Harvard Business Review

The Art and Science of Finding the Right CEO

by A.G. Lafley; foreword by Noel M. Tichy

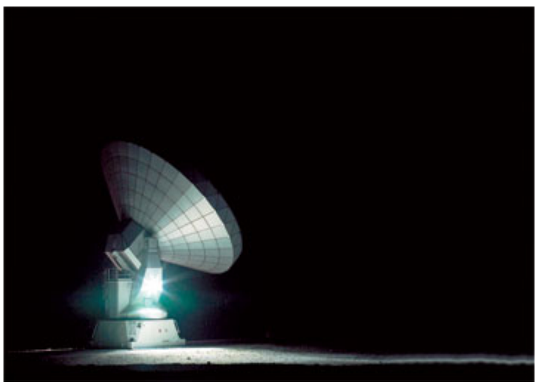
Idea in Brief

Planning for leadership succession is the most important job of a company's board of directors.

But boards and CEOs often neglect this key responsibility because other business matters seem more pressing.

At P&G, A.G. Lafley and his board began the process of selecting and developing succession candidates as soon as Lafley took office.

Succession planning demands the same coherence, discipline, and thoroughness that governance, enterprise risk, and strategic oversight do.



Artwork: **Vincent Fournier, *Space Project: Iram Observatory #02,*** 2006, France

Foreword: On September 30, 2010, when Hewlett-Packard announced the appointment of Léo Apotheker, formerly of SAP, as its new CEO, it marked the third time in a little more than a decade that the board of the iconic tech firm had passed over its internal candidates and selected an outsider to lead the company. Less than two months before, Mark Hurd had unexpectedly resigned from his post as CEO, amid a media-fueled firestorm over allegations of unseemly behavior.

The majority of commentators focused on Hurd's conduct, and others questioned the severity of the board's actions. Yet among the academic, journalistic, and investment communities, surprisingly little attention was paid to what was arguably the most critical issue raised by this incident: the lack of an adequate CEO succession plan at HP.

Hurd showed poor personal judgment, but the far more serious lapse by both him and the board was the failure to put in place a process that would have yielded at least a few internal candidates who were ready to step into the CEO job in the event of his departure—planned or otherwise. (Remember that Hurd's predecessor, Carly Fiorina, had also left the company precipitately, having similarly failed to institute a formal succession process.)

Indeed, uncertainty and confusion in the wake of a CEO's departure seem to be more the norm than the exception these days, even at many of the finest companies. And according to a survey of more than 1,000 directors conducted by PricewaterhouseCoopers and the magazine *Corporate Board Member,* nearly half of board members are dissatisfied with their companies' succession plans. Poor succession planning could explain why CEOs don't stay in office as long as they once did. The median tenure of a *Fortune* 500 CEO has fallen from 9.5 to 3.5 years over the past decade. Shorter tenures also make it harder for the next generation to get adequate vetting or preparation before stepping in.

Part of the problem is that boards typically don't get started on succession until the last year or two of sitting CEOs' terms. By then, a board has effectively opted out of the process, as it is presented with only one viable candidate—the incumbent's anointed heir—leaving no real choice.

For these reasons, we set out to capture key lessons from the succession process put in place at Procter & Gamble when A.G. Lafley was CEO, as well as from experiences he and I have had in other industries—A.G. as a director on boards of other companies, including GE, and as a special partner at the private equity firm Clayton, Dubilier & Rice, and I as an adviser to CEOs of global companies on succession and leadership development.

This article discusses some of the practices P&G instituted to build an internal leadership pipeline—one that produced numerous strong CEO candidates. A.G. had nine years to cultivate a team to lead the company into the future—a rare luxury. But the lessons from his experiences are generalizable. The process can be shorter but just as effective, and we've seen these practices work not just at large multinationals but at small and medium-sized companies, privately held companies, and not-for-profits.

—Noel M. Tichy

Boards—like CEOs—have plenty on their plates. Planning for events that appear to be far in the future, like succession, and that don't obviously influence day-to-day business results might seem to be a luxury or even a waste of precious time. Many CEOs don't push their boards to discuss what might happen when they leave, because they don't want to think about it—unless they know their departure is imminent. By then it's probably too late to start preparing succession candidates.

Nonetheless, choosing the next CEO is the single most important decision a board of directors will make. The selection of a CEO has a profound impact on a company's strategy, its execution, and, ultimately, its business and financial performance. All companies should have a plan for handling the normal transfer of power as well as for dealing with emergencies like health incidents, untimely death, and other unanticipated events.

