and participants in condition 2 and 3 saw only one scenario. All participants were asked to assume the role of a juror and sentence the year(s) of imprisonment for the pilot. In a pretest, the number of victims was verified to be a factor high on justifiability but low on evaluability, because harm is a reasonable basis of punishment, but average people usually do not have sense about the magnitude of harm in a single evaluation. Ethnicity of the victims was regarded as a factor high on evaluability but low on justifiability, that is, victims' ethnicity should not be considered when people decide the punishment against the pilot.

The results show that participants in the joint evaluation condition imposed more severe punishment on the pilot who killed 20 civilians (6.58 years of prison) than the pilot who killed 10 civilians (5.38 years of prison). However, participants in the two single evaluation conditions imposed similar punishment on the two pilots (4.33 vs. 4.21 years of prison) regardless of the number of the victims.

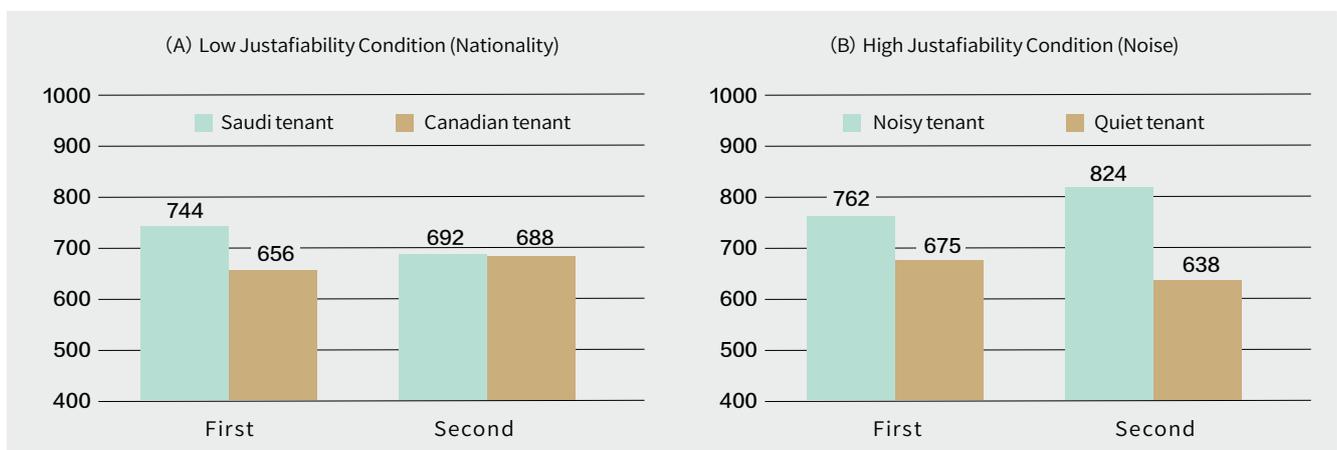


Fig 2. Rent in US Dollars

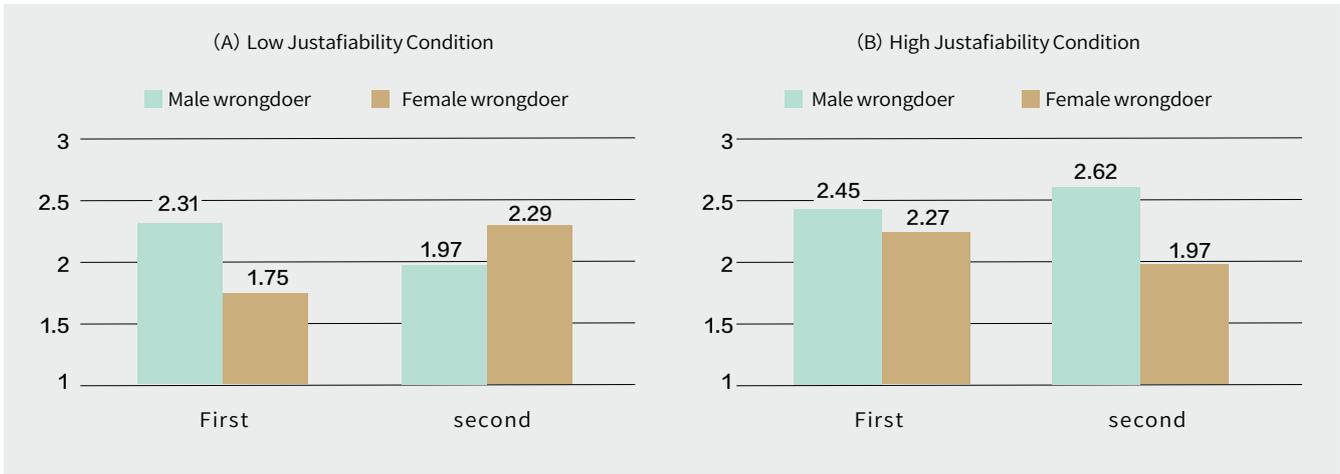


Fig 3. Severity of Punishment

These results suggest that, although the number of the victims is a reasonable basis of evaluation, it can effectively affect the decision only when put in a comparative context due to its low evaluability.

The researchers also prepared two other scenarios in which a US pilot killed either 18 Somalian civilians or 18 Belgian civilians. They found that participants in the joint evaluation condition imposed similar punishment on the two pilots (3.91 vs. 3.95 years of prison) regardless of the victims' ethnicity. However, participants in the single evaluation conditions imposed more severe punishment on the pilot who killed Belgians (4.6 years of prison) than the pilot who killed Somalians (2.68 years of prison). These results suggest that joint evaluation can help reduce discriminatory judgment toward the disadvantaged group, which may occur when ethnicity as an unjustifiable factor is not made salient in the single evaluation situation.

Study 2: Tutoring service

The researchers posted an advertisement on a Chinese service-exchange website looking for Chinese tutors for foreign students. The visitors saw one of three versions of the advertisement. In version one two foreign students, a French student and a Guinean student, wanted to hire a tutor. In the other two versions, only a French or a Guinean student wanted to hire a

tutor. Interested individuals could indicate their minimum hourly rate and contact information.

10 days, 141 people responded to the post. When pricing for two students (joint evaluation), the tutors indicated almost the same rate for the French student (RMB 77) and the Guinean student (76). However, when pricing only for one student (single evaluation), the tutors indicated a higher rate for the Guinean student (89) than the French student (60). Again, joint evaluation reduced discriminatory treatment, which happened in single evaluations.

03 Theoretical Implications

The studies above show that people make quite different decisions with regard to the same options that are placed in different orders or presented jointly versus separately. This demonstrates the effect of choice architecture and the limitation of human rationality.

To address the limited rationality, both decision makers and choice designers should be aware of and make use of the role of choice architecture. First, they should consider whether the factor that differentiates the choices is justifiable and evaluable. When the factor can be easily evaluated (e.g., gender, ethnicity, nationality, physical appearance) but is not a valid basis for the decision (e.g., pricing, sentencing), it is advised to consider different options simultaneously.

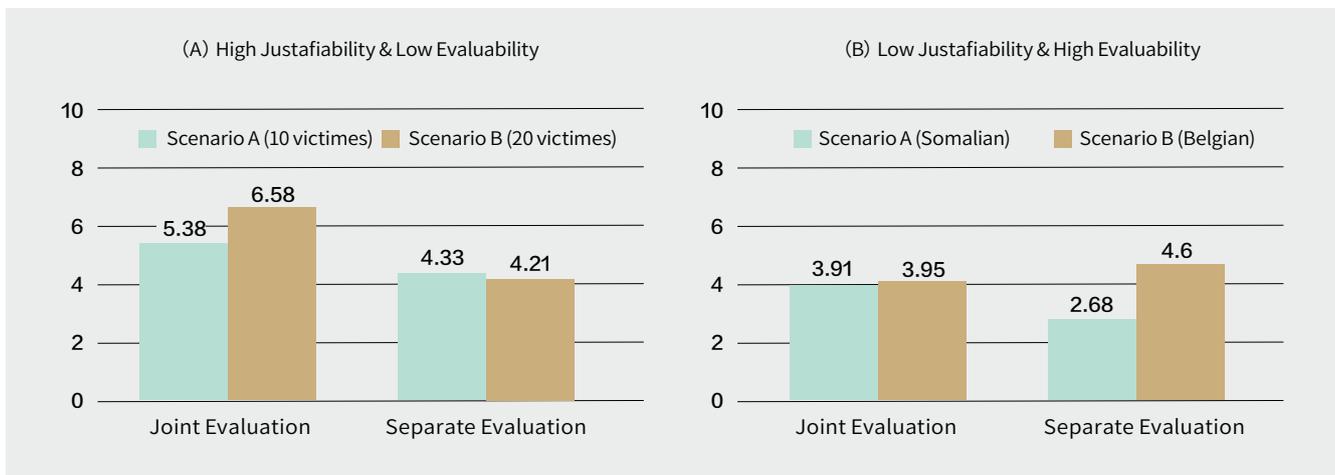


Fig 4. Sentencing terms (years)

Highlighting the factor can “remind” the decision maker that any difference in treatment would be associated with this factor and lead to an impression of bias or discrimination. When it is infeasible to juxtapose the options, placing the advantaged person before the disadvantaged person can also improve the welfare of both parties, as people cannot treat the

disadvantaged person ostensibly unfavorably after just treating the advantaged person favorably. Moreover, even when the factor is relevant to the decision (e.g., the number of victims, a certain type of experience), if the factor is difficult to evaluate independently, people should put options side by side so that they can make a relatively better decision based on comparison. 

Managerial Implications

Biased decision-making can happen to managers and employees in their daily work. For instance, in workplace sexual harassment, gender should not be the reason for tolerating the offender or blaming the victim. Customers’ physical appearance, age, gender, income level and consumption amount should not be the excuse for discriminatory treatment. Transgressions of organizational values and code of conduct should not be handled differently according to the transgressor’s hierarchy. In addition to business organizations, governments,

non-government and non-profit organizations should not make decisions based on factors such as the target group’s region, gender, ethnicity, and social and economic status.

It is worth noting that many decision makers are not aware of or refuse to acknowledge this limitation of rationality. Therefore, choice designers should wisely use choice architecture to nudge decision makers to overcome the limitation and make fair judgments and choices that contribute to the welfare and justice for individuals, organizations and societies.

This summary is based on the full articles, “Free-riding and cost-bearing in discrimination”, *Organizational Behavior and Human Decision Processes*, 163, 80-90, DOI: <https://doi.org/10.1016/j.obhdp.2019.08.003>, and “Beyond preference reversal: Distinguishing justifiability from evaluability in joint versus single evaluations”, *Organizational Behavior and Human Decision Processes*, 153, 63-74, DOI: <https://doi.org/10.1016/j.obhdp.2019.04.007>. Xilin Li (xilin.li@chicagobooth.edu) is a Ph.D student at University of Chicago. Christopher Hsee (chris.hsee@chicagobooth.edu) is a Professor at University of Chicago. The rewriter Zhi Liu (lz@gsm.pku.edu.cn) is an Assistant Professor at Guanghua School of Management, Peking University.

Fraud and Innovation

“Fake it till you make it!” This is probably Silicon Valley’s most important belief for aspiring entrepreneurs. While admiring innovations and novelty, most of us are much less adventurous than we perceive ourselves to be. Instead of taking a leap of faith to embrace something new, we are much more comfortable with joining the bandwagon when others have adopted new products, switched to new services, and invested in new ventures. For startup firms that are working on disruptive technologies to change the world, it does not seem to hurt to fake a bit by adding a few blue chips to the customer list, sneaking in one or two recognitions that should have received, or claiming a milestone that has yet to be achieved (but trust me, I will achieve it).

In the grand scheme of building unicorns and changing the world, “Fake it till you make it” seems innocent and probably even necessary and benevolent. Some bravado of “faking it”, on any given occasion, may provide entrepreneurs access to key external resources and advantages over others in venture survival and growth. Ambitious young companies overstating their success is nothing new. It is a widely used and seemingly harmless way to make firms go a little faster, easing market resistance. The problem is: Will “fake it” truly serve as a catalyst for “make it”? Or shall we pay a bit more attention to the cautionary tales of Theranos, WeWork, and Luckin Coffee to see the

dark side of the “fake it till you make it” philosophy?

