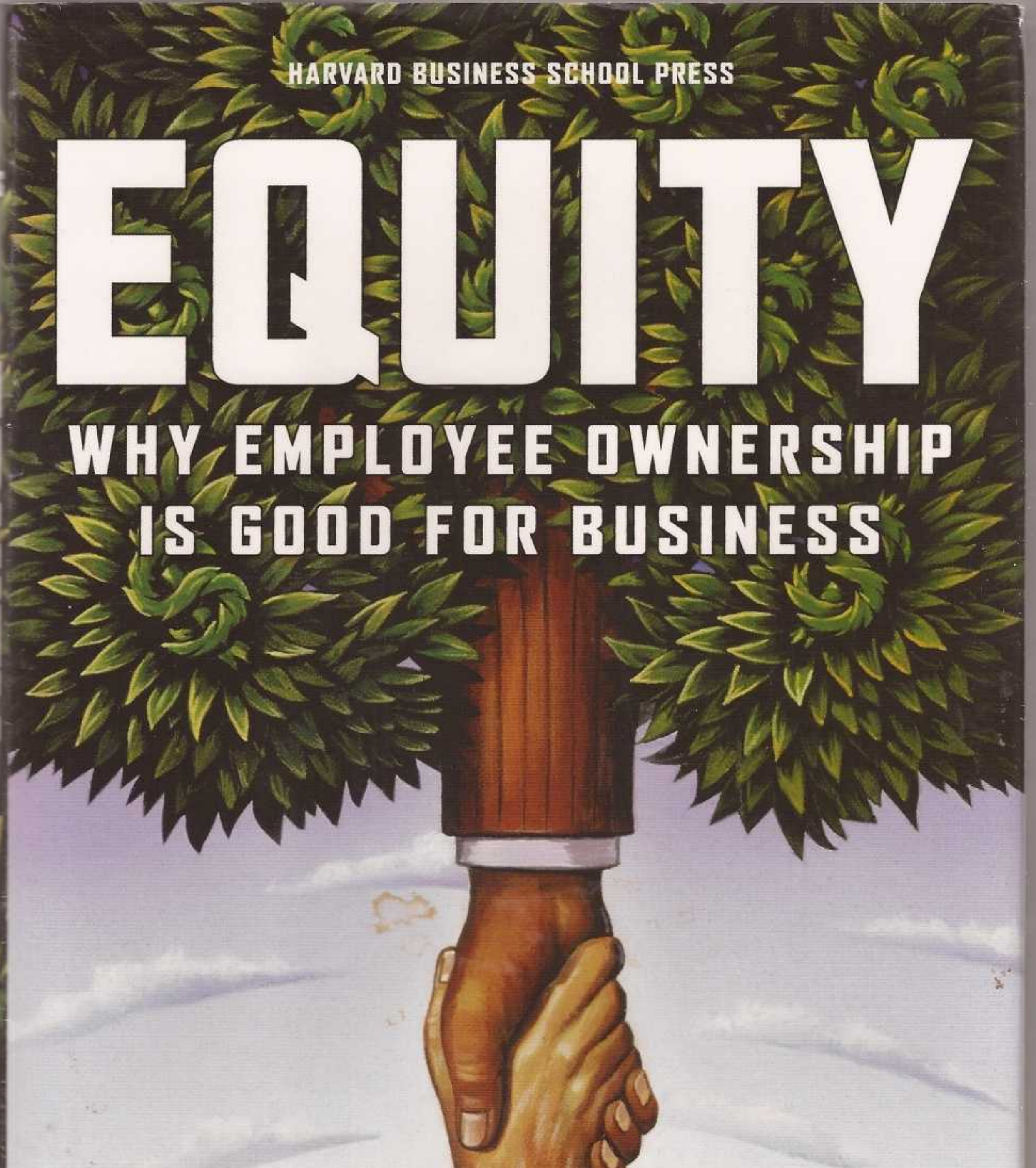

HARVARD BUSINESS SCHOOL PRESS

EQUITY

WHY EMPLOYEE OWNERSHIP IS GOOD FOR BUSINESS

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MARTIN STAUBUS

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The Equity Model

Stone Construction Equipment traces its ancestry back to a company called Stone Conveyor, established by a man named Guthrie Stone. In 1967 Guthrie's son Al took over the small construction-equipment shop and set up a new business to make cement mixers. The new company didn't do badly. In 1971 it hit $1 million in sales. By 1974 its six-, seven-, and eight-cubic-foot mixers had become something of an industry standard. In 1976 its sales were $5 million. The company branched out into motorized trowels and other concrete-finishing equipment. It bought state-of-the-art machining equipment for the factory, and it won a patent on a clutch system for those trowels. In 1979 Al Stone sold 2 percent of the stock to an employee stock ownership plan, or ESOP, which would hold it in trust for workers' retirement. In 1980 he brought in a marketing vice president named Bob Fien, with the thought that Fien might one day take over as chief executive.

But a couple of years later, for personal reasons, Al Stone decided he wanted to sell the business. Prospective buyers began touring the plant, and Stone's employees began feeling nervous. Fien proposed that, instead of selling to an outsider, Stone sell his stock to the ESOP. It's a common enough transaction in the United States: an ESOP borrows money to buy a company and then distributes stock to employee retirement accounts as the loan is paid off. Al was intrigued. The tax benefits were attractive. Fleet Bank was willing to provide financing. Fien would be taking over as president only a little ahead of schedule. So Al agreed. By 1985 he had sold 30 percent of his shares to the ESOP. In 1986 he sold the rest, and from that time forward the employees of Stone Construction Equipment were sole owners of their company.