Unfortunately, no such plan was in place at P&G in June 2000, when I was suddenly thrust into the role of CEO. The company had drifted, but I was determined to get it back on strategic course, operating with discipline and executing with excellence. Along with my presiding director, Norm Augustine, and my chairman and mentor, John Pepper, I was also committed to getting the P&G board and management team working well together again.

My leadership team and I devoted the first 100 days to improving execution with key customers and suppliers, and to making a few simple strategic choices that would turn out to be powerful enablers of company performance. We agreed that our focus would be to reinvest in core businesses and core strengths, ramp up in emerging markets, and build the beauty, health, and personal-care businesses organically and via acquisition. We also committed to strengthening P&G's leadership and management from top to bottom.

Nothing was more important to the short- and long-term health of the business than leadership development and training. We had to produce a cadre of executives who could help P&G regain its leading position in core businesses, expand into new categories and markets, and create a truly global enterprise that was well positioned for profitable growth—all at once.

So when Norm and I sat down to define the four core responsibilities of the board, we put CEO succession (and executive leadership development) at the top of the list, followed by strategic oversight at the corporate level, overall governance, and enterprise risk. Then, to signal more-intentional and ongoing involvement of the outside directors in the succession process, we changed the name of the Comp Committee to the Leadership Development and Compensation Committee.

The Four Kinds of Leadership Judgment: A Framework for Selecting a CEO

Ultimately, the choice of a CEO is a calculated bet on how good that leader's judgment will be when it comes to selecting the right people, setting the organization's direction, and handling the inevitable crises all organizations face.

With Warren Bennis, I have developed a framework that will help in examining a leader's past judgment calls and predicting future calls. The framework identifies four levels of leadership intelligence: judgment about yourself; judgment about your immediate team; judgment about your organization; and judgment related to stakeholders (decisions that involve your board, suppliers, customers, and community). Good leaders need capabilities at all four levels. The chart to the right presents the core issues—regarding people, strategy, and crises—in each area for which leaders must exercise judgment.

Great leaders are defined as such because a high percentage of their judgment calls are good. The key to such high performance is possessing knowledge that goes beyond a "just the facts" analytical capability. It is possessing deeper knowledge of the four domains.

Personal Judgment
People Personal judgments about your ambitions, role, and capabilities

Strategy Personal judgments regarding your career and life strategy

Crisis Personal judgments made during times of crisis and introspection

Team Judgment
People Judgments about who is on and off your team

Strategy Judgments about how your team evolves to meet business demands

Crisis Judgments about how your team operates and with whom during a crisis

Organizational Judgment
People Judgments about organizational systems for ensuring quality and capability of people in the organization

Strategy Judgments about how to engage and align all organizational levels in strategy execution

Crisis Judgments about how to work with the organization through times of crisis

Stakeholder Judgment
People Judgments about which stakeholders are important and how to engage them

Strategy Judgments about engaging stakeholders to frame, define, and execute strategy

Crisis Judgments about dealing with key stakeholders during times of crisis

—N.M.T.

Source: *Judgment*, by Noel M. Tichy and Warren G. Bennis (Portfolio, 2007).

One of our main goals was to develop a slate of strong internal CEO candidates on a continual basis. We believed this was the safest and surest path to a smooth succession. For one thing, our own executives would have industry knowledge and experience and a proven track record of results. They would have completed assignments that tested their mettle—their leadership, judgment, and character. Their past performance would, we believed, be the best indicator of their future potential. To check our assumptions, we benchmarked internal candidates against strong external CEOs that our directors knew. We concluded that an outside option wasn't needed and wouldn't be as good a fit for P&G.

Involve the Board Early and Often
Norm and I did not want to put our board in the position of having to make a last-minute decision on P&G's next CEO. (I was sensitive to the fact that I was the first "accidental CEO" at P&G, selected in a hurry after the sudden departure of my predecessor. Norm was determined not to let the directors put off the process until the last minute or, worse, be left with effectively no decision—one CEO candidate recommended by the incumbent.) We both wanted the directors to be engaged and personally involved.

Once the directors had agreed with us on their four core roles, we changed the way the board worked. We had six meetings a year. The annual shareholder meeting and an off-site visit to one of P&G's businesses accounted for two of them, but each of the other full board meetings was dedicated to one of the four responsibilities. And the first meeting of every year was devoted to CEO succession and executive leadership development.