In a recent paper published in *Administrative Science Quarterly*, Professors Yanbo Wang from the University of Hong Kong, Toby Stuart from the University of California, Berkeley, and Jizhen Li from Tsinghua University investigated the potential links between fraud and innovation. The authors tracked 467 Chinese high-tech firms that applied for government sponsored innovation fund to examine to what extent, in comparison with honest firms, organizations that fraudulently acquired resources are more likely to divert their intended purpose, i.e., investment in innovation-related endeavors. Rather than relying on mass media or law enforcement agencies, the authors identified fraud using a unique approach by comparing two sets of financial books prepared by each company for the same fiscal year that are required by the law to be identical. They found financial data discrepancy in over half of cases, in a direction beneficial to the firms. Furthermore, around 60% of the firms cooking their financial books received government funding but among the honest firms, only 47% were recipients of this fund. At first glance, fraud seems to be fruitful, at least in terms of access to financial resources.

Fraud and Innovation: Any Association At All?

Productive endeavors such as innovation require



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capital input. We are often told that money is fungible and does not come with a label - one dollar is one dollar and no matter coming from account A or B, it has the same purchasing power. From this perspective, fraud and innovation should be diagonal to each other, i.e., how the financial capital is acquired should not have an impact on how it is allocated. This is also reflected in our daily conversations - we rarely associate fraud with innovation and would feel disrespectful to link innovators with fraud or awkward to link fraudsters with innovation.

Are fraud and innovation so distinctive that they are not connected at all? Careful examinations would suggest that fraud and innovation are fairly intertwined with each other. For instance, Bernie Madoff is usually linked with Wall Street Ponzi schemes; however, he was also an electronic trading pioneer and as its chair, played a key role in the rise of Nasdaq in the 1990s. Likewise, Enron, an ultimate symbol of corruption and corporate decadence, was a pioneer in the utilities industry and was recognized by Fortune as “America’s Most Innovative Company” for six consecutive years. Before Enron, never did a company convert public utilities such as electricity, natural gas, and broadband into financial products and build up platforms to trade them like commodities.

While this claim might make many of us uncomfortable, fraudsters nevertheless possess many of the traits that are associated with innovators: They question the status quo, disrespect the convention, and think outside the box to create their own ways of obtaining what they want; and in the process, they embrace the risks of failure and social sanctions. When their endeavors are socially accepted, these individuals are lauded for ingenuity and bold acts of entrepreneurship. Conversely, when their endeavors are socially proscribed, these individuals would be judged to be deviant, misbehaving, and even illegal. In most cases, we judge them by the alignment between their activities and the prescribed goals of the society, rather than the action and the means themselves. Innovators are perceived as contributing to society’s

objectives and fraudsters as destroying them.

Financial Capital Through Fraud for Innovation?

Now, let’s revisit our initial question - will resources acquired through fraudulent means be invested in innovation?

While fraud and innovation share some commonalities, our answer to the question above is a “No”. Compared with resources obtained through honest means, resources acquired through fraudulent means are less likely to be invested in productive activities such as technological innovation that help build an organization’s long-term competitiveness. For companies that are created for the purpose of fraudulently acquiring resources, they almost certainly would allocate the newly acquired resources in ways that were not intended by the resource providers. These firms are thus not the focus of this study.

Instead, we focus on opportunistic deceivers, companies that are created to pursue lawful business objectives but at a certain point in their development, perpetrate fraud to acquire resources to gain advantages over competitors. These companies tend to weigh the pros and cons and commit fraud in specific situations. For some firms, fraud is a measure of expediency to cover up their temporary setbacks so that they would avoid the risk of losing key clients and getting permanently left behind, or add hyperbole to their solid records to earn an advantage in competition. For some other firms, they may feel fraud is a requisite to compete on a level field as cheating is prevalent and acting honestly would be a fool’s endeavor.

No matter it is perceived as a last resort, a measure of expedience, or the “icing on the cake”, fraud is used by firms to mislead resource holders so that the latter would believe them to possess the merits and credentials worthy of funding. While money is fungible, whether it is earned or not could make a big difference in its disposal. According to the theory of mental accounting, people compartmentalize their income into different mental accounts and make

resource allocation decisions within this set of mental budgets. For the same amount of money, we tend to place higher emotional value on our earned income than windfalls, and accordingly, we are motivated to spend the earned income on meaningful things. In contrast, for unearned income, the psychological pain associated with spending it would be much lower. One sociological study of money finds that, in Oslo's prostitution market, individuals used income from legal sources for rent payments and daily expenses, while using prostitution money to purchase drugs, alcohol and discretionary clothes. Unlike "honest dollar", "dirty money" is stained and apt to burn a hole in the pocket. All these studies suggest that perceptions of the valid use of funds are directly tied to how resources are obtained. No wonder people readily squander their unearned money and save/invest their earned income.

We may also examine the issue from an organizational theory perspective. Organizations are subject to the force of inertia and thus have a natural tendency to avoid making long-term investments in new projects whose returns are uncertain. Through cooking financial books, dodging environmental regulations, and overstating success and credentials, the act of fraud may create a release valve from external pressures that motivates organizations to invest in challenging projects. To put it another way, "fake it" may lead to a boiling frog problem - though firms may initially enjoy the comfort of being buffered against selection pressures, they would gradually lose alertness and self-discipline. Furthermore, organizations are learning entities where successful practices are reinforced and repeated. When fraud leads to

desirable outcomes, the practices associated with it will become routinized and even "improved". If an organization learns to implement fraudulent approaches rather than legitimate solutions, it inevitably eschews investments in developing staff and routines to diagnose problems, research solutions, and execute decisions. To put it another way, while fraud brings short-term

advantages in resource access, it also brings long-term damages to competitiveness buildup.

The authors found evidence supporting the view of cheater's discount in innovation. Specifically, among the sample firms, fraudulently acquired financial resources are less likely to be invested in productive activities such as hiring technological talents and patenting. To reduce the concerns of comparing apples with oranges, the authors used coarsened exact matching to identify pairs of fraudulent and honest firms that operate in the same industry and have similar historical trends in human resource practices and patenting activities. On the innovation input side, they found that fraudulent winners hired slightly more tech talents than fraudulent non-winners, but much fewer than honest winners. Because breaking rules to acquire resources generally requires less effort on the part of organizational actors than acquiring resources through legitimate means. Ill-gotten gains are akin to unearned income at the organizational level.

On the output side, the authors made a distinction between meaningful and window-dressing innovations. Meaningful innovations usually embody technological breakthroughs and high commercial potentials. Discoveries of this nature require significant investment, accrued learning and sustained efforts of experimentation. In contrast, window-dressing innovations embody much smaller technological advancement and lower commercial values. While technologically capable firms may file these window-dressing innovations as part of their patent pools to protect the commercial value of their more substantive innovations, others may file these patents to cover up their technological impotency. For the latter group, these patents are essentially Potemkin Villages that help them deliver an image of innovativeness to shield them from external scrutiny and to sustain their efforts to continue obtaining external resources.

The authors found a set of empirical results consistent with the view that fraudulent winners did not invest the innovation grants in building up their

technological capabilities. Among grant winners, the fraudulent ones file much fewer invention patents, which is associated with technologically meaningful and commercially promising innovations.

However, the fraudulent winners file many more window-dressing patents than the non-winners, a pattern that is missing in the comparison between honest grant winners and non-winners. 

Managerial Implications

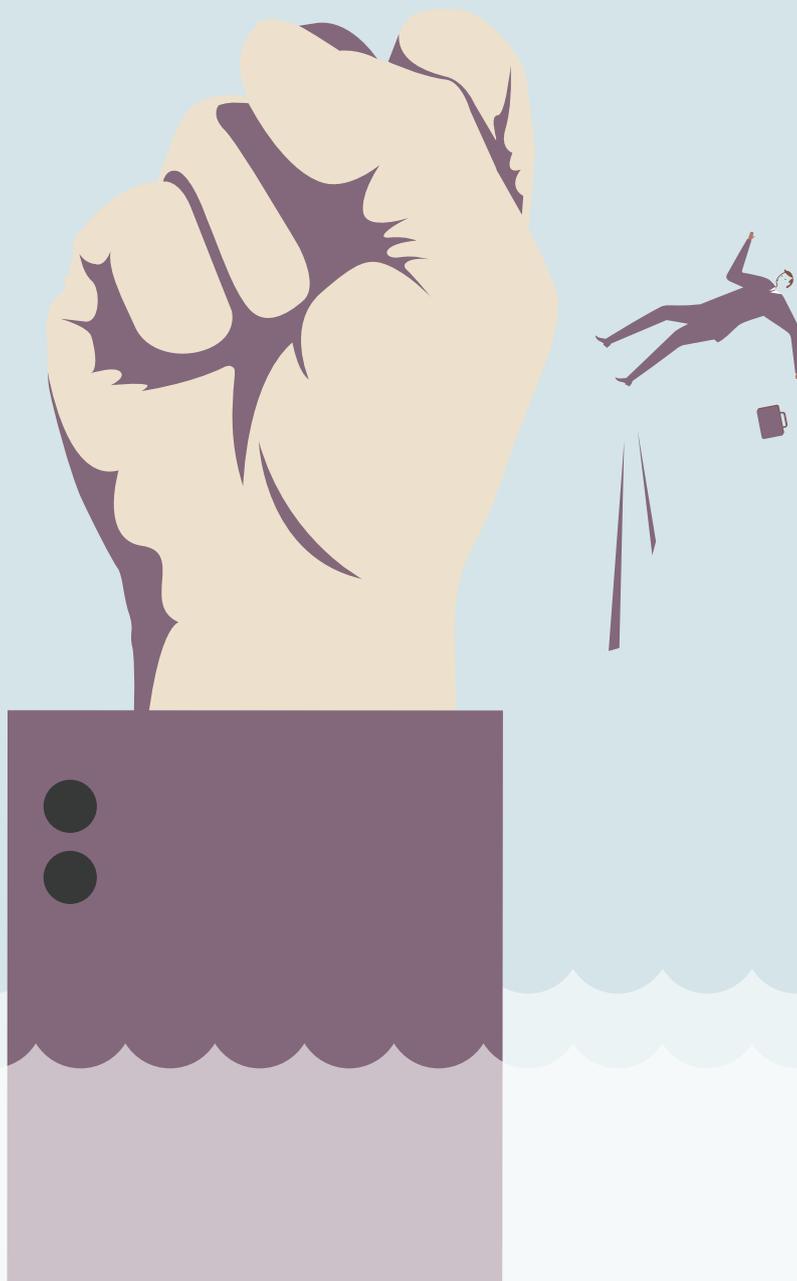
Although these findings are based in China, they can have broader applications. In more developed financial institutions with stronger regulations, scandal-implicated startups are nevertheless wide-ranging. The wall of notoriety is decorated with big names such as Theranos and WeWork, and the book of cautionary startup tales just got a new chapter when The New York Times reported that COO of Ozy Media impersonated a YouTube executive during a call with Goldman Sachs investors. It was later revealed that the buzzy digital media company has embraced dubious business practices for a long time, including broadcasting deals that did not exist and misleading marketing materials. Clearly, the “Fake it till you make it” culture is not merely a Silicon Valley or Chinese phenomenon, and careful observations suggest it has permeated many corners of our society, above and beyond the global hubs of tech entrepreneurship. While faking it helps one to “solve” an immediate challenge and we admire entrepreneurs who are clever, bold and think outside the box, entrepreneurs and investors have to set an alarm for themselves - once companies learn to take shortcuts in getting access to external resources and gaining unfair advantages, they may inadvertently incorporate these practices into their organizational routine and eventually become less willing to take the pain to build up their technological and organizational capabilities.

On the surface, the article focuses on a narrow topic about fraud and innovation, however, the underlying mechanism examined has far-reaching implications as it is essentially about the linkage

between resource acquisition and resource allocation, the economic activities permeating almost every corner of our society. Most of us must have read reports that big-ticket lottery winners winded up in bankruptcy, heard the catchy phrase “shirtsleeves to shirtsleeves in three generations” describing family’s wealth, or even recalled the excitement of calling friends for the “get the stipend from the government and let’s spend it” dine-out (if you attended colleges in China). At the surface level, these are disparate events; however, in all three cases, resource allocation decisions involved whether one had made serious efforts to earn the resources at his disposal. For unearned income, we rarely attach much emotional value to them and thus would not suffer much psychological pain for a splurge.

Fan Li, known as Tao Zhu Gong from the Spring and Autumn period in Chinese history, must have figured out the association between resource acquisition and resource allocation. Otherwise, he would not have insisted on sending his youngest son, rather than the oldest one, to the Chu Kingdom to rescue his middle son. For the youngest son who grew up mega wealthy, 1000 troy ounces of gold was nothing but a number. In contrast, for the eldest son who fought along with his father to build up the family fortune out of poverty, every single penny was earned by blood, sweat, and toil. For those who wonder what happened to the second son, it shall not be a hard guess once knowing it was the oldest son who got the mission to carry the bullion to “give away”.

