CHAPTER

6

The Leader–Member Exchange Theory of Leadership

PUT PEOPLE FIRST. It's people who make you, and your company, organization or community, successful or not, in good times and bad. Everyone wants to be successful. I often ask people, "Have you actually ever met anybody who wanted to go to work on a given day and fail?" The answer is inevitably no, and yet the way we conduct ourselves and develop relationships with those who work for us often suggests the opposite: we expect failure and therefore shape our efforts to defend, rather than shaping them to win.

—Rick Hillier, General (Retired)[1]

As the quotation above suggests, leaders need to interact with their followers. The leader–member exchange (LMX) theory of leadership is concerned with the interactions between leaders and followers (Daft, 2015). The traits, skills, and style approaches to leadership emphasized leadership from the leader's perspective. Situational theories of leadership are centered on the follower and the context in which the leader and follower interact with each other. In essence, these theories are about what leaders do to each of their followers (Northouse, 2016). The focal point in LMX theory is the dyadic relationship between a leader and each of his or her followers. In other words, LMX theory is concerned with the differential nature of the relationships between leaders and each of their followers (Daft, 2015; DuBrin, 2013; Yukl, 2013). We will describe two waves of studies that have examined the LMX theory of leadership.

[1]General Rick Hillier served in Canada's Armed Forces for 35 years. He served as the Chief of the Defence Staff (CDS) from February 2005 to July 2008 (Hillier, 2010). The CDS position is equivalent to the Chair of the Joint Chiefs of Staff in the United States Military.

The Early Studies

Graen and his colleagues (Dansereau, Graen, & Haga, 1975; Graen, 1976; Graen & Cashman, 1975) were the forerunners in the early studies related to LMX theory. They emphasized the vertical dyadic linkages that leaders developed with each subordinate. The relationship that a leader developed with his or her workgroup was the combination of all of these vertically dyadic relationships. This led to two broad types of relationships: those considered in-group relationships and those considered out-group relationships.

Relationships within the in-group are marked by mutual trust, respect, liking, and reciprocal influence. In-group relationships develop when leaders and followers negotiate that followers do more than required by their job description, and leaders provide more than that required by the formal hierarchy. In-group members are given more responsibility, more participation in decision making, more interesting job assignments, more tangible rewards, and more support for career advancement. In contrast, relationships within the out-group are marked by formal communication based on job descriptions (Yukl, 2013). In addition, in-group members communicate more, are more involved, and are more dependable than out-group members (Dansereau et al., 1975). Out-group members do what is required and no more (Yukl, 2013). They may be physically present but will only do what is necessary to retain their jobs. Mentally, they may have defected from their jobs, even though they still come to work, do enough to keep their jobs, and then go home. They will not go the extra mile that is often required to achieve higher levels of effectiveness.

The Later Studies

Whereas early studies focused on the differential nature of in-groups and out-groups, the later studies focused on enhancing organizational effectiveness. Essentially, empirically based studies have found that where there are higher-quality leader–member exchanges, there are lower employee turnover, better employee evaluations, more frequent promotions, better work assignments, more participation by employees in decision making, enhanced commitment to the organization, more favorable attitudes toward the job, and greater support and interest from the leader (Graen & Uhl-Bien, 1995; Liden, Wayne, & Stilwell, 1993; Northouse, 2016).

In essence, these studies demonstrated that leader–member exchange quality was positively related to results for leaders, their followers, the groups in which leaders and followers interacted with each other, and the organization as a whole (Graen & Uhl-Bien, 1995). This suggests that organizations where leaders develop good working relationships with each individual subordinate will outperform those organizations where the leader–member exchange reflects mostly out-group member relationships (Yukl, 2013).

Leadership Making

The later studies led to a prescriptive approach to leadership that has come to be called *leadership making.* Leadership making suggests that leaders need to form high-quality, or in-group, exchanges with nearly all of their subordinates, not just a small minority. Leadership making is also about the development of partnership networks beyond the workgroup throughout the rest of the organization. Developing these networks should lead to better organizational performance and greater career progress for those leaders who engage in this practice (Graen & Uhl-Bien, 1995; Northouse, 2016).

There are three phases to leadership making (Graen & Uhl-Bien, 1991). They are the stranger phase, the acquaintance phase, and the partnership phase. In the stranger phase, the leader–member exchanges resemble those described earlier as out-group exchanges. In this phase, members are more concerned with their own self-interest than with what is best for the group.

In the acquaintance phase, the leader or member makes an offer to do more for the other. This is a testing period during which the leader and the subordinate are checking each other out to see if they trust each other enough to shift to in-group status or the partnership phase. During this phase, member self-interest lessens, and there is more of a focus on the group's goals and objectives.

In the mature partnership phase, leader–member exchanges are similar in quality to in-group exchanges described earlier. Leaders and members who are in this stage with each other have developed a high level of "mutual trust, respect and obligation toward each other" (Northouse, 2016). Each leader–member relationship has been tested, and there is a confidence that the leader and member can count on each other. In this stage, leaders positively affect each member and are positively affected by each member. These leader–member exchanges go much farther than those previously defined as out-group exchanges in that there is a transformational nature to these exchanges that allows leaders and followers to pursue what is better for the team and the organization rather than their own self-interest (Northouse, 2016).

First Impressions

Some research (Liden et al., 1993) suggests that the leaders and members need to be aware that first impressions matter. Their results suggest that the initial expectations of leaders toward members and initial member expectations of leaders were positively associated with the leader–member exchanges two and six weeks later. In addition, initial expectations of the members toward their leader were good predictors of leader–member exchange quality six months into the relationship. This means that the leader-member exchange may be formed in the first days and that the old adage—you have only one chance to make a good impression—may be true (DuBrin, 2013).

How Does the LMX Theory of Leadership Work?

The LMX theory of leadership is both descriptive and prescriptive. In both cases, the heart of the LMX theory is the vertical dyadic relationship developed between a leader and each of her or his subordinates. From a descriptive sense,

LMX theory implies that we need to understand that in-groups and out-groups exist in groups and organizations, and that as leaders, we participate in their development. Goal accomplishment with in-groups is substantively different than with out-groups. In-group members willingly work harder than required and are more innovative in accomplishing goals. Consequently, leaders give in-group members more opportunities, more responsibilities, more support, and more time.

Out-group members work differently than in-group members with their leaders. They work strictly within the guidelines governing organizational roles and only do the minimum necessary. Leaders are fair to these group members in that they respond to them by strictly adhering to any contractual obligations. However, they are not given any special treatment by their leaders. These out-group members receive the benefits that they are due and that are required based on their contract but nothing more.

From a prescriptive sense, Graen and Uhl-Bien's (1991) leadership-making model allows us to comprehend LMX theory most clearly. Their prescription is to develop relationships with all subordinates who are similar to those described earlier for in-group members. In other words, give all subordinates the chance to accept new responsibilities, nurture better-quality relationships with each subordinate, develop relationships based on trust and respect with all subordinates, and make the whole workgroup an in-group (Northouse, 2016). Finally, leaders should form high-quality partnerships with people throughout the organization (Daft, 2015; Northouse, 2016).

Whether we view the LMX theory of leadership as descriptive or prescriptive, it works by emphasizing the dyadic relationship that both leaders and followers see as special and unique. Northouse (2016) suggests that "when these relationships are of high quality, the goals of the leader, the followers, and the organization are all advanced." Implied in this statement is that these goals are clearly defined and understood, as well as shared among all leaders and followers—this may be one of the prime responsibilities of leaders: to ensure the development of high-quality relationships between leaders and each follower. We encourage each of you to be willing to lead others but also to understand the responsibility you accept for developing special, unique relationships with each of your subordinates.

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The Cases

Carnegie Industrial: The Leadership Development Centre

A director within the leadership development program of a large multinational organization must decide how to manage a very difficult conversation she must have with her assistant director. The assistant director, who is older and more experienced (although less educated), interviewed for the director's position and didn't get it. The assistant director has never been happy reporting to her much younger boss and has felt consistently left out of major decisions. The assistant director had confronted the director about her feelings and threatened to resign. How should the director handle this difficult conversation?