At first, the idea of spending four hours on leadership and succession wasn't met with much enthusiasm. I'd just stepped into the job—where was the urgency? And the company was still struggling to regain its footing. The directors believed that they—and I—had other, more important things to do. Still, that first meeting turned out to be productive. In an extended executive session—attended by the outside directors; the global HR officer, Dick Antoine; and me—we entered into a spirited discussion of emergency CEO candidates and the first of many discussions of leaders with mid- and long-term potential.

We also wanted to regularly give the directors firsthand exposure to P&G's future leaders so that they could form personal impressions of candidates. Every director was encouraged to meet at least twice a year with business or functional leaders without any corporate P&G managers present. In addition, we set aside time before and after every board meeting for directors to interact with P&G's senior executives on virtually any subject of their choosing.

Once a year the directors and the management team would go to an international business location to meet directly with regional and local leaders for a full day—and also meet with their consumers, customers, business partners, and other external stakeholders. Teams of two directors would talk with the local leaders and then report back to the full board on what they had learned, their conclusions, and any required actions.

I could go on, but the point is, we were completely "open kimono." We set up and ran a totally transparent CEO candidate evaluation process with no constraints. The best directors really got to know P&G's leaders, across the businesses and around the world. We force-fed them enough of these opportunities that even the least proactive board members still had far more contact with and insight about P&G's leaders than boards have at most other companies.

Rethink the Role of the CEO

With the ultimate CEO succession decision resting squarely with the outside directors, I had to create a new and different role for myself as CEO. (Initially, this caused understandable ambiguity and some discomfort for me.) On the board I became the *catalyst* for CEO succession. With Norm, I led an inquiry process that was rich in dialogue and debate and focused on identifying and assessing the slate of internal candidates.

It was my responsibility to develop as many potential CEOs as we could—leaders who would be ready and able at any time to lead P&G under any circumstances we faced in the global economy, the consumer products industry, and our company—not to call out the one best candidate. My objective was to groom more horses for the race. I wanted horses that could run in all kinds of conditions and on all kinds of tracks. And I wanted the race to be a long one. I also wanted the board to be in a position—when it was my turn to hand over the reins—to choose the person who best met P&G's standards and best fit the specific needs the company would face over the next decade.

As part of this process, I led the development of criteria for the job, scenarios the company and industry might face in the future, and a list of ideal experiences that would prepare someone to be CEO. The directors and I worked on all these things collaboratively, in and out of board meetings, continually improving them to reflect the board's best judgment. Directors routinely requested my assessments of how candidates measured up against the CEO criteria and the various scenarios, and they counted on my candor. I made a point of knowing and understanding the contenders as well as I could. In the end, my opinions became an input that informed the board's collective judgment and its final decision.

In the company, and especially with the top 500 executives, I assumed the role of *leadership coach,* with the responsibility for identifying, training, and evaluating people with the highest potential. The top 500 belonged to the company and were on loan to the business units and disciplines. My job and the job of my executive team was to make sure we enabled every leader to develop to her or his fullest potential.

We elevated leadership development to the same level of importance as business strategy. We put in place capabilities and systems to manage talent, such as performance assessments, assignment planning, formal leadership training, and so forth. All business reviews now began with an evaluation of the strength of the organization and included specific development and growth plans for key executives in every unit and function. A rigorous talent assessment always preceded the review of actual business and financial results, strategies, and operating plans.

We treated every review that was part of the annual rhythm of running the business—the strategy review, the operating plan and budget review, the innovation strategy and plan review—as another opportunity to interact, start a conversation, and coach and teach P&G's developing leaders. We changed the format of these reviews from formal presentations to one-on-one dialogues between the business leader and me to enable a more candid and direct exchange and provide an opportunity for teachable moments.

Every month, I got a report from every president and general manager. Each one updated me on his or her business—how it was really doing and what was being done to improve its performance. These letters regularly triggered further direct discussions between the business leaders and me.

In addition, every month I had one-on-one conversations with 15 to 20 high-potential leaders to talk about what they were learning and how they were addressing their biggest business and organizational opportunities.

While the letters were structured and focused on improving the performance of the business, the calls and meetings were unstructured and free-flowing. The executives were expected to choose the agenda and to lead the conversation. But they also knew that any question from me was fair game—and that I wouldn't be bashful about my expectations of them or mince words when giving them feedback. These were private talks, with just the two of us. No other meeting or review afforded me deeper insight into the individual capabilities and personalities of P&G's future leaders.