The “Evil Pleasure”: Abusive Supervision and Third-Party Observers’ Malicious Reactions Toward Victims



How do people feel when their coworkers get abused by supervisors? In this study, the researchers investigated how abusive supervision influences interactions between abused victims and third-party observers. They predicted that people would experience an “evil pleasure” (schadenfreude) when they perceive a high level of rivalry with the victims of abusive supervision; the experienced schadenfreude then would motivate people to engage in interpersonal destructive behaviors (e.g., undermining, incivility, and deviance from interpersonal norms) toward the victims. The researchers further proposed that such malicious reactions would be attenuated if the groups have highly cooperative goals. Results based on one experimental study and two time-lagged field studies lend support to these hypotheses.



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When supervisors continuously display verbal or nonverbal hostility toward followers, this is abusive supervision. It tends to undermine followers' well-being and harm their performance. When abusive supervision happens in workplace, how do observers witnessing such incidents feel and react? From a justice perspective, people who witness mistreatment may experience social pains and feelings of injustice similar to those experienced by victims. It is also possible that people holding a strong belief in a just world are motivated to justify victims' unpleasant experience by blaming or derogating the victims. Yet another stream of studies suggests that observers may selectively apply justice rules to certain victims of mistreatment, depending on whether the victims fall within their scope of justice or whether the observers feel positive (or negative) toward the victims of unfair treatment.

In this study, the researchers departed from the above justice-related perspectives and instead focus on the rivalry relationship between the observer and the victim. Rivalry refers to an individual's perception of an established competitive relationship between the individual and a specific and identifiable opponent. Life is a competitive game, and workplace is potentially a theater for this game. People might develop rivalry relationships that focus on an opponent and winning against this particular opponent is of paramount importance.

Such a rivalry relationship exists in the actor's mind regardless whether material rewards are available. Research on rivalry has suggested that people are motivated to do whatever is needed to beat their rivals even if this feeling of winning is gained through passively seeing their rivals suffer. Therefore, the researchers proposed that when



there is high rivalry between the observer and the victim, observing abusive supervision of the victim may activate the observer's "evil pleasure," referred to by the German word *schadenfreude*.

Hypothesis 1. When an observer perceives high (versus low) rivalry with the victim, observed abusive supervision of the victim is positively associated with schadenfreude.

Schadenfreude can trigger destructive behaviors toward abused coworkers

Schadenfreude is the outcome of a desire that "others must fail". Through a social comparison lens, a rival is often seen as threatening to one's ego, and thus, people tend to minimize such threats through defensive behaviors, such as harming, when there is an opportunity. When observing a rival member being abused by a supervisor, the observer may feel delighted, not only because they feel better about themselves through downward comparison, but also because they see it as an opportunity to defeat the rival.

Supervisors often set the norms for acceptable and expected behaviors, and subordinates often follow their lead. Seeing one's supervisor abuse a

rival member provides an opportunity for the third-party observer to imitate the supervisor's abusive behavior. Thus, feelings of *schadenfreude* out of rivals' setbacks may drive focal individuals to reinforce their social comparison advantages and superiority by inflicting further harm to the rivals. *Schadenfreude* could therefore be viewed as a gateway drug that closes the door on compassion and encourages darker emotions and actions. Enjoying rivals' misfortunes may evolve into individuals' longing for more misfortune and the willingness to create it by themselves. The researchers proposed that:

Hypothesis 2. When an observer perceives high (versus low) rivalry with the victim, there is a positive indirect effect of observed abusive supervision of the victim on the observer's interpersonal destructive behaviors (undermining, incivility, and deviance) toward the victim via the observer's schadenfreude.

Highly cooperative group goals may reduce schadenfreude

Group cooperative goals refer to members' shared belief that their individual goal achievements are

positively related. In a group with highly cooperative goals, members' goals are integrated with each other and their own gains and losses tend to depend on the gains and losses of other members. In such a context, group members tend to develop shared identification and togetherness, which may promote group members to assume similarity, rather than dissimilarity, in an unfortunate fate with the victim, which is less likely to induce feelings of *schadenfreude*.

In contrast, in groups with low cooperative goals, members' goals are not aligned, but instead are independent from each other. Such contexts may boost psychological and instrumental benefits to third-party observers which result from the downfall of their rivals. Therefore, the researchers predicted that:

Hypothesis 3. When there are low cooperative group goals and high perceived rivalry, the positive relationship between observed abusive supervision of a victim and a third-party observer's schadenfreude is strongest.

Hypothesis 4. When there are low cooperative group goals and high perceived rivalry, the positive indirect effect of observed abusive supervision of a victim on a third-party observer's interpersonal destructive behaviors (undermining, incivility, and deviance) toward the victim via the observer's schadenfreude is strongest.

Methods and findings

The researchers conducted three studies to progressively test their hypotheses. Study 1 is an experimental study using undergraduate students to examine Hypotheses 1 and 2. Study 2 is a time-lagged field study to increase the external validity and test all the hypotheses. To address the limitations of Study 2 (e.g., lack of control variables) and replicate the findings, Study 3 used another set of time-lagged field data.

Study 1:

156 undergraduate students from a Chinese university participated in the study. Participants were randomly assigned to read one of the four conditions in a 2 (observed abusive supervision versus observed nonabusive supervision) by 2 (rivalry versus nonrivalry) design. In the "observed abusive supervision" scenario, a professor criticized and ridiculed a student's proposal; in the "observed nonabusive supervision" scenario, a professor criticized the student's proposal in a constructive way. In the "rivalry" scenario, the participant were instructed to imagine a long history of competing with the student being criticized in multiple contexts (and no history of competition in the "nonrivalry" scenario). Participants completed surveys that measure the key variables in the model, including control variables (belief in a just world; emotions of contentment and fear). Results from ANOVA and a bootstrapping analysis provided support for Hypotheses 1 and 2.

Study 2:

The researchers conducted an onsite survey at a state-owned bank in China. Participants were 140 frontline employees from 31 work groups. The researchers collected round-robin data in two waves in which group members rated all other members of their groups. The survey measured observed abusive supervision, perceived rivalry, group cooperative goals, *schadenfreude*, and interpersonal destructive behavior, as well as a number of control variables. Results from multi-level analysis provided support for Hypothesis 1, 2, 3, and 4.

Study 3:

The researchers conducted an onsite survey at a large chemical company in China. Participants were employees from different departments. The data were collected in two waves using the same design as in Study 2, from 405 employees in 90 work groups. Other than measuring the main variables, the researchers also measured a series

of control variables such as belief in a just world, moral identity, and the third party's leader-member-exchange relationship with supervisors. The results provided support for Hypothesis 1, 2, 3, and 4.

Conclusion

Together, the three studies suggest that when there is high rivalry between the observer and the victim, observing abusive supervision of the victim may activate the observer's "evil

pleasure" (schadenfreude). This then leads the observer to engage in interpersonal destructive behaviors, such as undermining, incivility, and deviance from interpersonal norms, targeting at the victim as a way to reinforce the observer's comparison advantages over the rival victim. However, having highly cooperative group goals may hinder observers from engaging in downward comparisons with the rival victims and, thus, may reduce observers' experienced schadenfreude and destructive behaviors toward the victims. 

Managerial Implications

We already know from previous studies that abusive supervision exerts a destructive force on the targeted employees. This study showed that abusive supervision also can deteriorate coworker relationships by activating some observers' evil pleasure and destructive behavior toward the targets of abusive supervision. Organizations, therefore, should be aware of the profound effect of abusive supervision on coworker relationships within work groups and take actions to reduce abusive supervision at work.

Organizations are fertile ground for cultivating rivalry among employees. Managers should be alert to the possible detrimental effects of interpersonal rivalry. Although rivalry has been found to promote greater work effort, it also has been associated with irrational decision making and unethical behaviors. Findings from this research demonstrate the

detrimental role of rivalry in spreading the destructive effects of an abusive supervisor. Therefore, a big challenge faced by organizations is how to benefit from the positive effects of competition at work while minimizing the negative side.

This research suggests that one way to counteract the detrimental effects of interpersonal rivalry is to establish and reinforce group cooperative goals. The researchers found that observers' malicious reactions toward abusive supervision of rival coworkers can be mitigated if the group has highly cooperative goals. This may provide a way forward for organizations to continue to reap the benefits of competition while reducing mistreatment among coworkers. Managers may cultivate a harmonious work climate, implement interdependent goals among team members, instill the concept of a shared identity, and enhance members' identification with and attachment to the group.

This summary is based on the full article, "The 'Evil Pleasure': Abusive Supervision and Third-Party Observers' Malicious Reactions Toward Victims", *Organization Science* (2020 online first). Erica Xu (erica_xu@hkbu.edu.hk) is an Assistant Professor at the Department of Management, School of Business, Hong Kong Baptist University. Xu Huang (xuhuang@hkbu.edu.hk) is a Professor at the Department of Management, School of Business, Hong Kong Baptist University. Rongwen Jia (jjarw@uibe.edu.cn) is an Assistant Professor at the Department of International Business and Cooperation, School of International Trade and Economics, University of International Business and Economics. Jane Xu (janexu422@gmail.com) is a lecturer at the School of Business Administration, Zhejiang University of Finance & Economics. Wu Liu (wu.liu@polyu.edu.hk) is a Professor at the Department of Management and Marketing at the Faculty of Business of Hong Kong Polytechnic University. Les Graham (l.n.graham@durham.ac.uk) is an Associate Professor at Durham University Business School, Durham University. Ed Snape (deanbus@hkbu.edu.hk) is a Professor at the School of Business, Hong Kong Baptist University. The rewriter Isabelle Yi Ren is an Assistant Professor of Management at the Feliciano School of Business, Montclair State University.

Executive Perspectives



COSTCO
WHOLESALE

About Costco: Based in Issaquah, Washington, Costco is the third largest retailer in the world, ranking #14 on Fortune 500. As of 2020, Costco's sales reached USD 163 billion, with its market value rising to USD 169 billion and a net profit of USD 4 billion. Costco employs 273,000 brilliant people globally. In 2019, Costco opened its first Chinese warehouse in Minhang, Shanghai.



Xiao-Ping Chen

Professor of Management,
Foster School of Business,
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James Murphy

Executive Vice President and COO,
International Division of Costco

How Did Costco, the Cheapest and Happiest Company in the World, Succeed in Foreign Markets?

Twenty years ago, when I moved to Seattle with my family, I was surprised to see that many of my colleagues were shopping at Costco, a place they had to pay membership fee to get in. Fast forward to today, I have been converted into a loyal member of Costco for 15 years and we shop there almost once a week. It even happens when we travel within the U.S., no matter it is Hawaii or Alaska, we will definitely go to Costco once, as visiting an old friend.

Reflecting my own experience as a customer, I could see how I changed my view of Costco over the years. The most important reason is the guaranteed high quality and low price of the goods and services it provides. Economically speaking, the amount of money I save from refueling my car can already cover the membership fee several times, not to mention other benefits like the travel packages it offers. The second reason is its focus on customer satisfaction, trying to help customers save money by setting its profit margin to 14%. This assures me that Costco has the customers' best interest in mind. More importantly, I like how Costco takes care of its employees, who are not only paid well and enjoy good benefits, but also have many growth opportunities. About 85% of the managers are promoted from within. This is why

Costco has happy and passionate employees, and such happiness is contagious, which is also a reason why I love shopping at Costco. No wonder Costco was dubbed "the cheapest and happiest company in the world" by BusinessWeek (2013).

I have been secretly hoping that Costco can open its warehouse in China so my family and friends there get to enjoy Costco's service and products. When I learned that Costco partnered with Alibaba's T-Mall a few years ago, I was excited. So when Costco finally opened its first Chinese warehouse in 2019, I was super happy, although it was 36 years after Costco opened its first warehouse in Seattle in 1983.

Why did Costco have such patience to wait for 36 years to enter the gigantic Chinese market? Especially after it opened a total of 115 warehouses in Japan, Korea, Australia, New Zealand, the UK, France, Spain and Iceland, and another 141 warehouses in Canada and Mexico? How does Costco develop its global strategy? What do they do to make sure that every warehouse will have sustainable success? With these questions, I interviewed James (Jim) Murphy, the Executive Vice President and Chief Operating Officer - International Division of Costco.