Bob Fien—the name is pronounced Feen—hadn't come to Stone with that plan in mind. But he might as well have. Born in 1932, Fien had grown up in Rochester, the son of a factory worker. At the University of Rochester he had studied management, becoming a disciple of the philosophy known as Theory Y. Theory Y, which calls for an empowered, engaged workforce, had been developed by the management theorist Douglas McGregor, author of the classic book *The Human Side of Enterprise*. McGregor contrasted his Theory Y with Theory X, the traditional command-and-control model associated with Frederick W. Taylor's ideas about scientific management. Theory X assumed employees were difficult to motivate and had little to contribute by way of useful ideas or information. McGregor argued that if you engaged people enough, they would help find ways to make their work more productive and efficient.

Before coming to Stone, Fien had served as president of two troubled companies—a publishing firm in San Francisco and a manufacturer of costume jewelry in Rochester—and had turned them both around, using the precepts of Theory Y. He was now ready to put his ideas about empowerment to work in a growing manufacturing business. Employee ownership seemed to lay appropriate groundwork, but no more. "It was obvious to me, being 100 percent employee owned by itself was nothing," he said recently. Alone, "it didn't mean a damn thing. We had to change the culture."

So Fien embarked on a mission to transform the outlook and attitudes of his company's employees. Stone Construction Equipment wasn't an unusually adversarial place—it had no union, for example—but neither was it a model of enlightened management. "When I came in [in 1976], the theory at Stone's was, come in, punch your time clock, go do your job, and that's it," recalled Stanley Gerhart. " 'You do what we tell you. We don't want to hear your ideas. You just do your job.' The buzzer rings when you go to break, the buzzer rings when you go back to work. The whole scenario. 'Build a million of this and don't stop till we tell you.' The old philosophy."

Fien sent all his managers to classes with an industrial psychologist to learn a more respectful way of dealing with the people they supervised. (Up to then, he says, "they yelled.") He began talking to employees, sharing information about the company and asking for ideas about improving things. He did away with time clocks. ("Time clocks convey the idea that you don't trust a person to write down when they come in. So we had a big party where they smashed the time clocks.") He abolished the quality-control department and asked employees to begin checking their own work. He sent not just managers but nearly everyone in the plant to classes where they could learn the techniques of "lean" manufacturing, the production system developed and pioneered at Toyota. The whole thing was a long, hard slog. Some of the managers didn't take kindly to the new approach and barked out orders the way they always had. Some employees figured they now owned the company and didn't need to show up for work every day. When Fien tried to talk to production employees about the company's financials—literally walking them through the income statement in a series of meetings—he saw heads begin to nod. But they weren't nodding assent, they were dozing off.

Still, Fien kept at it. He introduced monthly meetings to go over just a few key financial numbers. He asked people to form committees to take on responsibilities such as preventive maintenance on the machines. He added niceties such as "thank you" tags on every piece of equipment, signed by the last person who checked it over. If a customer called to complain about a piece of equipment, he or she could talk with the people who built it—and those people would go out to fix it if necessary. Eventually he organized production workers into work cells, each one charged with a particular set of tasks; the cells would meet daily to go over the day's work, trade ideas, and raise questions or concerns. All these innovations soon began paying off. *Industry Week* named Stone one of the ten best manufacturing plants in America. The company introduced major new products, such as a line of ride-on asphalt rollers. It built an addition to the factory, asking shop-floor employees to give advice about how to configure the space. Sales climbed steeply and in 1998 topped $40 million. But a funny thing was happening: the head count, which had peaked at more than three hundred, began dropping with attrition. People were finding ways to produce more with less labor. By the end of the century, Stone was down to about two hundred and holding. Its sales fell during the 2001–2002 downturn but picked up again in 2003. Still, there was no talk of adding people.[1]

ON THE SHOP FLOOR

To go inside the Stone Construction Equipment plant and talk with employees is to understand some pieces of this puzzle, and indeed to see in day-to-day operation the different methods of management that we are calling the equity model. The tour takes you through engineering and customer service; out onto the shop floor, where sheet steel and components arrive on the loading dock and are turned into machinery; past the parts department; and back again to the office.

In engineering, Scott Woodruff demonstrates software that allows Stone to cut as many parts as possible from a single sheet of steel. Woodruff developed the software himself. "We entertained buying a program outside, but Scott and others sent them a typical print," explains Dick Nisbet. "They laid out all the parts and got them all on a five-by-ten sheet. But Scott got them on a four-by-eight. So we didn't buy the software package; we kept Scott." Woodruff taught himself most of the programming he knows. Not long ago, he noticed that a redesigned bag splitter—a piece of serrated metal attached to the company's cement mixer, designed to do what its name implies—could be squeezed onto a part of the sheet that would otherwise be scrap. So he designed a new one and began incorporating it. "No one told Scott to reduce scrap," says Lynne Woodworth, the company's chief operating officer. "He saw an opportunity and did it on his own."

Out on the shop floor, Freddy Johnson runs a computer-controlled plasma arc cutting machine (made by Hypertherm, as it happens—another company with extensive employee ownership). The cutting machine takes instructions from Woodruff's software and slices the sheet of steel into usable parts. Johnson shows several small inventions he and his coworkers have come up with to make their jobs easier and to check the quality of their output: a homemade go/no-go gauge, an adjustable grinding table, a new cutting fluid that keeps parts cleaner and needs to be changed less frequently. Overhead is a recently purchased $40,000 crane that lifts the heavy steel sheets. Dissatisfied with the trouble and risk of using the plant's big crane for the job, as they did before, Johnson and other operators found out how much this smaller one would cost, figured in the advantages for safety, and showed management how much time the new crane would save. Buying it was a no-brainer. "We just bring the stuff up," says Johnson, referring to the ideas that regularly are batted about by his work cell. "We talk about it, cost it out. We try to figure out what's the best bang for our buck. And if it's worth doing, we go ahead and do it." Safety is a primary concern, not just because "we don't like getting hurt" but because it saves the company workers' compensation costs. "If we don't get hurt, we don't have to do the [insurance] claims, and we keep that cost down. When it costs the company money, that means there's that much less money I can make."