All these interactions, formal and informal, written and oral, changed the context and the content of the conversations between the potential candidates and me. I learned not only what they thought but also how they thought. I was able to observe firsthand their ability to influence peers not under their direct command. I could discern whether they were comfortable working from principles. I could test how they dealt with ambiguity, change, and pressure. I could get a feel for their self-control and self-awareness. Were they team players? Could they clearly define problems and opportunities? Could they make a call, be decisive, take a stand? Over the course of nine years, hundreds of meetings, and literally thousands of conversations, the ongoing dialogues I had with each individual helped me develop a deep understanding of every potential CEO candidate.

After every trip to a business I would share my impressions of P&G leaders with other key senior executives—the head of HR, the CFO, the chief technology officer, the vice-chairs—and, of course, with the directors.

Over time the list of candidates grew longer as the company's leadership development process kicked into higher gear and as we got to know the leaders in the organization better. By the middle of the decade we had multigenerational lists of candidates from age 35 to 55. We categorized them as "obvious CEO candidates" (ready to go), "front-runners" (ready in the next two to three years), "rising contenders" (judged likely to be CEO contenders at some point, but whom we needed to further develop and monitor), and "future prospects" (younger leaders showing significant promise). We vetted candidates thoroughly; we assessed their recent and cumulative performance. We continually raised the bar on what really constituted outstanding performance or outstanding leadership. As a result, candidates would move on and off and up and down the lists. My eventual replacement, Bob McDonald, was on one of these lists every year from the program's inception, in 2001, to his election, in 2009.

A Continuous and Evolving Process

Within my first year on the job, Norm and I, with the help of Dick Antoine, had created and led a succession process that was ongoing, not episodic, a priority for the board, and supported by appropriate resources, necessary capabilities, and systems.

This process did more than identify a broad and deep pipeline of qualified leaders, some of whom could develop into bona fide CEO candidates. It also provided a disciplined succession planning process for the 30 or so other top executive positions: the presidents who ran the businesses and the executives who oversaw the functions of the company—the CFO, the CIO, the chief legal officer, the global technology officer, the head of global HR, and so on.

Grooming managers for C-suite jobs takes several years. We put candidates through their paces. If they did well in a small business, we gave them a larger, more complex one. If they did well in a developed market, we sent them to an emerging market. We identified "crucible" assignments—critical jobs that were more challenging and often more complex than what they were accustomed to. These were the testing grounds for some of our highest-potential candidates. We planned the next two assignments out for many promising leaders. And because no single line or staff assignment can prepare someone for all aspects of the CEO's job, I thought it was urgent to start the process right away. You never know how much time you have to get ready for a transition, and the time you're given to develop leaders is precious. You should always do everything you can to prepare the strongest to step up.

So we kept raising the standards for the potential CEO candidates. We challenged them to manage acquisitions—and some tough divestitures of venerable P&G brands and businesses. We stretched them with the Gillette integration—the largest, most complex, and first really global acquisition P&G had ever done. We asked them to create and test new business models and start new businesses.

The process continued to evolve. In addition to the annual full board meeting dedicated to executive succession, the board's Leadership Development and Compensation Committee would review at least one critical element of leadership talent development (such as the development of women and minority leaders or leaders for emerging markets) four times a year.

We constantly refined the CEO criteria. We updated the range of future scenarios—identifying threatening trends—and worried about blind spots and whether we were looking around every corner. It became clear that in a more volatile, uncertain, competitive global world, the CEO job we were going to fill would only get more difficult.

All the directors had seen their share of effective and ineffective CEOs. Individually and collectively, they brought a wealth of experience to the table. They probed for potential weaknesses in candidates and challenged certain strengths. Some served as skeptics. Others dug into leadership styles and behaviors.

Define Criteria and Measure People Against Them

There are many theories about what makes a perfect leader. But most of them are useless when it comes to selecting a CEO. The process of choosing a CEO never will be scientific—nor should it be. Nonetheless, a clear list of must-haves is critical. For the senior-most positions at P&G, we agreed on a 10-point list of criteria (which is fewer than 100 words long). It also captures the essence of our requirements for a CEO. Some of the criteria have evolved over time, but they still reflect the leadership qualities we initially began looking for.