Xiao-Ping Chen: Hi, Jim! As head of Costco's internalization, you have participated in the opening of every warehouse outside North America (i.e., Canada and Mexico), and have accumulated rich experience in international business. It is a great honor to interview you today. I know you guys are super low key and very unassuming, and rarely take interviews, so I feel very fortunate to have this opportunity. Earlier this year, when I invited you to my MBA classes to share Costco's experience in internalization, you mentioned that when you first opened a warehouse in Japan, it actually took several years to make a profit. To me it is incredible to have such patience to turn things around in a new market. How did you adapt to the new consumers and culture in Japan?

Jim Murphy: In general, we discovered that it's a very large market, and we have a sense early on that our offer was not quite at the standard that needed to be. What we've learned is that people are looking for some American brands more than just a mix of American products. Because Costco has a unique cachet about quality and American products, we needed to capitalize on that more.

We learned a lot in that process, and we knew that in going to new markets around the world, we needed to do a better job in the early stages. And it just took a period of time for people to adapt to our style of merchandising, like large package sizes. The quantities of our products themselves don't necessarily fit small houses or small storage spaces, so people had to get creative on how they shop with us. Now you'll see many times that three ladies around the shopping basket with three beautifully dressed children. They all shop together and then divide up the items. Muffins are a great example. We sell a pack of 12 and everybody gets four. So they think



about how to use us even in those situations. Small businesses, restaurants, and daycare centers, however, always buy in bulk anyway, bulk rice, bulk oils. Everything they need to run their businesses always come in big size, so they understood. It took several years of testing, observing, and reflecting to truly understand how to do business there.

Xiao-Ping Chen: That's right, testing, observing and reflecting is very important. I think what's really interesting here is that in this case, it's the Japanese people who adapt themselves to Costco's style, rather than the other way around. This is quite remarkable.

Jim Murphy: Yes. Just in terms of our expansion, we tried to find markets where our model will work. And along the way we know we need to tweak things, particularly around fresh foods, for example, more fish, more sushi, those types of things work better in Japan. In this way we gradually shape a useful operation model. Another obstacle we met in early stage was that the local Japanese businesses had a totally different distribution model from ours.



They had many intermediaries, so products had to go through many ‘middlemen’ before getting on shelves, but we link customers and suppliers directly (like today’s platform businesses). Consequently, we were resisted by intermediaries, and they hindered us from getting products directly from the suppliers. We made a lot of efforts to overcome this problem.

These early years of learning actually helped us improve our ways of evaluating a new market. We now use 20 some different variables to do that, like the market size, the spending power, to define the total addressable market, and then we go down and consider politics and legal systems, labor cost, all the things associated with running a business.

**Costco’s Expansion:
The Organic Growth Model
Sets Itself for Success**

Xiao-Ping Chen: You mentioned that Costco adopts an organic growth model in entering a new market, which is great and very unique. Many companies enter a new market through

acquisition, joint venture, franchising, etc., and often send many expatriate managers to take on key positions. In contrast, for each new warehouse, you only send three or four experts from the headquarter, and hire locals for all other positions. In this case, how do you make sure that the Costco core values are executed with a localized team in HR practices, goods selections, and supplier relationship, etc.?

Jim Murphy: It’s actually three to four experts to start a new market, but not a warehouse. In Japan, there were three or four, and we had four in Australia. Everybody else, including the managers of our warehouses, they are all local. In an organic model, the most important part is to hire everybody else locally.

It’s a concept that has worked well for us over the years obviously, and very comfortable because the people that go over there from either the U.S. or Canada or the UK or any other country, they have a very deep knowledge of the business and particularly our company’s culture and how we do things. It’s important that they know what to do and how to do it, and when they hire the local people, they build that

Costco culture together. Then as time goes on, that expands. We learn the country's culture at the same time. We understand by working with these local people how to do business, what will work. We take advice and learn together. The new employees that are local learn our company culture, and we learn the culture of the new market. Mutual learning is very, very important for our development.

Why choosing the organic growth model? Because we are not in a real rush to rapidly expand. We've got enough time that we can grow the business and culture together.

Xiao-Ping Chen: This is truly remarkable. How do you select these three or four expats for a new market? Are they always the same people, or different people? What are the main criteria you use in choosing these people?

Jim Murphy: We first select a market country manager, and that person comes from the

operation side typically, being very well trained and having a lot of experience and success in running multiple locations. The operation experience is very important. He needs to know a bit of marketing, a bit of buying, a bit of human resource, and understand how to manage the business at a high standard. The execution of our models is very important to us, got to be the standards and the right quality.

Then we'll select a head merchant, a head buyer, that comes from the buying side of the business, either in North America or the UK or any other country that's qualified. That person understands the buying philosophy, which includes quality first, the packaging requirements, the efficiency with the supplier, and efficiencies throughout our business. That person can teach the buying philosophies to the new team. The third person is generally from the accounting or finance area. He/she can understand how we account for goods and how we move goods, and what we are looking for in terms of gap reporting



and all the things that are important to us from the financial and accounting side. Sometimes that's the third, but oftentimes it's another head operator, somebody that will support the country manager. That person has a lot of operational experience in running warehouses, maybe not to the same level as the country manager, but certainly well-steeped in how to run our business, hire people, train people, all components of the operation side of the business. Today the three or four experts are coming from a variety of different countries.

Xiao-Ping Chen: So normally these people will have been working in Costco for more than 10 years?

Jim Murphy: Yeah, 10 or maybe more. We have a lot of long-standing employees. Being in a new market also provides many opportunities for people to have the upward mobility, better than their opportunities in the U.S. or their home country.

Xiao-Ping Chen: I'm also wondering that when these three or four people recruit the local people, what are the main criteria they use in selecting the right people to join Costco?

Jim Murphy: We like people that are self-motivated. We think that if people are going to inspire others, they need to be self-inspired. So we like happy, friendly, outgoing people. We like people who can get along well with others, because it's a very intense people business. Of course experience and backgrounds matter, but we can teach most things in our business. It starts out with somebody with the right mindset, the right attitude, and self-motivation. We look for people that have had the opportunity to go to

school in many cases, like Chinese or Korean or Japanese people that have studied in the U.S., who are looking to go back to their home country and work for a company like ours. We spent a lot of time recruiting, and we've got some great candidates from the University of Washington, happy to say. They are all self-motivated and friendly and have a great outlook on life. So I think those are the initial criteria. Certainly, past experience is helpful, particularly for the first person that we hire in a team, because these people are generally the one in the highest levels, either in buying or in operations. So we'd like to see their backgrounds, who truly have at least a base of experience.

Costco's Mission: Continually Provide Our Members With Quality Goods and Services at the Lowest Possible Prices

Xiao-Ping Chen: I also remember that you give a lot of autonomy to the local warehouses, right? How do you assure that the local warehouses have sufficient autonomy in running their business, but at the same time doing it in a way that is consistent with the core values of Costco?

Jim Murphy: I guess to answer that, you need to understand our basic mission statement, our basic code of ethics, and how we run the business. When we put these experts in place, they fully understand the mission of the company, the code of ethics and how we run the business day to day. So when we open up a new market, it's their responsibility to continually teach that to the people that we hire locally, and reinforce that message throughout our daily operations.

It's a very simple mission statement, which is

to continually provide our members with quality goods and services at the lowest possible prices. We also have formalized orientation training sessions. Every couple of years we have a large meeting, and people will talk about our mission statement and code of ethics. We transfer our culture by reinforcing these messages. On a formal basis there's a structure, and on the informal basis, it's living the beliefs, it's walking the talk, it's operating our business day in and day out, which is more important. When we are challenged on a moral issue or ethical issue, then we know where to go, we know it's okay for people to do the right thing.

Now it comes to autonomy. We allow a lot of freedom locally to hire people, to buy locally, to make business decisions locally, to the extent that they stay within the boundaries that we've defined. The trick for us is getting the balance between centralized control and localized control right. We hope everybody gets an entrepreneurial spirit, and take personal pride and responsibility, then grow the business. If everything is directed from the home office, it's too much responsibility. Our secret is to keep the balance, which is also my main job.

Xiao-Ping Chen: That's great! So, more concretely, on the product side, what is the percentage in terms of Kirkland Signature products versus local, unique products?

Jim Murphy: We look at it in a couple of different ways. We look at imported items versus local items, and generally it's about 65% local and 35% imported.

We don't want to be completely U.S., we need food that tastes different, Mao Tai for example. Chinese people come to Costco for Mao Tai and it sells very well. This strategy works in

an internationalized company. We also leave a lot of item selection to the local markets, but products like Calvin Klein jeans are popular around the world. They make it a brand name. As for Kirkland Signature you mentioned, the percentage coming into our foreign markets are lower than we have in the U.S., because of ingredients or other restrictions that don't allow them to be introduced to the market. Not everything can be just loaded onto a truck and send to a different country. There are different regulations, particularly around food, vitamins, and supplements. But 65% local, 35% imported is about the right average.

Xiao-Ping Chen: You mentioned that you have this monthly in-person meeting with people from all over the world gathering in Issaquah, which is truly fascinating. This meeting will allow people to learn from each other, and about different methods, different markets, different products, successful or unsuccessful practices, which are very important for decision making. At the same time, it is also pretty costly. So why are you doing this? How do you run such meetings?

Jim Murphy: I found it very unique also in business to have these monthly meetings. We learn from each other about merchandise, what works, what doesn't. A bow tie from Los Angeles may sell very well in Australia or different places. We find Iberico ham from Spain, or Kirkland Signature seaweed from Korea to share around the world, making our business more interesting, more successful.

There are plenty of reasons to do it, and I still find it unique. One of the other aspects of bringing everybody together is a shared sense of ownership and togetherness in the business. Not only do we share, but we also put our numbers



up in front of our CEOs, our expenses and our profits, and how we compare to the plan. We do that in front of everybody else, so there is a peer responsibility, you don't want to look bad.

In fact, it's a unique side product of this monthly meeting. Yes, financially it is expensive, but there's nothing in our mind can replace the face-to-face contact. There are a lot of conversations, as well as camaraderie and joint culture building that go on. We call it the budget meeting, taking a day and a half. We also replicate that in every country. The UK will have a monthly budget meeting, also Australia. We do it locally as well as centrally.

Xiao-Ping Chen: I see, it's super important, and also another way of reinforcing the Costco culture. Have you thought about changing the location, like from time to time?

Jim Murphy: We have, and it's a great idea in

principle. But in practice, all our resources are here, the legal department, the central marketing function, the central HR function. All these people that do some of the presenting at the meeting are based here. So it will become even more expensive to take it to another country. But for my group, all of the country managers, about 10 to 12 people, we are going to do that. It enables us to see the local market in person and stimulates more ideas.

Costco in China: Learn to Walk Before Running

Xiao-Ping Chen: I understand that you normally consider 20 variables in deciding where to open a warehouse, and so far you have not opened any in Germany. How did you finally make a decision to open one in Shanghai, after assessing the Chinese market for more than 10 years?

Jim Murphy: Well, we'd love to be in Germany, but it's a very complicated country. It is the second largest country in Europe after Russia, which has great disposable incomes and all the things that meet the criteria. But the first thing we need is the planning permission to open large food and non-food business. And it is very competitive in German market, particularly in the food business. They have not only very well-run large supermarkets, but also a lot of small discount supermarkets. They do a terrific job on a limited SKU basis, with very, very sharp pricing, and very high quality. They also have their private labels.

As far as Shanghai, there's plenty of terrific markets in the country. It has been 20 years when we had a national business license, and we have studied the Chinese retail industry for,



I think, 17 years actually. We figure that many companies had come in with big hopes, and then most of them are gone. For example, Carrefour was sold to Suning, Metro was recently sold, and Tesco. The list goes on and on. We are a very conservative company, so when we move into a market, we are very deliberate on where to go and compare all the major markets.

In China, we focus on the areas that we thought we'd be most successful first. China is a big country, and we spent a lot of time in Beijing, Guangzhou, Shenzhen. We thought that Shanghai would be a better fit for our first entry. We were trying to build out a section of the country at a time, which we call districts or regions, so we choose greater Shanghai.

Suzhou, Pudong, and Minhang are where our first three locations are. If we cluster them together, it's easier to manage. We can also learn and train people in each other's location. We are certainly interested in Beijing, Shenzhen, Guangzhou, and all the major markets. But if we just plan the warehouses all over the country, it's difficult to manage. Logistics are a concern too.

Xiao-Ping Chen: My colleagues in Shanghai shared with me three concerns regarding Costco in China. First is that the big package model may not suit the needs of China's small family size. Chinese families usually have only one kid. The second concern is that the products are mainly standardized, not many novel products available.