Today's management literature, of course, is filled with anecdotes much like these—stories of empowered employees taking initiative, thinking and acting like owners of their company, even if they often aren't. The stories often provoke skepticism: how long are people really going to keep on behaving like that if there's nothing in it for them? But at Stone Construction Equipment the employees *are* owners, with stock piling up in their retirement accounts, and acting as such seems utterly ingrained. Nearly everyone offers examples like those just mentioned—something somebody did, on his or her own initiative, to improve things. Two employees volunteer to go to Mexico to fix a shipment that arrived in disarray. A team shaves a tenth of an hour off mixer production by deciding to put a mixer's tires on after painting rather than before. In the literature, the lesson typically stops at this point, as if business success somehow stems purely from a change in attitude and small everyday process improvements. Fien never bought that notion. Yes, he said, the culture is cool. Yes, the positive attitudes and process improvements developed by people such as Woodruff and Johnson are critically important. But equally important are the disciplines that govern the company's daily operation. These include a systematic long-range planning process; annual operating plans and timelines deriving from the long-range goals, with tight monthly checkpoints; a prescribed process for introducing new products; close management of sales accounts; and so on.

The key discipline seems to be an approach to production—lean manufacturing, as done at Toyota—that enables Stone Construction

Equipment to do things most of its competitors simply can't. Sheet steel arrives on the loading dock several times a day in small quantities; there is no warehouse. Parts are produced through what's known as a kanban system; each part needed by a workstation is "stockpiled" in two one-man pushcarts, and when assemblers find that one cart is empty, it goes back to the fabrication shop to be refilled. Stone forecasts demand, of course, and plans its overall capacity accordingly. But it does not build to forecast, it builds to order. It can take a customer's order for a customized ride-on compactor, painted green, on Tuesday, and ship the compactor out on Friday. It can crank out individually ordered smaller products such as mixers in twenty-four hours or less. Stone has thirteen product lines, more than 375 possible configurations within those lines, and endless possibilities for customization (for example, through different colors). Order a Stone Construction Equipment machine today, and you can have it—precisely as you ordered it—a few days later. Fien and Woodworth believe that this ability is the company's key competitive edge. It is a hard-to-emulate advantage that sets Stone apart and that has enabled it to prosper in a brutal market.

What makes the system work, however, isn't just the Toyota-style techniques, it's the willingness of Stone's employees to function in a manner that traditional manufacturing employees, accustomed to doing the same jobs day in and day out, would find astonishing. At 12:45 every day, Nisbet's factory supervisors, known as coaches, gather in a meeting room to plan production for the next twenty-four hours and to draft people to go to the departments where they're needed the rest of that day and the following morning. Throughout the day, each department has brief "huddles" to ascertain where they stand against the day's goals and to redeploy people as necessary. Virtually all the employees are cross-trained so that they can switch easily from welding to assembly to painting to something else. The job of figuring out how to meet a day's constantly shifting production goals is theirs, as much as it is any manager's. "The people on the floor get involved, so much involved that you wouldn't believe," says Stanley Gerhart. "I might say, 'Hey, I can get those two guards later; why don't you let me go get the robot parts; then I can run over and do the guards.' And another guy'll say, 'I'm gonna be OK for a while, Stanley; why don't you run over and get the robot, and I'll do the guards.' All these people put their heads together to come up with that thing at the end of the day." Whiteboards in each department track what needs to be done, who's responsible for doing it, and how things are going so far. "What you've got is each operator's name," says Nisbet, pointing to a board in the machine shop. "You see the 'one-third' sign up? That's a third of a day. They're going to do a checkpoint, like the quarters in football, and come back together for a three- to five-minute huddle at the third period." He gestures toward the board, which includes the notation "Joe—3." "Joe signed up to make three parts today by the first third. And he'll report at the huddle, 'I got three, or I got four, or I got two and a half and I'm in trouble making my signup today, so we might need to adjust the teams.' That's what you're seeing up there."

Nor does the involvement stop at the department door; people find other things to do while, for example, a milling machine is doing its work. Nisbet continues:

> The other thing we do in the machine shop is while we're milling, they see opportunities in other departments. They'll assemble gearboxes, they'll do the lower part of rammers out here, which in the old days were assembly jobs. So now they're taking advantage of their cycle time and actually doing more work to reduce the cost of that product. If you think about it, they are actually putting no [scheduled] time toward that job. Their actual time is toward this part that they're making, and so you're getting that one free.

In a conventional company, he adds, none of that would happen, because employees would complain loudly. "'You're making me do more work!' Well no, we're not. The guys, because of the involvement, the education, they are seeing the opportunity and bringing that to the bottom line."

That approach—everyone pitching in to figure out exactly what needs doing—seems to permeate Stone Construction Equipment, and not just on the factory floor. People in customer service huddle up at the start of the day to check on outstanding orders. People in the parts department watch the fax as it spews out the day's orders, and if necessary will call in a person or two from the shop to help fill them. Sally Schinsing runs the print shop, which produces product manuals and marketing materials, also on a just-in-time basis. "When we have corporate mailings, she will actually draft players from the organization—marketing folks, production folks—and when she's done, she sends them back," says Nisbet.