Goran Kapicic at Actavis China

The managing director of a multinational company turns a loss-making business into a profit-making venture by using his unique brand of leadership to change the organizational culture and develop a responsible proactive attitude in his employees. Throughout this process, many difficult personnel decisions must be made, including the decision to remove some senior employees who resist the necessary changes. Once under the new leadership team, recruitment and talent development become essential to the future growth of the company. The managing director wonders how to manage this challenge.

The Reading

On Leadership: Leadership and Loyalty

As Gandz writes, leaders expect their followers to be loyal and to be able to depend on their loyalty. . . . Good leaders understand that there is a difference between real loyalty and a related but different concept—fealty. Smart leaders understand that fealty is demanded, whereas loyalty is earned. In this article, the author notes some things that leaders can do to earn loyalty.

Carnegie Industrial: The Leadership Development Centre

Ken Mark and Michael Sider

Ken Mark wrote this case under the supervision of Professor Michael Sider solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Introduction

Even though she knew it was coming, Shannon Copley, a director at Carnegie Industrial's Leadership Development Centre, was taken aback by her co-worker's outburst of emotion. Eleanor Galvin, the assistant director, had just issued what sounded like an ultimatum, her voice trembling with anger. Galvin was livid that she was not being considered for a full-time position in Copley's communications program.

It was May 12, 2007, and both women were standing outside Copley's office in Somerville, Massachusetts. With colleagues watching her, Copley wondered how best to respond.

Carnegie Industrial

Carnegie Industrial (Carnegie), headquartered in Stamford, Connecticut, was one of the biggest

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corporations in the United States with $125 billion in annual sales and 45,000 employees. Part of the S&P 500 since 1985, Carnegie was both a manufacturer of products for the engineering and construction industry and an industrial consulting firm, with clients primarily from the U.S. northeast. Carnegie had grown rapidly in the past decade as a result of a series of acquisitions. As a result, its workforce comprised at least four distinct cultures. In an effort to amalgamate the group, a leadership centre, patterned after General Electric's Crotonville facility, was built in Somerville, Massachusetts, in April 2001. Somerville was chosen for its location, which was central to the various Carnegie offices.

The Leadership Development Centre, or LDC, was housed in a refurbished factory, completely renovated to modern standards. A staff of 25 was led by Executive Director Elizabeth Silver and three directors. The LDC offered a menu of courses and leadership development modules. All new hires at Carnegie spent a week at the LDC as part of their orientation at the firm. The curriculum for these new hires focused on team work, financial analysis skills and the basics of project management. The leadership modules were reserved for grooming talent at the mid- and senior-level management ranks. In addition to the specialized programs in team-building, finance and project management, courses in two general areas were available: technical competency (specialized courses in engineering or science) and communications (courses in conflict resolution, negotiation, and written and oral communication).

Shannon Copley and Eleanor Galvin

hannon Copley had been hired as director of ie LDC communications program in April)06, with a mandate to revive the program, hich had foundered in the past three years as idenced by its poor reviews. Attendees complained that the materials were either outdated or bland, and the instruction uninspiring. Although the former director had been relieved of his duties, Silver had retained the four staff members. Through an executive search firm, the LDC had interviewed several candidates for the director's position and had narrowed its search to two candidates, Copley and Galvin.

Copley, in her early 30s, had recently completed her PhD in English and Communications from a well-respected Eastern U.S. school and for the past three years had been working in the investor relations practice of a prominent Boston-based consulting firm. She was both articulate and approachable and was known for her innovative thinking and her project management skills. Copley had an informal business approach that valued results over decorum and hierarchy. Copley would arrive at work in casual clothing, wearing Birkenstocks. She encouraged her staff, all of whom were in their late 20s and early 30s, to dress in a similar manner. She disliked meetings, preferring to communicate through e-mail or personal contact. When she did gather staff for meetings, she was informal but efficient. She ran her meetings quickly, with lots of casual banter and humor, and her staff seemed to appreciate both the brevity of the meetings and Copley's enthusiasm. When clients addressed her as "Miss Copley," she would correct them with a wave of her hand. "Call me Shannon," she would say. On the other hand, Copley could be business-like when the situation called for it: when the consulting firm faced an accelerated deadline for the completion of a client project, Copley was able to work efficiently within her team setting to complete the job ahead of time. Her collaborative style was appreciated by her co-workers and superiors, and she had been recently promoted to manager level. Most recently, Copley had created an effective communications program for one of the firm's clients, and the program was winning plaudits from users. When

Copley was interviewed for the position, she impressed Silver with her candor, innovative thinking and confidence:

> I've seen effective and ineffective programs. And effective programs are typically more than remedial in nature and accessible to employees throughout the business. Your previous communications program was both inaccessible and remedial. It sent the message that, if you used it, you were in need of help. When your managers sent staff to the program, the staff felt they were being criticized—that their communications skills weren't adequate. Furthermore, there were some important areas that the previous program wasn't equipped to handle, like working with the business's growing number of overseas managers whose English language skills put them at a disadvantage here in the U.S. Programs like this should be open to all associates, whether they're native English speakers or not. Everyone can benefit from improved communications. I know there's some apprehension about the costs of such a program—if we make it less remedial and open it up to lots of people as a viable part of their leadership training in the company, there would be many candidates being coached—but we shouldn't limit it to the ones who need remedial help. We should use dedicated personnel for the coaching and have learning teams from the different ranks. Junior team members can learn from seniors and vice versa. If you hire me, some of the program elements may seem avant-garde but they'd represent current thinking in the field. Don't hire me if you don't want change.

Eleanor Galvin, the other candidate for the director's position, held a master's degree in English from Oxford University and had spent 20 years in the human resources department of an international technical services firm, where she had specialized, among other things, in the leadership development of managers for whom English was a second language. Galvin was 50 years old. A conservative person by nature, Galvin preferred formal business attire at all times and dressed immaculately in expensive business suits. She was known for her attention to detail and her love of protocol and process. Galvin was reserved, cool and analytical in her business approach, but beneath the reserve was a professional respect for co-workers and clients. Galvin had been instrumental in working with her team to develop a well-regarded coaching program. Although her team of subordinates had initially envisaged a broad-reaching, high-impact (but costly) program, Galvin was able to work with them to create a more focused and thriftier version. The team never seemed to disagree with Galvin's suggestions because she was the most senior person on the team. Since joining the firm, Galvin had been promoted through four ranks from assistant manager to senior director. Her superiors praised Galvin for her no-nonsense business style. "Miss Galvin's tough but fair," quipped a junior employee. Two months earlier, Galvin left the job to be closer to her family in Somerville and was actively seeking another position.

When Galvin was interviewed for the director's job, Silver was pleased with her grasp of the objectives and her precise answers:

> We should aim to help employees who can improve the most, and we should do this in a cost-effective way. There should be clear deliverables and regular progress updates. Although we would welcome suggestions from our team members—after all, the best ideas can come from anywhere—we need to keep this program focused. The last program was very good, but the material could be refreshed. Let's not throw out the

baby with the bathwater, so to speak. Too much change can be confusing to everyone, especially before we do the required analysis of existing processes.

The "Communicate!" Program Is Created

Although Silver was impressed by both Copley and Galvin, she decided to offer Copley the director's job on the basis of her superior academic credentials and her previous experience creating a communications program, which Silver believed would bolster both Copley's credibility in the training sessions and the LDC's credibility throughout the organization. An assistant director's position was created and offered to Galvin. Silver was delighted when Galvin accepted despite the assistant director's position being only half-time. Silver strongly believed that the skills sets of the two hires were complementary and that both could work together to build an excellent program. Certainly, the two women had different approaches, but Silver believed that increased diversity of thought and personality in the workplace could lead to better results.