The third one is that they cannot buy Costco products online, whereas Sam's Club has already adopted the online-offline model, through which customers can buy everything online, which is more in alignment with Chinese consumers' shopping habits, because everyone is shopping online today. Have you thought about changing some practices to meet the needs of local consumers?

Jim Murphy: Yes, but we like to learn how to walk before we run. We want to open in a couple of locations and develop our buying teams. You are right, we need more unique items, but the problem is figuring out how to get those unique items in. Sometimes there's ingredients, packaging, labelling and many problems in importing products. We've always loved the uniqueness of our business model, particularly food items from the U.S. that people are interested in. So we've got a long way to go to keep that uniqueness up. The Kirkland Signature you mentioned is very well accepted, so we can get many things in with a Kirkland Signature brand. But it's not everything obviously, there are restrictions on, as I mentioned, vitamins and supplements. There are lots of complications around that, and it just takes time, but we'll get there. That's part of the learning process when you first open a new market. But we've been very well received with large packages. We sell 12-pack French croissant, and we need to fill extra ovens to keep up with the demand. Huge packages of cookies and beef are very popular. The beef comes from the U.S., which is USDA Choice or USDA Prime. And we sell high quality Australian products as well, all in bulk packages. So the packages don't seem to be the problem. We just got in 24-pack kiwi, even larger than the package in the U.S.. Whether it's Washington

state cherries or other products, all these things are in Costco sizes and so far so good. Partly because we choose the right market, they are very well accepted.

The other part of the question was around E-commerce, where apparently China is way ahead of the U.S.. In our business in China we've got electronic memberships, and you can pay with your cell phone and manage on related Apps. We use three methods of payment, Ego, WeChat and Alipay. But we don't have any logistics in place to support an e-commerce business. We've got a brand new buying team, brand new buyers. They are just learning how to buy for the brick and mortar business. When we develop more warehouses, we will have logistics and more expertise in our buying steps to support e-commerce. It's a natural progression for us. There's an orientation to have that, it's just a matter of time. Meanwhile, some people love shopping with us in warehouses, they love to feel the excitement in this great big beautiful location, all on one floor, so you don't have to go up or down.

It's a lot to ask people to pay a fee to shop. You mentioned Sam's Club, they follow the e-commerce of Walmart. At first they did on their own, and then they switched to JD. I think that's a great thing for both JD and Walmart. But you know, Sam's has been in China for 25 years. And Costco has been there for one year. We will get to e-commerce eventually.

Xiao-Ping Chen: Excellent. Another question is, are you encouraging local innovation, and what are the strategies you are developing in attracting new members and retaining existing members? Membership is extremely important for Costco.

Jim Murphy: Yes, usually a large part of our profits comes from membership. The best thing that we

can do now is to execute our business model to the highest levels we can, like maintaining standards in cleanliness, hygiene, service, and the general maintaining of the facility. Make it at the highest level, not only get to that level but maintain it over time. The secret to our retail success is executing the business model to a highest level, so that's why it's so important to take care of our people and keep them long term, because they become very skilled at maintaining that high level of operation.

That's true with the buying side too. Give the best items at the best prices and move it through the system as efficiently as possible, so we can lower the price. People shop with us not because they like us, it's because we have great merchandise at great prices, which really delivers the value of the model. But it's not okay to have great value in a dirty environment. The best thing we can do to market the business is the word of mouth of the members that shop with us, because what they tell their friends is most trusted, much better than us advertising or marketing. Particularly in China, people don't necessarily trust the news media or the advertising as much as they do each other and their family members and friends.

Costco's Success: The Recipe is Simple, But the Execution is Difficult

Xiao-Ping Chen: *Would you summarize the secret recipe for Costco's success around the world, and your advice to our global managers?*

Jim Murphy: When I think about our business in our home country as well as in our various markets around the world, I think it's the business model itself, which really has a unique ability to deliver value. Quality merchandise at great prices

is what our business is based on. If we don't have one or the other, it doesn't work. So the business model in its design is simple and clear, and the value proposition is there. Even in markets that we only have one location, we can still deliver value through the way we operate. That's really important. Of course the membership fee offsets the cost of doing business at low prices continually, and we have different strategies to reduce costs in the business model.

The second thing, and probably equally important is the company's culture, the idea of taking care of the members and looking after their interests. They pay a fee to shop with us, and they deserve great quality merchandises at great prices and great standards. So take care of our members, stand by our merchandise, guarantee customer satisfaction, and the membership fee is guaranteed. Meanwhile we take care of our employees along the way, let them learn how to do their jobs really well, so they stay with us and build their careers together. Even more, they have their family members work with us. And look after the suppliers' needs and develop long term relationships, rather than just one off transactions. Pay our bills on time to our suppliers.

It speaks volumes for how the company was designed to operate. We want to do business with our employees, our members, and our suppliers. Those operating principles form the basis of our company's culture, and together they may contribute to our success. Growing organically is a conscious decision and that's very effective. We know where we are not coming in and try to stick to the culture in a new market.

Xiao-Ping Chen: *They all sound pretty simple. If one just need to stick to these simple principles and do a good job and can be as successful as Costco,*

how come this business model is not imitated?

Jim Murphy: That's a great question. When looking back to our history, we started as the "Price Club" in San Diego with the family name of Sol Price. It was based on the European cash and carry model, namely warehouses with cash registers. They sell products very inexpensively, because you have low overheads, and if you charge membership fee, it will further reduce the overheads. So the concept sounds good, but not many people had good appetite for low margin business. Because it's a very low margin business, you have to have a lot of disciplines in how to run the business and cost control, and everything that contributes to lower, lower costs, and lower, lower prices for members. Not many retailers have that appetite. They look at a piece of merchandise and think, "how much we can get for this?", whereas we look at that same piece of merchandise and think "how little can we charge for that?" Our business logic is different.

Xiao-Ping Chen: Ah, that's it! Huge difference in business logic.

Jim Murphy: When we first started Costco, like in the mid 1980s, there were many competitors, probably eight in the United States alone, but none of them could figure out how to do it. Today we have Sam's and BJ's. BJ's is at east coast and Midwest primarily. It is different from Costco, but both charge a membership fee and they've been fairly successful. Sam's club is also in Mexico and China, and some warehouses in Brazil. But after coming into China, we see Hema owned by Alibaba. There is also Wumart who bought Metro. I think they would like to have this kind of model too. Metro is slightly different from Costco, no membership fee but house with cash

registers, primarily for small businesses. They are based out of Germany and getting globalized. There are competitors even in South Korea. Emart developed a concept called "traders". "Traders" is a warehouse with no membership fee, but they have a similar format, big packages and boxes. They are imitating. But I'm not sure that any are successful.

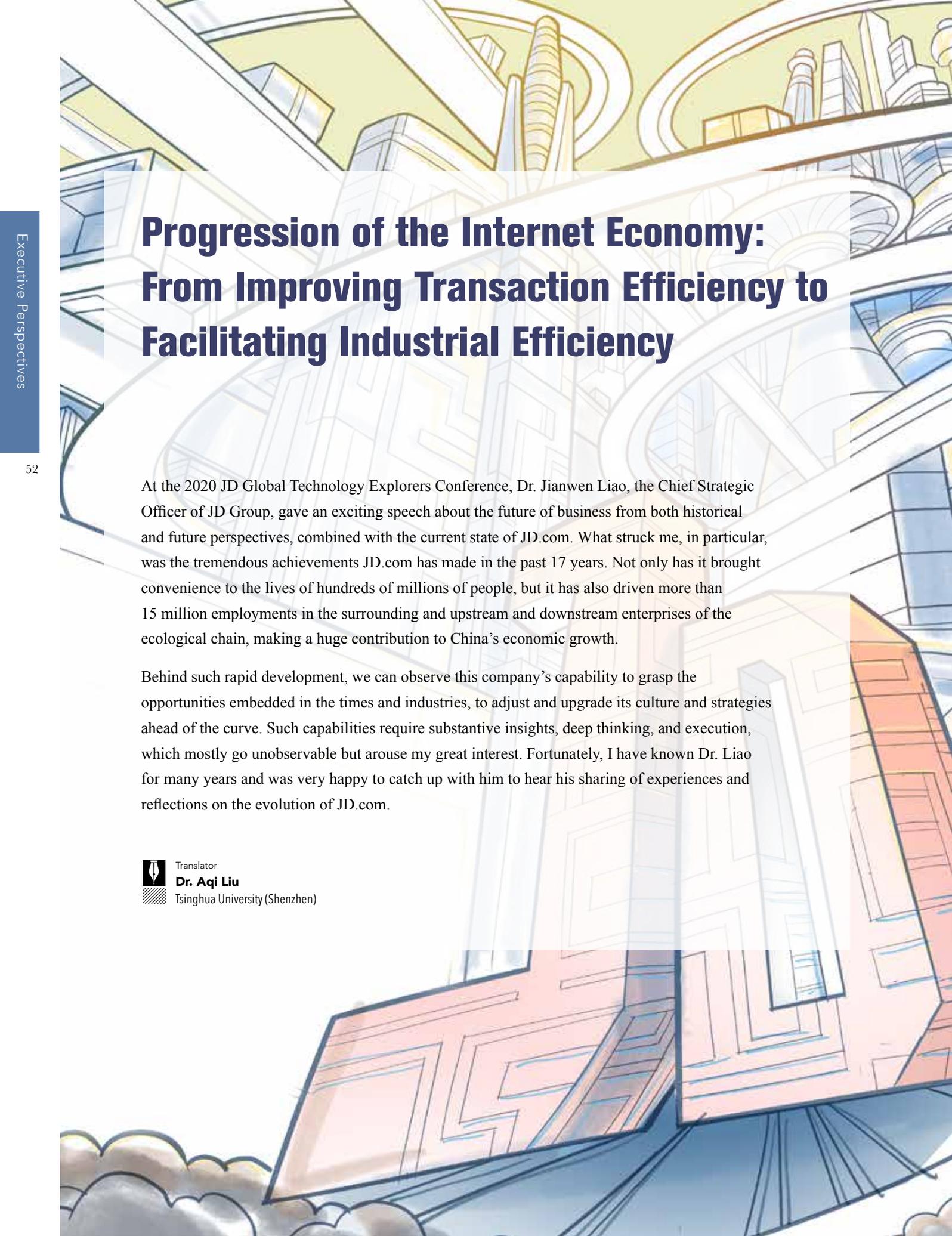
Xiao-Ping Chen: Do you think the problem is in the execution?

Jim Murphy: It really is, and it goes back to the culture, and taking care of people as well. It's not rocket science, but not many people can get it. I mean it is a simple concept, and we really spend a lot of efforts, trying to keep it simple. Because as you get big, lots of rules and compliances and many things will come into play. Distill it down, make it as simple as possible, and hang on to a small set of core principles really has been helpful.

Xiao-Ping Chen: Yes, I totally get it. You have been in this business for more than 20 years, do you have any advice to global managers?

Jim Murphy: The advice is to, I guess, treat people fair, be respectful, and be compassionate. Sometimes people can let arrogance and hubris slip in, and it's not helpful, not long term at least. As for business management, I like the organic growth model, I like the cognizant balance of centralization and decentralization, because I think it is equally important to building the teams locally and to building the entrepreneurial nature of the business.

Xiao-Ping Chen: Thank you so much, and I really think you embody the Costco values. You walk the talk, and you are so real and so great. ☑



Progression of the Internet Economy: From Improving Transaction Efficiency to Facilitating Industrial Efficiency

At the 2020 JD Global Technology Explorers Conference, Dr. Jianwen Liao, the Chief Strategic Officer of JD Group, gave an exciting speech about the future of business from both historical and future perspectives, combined with the current state of JD.com. What struck me, in particular, was the tremendous achievements JD.com has made in the past 17 years. Not only has it brought convenience to the lives of hundreds of millions of people, but it has also driven more than 15 million employments in the surrounding and upstream and downstream enterprises of the ecological chain, making a huge contribution to China's economic growth.

Behind such rapid development, we can observe this company's capability to grasp the opportunities embedded in the times and industries, to adjust and upgrade its culture and strategies ahead of the curve. Such capabilities require substantive insights, deep thinking, and execution, which mostly go unobservable but arouse my great interest. Fortunately, I have known Dr. Liao for many years and was very happy to catch up with him to hear his sharing of experiences and reflections on the evolution of JD.com.