Stone's methods have their drawbacks. "It's a very, very fast pace," acknowledged Gerhart, who is in his fifties. He sometimes worries that he won't be able to keep up. "I'm an old man in a young man's game." Nor does every last employee buy into the equity model. A welder named Burt Farley, asked to talk to a visitor, declared firmly that Stone was "not the Shangri-la that Bob [Fien] might want you to think it is," and said that he himself worked at his own pace regardless of the daily goals. "Sometimes their expectations are a little more than I care to do, and I don't feel bad about that." Farley didn't even buy the idea that he was "really" an owner. "This company is really no different than any other company, is it? The ESOP is nothing to me until I get ready to retire. Until then I work for The Man." On the other hand, Farley reported that he had been at Stone twenty-four years, held roughly $100,000 worth of equity in the business, and considered the company a "good place to work." He may be a reminder that no management system can please all of the people all of the time.

But Stone Construction Equipment—the company—is a reminder that Americans don't necessarily have to cede every manufacturing job to lower-wage competitors. Because they have found a different way of working together, Farley, Gerhart, and the others still have jobs. The people who worked for Stow, 180 miles down the road in Binghamton, do not.

THE "EQUITY ATTITUDE"

The central phenomenon we observed in the businesses we visited—in fact, it may be the defining characteristic of an equity company—is a particular attitude, a turn of mind that most of the people at Stone Construction Equipment seem to have taken to heart. It might be described with the phrase *This is* our *company, and we will do whatever is necessary to help it succeed.* This attitude shouldn't be idealized or taken lightly. It is difficult to engender and to maintain. It typically entails a ton of hard work and extra effort. Like any business owners, employee owners in these companies are rarely idle. They put in off-the-clock hours. They keep a sharp eye out every day for ways to save a nickel or bring in another dollar. They worry about what to do when the numbers don't look right. They do not say, "That's not my job" when something needs doing; they plunge in and do it. "When a machine operator left W. L. Gore last year," wrote *Time*'s Laird Harrison in 2002, "the human resources department naturally began looking for a replacement." Then before anyone got as far as posting a want ad, the man's former team members met and figured out how they could make do with one less body. They would have to work harder without more pay, but they wanted to do what was best for the enterprise. Said Gore human resources associate Sonia Dunbar, "That doesn't happen at other companies."[2]

But of course it does happen at companies that, like W. L. Gore & Associates, take equity ownership seriously. In fact, we heard versions of this attitude not only at Gore—see chapter 6—but at companies large and small, in many different industries, from veteran employees and those more recently hired, from professionals with PhD's, from managers with (and without) MBA's, and from frontline workers with high school educations.

Take the twenty-plus people who work at the King Arthur Flour retail store in Norwich, Vermont, just off Interstate 91 and across the river from Hanover, New Hampshire. One of the oldest companies in America, King Arthur has metamorphosed over the last several years from a producer and distributor of high-grade flour to a specialty company that caters to amateur and professional bakers. It sells its wares—flours, mixes, baking implements, and the like—over the Web and through a catalog as well as through retail outlets. Its own retail store and baking-instruction center have become a destination for baking aficionados, a pint-sized version of what L.L. Bean, for example, is to outdoors enthusiasts and fashionistas. King Arthur is 100 percent owned by its 150 employees, and store manager Cindy Fountain describes what it's like to run a retail outlet in which everyone is an owner:

> We're employee owners here. We're all partners in providing our customers with a retail experience that they will enjoy, be comfortable with, remember. Opening the doors is one of my

> favorite times of the day. My team leaders and I get in a huddle. We determine what's going to happen that day. We discuss the budget number for the day, where we need to be at the end of the day . . . Cindy Johnson, she's the one on the sales floor. She needs to know, three hours into the day, OK, a quarter of our sales are there. At noon, are we halfway there or not? And she can make the call: we're a little under budget today, does anybody want to go home? Or, gee, we're busier than we thought we were, a bus came in we weren't expecting, can you spend an extra couple of hours? The employees are absolutely flexible . . . because we own the company. Doesn't mean I won't be grouchy and tired sometimes, but I own the company.
>
> We don't have a laundry service. We take our dirty towels out of the kitchen every day and take them home. Susan Miller takes all the things that are used in the baking-education center home and washes them. It's crazy, but it's true . . . Cindy Johnson does all our gift certificates—getting an envelope, putting a catalog in it, putting a gift certificate into it, making a pretty presentation. We're very proud of the store, and the company. As the manager, having a team of employee owners actually makes my job easier. A few times a year, we host storewide sales, and these sales require more staff than usual. I have never had a problem asking staff to come in early to help prepare, to stay late to help close, or even add an extra shift if necessary. As a company of employee owners, the response is always, "What can I do to help?"

Or listen to David Snyder, of SAIC, which is about as far away from King Arthur as you can get. His company, headquartered in San Diego, California, is a *Fortune* 500 giant, with close to $7 billion in revenue and more than forty thousand employees. It is almost wholly owned by present and former employees through a variety of broad-based stock-ownership programs that we will discuss in chapter 5. Snyder, an MIT graduate with a master's in economics from UCLA, has had a long business career with high-tech firms and since 2000 has been director of business development for SAIC. His job is to license technologies developed by SAIC scientists and engineers into the commercial sector:

> It's astonishing to me. A company our size, being as far-flung as it is, I routinely communicate with people by e-mail or telephone, some of whom I've never met. And yet I hear the same words coming out of everyone's mouth: "As an employee owner," they say, "I think we should protect our intellectual property this way." Or "We should try to get some extra money for ourselves that way," or "We should watch that expense." That phrase always comes out: "As an employee owner, I think . . ." It's almost like a code word.
>
> This may sound weird, but I treat my own job like my own little business. Every day—and I don't mean that figuratively or metaphorically—every day I ask myself, "What am I going to do today that's really valuable from a dollars-and-cents point of view?" All too often, working in an office, you get caught up in "I'm busy therefore I'm productive." [laughs] But if I only work ten minutes a day and I have brought in $10 million during those ten minutes, that would be a good day. It's the value of what you do. That's what I try to focus on.