"I trust you to turn this program around," Silver said to Copley on her first day of work. "Here is your budget, here are your people, and you have free rein to shape this program. The only caveat is that I would like you to work closely with Eleanor Galvin."

"No problem," replied Copley, confidently. It was April 2006, and Carnegie's recruiting season was just under way. Copley knew that she had at least a month before the new hires were ready for training. In addition, mid-level and senior staff were busy completing mid-year reports and interviewing candidates. Copley called a meeting of her five team members (four from the previous director's team and Galvin) for a brainstorming session. They developed a list of priorities, then identified key action items. The sign-up web page on the intranet was updated, presentations were scheduled for each of the business units and a curriculum outline was developed.

In the first few weeks, Copley sensed that Galvin was having trouble adjusting to her new role as the second-in-charge. On the first day, for example, Galvin had approached Copley and, shaking her hand, congratulated her on her appointment. Galvin had thanked her, assured her that she was looking forward to working with her and then said: "I'm a little confused, though, as to which office should be mine." Silver had previously asked Copley whether it was "okay with her" to share an office with Galvin for a few weeks until better offices became available for both. Copley had agreed with the arrangement and had assumed that Galvin would also have no problems with the arrangement. However, for Galvin, the lack of an office was a bigger deal than Copley had anticipated. "I just feel," said Galvin, "that it looks bad to the staff and to the whole organization to have two directors sharing an office. Can you try to find me an office of my own as soon as possible?"

Although she was a little surprised at the exchange, Copley talked to Silver, made a few telephone calls, spoke to one of her managers and found an office for Galvin. Galvin seemed delighted with the larger office, which had a window facing the park. Indeed, she spent a day at the company storage building looking for new office furniture.

Within six months, the communications program was generating positive reviews. The program's four managers—who were all in their late 20s—seemed to be excited about the new direction of the program, and they could often be seen spending time on program work after normal business hours. Copley and Galvin led training sessions for the managers once a week. Copley soon felt quite close to her managers, kindred spirits in many ways. Two of them had PhDs, and the other two had MBAs. They were young, bright, enthusiastic and incredibly quick learners. Copley often told Silver that working with them was one of the best things about her new job. These managers were the people who would help popularize the new program throughout the organization and train new program instructors—they were the core of the program—and Copley felt lucky to be able to mentor them.

Galvin, however, had some trouble with the managers. At the first training session, she seemed defensive, as if disconcerted by working with people who had the same if not more education. She spent a lot of time lecturing, used PowerPoint presentations and didn't entertain many questions. Copley, in contrast, passed out readings ahead of time and ran her sessions as small-group discussions. The managers seemed to respond with greater interest to Copley's training, but Copley felt that the difference in style between Galvin and herself was perhaps a good thing—the kind of balance that Silver was looking for in the program. Still, she noticed that the managers spent a lot of time with her and almost invariably brought any problems they encountered to her not to Galvin. Silver was worried that she was unintentionally disempowering Galvin in front of the other staff, a move that would make more work for Copley and cause Galvin obvious concern.

As time went on, Galvin, in Copley's opinion, continued to have trouble adjusting to the more collaborative, informal environment Copley wanted to create. In training sessions or when meeting with others in the organization in an attempt to sell the new program, Galvin continued to be almost rigidly methodical: she was more comfortable with one person after another speaking in turn, preferably starting with junior employees and ending with the most senior employee in the room. Her body language suggested that she had difficulty tolerating "push back" or "constructive criticism," although she had less of an issue when she was addressing the junior staff. Some managers within the company responded well to Galvin's style, however, and Copley continued to feel that Galvin, although quite different from her, was an asset to the program. Furthermore, Copley had by now found several portfolios in which Galvin's training and her aptitude for analysis and process were benefits (the development of communications courses targeted specifically at international leaders, for example), and Copley had made sure that these portfolios kept Galvin away from the more central decision-making process in the program, and, often, away from Copley's office.

Rumors and Reports

In March 2007, one month before the new program had completed its first year of operation, a friend from her old firm called Copley to tell her that he had met Galvin at a conference the week before. According to Copley's friend, Galvin had been actively soliciting offers from other employers at the conference. He had overheard her say that she was quite unhappy with the situation at Carnegie—that she felt "secondary" and "unappreciated" and would welcome a chance to run a program of her own. Her friend had also heard her say that she did not like being subordinate to someone nearly 20 years her junior. Copley recalled that at a dinner that both she and Galvin attended, she had overheard Galvin introducing herself as "one of the two directors" of the communications program. Copley had let it go without saying anything, although her husband, who had also overheard the comment, was angry.

In April 2007, with the program's first annual review of employee performance looming, Copley tried not to let what she had heard affect her judgment. She thought she would give Galvin a "very good," one notch short of "outstanding," because Galvin had indeed attained the goals Copley had set for her, and in the demanding environment of a new initiative. However, Copley felt that Galvin was still trying too hard to lecture to the managers, and that although her guidance was sound, her tone was condescending. One manager confided to Copley that, on more than one occasion, participants had noted on their feedback forms that they found Galvin "arrogant" and "aloof." And yet program enrollment was up 100 per cent, and positive reviews had tripled during the year. Silver was clearly happy at this rapid turnaround. In addition, Copley, Galvin and their team were accomplishing this feat with a smaller budget than before. The communications team was lauded for its success in improving skills across the organization, and Copley received a steady stream of congratulatory e-mails, which she shared with her staff. Talk at the management ranks suggested promoting Copley into an operating role within a few years. Galvin wasn't a great "fit," to be sure, but Copley had to admit she was part of the program's success.

Before actually writing Galvin's review, Copley met with her to discuss the process that would be used for the review. Galvin expressed concern with the use of "360-degree" feedback that incorporated managers' reviews of their superiors. Copley argued that she felt the managers' feedback was vital, given their centrality to the program and their very strong qualifications and performance. By this time, Copley was growing weary of Galvin's constant conservatism. She seemed to be trying to protect the status quo. Galvin, however, continued to argue vociferously that only her superior should provide feedback. Finally, Copley said, "Okay, if you only want my feedback, then I'm happy to limit the appraisal to my response alone." Galvin looked shocked. "I wasn't talking about your feedback, Shannon," she said. "I was talking about direct feedback from Elizabeth." Copley, confused, told her that Galvin reported directly to her, not to Silver. Galvin insisted that, as one of the two program directors, she reported to Silver, and angrily left the office. A few minutes later, Silver phoned Copley to say that she had just met with Galvin, who was unclear about the chain of command, and that Silver had informed Galvin "in the clearest possible terms" that Galvin reported to Copley.

Two weeks after the reviews were completed, Silver approached Copley:

> We're very pleased with your performance, Shannon, and we hope that you're happy with your role. We certainly want to keep you here. I want to tell you this in person because, as you know, the firm is facing difficult times and we have cutbacks across the organization. Fortunately, I made it clear that your program has my full support and, as a result, we shielded it from the cuts. The unfortunate thing is that we won't be able to expand the program as we discussed a year ago. In fact, I don't know if we'll be able to put in a budget increase in the next two years or so. I hope you understand.

Copley replied, "I can work quite well with the budget you've given us, Elizabeth. We'll make do." As she walked out of Copley's small office, Silver said, "I should also tell you that we're looking for your enrollment numbers to increase and your ratings to increase next year. This was the condition the management team asked of us, in exchange for protecting the current level of funding." Copley looked back and smiled.

A Difficult Conversation

Although Copley was happy to accept the challenge of increasing program enrollment and ratings on the current budget, she knew that the decision to freeze funding would not be taken well by Galvin, who wanted a full-time position. Indeed, Copley had just met with Galvin to talk about Galvin's completed performance review. Deciding that she did not want what might be simply differences in leadership style to affect the objectivity of her review, Copley had, at the last minute, decided to give Galvin an "outstanding" rating, despite her own reservations about Galvin's performance and the equivocal feedback from the managers. However, during the meeting, Galvin had used Copley's review to suggest that she be given a full-time position. Copley had told her that funds were frozen. Galvin had suggested letting one or two of the managers go, thereby freeing funds for a full-time position. Copley had responded that her suggestion wasn't an option. Galvin had left the meeting angrily and had called in sick the next day.