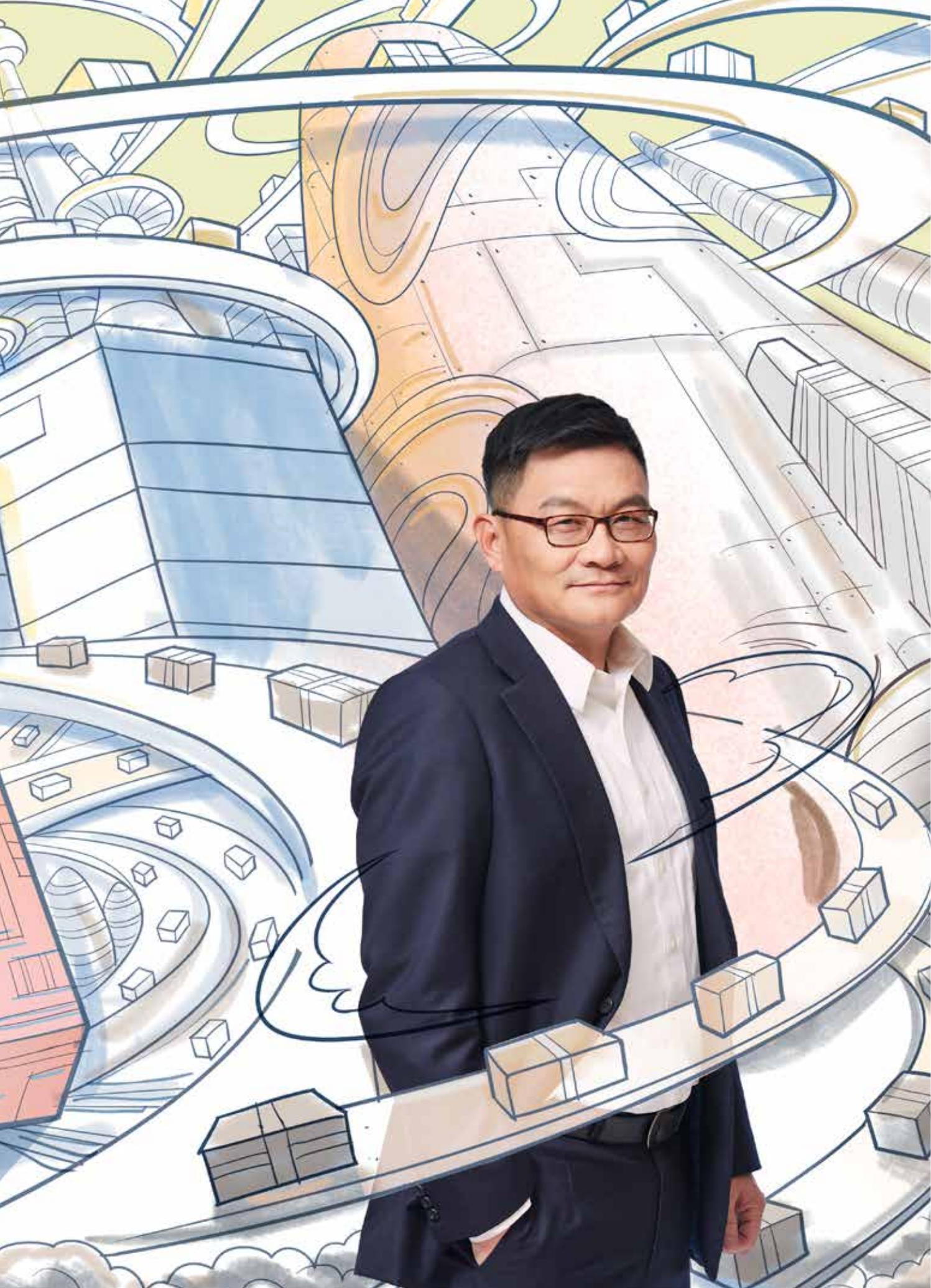


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Xiao-Ping Chen: Hello, Jianwen! I remember you once said, “The infrastructure of the next era was built upon the first half of the Internet, indicating that all industries will reach an inflection point and suddenly face discontinuous changes, wherein you cannot reach ‘the new continents by relying on the old map.’” I found this statement very insightful. Can you explain the successful listing of JD Health from this perspective? Did you use a new map? If so, what kind of new map is it?

Jianwen Liao: OK. Before talking about JD Health, let me put JD back into the larger industry background rather than focusing on itself. We say that the first half of the Internet has improved transaction efficiency through effective matching between supply and demand so that consumers can better find satisfactory products and services. It focuses on the end of the value chain, that is, how to satisfy consumer needs. In this sense, the first half of the Internet has aimed to increase the efficiency of a traffic-driven transaction. However, many changes will happen in the second half because the increase in transaction efficiency will reach a saturation point. Now, this point is coming.

Meanwhile, we can observe that the technology-driven industrial changes are moving from the

transaction side to the supply side. Especially, the technological revolutions, driven by artificial intelligence (AI), Internet of Everything (IoT), blockchain, and 3D printing, gradually move their foci from transaction side to the upper stream of the value chain. From the perspectives of industrial development trends, especially digital transformation, the entire internet industry needs to shift strategic focus from the “Consumer Internet Stage” that heightens transaction efficiency to the “Industrial Internet Stage” that centers on improving the overall supply efficiency.

Looking back to the retail industry and JD, you will find it interesting that JD’s business model is different from other e-commerce companies in the first half of the Internet. We adopted an integrated and centralized model, featured as an enormous open shelf space with a supply chain behind it. However, the centralization began to collapse in the second half, substituted by decentralization and fragmentation. Typical scenes of fragmentation include content e-commerce, social e-commerce, and live streaming/broadcasting. Meanwhile, the brands also become fragmented. Many years ago, a shampoo from P&G could take the lion’s



share of the market, which is impossible now. Overall, fragmentation happens everywhere. In this scenario, the traditional centralized model that emphasizes the aggregation of people, merchandises, and context will be subject to grand challenges in the context of fragmentation.

Why do I say that JD is different from other e-commerce companies? Because we have actually engaged in the Industrial Internet in the first half of the e-commerce revolution. Specifically, we started to build a logistic system since 2007 to ensure the efficiency of the supply chain. Now, we must upgrade the supply chain as a response to the second half of the e-commerce revolution. That means that the fundamental logic that has not changed in JD's operation is the supply chain logic.

Regarding the notion of fragmentation, we face the problem that the centralized model

cannot offer timely responses in the fragmented scenes. Conversely, it is also difficult for fragmented players to build a retail infrastructure with heavy assets and network effects.

In the past few years, we have gradually figured out a logic that would help JD to solve that problem. JD must move from a vertically integrated model to become a vertically disintegrated open model, which is quite interesting. Theoretically, a vertically integrated model can be cost-efficient as long as the value chains are coupled and every step is under control. However, such a strongly coupled model is not agile enough because the fast-changing environment requires each component of the value chain to make quick adjustments and effective adaptation. Therefore, a proper way is to separate the whole value chain into individual open platforms, with agile responses and swift

combinations, to offer better service in various scenarios.

Xiao-Ping Chen: So JD's logic is to open every component in the value chain and upgrade it into an open platform. Then, the company can be proactive by connecting the various small boats to the big platform to serve them.

Jianwen Liao: That's correct. In this sense, our core business – JD Retail – becomes a big KA (key account) in the open platform. For example, in the past, our logistics system only served our own retail business. But now, JD logistics can offer services to other companies. This way, JD Retail becomes one of its customers, rather than the only customer; thus, the enterprise logistics service is turned into a logistics enterprise. After a few years of operation, its revenue from outside companies has exceeded 50%.

We have formulated this strategy from 2017 and called this logic "Retail as a Service" (RaaS for short), which consists of two parts: RaaS = retail + retail infrastructure. As an e-commerce company, our core business is retailing. Yet, we emphasize the value of our retailing infrastructure by making it an open platform that can offer services to other small businesses.

Xiao-Ping Chen: Retail as a Service (Raas) makes me think of another word, SaaS (Software as a service).

Jianwen Liao: That's right. SaaS is about cloud service, also indicating an open platform. We borrowed that concept to propose RaaS because we need to become more open. Our retailing business is enabled and empowered by retailing infrastructures. Going back to JD Health, as you mentioned initially, it also becomes an open



infrastructure, similar to the logistics system. In fact, many business units within JD Mall are becoming more and more open.

The Logic of JD Health: Opening Up the Internal Businesses

Jianwen Liao: JD Health is a very interesting case that reflects an important thinking. I've been thinking about a question: While retailing means selling goods, it would be more important to sell after-sale service. For example, a refrigerator retailer can also provide services like installation and maintenance. Similarly, there should be a huge demand for human health services beyond the sale of health-related goods.

JD Health offers two drug-based services.

One is JD Pharmacy, and the other is Yaojingcai. JD Pharmacy is a B2C drug retail service, including online and offline pharmacies and home delivery services, while Yaojingcai offers B2B services to offline drugstores. These drugstores are akin to convenience stores that require high-quality value chain services, and Yaojingcai aims at their demand and offers procurement services for these stores. In this sense, JD Health has both 2B and 2C platforms. Based on these transaction-based platforms, JD Health moves upstream by inviting doctors to provide diagnosis services in this platform, thereby establishing a close loop of “goods plus services” in the health industry.

Furthermore, based on the diagnosis services from doctors, we can extend our business to comprehensive medical solutions, such as chronic disease management, and JD Health will become people’s health housekeeper. To achieve this goal, we need to cooperate with more hospitals and doctors. In the future, we can imagine that medical robots can provide many services. Therefore, JD Health has grown from goods circulation to diagnosis and eventually will evolve to health solutions.

Xiao-Ping Chen: In this sense, JD Health has established a small independent ecosystem that provides complete health services for the public.

Jianwen Liao: Yes, that’s right. Why did we spin it off? Because it represents a solution rather than merely retailing. However, this solution still shares a common infrastructure, ranging from the network traffic to logistics service, offered by JD. The logic of infrastructure is related to today’s topic, strategic transformation. Our business has evolved from merchandising to services and finally to technological services, which is our

central logic.

Except for JD Health, other businesses such as JD Industrial Products have experienced a similar process. Previously, we had a well-developed industrial MRO (Maintenance, Repair & Operations) unit in our retail business. Meanwhile, we invested in an external MRO firm called Gong Pin Hui. We then extracted JD’s MRO business and merged with Gong Pin Hui to establish an independent JD Industrial Products, which operates very well. In addition, our second-hand commodity business – Paipai – was divested and merged with Love Recycling (Ai Hui Shou). Then, this firm has grown into a unicorn and one of the largest mobile phone recycling platforms. It successfully went public in the US last June, with a new name Wan Wu Xin Sheng.

Of course, the listing of JD Logistics reflects one aspect of infrastructure division. The former cases, such as JD Health, JD Industrial Products, and Loe Recycling (Ai Hui Shou), all represent such a separation process of JD Retail, talking another form. I think the process of JD’s division can answer your question – why we consider the industry to reach an inflection point and why we must open up in the second half of the Internet era.

Xiao-Ping Chen: Awesome! You answered my question from the industrial background and JD’s vision. It seems that JD has endless potential to generate independent businesses. You mentioned several successful cases that grew out of JD Mall, creating independent ecological systems, and going public. Since there are many different categories of goods and services in JD’s system, does it mean that they all have the potential to replicate this division process?

Jianwen Liao: No. We have been very cautious because the logic is not based on category of

goods but on business models. That said, the centralized arrangement did not align with the changing business model. For instance, the health business is a service, not a commodity transaction. These two are completely different business models. Relatedly, the infrastructure behind our business (e.g., the logistics) and other industrial products are serving other business clients rather than individual consumers, indicating a different business model. Therefore, the business model is the first prerequisite for classification.

Second, it is interesting that we usually do not have strong competitive advantages in the separated business sectors, such as Industrial Products (MRO) and recycling business (Ai Hui Shou). Therefore, we extracted them out, found stronger partners, and then absorbed their capabilities as our own. The third rule is the neutrality position. A business will serve all external businesses once it becomes an open platform. When the logistics unit was JD Logistics, it was part of JD and only served our own retail business. However, when operating independently, we must ensure that the logistics platform is fair and neutral to offer high-quality service to all customers beyond JD. Only through this way can an independent business obtain higher prospects for future development.

JD's Cultural Values and Strategic Upgrading Are Complementary to Each Other

Xiao-Ping Chen: That's great! I have also noticed that the cultural values and corporate strategy of JD have been constantly updated and upgraded over the years. You have just explained the changes in corporate strategy very thoroughly.

Now I wonder how JD's cultural values evolve and the relationships between corporate culture and strategy. Do cultural values come before strategy or the other way around? Or do they influence each other? Please help us sort out this question.