John Cain is chief executive officer of Scot Forge, a five-hundred-employee open-die forge shop with three locations northwest of Chicago; in keeping with company tradition, he likes to wear a bright tartan sport coat to work. Scot, which is wholly owned by its employees, converts raw steel into huge rings and other shapes that are used in heavy industrial machinery and defense applications. What matters most to many of Scot's customers, Cain explains, is delivery time: if they have a machine that is down because a big gear must be replaced, they can't afford to wait a minute longer than is absolutely necessary. So Scot prides itself on getting the job done when the customer needs it:

> And even if it's something that's not a typical lead time, if you have to short-cycle that thing, we will work Sundays. It's not a management thing; it doesn't take any involvement from me at all to get that done. If I come in Sunday and just walk through to see what's going on, there are two or three machines running. I'll go up and talk to [the operators]; they'll know everything about the customer, the job, where it's going, why they

> need to be there doing it . . . No one has to come in here and get overtime approved. And no one says, "Well, is it worth it to me giving up my weekend to keep the customer satisfied?" They understand this as an owner; in business you're here to serve customers. They find ways to share the load and share the time . . . They might work a shorter shift: maybe they can come in and work four hours at a time, or three, four guys will come in and get it done instead of one guy having to spend the whole weekend. We don't say, "You gotta work Saturday" or "You gotta work Sunday." They know better how to get it done. We owe them the information so that they can figure out the best way to get it done. Many times they come up with a plan to get it accomplished without having to work through a weekend.

Tom Allison, a heat-treat operator who has been with Scot four years, explains why he thinks people at the company work this way:

> I guess if you're an employee and you understand you own a part of it, you're going to work harder for yourself than you are for someone else. Because someone else is going to be making the money, and you're doing the work for them. Here you're doing the work for yourself. It all comes back to that . . . I would say that if I was at any job, I would give 100 percent. But you feel much better when you come here and you're working for yourself. It's good to see the guys around you all giving 100 percent [too].

And John Kasprzak, a machinist who has been with Scot five years, describes how he personally approaches his job:

> We're an employee-owned company. We care, and we're watching what people around us are doing . . . For myself, in my job, I'm always looking for things that I can do faster. Be more profitable. Be more profitable. The more profit we can bring in on this machine I'm running, the more my shares are worth, the better my retirement is going to be. The bigger my dividends are going to be. All those things, they're all based on how we work and how everything goes. And just being effective and efficient.

It should be noted that this attitude turns a couple of centuries of capitalist history on its head. Employee ownership and equity-based management, if we can call it that, establish a rough unity of interest between management and labor, and between owners and employees. It puts people who traditionally have fought with each other, or at least regarded one another with perpetual mistrust, on the same team. Brad Bartholomew, a Southwest Airlines captain who has written extensively on airline labor relations—and who, like virtually all Southwest employees, holds stock in the company—succinctly describes the difference in his industry between the conventional model and the equity model. The former model

> . . . basically says management's job is to handle everything associated with the company's success and labor's job is to fight to get what it can from the company . . . Following this path generates little talk or concern with making the total pie bigger. Labor relations and profitability are consistently ugly. [The latter model] . . . says both management and labor are sailing on the same ship and must find a way to work together—sharing in the setbacks and the booty. On this path there is a genuine shared focus on making the pie bigger. Labor and management work cooperatively to find solutions and implement them together. Both sides feel a sense of pride, uniqueness, and ownership. Disagreements and heated arguments do sometimes occur, but they are not resolved by fighting.[3]

THE THREE ELEMENTS OF THE EQUITY MODEL

So how does a company reach the point where most employees share this attitude? That's where the specifics of ownership and management come in—how the business is structured and how it is run. None of the companies we studied followed exactly the same path. But the research and interviewing suggest that there are three key elements and that without all of them, it won't work. One element is equity itself—stock ownership significant enough that it matters to employees' financial future. The second is a culture that helps people think and feel like the owners they are. The third, and often overlooked, element is a shared understanding of key business disciplines, and a common commitment to pursuing them. We'll briefly examine each element of the model here and then return to them in considerably more detail in chapters 5, 6, and 7.

Equity Ownership

Ownership is indispensable because it is what tips the balance of the conventional employment equation.

Traditionally, those who provide the capital to a company own the entire business. Management is accountable to these owners and to nobody else. While owners can lose their money if the business goes south, they have a claim on *all* the earnings and *all* the growth in equity value if it succeeds. So their interest in the company's growth and profits is paramount. If you weren't born with the talents of a Michael Jordan or a Madonna, and if you didn't happen to choose wealthy parents, this is how you can get truly rich—by investing in and building a successful business.

If you are a traditional business owner, however—and if your company is larger than a one-person or one-couple operation—you face a time-honored challenge. You must pursue growth and profits through a workforce of employees who do not share your interest in growth and profits. Of course, employees have an interest in seeing that the company fares well enough that it does not close its doors and eliminate their jobs. And if it grows, *maybe* they can earn more money or get a better position. But the connection between business success and their own is at best tenuous and uncertain. So unless the company is in dire straits, why on earth should they exert themselves unnecessarily to make sure that it succeeds and prospers? Why should they come up with time-saving ideas or productivity improvements? Indeed, why should middle managers listen if they do? As Tom Allison observes, "Someone else is going to be making the money."