On May 12, 2007, Galvin approached Copley's office, and, standing in the doorway, burst out in tears:

> It's not fair to me not to provide me with a full-time position. I've worked really hard—as hard as you—over the past year, and my contributions have been central to this program's success. But you, Shannon, have basically alienated me from the managers, and you've deliberately kept me out of the loop during some of the most important program decisions this year. You don't trust me, and this is the first place I've ever worked where I wasn't trusted. It really hurts, and I can't go on like this. You either tell me right now how you feel about me and whether you'll ever support a full-time position, or I quit.

Goran Kapicic at Actavis China

Lowe Joo Yong

Professor Lowe Joo Yong wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author may have disguised certain names and other identifying information to protect confidentiality.

Goran Kapicic could look back at his time with Actavis China with much pride and satisfaction. By January 2012, the firm had finally earned a profit—a rare feat for a foreign generic drug-maker in China. Thinking back on his arrival at Actavis two years before, Kapicic knew he had come a long way, having made some difficult personnel decisions and overcome tremendous cross-cultural and international challenges, including threats to his life.

A capable and reliable core team was now in place to take Actavis China to the next stage of growth. Kapicic had realized that to succeed in China's extremely competitive generic drug market, there was a need to raise quality and gain consumer confidence. His strategy was to produce drugs of European quality that would be priced attractively to the Chinese market, but this plan would require a heavy investment in the recruitment and development of human capital talents. Given the low margins and difficulty of earning a profit, how should he strike a balance between the need to spend prudently and the need for employee development?

The announcement of the acquisition of Actavis by Watson Pharmaceuticals also meant uncertainty for Kapicic and his people. How would this change affect his employees, and how should he prepare them for the integration of Watson and Actavis? Would he have a new role? Would he still have his job?

Goran Kapicic

Kapicic was born in Croatia to an engineer father and a college-teacher mother. He credited much of his character to his traditional Croatian father, who was strict and uncompromising. Kapicic recalled:

When I was in high school, I never had any vacations. My father always made me work while my friends were enjoying their holidays. His philosophy was: if you want to enjoy life, work first. I was therefore made to earn before I could go for a holiday. When I dated my first girlfriend, he also made me work to cover the cost of the petrol so I could take my girlfriend out in his car. I did not understand him then and felt he was very hard on me. Now, when I look back, I greatly appreciate the education he gave me. It built my character and developed in me a strong work ethic and discipline, which have been very important to my career.

Kapicic obtained a degree in international trade from the University of Zagreb and began his career as an assistant to the marketing director of Pliva, a famous Croatian pharmaceutical company that was ranked seventh in the international generic pharmaceutical industry at that time. He moved to the sales department and became the sales manager after just one year. After six years, in August 1993, he was sent to establish Pliva's office in Beijing.

That move was the beginning of a 20-year long career in China, in which Kapicic led many world-class generic pharmaceutical companies, including Pliva and Barr Laboratories/ TEVA. Most recently, he was personally recruited in 2010 by Hordur Thorhallsson, the executive vice-president of Actavis, to head its operations in China.

Actavis China

Actavis made its entry into the Chinese market in 2005. In China's complex pharmaceutical market, global and domestic players operated in an extremely crowded and competitive environment. More than 1,000 international enterprises vied for space, along with in excess of 5,000 domestic players, in this highly fragmented generic drug market.[1]

Actavis was a leading global player in the development, manufacture, and sale of first-class generic pharmaceuticals (see Exhibit 1 for Actavis China's product line). The successful integration of a number of acquisitions had made Actavis one of the largest companies in its industry, with 1,100 molecules in its stable and an annual turnover of more than 1.8 billion euros (2011). Founded in Iceland in 1956, Actavis was now based in Zug, Switzerland, and operated in more than 40 countries with more than 10,000 employees.

As managing director, Kapicic headed Actavis's China operations. In the 2.5 years since Kapicic had taken over, Actavis China had moved into profitability. To achieve that, Kapicic had to carry out some major transformations in the firm by changing its organizational culture, replacing key personnel, and instilling in the workers a strong sense of motivation and productivity.

Even though it was not doing very well, Kapicic willingly joined Actavis China because he relished the challenge.

I am a person who likes challenges. For me, making patients on their deathbed walk again is the ultimate challenge. I was looking for something like that, something that would make a difference to others' lives. Coming to China to rescue an ailing company excited me. Many foreign executives are describing China as "mission impossible," a position I strongly disagree with. It is always about people management and respecting the local culture.

[1]"China's Pharmaceutical Industry—Poised for the Giant Leap," www.kpmg.com/cn/en/issuesandinsights/articlespublications/pages/china-pharmaceutical-201106.aspx, accessed February 15, 2013.

Leading Change

Actavis China was founded in 1958 as a state-owned enterprise known as Foshan Pharmaceutical Plant. It was bought by Australia's Faulding Pharmaceuticals, which was in turn acquired by the U.S. firm Alpharma in 2001, before Actavis acquired it in 2005. When Kapicic took over Actavis China, it was a loss-making operation. However, by 2011, it started making its first profits. How did Kapicic transform a loss-making entity into a profitable one?

> When I took over, there was so much negativity about this place here. I found so many negative comments about this company on the Internet. The comments included "this place has no sunshine, and people are living in darkness," "no directions," "people always quarrelling," "nepotism and bad HR practices," "don't go there," "lots of gossiping at work," etc. I was so shocked. Why were there so many negative comments about the company? I realized my immediate task was to restore my employees' confidence in the company. I had to change the negative atmosphere here.

Edward Wu, the warehouse and distribution manager, a company veteran who had witnessed the full-scale transformation, commented that:

> One of Kapicic's biggest contributions to the company was to change the way people work here. Previously, when a problem occurred, nobody wanted to take responsibility. There was always a lot of finger-pointing. Today, when a problem occurs, we all come together to solve it because it is our responsibility. We now work as a team. There is a great deal of satisfaction when we can solve the problem. This is amazing.

Kapicic also brought with him a refreshing leadership style. Everyone in the company—even his personal driver—called him by his first name because he did not want to be known as "Mr. Kapicic." This style contrasted greatly with the way superiors were addressed in most Chinese firms. The difference was particularly obvious because the employees still had to address Kapicic's deputy, Li Hongkui, as "Mr Li." Although Actavis was a Swiss company, Kapicic was the only non-Chinese member of the company. Meggie Cheng, director of human resources (HR) and administration, described Kapicic's style:

> Kapicic practices empowerment. He rarely directs employees on what to do. He likes us to take charge of our work and find our own solutions to our problems. However, he will always offer a listening ear to us and offer input whenever it is needed.

Doing Business in China

Having worked in China for more than 19 years, Kapicic had developed a strong understanding of the market, the people and the government of China. In an interview with a Chinese-language newspaper in January 2012, Kapicic was described as a "China market expert" (中国通). In particular, Kapicic was keenly aware of the need to mediate between the demands of his headquarters and the local market:

> I have seen so many Western expatriates come to China. Some succeeded; some failed. I always feel that when entering another country, an important ingredient for success is to understand the people, the culture and the government. Trying to impose one's practices from home to the workplace here is often a recipe for failure. I have been on the phone many times to explain to my boss and CEO and the people in our

HQ that HQ policies and practices must take local circumstances into consideration. At the same time, I have to explain to my staff that, as employees of an MNC [multinational company], they need to fulfill certain requirements set out by the HQ. This is the most challenging role of being the top guy of an MNC's operations in China. You have to mediate between the demands and expectations of both sides. I feel sandwiched between the two sides at times.