Jianwen Liao: JD.com is a strongly value-oriented company, which derives from the founder's ideology. We have iterated several versions regarding corporate values. For example, the core values of JD in 2013 are "Customer first, Integrity, Teamwork, Innovation, Positivity, and Passion." When we launched the retail service strategy in 2017, our company values have become "Right Way to Success" and "Customer First."

Xiao-Ping Chen: Yes, I remember when I interviewed Richard (Liu Qiangdong, the founder and former CEO of JD) in 2017, he mentioned these two core values.

Jianwen Liao: The latest version in 2019 includes six core values – Customer first, Integrity, Collaboration, Gratitude, Hardworking, and Responsibility. Why do we make such changes? Let me first talk about the commonalities across all these versions. "Customer first" remains unchanged over time, which represents the most important value. No matter how our business evolves, 2B or 2C, Richard (Liu Qiangdong) has always emphasized the fundamental issue – how to create long-term value for customers. I often say to my colleagues that the highest barrier of JD is "continuously creating long-term value for users." This vision has become the ultimate reference point for all our strategic decisions.

Here are a few examples. As you can imagine, it was not intuitive that we entered the logistics



business in the early stage. Richard decided to invest in logistics in 2007 when JD's business was very young, while other players such as Dangdang, Newegg, and Amazon were already flourishing. However, Richard decided to use our first external financing to establish logistics. Why? There were several considerations. First, at that time, the costs for logistics and enforcement accounted for 18.5% of the turnover of social retailing in China. That means that when you purchase a good with 100 yuan, 18.5 yuan is paid for logistics and fulfillment, while this ratio in Western countries is around 8%-9%. A gap of 10% leads to 40-50 trillion costs for the entire retailing industry in China. Such a huge cost can be largely attributed to inefficient logistics arrangements. For example, a bulk of cargo has to be moved seven times to reach the customer. Can we reduce this number to twice or even once? Or can the goods be delivered from the factory directly to the warehouse without

transition through 1P, 2P, or 3P?

Second, another way to save the delivery time is reducing the inventory turnover, such as from 90 days to 30 days.

This simple idea indicates great opportunities for value creation in the retail industry. If we can grasp this opportunity, our company will realize its value, which is long-term oriented. How about the cost level today? It is 15.2%, reducing from 18.5% to 15.2% after more than a dozen years since 2007, still leaving a large space for improvement. We are applying novel technologies to extend this efficiency frontier. When we talk about "customer first," regardless of 2C or 2B, the core question is always "how to improve customer experience continuously?" including the overall experience derived from the price, service, and quality. To sum up, this is the primary principle—customer first.

The second common value is integrity, the same as our fresh slogan, "Right Way to Success." Integrity is not easy for business actors in China's business environment. When Richard started his first business in Zhongguancun, he created a simple rule for his business, that is, "authentic licensed goods," which was reflected in the choice of goods and how to cooperate with your suppliers. Actually, many suppliers of agency brands of JD told us that most of their profits came from JD's platform while they could hardly earn any profits from other platforms. JD has made the rule of sharing profits with suppliers when its net profit exceeds a certain level. It is the platform's responsibility, which, I think, is closely related to integrity.

The third common value is the spirit of hardworking. JD emphasizes hardworking and execution. Because you only need one reason to accomplish one thing, but you can find countless excuses for failures. Moreover, we added another



term that was not emphasized in the past, collaboration. Why do we especially emphasize the spirit of collaboration? Because JD's system has grown very large, with continuous spinning-offs, leading to diversified business groups and business units (BG and BU), including retail, digital, logistics, property management, insurance, health, etc. Therefore, the coordinated operations of the entire group become extremely important. How to ensure everyone see the big picture and think from the global view? In addition, the coordination costs increase as our business group becomes large. Our integrated and open strategy places high requirements for collaboration. The cross-BG and BU collaboration must be strengthened through cultural values. This kind of collaboration, to a certain extent, contains both intra- and inter-firm components.

In the past, all departments of JD served JD

Mall. After implementing the open strategy, the original business sectors must learn to serve other customers, which is a very big change. For example, when the technology team only offered internal service, its responsibility was to fulfill internal requirements, such as developing an app. As a result, they hardly considered whether this technology is easy to use or fits the customer's organizational context. However, after opening up, they must pay attention to user experiences, especially for multiple users. In this sense, collaboration not only facilitates internal service, but more importantly, can enhance the alliance performance with external partners through horizontal coordination.

Xiao-Ping Chen: From this perspective, the cultural value of collaboration is based on the requirements of JD's current strategy.

Jianwen Liao: Yes, it is to a large degree. Culture and strategy are complementary. As you noticed, we proposed two new values -- gratitude and responsibility. Why should we emphasize gratitude? To a certain extent, JD is already a big company, yet there are substantial differences between big and great. It is important to maintain humility and its original intention as a company grows big. I often say that arrogance is more terrifying than slowness. It is easy to become arrogant when a company grows big, treating the platform capabilities as personal capabilities. A company should have a grateful and humble attitude that could enable it to be more agile to perceive changes in the industry. We often reflect that why we cannot understand or learn from a new competitor. I think the most important reason is our cognitive biases, e.g., we often look down upon new entrants. Humility and gratitude have three implications. The first is balancing the relationship between individuals and organizations, which requires certain platform capabilities that enable individuals to create values on the platform. Second, humility can enhance our sensitivity to changes in the organization and industry.

The third is to be grateful for this great era. China's revival and economic development bring vast opportunities and potentials. JD, as an enterprise, has been lucky to be synchronized with the growth of the country. Therefore, we should be grateful and bear more responsibility. Recently, we initiated and promoted a movement called "responsible consumption" within our company. We intend to combine consumption with the social environment and address grand social issues such as poverty alleviation. These actions reflect our gratefulness to the whole society.

Xiao-Ping Chen: Regarding responsible consumption, I would like to share one of my observations. I have noticed that excessive packaging is prevalent in China's snack industry, which is extremely harmful to the environment. Will you prohibit these foods from being sold on the JD platform?

Jianwen Liao: Yes, the problem of excessive packaging material is really serious. For example, there are hundreds of millions of orders in the food delivery platform per day, leading to the consumption of hundreds of millions of plastic boxes. Think about it, it's tens of billions of plastic boxes a year! Moreover, these plastics are of poor quality and cannot be recycled or self-digested for 50 years, seriously polluting the environment.

We divided consumption into four stages. The first stage is quality consumption, emphasizing authentic licensed products, good quality, and low price. Once the quality is satisfied, people start pursuing brands and moving to the second stage, brands consumption. The third stage is taste consumption, wherein people seek industrial aesthetics, design, and coolness. The last one is character consumption, considering whether the consumption behavior will affect the society and environment. I think the food delivery service is unlikely to be popular in Northern Europe because the Nordic people are very concerned about the ecology and natural environment. As a retail company, JD can affect the operation of the entire value chain. For example, the Qingliu plan initiated by JD Logistics promotes the application of recycled cardboard boxes and electric vehicles to reduce carbon emissions, highlighting our spirit of responsible consumption.

Xiao-Ping Chen: Your company is very considerate. In this sense, JD's cultural values and corporate strategies complement each other, constantly evolve, and mutually shape each other.

Who is JD.com? A Dreamer, A Value Holder, and A Crowd Runner

Jianwen Liao: Yes, JD is 18 years old this year and will soon become an adult. Last year, we did several major things: we revised our mission, re-located our focus, and finally formed JD's Strategy 2.0. Let me use three words to answer your question – Who is JD? First, JD is a dreamer who always dreams big. For example, our office building in Yizhuang was a wasteland in the past, but Richard bought it when he was still in Zhongguancun. He dreamed that in the future, we would build a big company. As U.S. big companies are mostly located in the suburbs, we would move to the suburbs. JD is a dreamer because its founder has always been a dreamer. Second, JD is a crowd-runner, leading our suppliers and partners to keep running forward. Third, JD is a value holder. We stick to long-termism that continues to create long-term value for our customers.

Xiao-Ping Chen: The three characteristics of JD, chasing dreams, holding values, and crowd running, are all reflected in your new strategy of “digital-intelligent social supply chain.” First of all, realizing digital intelligence and serving society is a big dream, and pursuing this dream requires strong adherence to JD's long-term values. Further, JD's platform can open up the entire industrial chain, from the front to the end, thus forming industrial Internet and leading a crowd to move forward. This landscape is very grand.

In my opinion, JD has performed quite well in the last five sections of the industrial chain, namely marketing, trading, warehousing, distribution, and after-sale services, with high transactional efficiencies. Meanwhile, JD is strengthening its capability at the front end of the industrial chain: creativity, design, R&D, manufacturing, and pricing. Can you share a few specific examples to illustrate this change?

Jianwen Liao: We have been thinking about how the company can adapt to changes in the external environment. The essence of strategy indicates a continuous adaptation to the external environment, which is a dynamic process. However, we also need to focus on what will not change in the next ten years because it would be meaningful to make long-term investments on the basis that has long-term values.

As mentioned earlier, JD's DNA has always been the supply chain. We engaged in the industrial Internet in the first half of the e-commerce, while in the second half, we focus on improving industrial efficiency beyond transactional efficiency. Therefore, we need to repack our supply chain, which contains five major changes: (1) from goods to services, with a typical example of JD Health; (2) from physical to virtual, especially data-driven; (3) from domestic to international. In the past, JD only focused on China's supply change and Chinese consumers. Now, we think about how to serve global consumers using the Chinese supply chain while serving Chinese customers based on global value chains; (4) from the last five ends to the front five ends of the supply chain, indicating moving from downstream to upstream to improve efficiency of the entire industry, and (5) from 2C to 2B. These five aspects will be integrated, that is, “five-to-one,” and ultimately become the

“digital-intelligent social supply chain,” as we just mentioned. What does the word “social” mean? It means that the supply chain must be an open platform in which we can leverage socialized resources and turn them into new infrastructure. In other words, the infrastructure in the RaaS era only served retail. But the new infrastructures will shape the landscape of the retail, finance, insurance, and medical service industries, mainly improving industrial efficiencies.

Let me give you an example of C2M (Customers to Manufacturing) in computers. For instance, Hewlett-Packard (HP) produces computers and sells them on the JD platform, thus generating inventory issues. How can we help HP reduce inventory? Based on JD’s data analysis, we knew the consumers’ preference and demand for the screen, operating system, memory, keyboard, designs, etc. We pass the data to HP and invite Intel and Microsoft to join. After the design was passed to manufacturing, JD could inform the relevant manufacturers how much, where, and what specifications to supply, thereby increasing industrial efficiency. This process reflects our upgrading from the last five ends to the first five ones.

Xiao-Ping Chen: That’s amazing! After connecting/integrating these ten stages on the supply chain, your company will have unlimited potential by replicating this process on different products. In general, supply chain upgrading can greatly reduce costs and improve industrial efficiency and social benefits.

CSO’s Working Logic: Turning Individual Thinking into Company Thinking

Xiao-Ping Chen: How do you position yourself as

the JD’s Chief Strategic Officer?

Jianwen Liao: As a chief strategy officer, regarding strategic planning, I mainly do three things to achieve one goal, that is, how to spread the strategic thinking from a few people’s brains to a group of people’s brains. This is the logic of my role positioning.

Xiao-Ping Chen: Concise and clear. How do you achieve this goal?

Jianwen Liao: I think individual thoughts are not important until they become collective wisdom. Strategy is always forward-looking. When the strategy becomes collective thinking, it can direct the company’s logic from a short-term KPI focus to a long-term orientation, thus carrying out strategic layout and creating long-term value.

I mainly do three things: mindset, method, and management (3M). The mindset is akin to a top-down strategic planning process. For example, the way we foresee the ultimate industry picture can inform our current organizational structure. In practice, JD has developed the “LEGO building theory” that produced componentized and productized thinking. One of the major responsibilities of a firm’s CSO is to answer the questions about the origin of strategy and how the strategy is designed, in relation to the ultimate picture of an industry. It must go beyond individual thinking to be transformed to strategic thinking, which is the essence of mindset.

We formulate the company-level strategy directly, including retail as a service, the ecosystem of the next technology industry, strategic upgrades, etc. The headquarter cannot make strategies for sub-units because we do not possess enough detailed knowledge to understand the specific situations. However, we must ensure the sub-strategies of the open

platforms to be in alignment with the group strategy, which relies on a set of methodologies to achieve. I have developed a set of methods for strategic management called “One House, One Picture, and One Table.” One House means strategic house, and One picture includes a business panorama and a strategic decoding map etc., forming a set of standard methodology.