Modern management has recognized this divergence of interests and has created a whole kit bag of carrots and sticks to address it. Employees get frequent performance reviews, always backed by the threat of dismissal. They are subjected to motivational speeches and team-building exercises, in hopes that they will be inspired to perform better (and not look for a job somewhere else). They are "incented" with bonuses, merit raises, and prospects of promotion. Readers who serve in corporate human resource departments will recognize themselves as the keepers of these kit bags and no doubt can talk intelligently about how their own company uses a judicious combination of both sanctions and stimulants. But whatever an individual company's mix, the expectation is that employees will not move forward to pursue corporate growth and profits without them. The expectation is often clearest in unionized settings, because of the overtly adversarial system of labor-management relations that has been part of American law since early in the last century. The strike and the lockout are this system's quintessential weapons: each says, in effect, *we on our side are willing to damage the company*, where our joint interests lie, in order to further our own interests at the expense of yours.

In principle, employee ownership transforms this dynamic because it gives everyone in the company a direct and visible interest in the longer-term success of the business. From top management to the front lines, the participants in employee-owned companies are partners in enterprise, sharing a single agenda and common goals. But note that we said "in principle." In practice, the traditional assumption of conflicting interests does not disappear overnight. Changing it depends partly on *how much* equity employees own. Sporadic gifts of one hundred stock options, or a few shares added to 401(k) retirement accounts each year, are unlikely to make the recipients recalculate their economic interests. Substantial holdings, however—holdings that grow significantly from year to year—may do just that. Change also depends on education that helps employees understand the implications of their equity ownership. This is a theme we'll return to repeatedly in this book.

These not-too-surprising truths are reflected in a common perception at equity-based companies, which is that it often takes a while for new employees to "get it"—to realize that they actually are co-owners of the business—and that one key element in getting it is simply watching the value of their holdings mount. Here is Karen Garsson, director of stock programs at giant SAIC:

> I think there are a number of people, to be honest with you, to whom ownership doesn't mean a lot at Day One . . . But ownership is a core part of our company, and over time we see that

> folks really start to understand it. The light goes on after a while, and people begin to value the opportunity to own part of the company they work for.

And here is John Czerwinski, who works in a sales role at W. L. Gore & Associates, which with approximately seven thousand employees is still one of the larger employee-owned companies:

> I've watched a lot of new people come in. It really surprises you, because they're very capable, very savvy; they talk about Gore and what we offer. The ASOP [associate stock ownership plan]? It's "Yeah, yeah, I know we've got the ASOP." And then you talk to the same person two, three, four years later, and it's like, "Holy cow, I never really understood what you were talking about." I've had a lot of people all of a sudden say, "OK, this is an interesting horse to ride." Because they could see, ching ching, they could see something was really happening to them.

It doesn't seem to matter, incidentally, what percent of a given company's stock any single employee owns. For larger companies—particularly those that are publicly traded—the percentage owned by employees as a group is usually small (less than 20 percent) anyway. What does matter is the size of the stockholding as compared with an employee's personal financial expectations. You feel like an owner when what you own feels like a significant asset.

But while an ownership interest of real financial substance is necessary, it is hardly sufficient. The way a company goes about its business needs to change in key ways as well. If it grants plenty of stock but then says in so many words, "Now back to work as usual," it will get results as usual. What it has to do instead is create an environment—a culture—in which people come to feel like the owners they are.

Ownership Culture

The typical "culture" at conventional companies—the norms and expectations that govern what people do every day on the job—has evolved considerably over the past couple of decades. Employees and managers were once part of a rigid hierarchy. They did what they were told to do by those above them in the chain of command, and they didn't ask questions. The hierarchy was reinforced by different expectations relating to dress, hours, freedom to come and go, pay and bonuses, parking spaces, office size, job titles, and a dozen other indications of power and status. More recently, many companies have tried to soften the hierarchy. They have done away with some status distinctions (no reserved parking spaces, no executive lunchroom). They have preached that "people are our most important assets," and have exhorted employees to use their brains as well as their hands. They have announced that they wanted their employees to have a "sense of ownership," even when no actual equity ownership was available to employees. (This is a bit like taking hungry people into a restaurant to give them a "sense of lunch," without allowing them to order anything.) Line managers, of course, didn't always buy into such high-minded pronouncements. They had reached their current positions because they were good at telling people what to do, and they weren't about to change now. Most employees remained pretty skeptical as well, for the reason outlined earlier: most of the benefits were still going to someone else.

Equity companies usually resemble these conventional businesses in some respects. They have presidents and chief financial officers. They have middle managers and supervisors. But they can alter the assumptions of hierarchy far more dramatically, simply because the underlying economic reality is different. Employees find the idea of acting like owners less hypocritical and therefore more appealing. Managers may find it somewhat more difficult to bark out orders to fellow owners. At their best, such companies eliminate the sense of "us" and "them" that pervades traditional companies—they become "us" companies in a way that is almost palpable. Again, however, none of this happens automatically. Companies must find ways to communicate the message that this workplace is different and that the role of employees and managers is not what it would be at a conventional business.