Kapicic believed that many Western expatriate managers had taken the challenges of their China assignments too lightly. They often did not put in enough effort to understand China's people and culture and the way that its government departments worked. Kapicic felt it was important that a company's top executives spent a substantial period of their careers overseas so they could better understand the issues their employees faced when posted to foreign countries. Kapicic understood the fundamentals of good leadership:

I strongly believe that leaders need to know their businesses inside out. They need to understand their people and operations (they need to spend a long time in the country), talk to their people, listen to them and also share information with them. Leaders should *love* what they are doing and they need to be passionate about their people and work. Inspiration and motivation does not come only from speeches and talks at company events. I believe that a real leader needs to energize everyone by setting the right example.

I have read Sun Tzu[2] many times and have learned about his brilliant strategies and China. "Know the terrain, know the weather, know your enemy and know yourself, and victory will be yours." Such wisdom really applies to foreigners doing business in China! This understanding will enable one to fight a good war, since business is perceived like war in China.

The Dream Team

At Actavis China, Kapicic seemed to have hit on a winning management formula. When he accepted the job, the first person he wanted to hire was Li Hongkui, whom he has known since 1994. Li became Actavis China's Deputy managing director (MD) and general manager of operations, effectively the second-in-command (see Exhibit 2 for organizational chart) because Kapicic was keenly aware of his value:

Although I am the managing director, I regard Li as the most important person in the company. I do not treat him as my second-in-command; I consider him my partner. I give him the biggest office in the company, much bigger than mine. This is because I recognize his importance to the company. You can say I give him a lot of "face." Working in China, one must understand the concept of face and its importance. I have found that knowing when and how to give face is a very important interpersonal and leadership skill.

Actavis is a Swiss company. Although it operates in China, the Chinese operation has to follow many of the guidelines and policies established at the headquarters for all of Actavis's overseas operations. While I manage the

[2]Sun Tzu (author), John Minford (translator), *The Art of War*, Viking Books, 2002. Sun Tzu was an ancient Chinese military strategist. *The Art of War* was considered a masterpiece on military and, more recently, business strategy.

Chinese ... very important role in bridging our Chinese operations with our headquarters. I am the link between the parent company and its Chinese operations. Li, on the other hand, concentrates solely on running the operations. He is Chinese, so he understands the local culture and how people work. He has immense experience in running the operational aspects of a factory. I, on the other hand, am European, so I understand the requirements and expectations of our headquarters. But with my long-term experience in China, I live and breathe the Chinese way of doing business. We therefore make a perfect partnership. I see us as the dream team (see Exhibit 3).

Li Hongkui

Li was an MBA-educated engineer and licensed pharmacist before coming to Actavis. He served as the director of the Shenzhen Research Institute and the vice-president of the Shenzhen Pharmaceutical Factory. Kapicic's presence represented a key reason for Li to join Actavis:

> I was already doing very well at the Shenzhen Pharmaceutical Factory. I worked for a big organization and received a very good salary. I had no reason to join Actavis, absolutely not. So the only reason was Goran. I made the decision to join Actavis out of friendship. You can say we both like each other, and we also like the challenges of taking over a poorly run company and turning it around. Although we have had to deal with so many challenges and make some very difficult decisions, we have never disagreed. It is amazing. There were many times when, without us meeting and discussing, we both made the same decisions over a matter. There were times when I interviewed job candidates in the morning and Goran interviewed them in the afternoon, and when we came together to discuss our choices, they matched perfectly. We really think alike. And this incredible mutual understanding between us is a key factor to the success of our company.

Painful Decisions

Change is never easy, both for those who must initiate it and for those who must experience its effects. However, for organizations to transform and move in the right direction, change and painful decisions are inevitable. Kapicic, who became fairly conversant in Mandarin after spending 20 years in China, was clear about the importance of change:

> There is a Chinese saying that water can carry a boat, but it can also capsize the boat. I believe the same about people in organizations. People are the fundamental units of an organization. Good people can drive an organization to success just as bad people can drive the organization to failure. Based on this principle, I made a few difficult decisions to remove some key personnel who stood in the way of this company moving forward. These long-time senior employees perpetuated the old culture.

Kapicic recalled having to deal with the former sales director:

> We realized there were sales activities that might be acceptable in China but were not compatible with our practices and requirements from a European standpoint. I felt we needed to change the way sales activities were carried

> out. However, my attempts to change things were met with strong objections from the then-sales director as well as from the whole sales team. Overnight, I faced the prospect of losing the entire sales team. However, there could be no compromise. One must be firm in order to initiate change.

Kapicic's initiative resulted in a massive change of personnel in the sales department. Their departure enabled Kapicic to bring in an outstanding salesperson from another company.

Song Chengyan

Song Chengyan stood out as an example of an employee who succeeded under Kapicic's leadership. Kapicic asked Song Chengyan to move from his job at Hunan Fang Sheng Pharmaceutical to join Actavis as the deputy sales manager in Sales Department II. (Actavis had two sales departments.) Within 10 months, Song was promoted and became the manager of Sales Department I. Six months later he was promoted again to become the manager of both sales departments, leading a team of 90 sales people who covered the whole of China. (See Exhibit 4 for Actavis China's market reach.) Kapicic praises Song thoroughly:

> Song is an exemplary employee. He is extremely hard-working and responsible. He has a work ethic that is consistent with what I want to see in my employees. Above all, he has a very strong desire to learn. I personally feel that continuous learning is a very important factor for an individual's career growth and organizational success. If one loses the desire and motivation to learn, it will be the beginning of decline.

In turn, Song trusts Kapicic's judgment and respects his leadership style:

> Goran is a true gentleman. He is a great motivator, gives me a lot of room, and trusts me. I derive much satisfaction because of the opportunity to take control of my work. I often work late in the office, sometimes past midnight, but although I am tired, I find my work very enjoyable. Money cannot buy all of this. I follow Kapicic's approach when working with my subordinates. I learn a lot from him about leadership and motivating subordinates.

People Development

As the managing director of Actavis China, Kapicic embraced three important priorities:

1. Like any other managing director, Kapicic was ultimately responsible for the profitability of the local business. To that end, Kapicic had to devise strategies that would allow Actavis China to succeed within the hyper-competitive generic drug industry.

2. After identifying the necessary success strategies, Kapicic had to ensure that each one was successfully executed. The biggest challenge was always about striking a balance between the requirements of the headquarters and the ground. For this task, Kapicic had the very able Mr. Li to help him manage the operations in China.

3. Over the long run, Kapicic had to develop talents that would drive the company's future growth, which was not an easy task. He recognized that if the company were to rely solely on him and on Li, it would always be stretched. Thus, Kapicic needed to recruit and develop more capable employees to help lead the company forward.

The company was now in good hands. The personnel turnover meant that those who blocked the firm's progress had been removed. At the moment, the key team comprised individuals who had been personally recruited by Kapicic and who were in place to grow the company to the next level. At the same time, however, some of the older employees still remained, and they were slow to change and could present challenges for the company going forward.

Kapicic was a strong believer in investing in employee development. His most recent recruit was the new director of HR, Meggie Cheng. Cheng had worked for an American MNC in China before joining Actavis, thus making her familiar with Western-style management. Part of her job was to professionalize HR management in the firm. Cheng observed:

> I see Goran's greatest strength as his ability to delegate the right things to the right people. In this way, he not only gets things done but also develops employees. As I talk to various employees, the common consensus is that Goran has brought about positive changes since his arrival and has given employees a sense of direction in their work. We should continue this process of change and let people grow.

What Kapicic wanted was a systematic process of developing people. However, good-quality developmental programs would be expensive. The company was starting to make money, but the generic drug industry remained a very competitive market with very thin margins. Was this the right time to start investing heavily in employee development? If so, how should employees be chosen and ranked for the development process? What sort of developmental programs should Kapicic select, and who should serve as the company's training providers? Or should Actavis China develop its employees through on-the-job experience, which was the current practice?