For example, in the business panorama, we clearly define different layers: the context, the platform, the product, and the capabilities, enabling horizontal searches for shared capabilities. One Table relates to strategic decoding, achieved through “four settings” – setting directions, goals, measures, and responsibilities. When this methodology is finalized, JD builds a SaaS service (Strategy as a Service). After implementing this approach at the company level, we mandate that each BG and BU follow this approach and replicate the same process, ensuring the alignments between their strategy and the company strategy.

Xiao-Ping Chen: This means that in addition to thinking about the overall company strategy, you also teach each unit how to formulate their own strategies.

Jianwen Liao: Yes, we have the tools and methods to guide their implementation. Management is a process and has its cycle. For example, we hold a company-level strategy meeting in September every year. After the meeting, we must decode the strategy, reflect it in the budget, and follow up every quarter in the second year. At the company’s operation analysis meeting, we will retrospectively analyze financial data from strategic, organizational, financial, and compliance perspectives. With a comprehensive inspection, we ensure our

financial condition is very healthy in all aspects. In this sense, our strategic management covers top-level design, strategic methodology, and operation, thereby achieving vertical consistency and horizontal coordination.

Xiao-Ping Chen: In this way, you have also taken advantage of your talents as a former professor, applying class knowledge into business practice and seeing good results. So enjoyable!

The Logic of JD’s Globalization: Leveraging Global Resources to Enhance Competitiveness

Xiao-Ping Chen: I did some research about JD’s internationalization and found that JD has developed the overseas market for six to seven years, from Indonesia, Thailand, Vietnam to European and American countries, including cooperation with Google and Wal-Mart. In some markets, JD was successful, such as in Indonesia and Thailand, while in other markets, it is not. Can you share the basic strategy of JD’s internationalization?

Jianwen Liao: The globalization of Internet companies is still in its early stages. We have made some major changes this year and merged all overseas businesses into JD International.

Xiao-Ping Chen: What are these overseas businesses?

Jianwen Liao: There is a retail business, or e-commerce, mainly in Southeast Asia. There is also the logistics business because cross-border e-commerce is now very active,



increasing overseas demand for cross-border logistics service. Both of them are placed in JD International.

Xiao-Ping Chen: I saw that JD's business in Indonesia was replicating its Chinese model, building the entire logistics system by itself. How does it work now?

Jianwen Liao: That's correct. It was an idea of B2C business at that time, which is different from C2C. The latter one is a light model with bilateral transactions so that the growth will be faster. But JD's basic model is B2C, like a tank that moves slowly. Let me first return to the general topic of internationalization and make a few basic judgments.

First, China has led the development of

e-commerce worldwide. We immediately entered a cashless society, and the Internet penetration rate has exceeded any other country in the world. China's internet business has covered every channel. Take JD.com as an example. We serve 400 million consumers with countless warehouses and 5 million SKUs compared with Wal-Mart that has 150,000. Meanwhile, our average turnover is only 34 days.

Second, where are the overseas opportunities? Returning to the insights of the first and second half of the Internet era, we can observe that the e-commerce industry has begun to consolidate after two decades of development. It would be very difficult to enter an established field, even for e-Bay, Amazon, or Facebook, unless you have a brand new business model. Also, it is not wise to choose direct competition with Amazon. However,

there are vast opportunities in many emerging markets, and where is JD's opportunity? The foremost one is the retail infrastructure capacity that JD has accumulated in China. We can extend this capacity to foreign countries and improve their infrastructure, and Southeast Asian countries are ideal. From this perspective, the internationalization of e-commerce is actually the internationalization of retail infrastructure.

In addition, when talking about globalization today, we mean a globalized JD rather than the globalization of JD. Our primary goal is to leverage pockets of excellence in different parts of the world to enhance JD's competitiveness instead of occupying the market shares in other countries. For example, how can we offer better services for Chinese consumers? One way is to use the global supply chain to enhance our service quality, not just focusing on the Chinese supply chain. Meanwhile, we can also utilize the Chinese supply chain to serve global consumers. Because at the technical level, Israeli technology, Russian technology, and algorithm engineers are also very important to us.

To summarize, globalization is not merely an extension of e-commerce but how to leverage global resources to enhance global competitiveness. Since China has already reached omni-channel, the next step could be pursuing omni-channel in European and American countries. From the e-commerce perspective, maybe we should cooperate with Amazon instead of competing. As an operating platform, we can take Chinese merchants to go global and help them operate on Amazon, e-Bay, or Wal-Mart.

Xiao-Ping Chen: Therefore, globalization means using JD's internal and global resources to realize its dream of building the "digital-intelligent social supply chain."

Supporting Strategy 2.0 and the LEGO Organization: Empower the Front-line Managers

Xiao-Ping Chen: The next question is related to organizational structure. JD pays special attention to innovation. Recently, it launched a LEGO organization structure with Big Boss as the core. Can you describe the specific form of this structure? Why does this architecture contribute to the innovation and agility of the enterprise?

Jianwen Liao: In 2017, President Liu (Richard) wrote an article called "LEGO building theory." Why use the word LEGO? Related to the strategic logic we just discussed, the unbounded retail indicates fragmented consumption in the future. In this regard, our organization should become blocks, like LEGO, to ensure agility. Relatedly, we can turn various internal capabilities into capability blocks through a process of decoupling. Such capabilities only served the organization in the past. Yet, after decoupling, the capability blocks can further become a product that can be utilized by JD's internal units, as well as external organizations. The process of componentization and productization is at the core of the LEGO building theory.

Today the external environment pushes organizations to become more agile, but the previous vertical integration model can hardly be agile. Our LEGO organizational structure with Big Boss can solve complex management problems through minimal units. What does it mean? Now JD.com has 320,000 employees, with a diversified talent structure that covers various industries, professional backgrounds, and occupations, including blue-collar employees, top scientists, and different levels of managers. We

can establish an agile organizational structure based on these components. Why? Because the Big Boss structure treats each business unit as an independent entity, assigning each manager as a Boss that can make independent decisions. For example, a previous logistic station master needed to propose a financial budget to the company. Then, the headquarter approves the budget and decides how many people the station could recruit. But now, we turn the station master into a Boss who can decide what the station will do and whether it will double the income in the next year. Through the Big Boss structure, we delegate the decision-making power to the people closest to the customers and who know the master the best, making our entire organization flatter.

Xiao-Ping Chen: In other words, you give the manager (Big Boss) a lot of autonomy.

Jianwen Liao: Yes. In this way, we can make flexible combinations according to strategy and business to better adapt to external changes.

Xiao-Ping Chen: How long has this organizational structure been implemented?

Jianwen Liao: We have gradually promoted the structure within the company. It has been two years since the pilot.

Xiao-Ping Chen: What kind of changes have you seen in the past two years?

Jianwen Liao: We have accumulated many internal cases that demonstrate a salient improvement regarding reducing management costs and improving efficiency. For example, JD Logistics has become more efficient and profitable, which

can partly be attributed to the Big Boss system to a large extent.

Xiao-Ping Chen: Is the increase in efficiency related to this organizational structure innovation? Organizational innovation aims to make employees more creative, stimulating them to optimize processes and continuously propose new ideas.

Jianwen Liao: This structure gives freedom and autonomy to the managers closest to the customer. Rather than telling them how to optimize, this structure enables them to determine key issues such as budget, operation, and recruitment, encouraging them to optimize and try new ideas.

In addition, there is a substantial reduction in management costs, and of course, the most important thing is that the organization becomes more agile.

From a Scholar to a Practitioner, from Merely Observing to Deep Diving: Gaining Penetrating Insights

Xiao-Ping Chen: Now let me ask a question related to yourself. In your career, you have changed your role from a professor in CIBES to JD's CSO, which is a transformation from a scholar, a bystander, to a practitioner. Could you please share your perception and experience in this process?

Jianwen Liao: I feel very lucky that a professor can serve as a professional manager in a Fortune 500 company at a certain stage of his life.

What is the most critical difference between professors and professional managers? It feels like that I saw a problem at an altitude of 5,000

meters in the past, but now this dimension becomes 1 meter wide and 10,000 meters deep, which are two completely different perspectives. A professional manager needs to deeply understand many aspects, covering strategy, organization, and business. The biggest gain is that I have sensed a rhythm in a big organization, which is quite subtle. I remembered an early academic study about temporal patterns by Professor Kathy Eisenhardt at Stanford University. She has done a lot of entrepreneurship research, generally using a small sample, such as five or six start-up companies. She summarized that one company would show different behaviors at different stages, forming a pattern across time. If you ask me how I feel about corporate strategy, my answer is that I can suddenly see a pattern at a specific stage. Of course, I only observe one company, JD, rather than several samples. When JD comes to a stage, I can imagine how its strategy and organizational structure should change, a rhythm of strategy. For example, I proposed Retail-as-a-Service (RaaS) in 2017, and we initiated Strategy 2.0 last year, considering the changes in the technology ecosystem. But before that, we had already started planning, revising the positioning and the mission. It was the first time that I felt a sense of rhythm in strategic management.

Xiao-Ping Chen: You feel the pulse of this company, vividly.

Jianwen Liao: Yes, JD is an organism, which is 18 years old this year and has formed its own values and world views. Although we can predict what it should do now and how it will be when it is 25 years old, based on the data, it is quite different when I actually feel its changing. Therefore, I think the rhythm of strategy is an



interesting topic that has not been well addressed in academic research.

The second experience is the exercise of condensed wisdom. When you are a scholar, you can elaborate on the theoretical framework in detail. But in practice, it is more important to make it simple, such as a 15-page paper into one sentence or one word, with penetrating power from the top executives to front line employees. The ability to condense, or the penetrating power of thinking, is very important for a scholar who transforms from research to practice. Because in practice, thinking and communication must be penetrating.

Xiao-Ping Chen: As you just summed up the changes in people's consumption trends: from quality and brand consumption to taste and character consumption, it is this kind of condensed wisdom.

Jianwen Liao: Yes, that reflects the penetrating power. The third reflection point is the process of turning theory into practice. It is the first step to equip your thinking with penetrating power, and then turn it into a penetrating idea or insight

that everyone can share and apply. This process includes a set of strategic methodologies related to how to decode and how to implement. Relying upon the methods, we can use the findings from academic research to build a strategy-driven organization. As I introduced before, the 3M method, from cognitive mindset to implementation methods, then to the management, can ensure that the organization achieves its long-term goal.

Xiao-Ping Chen: I think you have done an excellent job in connecting the key processes in strategic management. You have good training in management theory, you have sharp observations and deep thinking, and then you have the ability to articulate them clearly and concisely so that everyone understands them. Moreover, you develop your methodologies to guide people so that they can implement the strategies consistently to achieve goals. Most people say that academic theories are far from practice because they are relatively abstract and empty, and we can hardly realize them. However, you can bridge the gaps between theory and practice. Do you have a feeling of “dreams come true?”

Jianwen Liao: Haha, I recently gained a lot of insights. I think that strategy is the art of balancing contradictions, such as changes versus constants, continuity versus discontinuity, mainstream versus non-mainstream, imagination versus restriction, etc., which are quite interesting.

Two Maxims: All Limits Are Cognitive; Arrogance Is More Terrifying Than Slowness

Xiao-Ping Chen: That’s wonderful! I hope we will

have a chance to talk in detail next time. Finally, I would like to ask you to summarize the thoughts and wisdom you most wanted to share with entrepreneurs and managers.

Jianwen Liao: I have two sentences to share. Both are summarized and condensed by myself.

The first one is, “All limits are cognitive limits.” Many entrepreneurs believe that their perceptions are correct. However, when the industry changes discontinuously, most people still use their past experience to interpret the external environment. According to my observation, there are three kinds of people: those who make things happen, those who watch things happen, and those who ask what happened. Why do some great companies fall and some start-ups rise? The reasons are related to one’s cognition. The information already exists, but you will be obsolete if you ignore the information or consider it irrelevant to you. Why do many firms reach a bottleneck of growth? It is not the bottleneck of ability but the bottleneck of the manager’s cognition. So I say that all limits are cognitive limits.

The second one is, “Arrogance is more terrifying than being slow.” I have explained this one before so that I won’t repeat it here.

Xiao-Ping Chen: The arrogance in this sentence is actually related to cognitive limitations.

Jianwen Liao: That’s right, but some people do not have true humility and a sense of hunger even though they say they wanted to make constant changes. These people are doomed to become obsolete. Therefore, arrogance is more terrifying than slowness.

Xiao-Ping Chen: Very insightful! Thank you for your wonderful sharing! 📧

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