One technique for establishing a culture of ownership is simply to share large amounts of information about the business and its operations, including much of the financial data to which investor owners are traditionally privy and that senior managers use to run the business. Nearly all of the smaller companies we studied hold monthly all-hands meetings to review key financial figures and other issues of concern. Nearly all publish the numbers in newsletters or reports to their employees. SAIC conducts quarterly Webcasts, available to every employee, in which the CEO and CFO report on and analyze the company's financials, in much the same way that executives of publicly traded companies conduct quarterly conference calls with analysts and large investors. Note, however, that simply sharing consolidated financials at the corporate level once a quarter, in the manner of public companies, is not sufficient. What's important is that employees see the operational financials—plant, office, or store-level—that managers use to make decisions.

Conventional companies can assume that their principal owners don't need any instruction in matters like how to read a financial statement. Equity companies can't. So many devote substantial resources to training in business literacy. At Green Mountain Coffee Roasters, for instance—a six-hundred-person publicly traded company headquartered in Waterbury, Vermont—employees organized and taught a seven-and-a-half-hour course, spread out over three sessions, that instructed people in the basics of the company's business ("tree to cup") and financials. "By design, the classes were cross-functional," says Roger Garufi, a machine operator who was one of the course designers and instructors. "You'd be rubbing elbows with people from the senior leadership team or the roasters. Everyone in the classroom was in a different department, which was really nice."

A second technique is simplicity itself: before making decisions, managers ask employees what they think. One company—Atlas Container Corporation, a box-manufacturing business with several plants in the eastern United States—went so far as to ask shop-floor employees to choose between competing suppliers of a $1 million corrugating machine; when the employees selected an American-made model, the company's top executives agreed to the decision even though they favored an Italian machine.[4] YSI, a manufacturer of precision sensor measurement instruments with headquarters in Yellow Springs, Ohio, and thirteen other locations around the world, holds regular company meetings to discuss issues. Anytime YSI introduces something new, says chief executive Rick Omlor—a policy, a process, whatever—"we ask how people think about that, how they feel about it. As carefully as you might think about all the aspects of a new policy or plan, there will be two or three that you never [anticipated]. You just don't know what you don't know." Employee concerns, he adds, frequently lead to changes. "Every time we have done that, we have modified the plan or the process . . . It's not about people voting on everything and making every decision. But on big decisions that affect the whole company, at least let them participate in the discussions." At a growing number of companies, moreover, management simply entrusts employees to make decisions on their own. Teams at W. L. Gore & Associates and at many other businesses have considerable authority to run their own part of the workplace, including setting their own work schedules. Individual employees at Southwest Airlines and at many other businesses are allowed to make decisions on the spot, in the best interests of the customer, without asking a supervisor. We'll see more examples of this sort of self-management in chapter 6.

Equity companies have also developed a host of other techniques, at once symbolic and substantive, for breaking down hierarchy. Like Stone, for example, Scot Forge did away with time clocks and now describes itself as having an "all-salaried workforce." The phrase isn't strictly accurate—federal law requires nonsupervisory employees to be paid by the hour, because they must be paid overtime after forty hours a week—but it captures something important, which is that hourly employees are trusted partners and won't be docked if they have to run out to a doctor's appointment. The companies are also much more likely to implement the host of "participatory management" techniques that have become conventional wisdom (if not conventional practice) about how companies should be run. These include work cells, self-managing teams, cross-functional teams, open-book management, job enlargement, devolution of authority to lower levels, and other approaches to structuring—not just encouraging—employee involvement in workplace decisions.

Some of the cultural changes have a direct impact on people's careers and livelihoods. Equity companies make a point of cross-training people, encouraging career development, and promoting from within. They also take a different attitude toward layoffs, the threat of which has become the bane of nearly every employee's existence in today's turbulent economy. They may let people go in a pinch; no company that expects to survive can swear it will always maintain employment. But layoffs are a last resort, not a first. In 2003, Cindy Turcot, chief operating officer of Gardener's Supply, a catalog retailer in Burlington, Vermont, reflected on her company's situation:

> And this year again, we had a soft time, so I said, "These are the steps before we do a layoff. First, there will be no new positions. Then a pay freeze. Then pay cuts. Only then would we do layoffs. So there are three steps before we do layoffs, and I will tell you every week if we have gone beyond step 1."
>
> I don't want people to go to fear. When they're in fear, when they think they're going to lose their job, I don't want that. So that's the goal: let people know where they are. Then they can go to the place of "What can I do?"

In fact, Turcot reports, the "What can I do?" mentality in this case was startlingly productive: Gardener's realized some $400,000 in savings over the course of the year, thanks to employee ideas. That made a big difference to the $60 million company's bottom line. "Even though sales are down," said Turcot, "we are going to hit our budget target for profitability. I attribute a lot of that to what employees are doing."

Business Discipline

All profitable companies make money by assembling a variety of components. They bring together capital equipment, money, and warm bodies, and they apply a series of business skills, such as production or service-delivery expertise, sales and marketing, and financial management. Exemplary companies are successful mostly because they learn to do things with some of these components that their competitors can't. They focus on one or more business disciplines and turn themselves into world-class practitioners. Thus no competitor has yet been able to match Intel's ability to produce and market leading-edge computer chips, or Wal-Mart Stores' ability to keep prices low.

At successful equity companies, employees both learn and drive the business disciplines that help their company do well. This is one key theme of the book you are holding. In the past, notions such as employee involvement and employee participation have been less than rigorously supported. They have been based on no more than a loose belief that it is good for companies, as well as good for people, to have employees a little more concerned with the day-to-day operations of the business. An explicit connection between that involvement and business performance has been lacking. When employees understand their companies' key business disciplines, however—when they understand both how to contribute to improving performance and how to measure the results of their efforts—the connection is clear. There is a line of sight from job to business performance, from engagement to results.