Looking Ahead

Kapicic had identified some challenges and opportunities:

> The Chinese government wants to raise the standard of generic drug manufacturing here. At the moment, it is very difficult to market medicine produced in China to overseas markets because of image problems, especially after the recent scandals of melamine-tainted milk and chromium-tainted capsules (see Exhibits 5 and 6). Raising the standards of production is necessary for the market to become confident in Chinese drugs. I foresee many smaller companies dropping out as a result of this rise in standards. There will be a major consolidation in this market for the next five years.
>
> As the generic drug market is so competitive, with low margins, we need to look at innovative ways of differentiating ourselves. We want to market our products as having "European quality at Chinese prices" (see Exhibit 7). This is why we are investing more in R&D. This is not R&D to find new drugs, but R&D in existing non-patent drugs. These R&D activities will focus on improving operational efficiencies, raising the quality of drugs, and finding innovative ways in which the drugs can be administered. For example, if a drug is now made in the form of a capsule, can it be made into liquid or a cream or a patch that may appeal to the market? We are also keen to develop traditional Chinese medicines and

> package them to make them more acceptable by the younger generation. In order to do this, we need to be able to attract talented and committed individuals to join us. So the fundamental issue is still people. We need the right people to take us to the next level of success.

On 25 April 2012, Watson Pharmaceuticals and Actavis Group jointly announced that Watson had entered into a definitive agreement to acquire privately held Actavis for approximately EUR4.25 billion up-front (see Exhibit 8 for the press release). As a result of this acquisition, Watson would become the third largest global generics company, with anticipated pro forma revenue of approximately $8 billion in year 2012.

What implications would this acquisition have on Kapicic and his operations? As news of this acquisition became public information, how would Kapicic's employees react to it? Would this change in ownership affect their morale and work performance? Without any additional information, what could Kapicic do to manage employee morale in the lead-up to the integration of Actavis and Watson?

Funding is supported by National University of Singapore School of Business

Exhibit 1 Product Line of Actavis China

Description subgroup	Generic names of products	Product picture
Anti-acids, anti-flatulents, and anti-ulcerants	Ranitidine Hydrochoride\meprazole\Cimetidine	
Functional gastro-intestinal disorder drugs	Domperidone(digestion)\Ma-Ren(TCM: constipation)	
Sperm activitiness	Wu Zi Yan Zong (TCM)	
Antifungals, Dermatological	Miconazole Nitrate	
Cardiovascular system	Enalapril Maleate	
Antineoplastic and immunomodulation agents	Carboxymethlstarch Solution	
Anti-asthma	Theophylline and Guaifenesin	
Vitamins	Vitamin B Complex\Vitamin B1\Vitamin B6\Vitamin C	
Antibiotics	Cefradine\Cefalexin\Amoxicillin\Norfloxacin	

SOURCE: Company files.

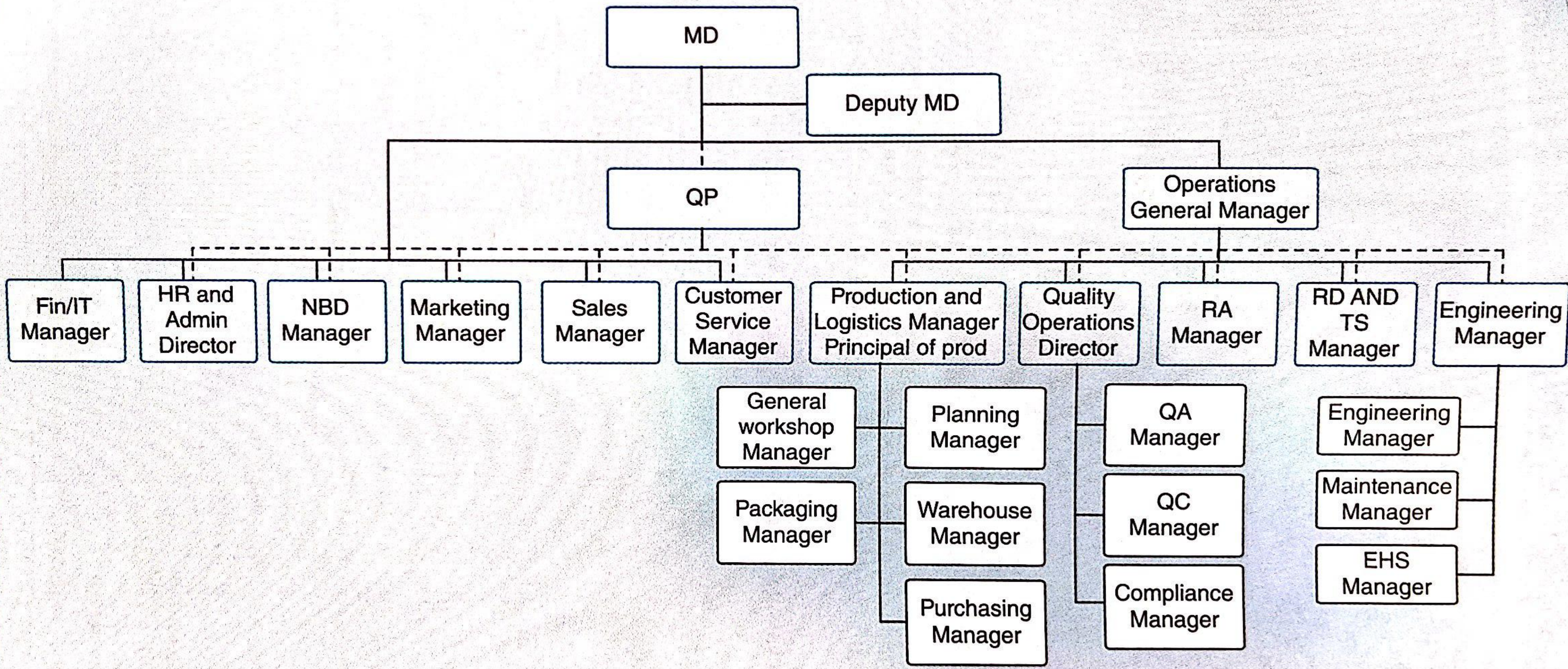
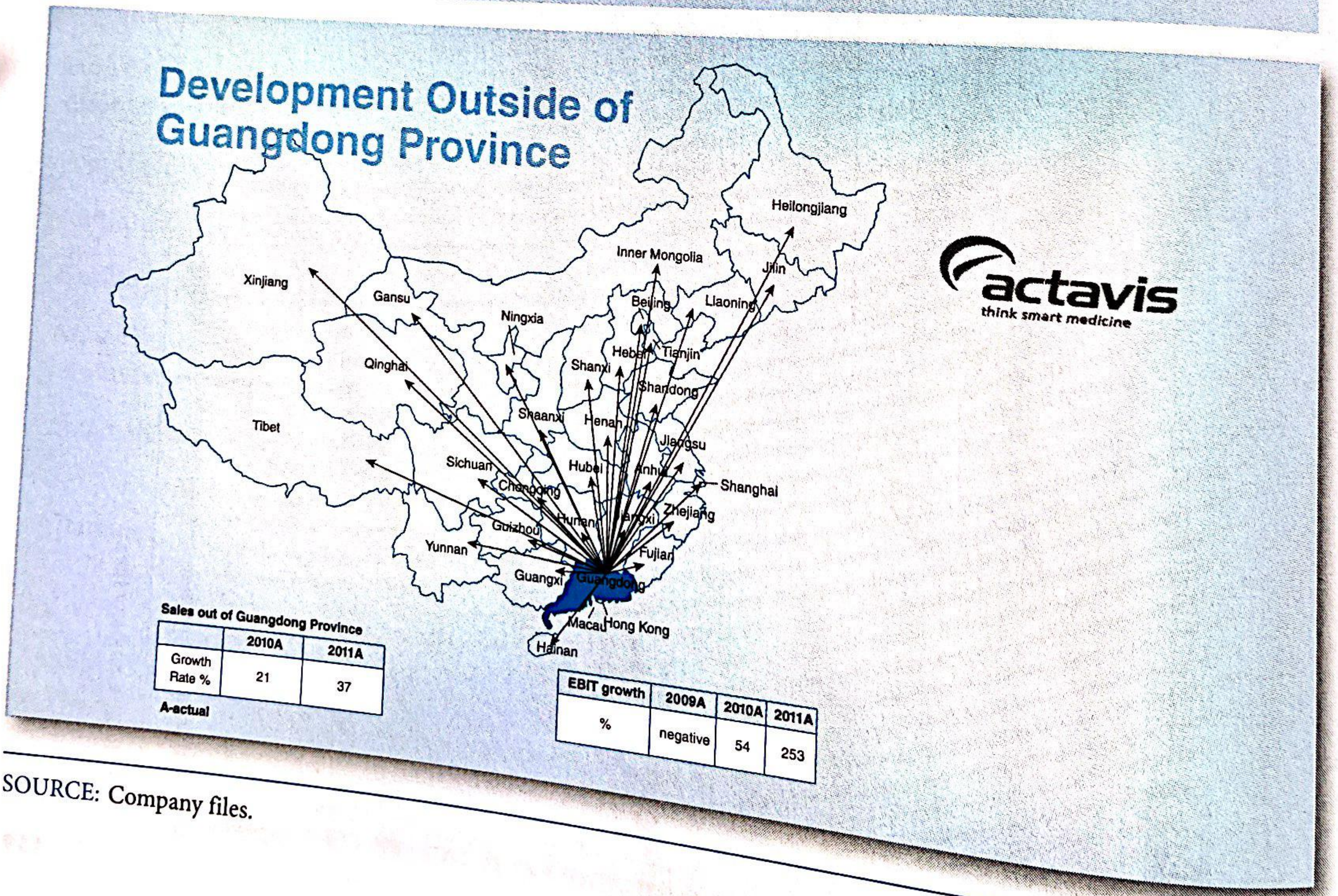