P&G's Criteria for Senior Executives

Character, values, and integrity

Proven track record: business, financial, and organization performance

Capability and capacity builder

High energy and high endurance

Visionary and strategic leader

Inspiring, courageous, and compassionate

Productive relationships with colleagues, partners, and other external stakeholders

Embraces change. Leads transformational change

Calm, cool, and resilient in the face of conflict and criticism

Institution builder. Prioritizes greater good and longer-term health of the company

As our list shows, we've learned that we must go beyond the obvious business and financial results and assess potential performance based on intangibles. To borrow a poker term, business and financial results are "jacks or better" and do not help us discriminate among contenders. And even qualities like IQ can be deceiving. The smartest guy in the room doesn't always have the EQ (self-awareness, intrinsic motivation, empathy, and social relationships) or the judgment (common sense tempered by experience, maturity, and training) to be the best possible CEO.

With our criteria to guide us, we held in-depth, highly personal competency and learning-focused interviews with a cross-section of potential candidates of various ages. These were conducted by Dick Antoine; his successor, Moheet Nagrath; and Bill Conaty, the former global human resources officer of GE, whom we brought in as a consultant. We also sought feedback from external executives with knowledge of the candidates. Some of the best insights actually came from these outside sources—other CEOs, suppliers, customers, investors, and partners.

What individual candidates sought psychologically was another important insight into their leadership qualifications. Some candidates just needed to understand their assignment and their performance, while others needed occasional reassurance. Still others needed more frequent hand-holding. Ideally, we were looking for candidates who were self-confident, self-sufficient, and self-directed.

The CEO job is an incredibly lonely job, which is why you need EQ to go with IQ, the ability to connect and collaborate, real courage, and impeccable judgment. The board needs to understand all these variables.

Explore Multiple Scenarios and Plan for Contingencies
For at least 20 years, companies have used scenario planning in developing business strategy. We applied the same technique to CEO succession.

A scenario is a coherent description of how the future might look. You can't know what actually will happen, but you need to make some educated guesses and imagine multiple versions of the future. You should look at a range of possible shifts and developments in the global economy, core industries, technology, channels, customers, competitors, and of course your own company's strategy and business model. How will these changes affect the specific skills and experiences the organization will need in its CEO? Which aspects of your strategy and business model do you expect to remain more or less constant? In our case, we felt that our core household-care businesses had ample room for growth and that our branded innovation model was still creating significant value. We believed that our beauty, health, and personal-care businesses would offer additional growth. And we still saw major opportunities in Africa, Asia, and Latin America; some of our competitors had been there since colonial times, and we had a lot of ground to make up.

On the basis of these assumptions, we believed that over the next five or 10 years we'd probably be looking at an evolutionary strategy, not a revolutionary one. We would need a CEO with significant international experience, who would continue the rapid expansion into emerging markets and bring operating discipline, productivity improvements, and a streamlined approach to our global operations.

Six Things I've Learned About CEO Succession

It's a horse race.
More horses are better. More candidates mean you have more choices, more breadth and depth of leadership, more leaders performing at their peak and delivering better business results, and more leaders to take on more business opportunities. But the horse race doesn't have to be public. It doesn't have to divide the organization, and it doesn't have to distract from the business.

It's not personal.
It's not about you, the incumbent CEO. It's about the institution and its future. Throughout the process, in every interaction with the board or any director, in every interaction with an executive or a potential candidate, you have to set your personal feelings and relationships aside. No favorites, no appearance of favorites.

It's hard to let go.
It would have been easy for me to agree to stay on until I was 65. I was a known entity with a proven track record—a safe bet for the board. But I was convinced that would be the wrong decision and that it was better to transition sooner rather than later. I felt my successor should ride the economic recovery (however modest it would be) behind an evolutionary strategy and a new leadership team. Our industry was relatively stable. P&G's business model was still competitive. The company's results were solid, and as an organization we had the skills and experience required to execute our strategies. If we waited another two or three years, we would risk losing top candidates and effectively pass over an entire generation of strong P&G leaders. My successor, Bob McDonald, was more experienced and far better prepared to be CEO in 2009 than I had been in 2000. Still, it was hard to get my board to let go. But with the help of Jim McNerney, Norm Augustine's successor as presiding director, we were able to persuade the directors, in a series of individual and group discussions, to embrace a change in leadership and support the new CEO.