Not surprisingly, that connection is easiest to see in small companies, although the equity model can work just as well in large ones as in small ones. Consider the story of Jackson's Hardware, a sixty-seven-person, 100 percent employee-owned company in San Rafael, California.

Like Stone Construction Equipment, Jackson's is the kind of business most people think has vanished. It is an old-fashioned, single-store hardware and home-goods retailer that has survived and prospered right under the nose of big national chains. "We have a Home Depot located about a mile and a half from our store," said company president and general manager Bill Loskutoff. "We have an Orchard Supply—it's owned by Sears—about a half mile away." Loskutoff ticked off several other larger competitors—lumber yards, contractors' supply chains, a regional home-improvement center known as Yardbirds—and reported a curious fact. "When Orchard Supply came to town, our business increased. When Home Depot came to town, our business increased." Asked why, he shrugged. "People who were not customers of ours, maybe they had gone to various places and were dissatisfied. They thought they would find their ultimate hardware store at Home Depot, but they got there and found out it wasn't. They just kind of migrated over to us, and our business kept growing."

Jackson's competitive advantage lies in friendly and knowledgeable customer service, the kind often missing from big chain stores. It is set up to deliver precisely that. There are no cashiers: associates are expected to take customers through an entire transaction and to make sure they have everything they need. Managers and supervisors wear walkie-talkies on their belt so they can call in experts from another department if they can't personally answer a customer's question. Associates typically move from one department to another over time so that they can build their own stock of knowledge. (The average tenure at Jackson's in 2004 was roughly ten years.) The importance of customer service is drilled into every associate's head. "At larger companies, people don't seem to care as much," says Mark Helm, a warehouse supervisor who worked at Home Depot before coming to Jackson's. "The people here are more concerned, making sure they follow through with their customers. And if they don't, they have to answer for it. Don't leave the customer with bad service. Give good service. We're not going to differentiate ourselves [otherwise]."

From a financial perspective, however, what matters to Jackson's associates is weekly and monthly sales. The sales number is a gauge of how well they are serving their customers. It is also the store's key metric of business performance. Jackson's associates know that their colleagues can source the store's wares effectively and price them appropriately. So if sales are healthy, the bottom line will be healthy as well, and the company will prosper. Accordingly, people throughout the organization worry about sales levels the same way company founder H. C. Jackson must once have done, when he was the sole owner. The monthly sales goal and month-to-date figures are chalked up on a whiteboard in the lunchroom. A dip in sales is the occasion for quick action. In late 2003, for instance, associates noticed sales were a little sluggish, and someone proposed a special holiday sale. This is how one group remembered it a few months later:

> *Steve Graham, showroom manager*: We were watching the monthly goals. We are on a fiscal year, July 1 to June 30, and we're a construction-oriented company—so the winter can be kind of dreary! It was a point where we were almost halfway through our year; we were doing OK, but we could really see that we could get up and over, hit our goals, or we could fall apart. It could definitely have gone either way. And from that, we started looking at, let's do everything—what can we do? Let's do everything we can to push this hard and get over the top and stay there.
>
> *Carolyn Emge, accounts-payable clerk*: We were saying, what can we do? And everyone was throwing in ideas. [One idea was the special sale.] We had the monthly meeting and suggested to the other associates that without them we can't do the sale.
>
> *Robert Akins, service supervisor*: And everybody came together. Everybody went in to decorate the store, work extra. And the

> buying team did a really great job by getting bonus [deals] with our vendors. So everybody did their part. Nobody was complaining about having to work overtime. It was just one big team effort.
>
> *Carolyn Emge*: And we had a goal—wasn't it $100,000 in one day?—we had a goal that we were trying to meet, and it got fun during the last two hours. "Are we going to make it?" And we did!

Employees at other equity companies learn to focus on other metrics, depending on the key business disciplines. The metrics may be numbers right off the budget, or indeed right off the income statement (gross margin, cost of goods sold, net profit). Or they may be operational variables that directly affect the company's financial performance. Stone Construction Equipment's lean manufacturing system, for example, by itself boosts efficiency and lowers costs, when compared with traditional manufacturing. But employees' tracking and monitoring make the lean system even more efficient than it otherwise would be. The key number shop-floor employees watch is labor variance, meaning the difference between actual and budgeted labor content on any one product. Teams set labor variance goals. They track their performance day in and day out. Any time they beat their goal—symbols again—managers cook and serve the employees an elaborate meal. "I imagine [the mixer cell] will have steak, shrimp, and lobster on Friday," said Dick Nisbet one day in late 2003. "Their goal was a $3,500 labor variance for the month, and they came in at $4,700." Thus does Stone make itself a little bit more competitive, day in and day out, week after week and month after month.

So that is the equity model: stock ownership, a culture that enables people to feel and think like owners, and a shared commitment to key business disciplines. As we noted, we'll look in detail at the three elements in chapters 5, 6, and 7, one element per chapter. We'll dissect each one; we'll show how different companies put the basic notions into practice; and we'll draw out the lessons for companies that want to embark on this high-performance journey. But first we want to take a little detour into history. People familiar with management theory will recognize that our model has two ancestors: employee ownership, on the one hand, and what has been called participative (or participatory) management, on the other. The combination of the two makes for a particularly powerful change in employees' attitudes and actions, hence for a dramatic improvement in business performance. Curiously, however, these two strands have very different pasts. Despite some overlap, reformers and management innovators have typically focused on one or the other of the two goals, not on both at once. That led to some dead ends and disasters, such as what happened only a few years ago at United Airlines. If it's true that those who don't remember the past are condemned to repeat it, we should review these two disparate ideas carefully so that nobody again tries to separate them.