MD
Deputy MD
QP
Operations General Manager
Fin/IT Manager
HR and Admin Director
NBD Manager
Marketing Manager
Sales Manager
Customer Service Manager
Production and Logistics Manager Principal of prod
Quality Operations Director
RA Manager
RD AND TS Manager
Engineering Manager
General workshop Manager
Planning Manager
Packaging Manager
Warehouse Manager
Purchasing Manager
QA Manager
QC Manager
Compliance Manager
Engineering Manager
Maintenance Manager
EHS Manager

Exhibit 3 Goran Kapicic and Li Hongkui: The Dream Team

SOURCE: Company files.

Exhibit 4 Actavis China's Market Reach



SOURCE: Company files.

Exhibit 5 News Report of Toxic Milk Scandal

Melamine Tainted Milk Re-Emerges in Northwest China Plant

BEIJING, July 9 (Xinhua)—Food safety authorities have seized 64 tonnes of raw dairy materials contaminated with the toxic chemical melamine, in a dairy plant in northwest China's Qinghai Province, the provincial quality watchdog said.

Tests of samples of the milk powder showed up to 500 times the maximum allowed level of the chemical, said the quality watchdog in Gansu Province, where the contaminated milk powder was first discovered.

Police traced the source of the milk powder to Dongyuan Dairy Factory, in Minhe County in neighboring Qinghai Province.

Another 12 tonnes of processed milk powder products, also tainted, were also seized.

About 38 tonnes of the raw materials were purchased from north China's Hebei Province, the source of the toxic baby-formula scandal that brought down the Sanlu dairy company in 2008, police said.

It is possible that traders had bought tainted milk that was supposed to be destroyed after the 2008 scandal, planning to process and resell it, said Wang Zhongxi, deputy chief of the quality control bureau in Gansu.

An employee of the Dongyuan Dairy Factory, Liu Xiping, sent three samples of milk powder for testing by Gansu's quality control bureau for melamine content test on June 25.

The bureau called the police after test results showed the samples had excessive levels of melamine.

A police investigation found the plant wanted to know the melamine content of the raw dairy materials they bought so as to dilute the melamine level in the milk powder before sale.

Police have detained the owner and production director of the factory.

Milk powder produced in the plant was mainly sold in east China's Zhejiang and Jiangsu provinces. Only a small amount was sold in Qinghai.

Zhejiang's food safety commission said Friday they had seized three tonnes of Dongyuan milk powder in food processing factories in the province.

The tainted milk powder, in 25-kilogram packages, was mainly used to produce dairy products like ice cream, said the commission.

Most of the contaminated milk powder was still being processed and had not entered the market, it said.

Meanwhile, in Jilin City of northeast China's Jilin Province, authorities were testing samples of milk powder suspected of having excessive levels of melamine, the city's industry and commerce bureau said Thursday.

(Continued)

Exhibit 5 (Continued)

The bureau has seized more than 1,000 packages of milk powder produced in the neighboring Heilongjiang Province from a store after a random test found one of them had a high melamine content on June 22.

However, it did not say when the test results would come out.

Jilin's provincial quality control bureau said Thursday it would start a general check on dairy products in the province on Friday.

Some milk producers have added the industrial chemical to products to fool protein content tests. The practice caused the deaths of at least six Chinese babies in 2008 and left another 300,000 infants ill.

A dairy farmer and a milk salesman were executed November last year for their roles in the scandal, which also resulted in the bankruptcy of state-owned dairy producer Sanlu.

Sanlu's general manager, Tian Wenhua, was given a life sentence in January 2009 on charges of producing and selling fake or substandard products. Altogether, 21 people were convicted in connection with the scandal.

SOURCE: http://news.xinhuanet.com/english2010/china/2010-07/09/c_13392414.htm

Exhibit 6 News Report of Toxic Milk Scandal

BEIJING, April 23 (Xinhuanet)—A revelation of the production and sale of toxic capsules by China Central Television (CCTV)'s "Weekly Quality Report" last week has shocked the nation; and related authorities, especially those in medicine and food safety, have taken remedial measures immediately to correct the situation.

CCTV reporters investigated manufacturers in east China's Zhejiang Province and north China's Hebei Province for a few months to find out that dirty scrap leather was used to make industrial gelatin, which eventually ended up as medical capsules.

Toxic Capsules Exposed

China's State Food and Drug Administration (SFDA) checked 33 capsule medicine products, with 23 out of the 42 samples found to have excessive chromium—a toxic heavy metal.

Testing of capsule samples marketed in Beijing and Jiangxi, Jilin and Qinghai provinces, among other areas, showed that a total of 13 types of medicines from nine pharmaceutical factories are problematic in terms of the chrome content.

The Chinese Pharmacopoeia, amended in 2010, permits no more than two milligrams of chromium per one kilogram of medicine. However, the toxic capsules involved were found to have a chrome content of more than 90 times the national standard in extreme cases.

Song Xunjie, manager of Hebei Xueyang Glair and Gelatin Factory, confessed that the industrial gelatin is made from leather leftovers that are supposed to be used in leatherwear, after they were processed with calcium oxide and industrial acid base. The manager was reported to be a supplier to companies across the country.

An employee with a capsule factory in Xinchang, Zhejiang Province said that the industrial gelatin, secretly used by local producers, could significantly reduce the costs and were thus very popular, despite the fact that its chromium content exceeds the national standard, according to the CCTV report.

Public Outrages

The scandal has drawn great outrage online. Thousands expressed their anger to the manufacturers and doubt over the supervision department's lax controls.

Many Internet users said online that the Chinese people need responsible companies and strict and feasible supervision mechanisms. They called on relevant authorities to perform and establish a well-functioning mechanism to improve food and drug safety.

Already exposed for producing fake drugs last year, the Sichuan Shuzhong Pharmaceutical was caught again in this scandal, and people can't help asking: What role did the supervision department play?

A microblogger nicknamed "Lixiaoyue" on Sina's Weibo.com, a popular Twitter-like service in China, said, "Are we still able to be cured, given that the medicines coming to our rescue are poisonous themselves?"

Many people interviewed attributed the root cause of pervasive fake drug production to the problematic bidding mechanism in medicine marketing.

The mechanism favours only the pricing: the lowest-price bidder will always win out while the product quality and the producer credibility are forgotten.