The process will never be perfect.
By its very nature it is messy and imprecise. No one anticipated a global financial crisis or the worst global recession since the Great Depression, but we adapted our business strategy and tested the final CEO candidates against more-uncertain and volatile scenarios before making a final decision.

Move over, move out, move on.
The day Bob McDonald took over, he was sitting in the CEO's office and led the executive team meeting. I had already moved out of that office and to another floor in the building. Before the year was out, when the transition criteria were met, I retired as chairman and moved on...out of Cincinnati...and on to the next chapter in my life.

CEO succession forces the board to up its game.
A more rigorous, inclusive, and ongoing succession process builds the board's ability to work with the CEO and fosters strong relationships between the board and the management team.

—A.G.L.

Remain Flexible but Focused
The choice of a successor isn't a done deal until the votes are cast and the announcement is made. It can change at any time, which is why I refused to talk about it, despite obsessive curiosity on the part of the outside world. I was continually asked, "Who is your likely successor?" "Who is most like you?" and "Who is your favorite?" It didn't matter who was most like me; I had taken over under different circumstances at a different time. All the candidates were my favorites. They were developing and growing and making significant contributions to the business. The only time I allowed anyone to pin me down on any successor was when the board asked, "Who should step up in the event of an emergency?"—a question we revisited every year. And the person I'd choose in that case wasn't necessarily the person I'd choose to lead the company under a normal transition.

You should also keep in mind that as the incumbent CEO nears retirement age, the conduct of some candidates inevitably and understandably starts to change. After I turned 60, a few potential successors started to get anxious, and some unhealthy behavior began to creep in. People would try to carve out fiefdoms. They would try to enlist supporters. They would pay more attention to where people sat and who presented at various company events. I tried to mix things up to keep everyone involved—and to keep people guessing and a little off balance. I tried not to give away any hints about how the company was thinking about succession. Still, unwelcome things happen. The media publish stories speculating about certain candidates; analysts write reports evaluating potential CEOs. It can stir people up.

Virtually all the candidates were assigned important company projects. Such projects offer opportunities that broaden people and test their thinking and skill at influencing others in a high-performance team setting. We also asked candidates representing a range of generations to lead or participate in special task forces that focused on one aspect of the company that required transformation, such as taking innovation to the next level, accelerating emerging market growth, enhancing productivity, or simplifying the way we worked. If outsiders followed these assignments carefully, they might have been able to identify some of our top development players, but that risk was worth it because these projects kept people focused on building the business. When the global financial crisis hit in the fall of 2008, we were well along in succession planning. While it was vital to continue to run an orderly process, it was doubly important that we not take people's attention away from the business challenges at hand.

As I saw at P&G, when the hour of succession nears, different candidates begin to follow different strategies. Some move on—they leave to become CEOs at other companies. Some decide that they are going to run the race to the end. They're confident in their leadership. They're still growing, learning, and developing. They believe they can make a difference and are willing to take a role other than CEO if it's still important to the company. Others get to a point where they know they've made the short list but choose to opt out of the race altogether. Sometimes they stay with the company; sometimes they move on to a new vocation or career.

Selecting the next

CEO, in addition to being the most important responsibility of the board, is one of the most difficult tasks a board will ever undertake. Two-thirds of all corporate directors admit they don't give succession planning sufficient energy and time. At P&G, we have discovered that engagement and open and spirited discussion, deliberation, and debate among the directors and between the directors and the CEO is the way to avoid this problem and unleash the real power of an ongoing succession process.
Though leadership development at P&G entails a substantial investment of executive resources, it has paid off thus far. Over the course of the decade, sales doubled, profits quadrupled, and P&G's market cap increased by more than $100 billion, making it one of the 10 most valuable companies in the U.S. P&G has grown its market share and profit margins in all its core businesses; built a competitive and global beauty, grooming, and personal-care business; and quadrupled the size of its business in emerging markets. What's more, the leadership development process has allowed us to build more meaningful relationships among top executives and the board, making for a better quality of dialogue and higher levels of trust that carry

over to other important board responsibilities like risk management, governance, and strategy.

An open and transparent succession process depends on the proactive involvement of all directors. Its ultimate success is determined by judgment—informed decisions based on both the insights of the outgoing chief executive and the collective wisdom of the board. No other issue demands more candid and open discussion. No other issue demands more collaboration and mutual support between the board and the CEO. And no other issue does more to put the greater good and long-term health of the institution ahead of personal or other short-term considerations.

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