This kind of bidding mechanism, which emphasizes price rather than quality, forces drug manufacturers to produce fake and inferior drugs, because the low price is usually realized through illegal cost-saving measures, said a private-equity magnate.

An annual report of Tonghua Golden Horse, a listed company on the Shenzhen stock exchange, released on April 18, showed that the revenue of the toxic capsules named by CCTV report was 10.9109 million yuan, 45.14 per cent higher than last year.

Loopholes Exist

Sun Zhongshi, an expert with the National Rational Drug Use Monitoring System under the Ministry of Health, said current regulations require drug authorities to check the quality of active ingredients only before they enter the market.

What's more, some underground factories that produce problematic capsules are not registered with local drug authorities, making supervision impossible, Sun added.

"The relatively lax quality check of non-active pharmaceutical products like medicine capsules has become a loophole used by profiteers," Sun said, urging relative authorities to improve the situation.

Exhibit 7 Press Interview of Goran Kapicic

Brief translation:

This article is headlined—***Goran, the challenger to local generic drug-makers***. The news report carried an interview with Goran Kapicic, MD of Actavis in China. In this interview, Kapicic talked about his confidence in the Chinese market, although he expected a crucial period of consolidation lasting about five years. During this period, weaker firms would be eliminated, but stronger companies would grow in strength. The key for foreign generic drug-makers was to understand the local culture, politics and economics. He also talked about Actavis's slogan in China, which was "**European Quality, Chinese Prices.**" The company aimed to produce drugs of high European standards and yet be able to sell at prices attractive to the Chinese market. This was possible through operational efficiency and innovation. He also emphasized the company's long-term commitment to the Chinese market. In the short term, the battle was for survival, but in the long term, their strategy would bear rewards.

SOURCE: Company files.

Exhibit 8 Press Release of Watson Takeover

Watson Pharmaceuticals + actavis

NEWS RELEASE

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Watson to Acquire Actavis Group for EUR 4.25 Billion

- Creates 3rd largest global generics company -
- ~$8.0 billion anticipated pro forma combined revenue in 2012 -
- Significantly increases scale of Watson's ex-U.S. generic business -
- Accelerates revenue and earnings growth -
- Immediately accretive to non-GAAP earnings, before synergies -
- Greater than $300 million annual synergies anticipated within 3 years -
- Strong combined cash flow allows for rapid pay-down of debt -
- Additional earnout contingent on Actavis 2012 performance -

PARSIPPANY, NJ – April 25, 2012 – Watson Pharmaceuticals, Inc. (NYSE: WPI) and Actavis Group today jointly announced that Watson has entered into a definitive agreement to acquire privately held Actavis for approximately EUR4.25 billion upfront. As a result of this acquisition, Watson will become the third largest global generics company with 2012 anticipated pro forma revenue of approximately $8 billion.

On Leadership: Leadership and Loyalty

Jeffrey Gandz

Leaders expect their followers to be loyal and to be able to depend on their loyalty. This is why we have such a visceral reaction when a David Radler turns on a Conrad Black or an Andrew Fastow cooperates with the prosecution to give evidence against his superiors at Enron. Emotive phrases like "ratting" or "biting the hand that has fed you" find their way into otherwise sober commentary. They conjure up childhood prohibitions on snitching and sneaking.

Leaders themselves have been known to go into paroxysms of rage followed by periods of deep hurt and even depression when they find that support on which they had counted is no longer there. And individuals have paid a steep price when their leaders conclude that they are no longer loyal and cannot be trusted to do their bidding, and so find themselves marginalized in decision making and personally shunned.

Good leaders understand that there is a difference between real *loyalty* and a related but different concept—*fealty*.

Give Me Loyalty, Not Fealty

Both loyalty and fealty share some things in common; they call for allegiance, faithfulness, and fidelity. But they differ in one remarkable respect. Loyalty embraces the concept of allegiance to an authority to whom such faithfulness is lawfully and morally due. Fealty, on the other hand, describes the fidelity of a vassal, slave or feudal tenant to his lord and master or, in modern parlance, the unqualified fidelity of a person to his or her boss.

Fealty is dangerous in corporations as well as in other social organizations. It leads to unethical, corrupt and often illegal actions spreading to the many rather than the few, to covering up those actions sometimes to the point of obstructing justice. Loyalty, on the other hand, is a positive dimension of business since it provides a force of energy that binds people together in the pursuit of worthwhile goals.

Fealty can be coerced or bought. Consequently, when the power relationship no longer exists or a better "deal" is available elsewhere—from another employer, or a prosecutor offering a more lenient sentence—the bond of fidelity is snapped. This is not an act of disloyalty but, rather, a belated recognition that the bond was composed only of self interest. The more enlightened that self-interest, the more individuals will act in ways that are beneficial to them.

Loyalty is made of sterner stuff. It is built on sound moral foundations, of which lawfulness is one but is not the only one. People who are bound by common values and moral beliefs are not easily deterred from supporting each other. They are neither discouraged by adversity nor deflected by better offers.

It explains why many people do work for which there is little extrinsic reward, why they serve their countries or churches or other social movements as volunteers or in poorly-paid positions; why they choose to work for companies that pursue socially responsible and responsive policies; why they are attracted to companies that have reputations for treating individuals and groups with dignity and respect, who are committed to their development, who provide employees with the opportunity to speak up and speak out about things with which they disagree, who have good whistle-blowing policies and

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who do not tolerate leaders who do not support these value-driven actions.

Such moral beliefs are not necessarily inconsistent with the capitalist system or the obligations of private sector managers to maximize shareholder value. Creation of economic activity leads to better lives for people, generation of profits results in investment in growth and contribution of taxes, and so on. Business can be and often is a force for good. But, sometimes, business activity does create conflict between personal morality and financially attractive activities. Ask me to be involved in a company selling tobacco products and I will say "No!" Ask me to endorse advertising approaches that deliberately mislead potential customers and, again, you cannot expect my loyalty to the company, my boss, my colleagues on the executive team to guarantee my assent to the advertising campaign. Generate profits for shareholders at the expense of environmental depredation, and you violate my sense of corporate social responsibility. Do this often, and any bonds of loyalty that might have been generated in the past erode.

Moral beliefs are not unchangeable. Not that long ago, many people had deeply held beliefs about separation of races, the evil of religions other than their own, or relationships between same-gender couples. These values were supported by the laws of those times. There are still people who hold to these beliefs, who are prepared to go to extraordinary, sometimes illegal lengths to preserve them and who willingly give their loyalty to leaders who espouse them. These time-warps are troubling to many people, yet they form part of today's operating environments for business.

Individuals' moral development is also dynamic. Some have strong foundations through family or early institutional influences while others grow up in more free-thinking environments. Some views change over time, others remain stable.

Some people are quick to realize that what they are being asked to do by their bosses is wrong, others either don't question, accepting that their boss must be doing the right thing because he or she *is* their boss, or going along with the request because they accept that "that's the way it's done in this business." Such moral naivety is not evil but it can lead to bad things.

Smart leaders understand that fealty is demanded whereas loyalty is earned. And they earn this loyalty by doing a number of things:

- They understand the values of the people they lead and try to build their business strategies, plans, processes and practices in ways that are congruent with those values. This is the acid test of the "respect for the individual" that we see in so many organizations' value statements.
- They are sensitive to and respect changes in moral values within the societies in which they operate. Occasionally this will put them at odds with prevailing societal values, and they must make difficult personal decisions either to conform or quit.
- When they see other leaders in their organizations acting in ways that are morally offensive, they speak up . . . sometimes at personal risk. They channel their dissent constructively. . . . Chaining oneself to railings is not usually an effective way to challenge corporate decisions! But they seldom just go along with the decision as an act of fealty.
- They promote debate about contentious issues to ensure that there is openness and transparency and that people do not feel that expressions of doubt are interpreted as "disloyalty."

Above all else, smart leaders understand: Never, never expect or depend on fealty—earn loyalty!