Preface

THIS BOOK IS a sequel to an earlier work that both explored the effects of high commitment work practices on organizational performance and sought to understand the reasons why these manifestly effective ways of managing the employment relation weren't more commonly or readily adopted. After publishing *Competitive Advantage Through People* in 1994, I taught the material in both a required MBA course on human resources at Stanford and in executive seminars all over the world, and this experience, along with a number of outside developments, convinced me of the need for this book. First, additional data became available that make a powerful business case for managing people effectively as a source of outstanding organizational performance. Second, I developed even more of my own experience with organizations that were managing people effectively, and I also enjoyed contact with and learned from organizations that were trying to change but having difficulties doing so. From all of this field experience I acquired a better understanding of the factors and issues associated with implementation and learned more effective ways of assisting organizations in thinking about human resource issues.

But perhaps my biggest reason for writing this book was that I was particularly intrigued and troubled by the trends I observed in management practices as well as by some reactions to the ideas in the earlier book. I was told, both by practicing managers and by people such as John Paul MacDuffie, who reviewed *Competitive Advantage Through People* for the journal *Administrative Science Quarterly,* that at least some of the dimensions of high performance work systems that I had highlighted as being important, such as employment security, might be of value but were nonetheless decreasing in frequency. In fact, the ability and willingness of U.S. firms to downsize and restructure was argued by some observers to be a source of the resurgence in the competitiveness of many American companies. Nor was this the only example of a discrepancy between what theory and research prescribed and what firms were doing. Contingent work was on the rise, diminishing the connection between people and their organizations even as businesses claimed to be seeking a committed and motivated work force. Individual piecework and a return to the control-oriented ideas of Frederick Taylor seemed to be enjoying a resurgence even as "empowerment" became an increasingly overused word. Even as evidence accumulated about the slow diffusion of more effective work practices, sympathy for any role for public policy or collective action, paradoxically, decreased. And so it went.

It was as if the trends in actual management practices were moving in one direction while the evidence grew supporting practices based on an opposing approach. Consequently, I wanted to explore the two possible explanations for this dichotomy. One is that I and many others were simply wrong in our ideas about these issues. The second was the possibility that much of the conventional wisdom, at least as represented in the U.S. business press, and a great deal of current management practice was inconsistent with both logic and data. Organizations might be incurring long-term organizational problems for short-term palliatives.

In doing the research and writing for this book, I have come to understand that ideas with both empirical and logical support that seem on the surface to be common sense often aren't implemented and sometimes aren't even recognized. Simply put, common sense is not all that common. The incorrect implication frequently drawn is that if something isn't being done, it must not be as useful or worthwhile as is thought. This idea of adaptive, rational behavior is deeply ingrained, but it is not invariably correct. I have had conversations with Louis Uchitelle, who writes about work-place issues for the *New York Times,* during which we have shared the observation that sometimes people in organizations simply don't practice basic common sense, don't behave strategically, and aren't always thoughtful or logical about the policies they implement. As I learned that my observations about the role of labor unions, new employment arrangements, compensation practices, and, for that matter, government action defied both conventional wisdom and dominant ideology, I frequently heard comments to the effect that "everyone is doing (or thinking) something else, so what can we do?"—even as the speaker recognized the folly of current organizational arrangements.

From considering these challenges and ideas, I developed two insights that I believe to be common sense but which are nevertheless not widely held or implemented: First, it is almost impossible to earn above normal, exceptional economic returns by doing what "everyone else" is doing—prosaically put, you can't be "normal" and expect "abnormal" returns; and second, it is also impossible to achieve some lasting competitive advantage simply by making purchases in the open market—something that anyone can do. It became clear to me that I needed to write another book in which I more directly confronted the most unhelpful and incorrect variants of "conventional wisdom." So, here it is.

Introduction

Something very strange is occurring in organizational management. Over the past decade or so, numerous rigorous studies conducted both within specific industries and in samples of organizations that cross industries have demonstrated the enormous economic returns obtained through the implementation of what are variously called high involvement, high performance, or high commitment management practices. Furthermore, much of this research serves to validate earlier writing on participative management and employee involvement. But even as these research results pile up, trends in actual management practice are, in many instances, moving in a direction exactly *opposite* to what this growing body of evidence prescribes. Moreover, this disjuncture between knowledge and management practice is occurring at the same time as organizations, confronted with a very competitive environment, are frantically looking for some magic elixir that will provide sustained success, at least over some reasonable period of time.

So, even as firms desperately seek success and the evidence for at least one important source of economic success—how firms treat their people—accumulates, many if not most organizations are doing precisely the opposite of what they should. Rather than putting their people first, numerous firms have sought solutions to competitive challenges in places and means that have not been very productive—treating their businesses as portfolios of assets to be bought and sold in an effort to find the right competitive niche, downsizing and outsourcing in a futile attempt to shrink or transact their way to profit, and doing myriad other things that weaken or destroy their organizational culture in efforts to minimize labor costs—even as they repeatedly proclaim, "people are our most important asset."

Our first task in this book is to consider what are the real sources of organizational success and, indeed, if it is actually still possible to build firms capable of achieving sustained levels of outstanding performance. So, the first two chapters explore the relationship between how firms manage people and the profits and performance they earn. The returns from managing people in ways that build high commitment, involvement, and learning and organizational competence are typically on the order of 30 to 50 percent, substantial by any measure. We will see, from both quantitative evidence and qualitative case examples, that it is more important to manage your business right than to be in the "right" business. Success comes from being able to effectively implement a competitive strategy, not merely from having one.

When we next consider the basic elements of high performance organizations, in chapter 3, and a framework for implementing and aligning these practices, in chapter 4, we will begin to understand why, in spite of the extensive literature documenting the extraordinary economic returns that can be achieved, so many managers don't implement these ideas. Many of these management principles seem to fly in the face of both conventional wisdom and common, increasingly dominant, practice. There is a dramatic increase in contingent work arrangements, for example—use of part-time, temporary, or contract employees—as well as a growing reliance on corporate downsizing, both of which diminish the connections between people and their organizations even as the organizations using these strategies claim to be seeking a committed and motivated work force. Individual piecework and a return to the control-oriented ideas of Frederick Taylor and the scientific management school are enjoying a resurgence even as the word "empowerment" becomes so overused as to be trite. Organizations are obsessed with reducing their pay rates even as the evidence grows that (1) labor rates are not the same thing as labor costs, (2) in many industries, labor costs are not the most important or even a significant component of total costs, and (3) many alternative and frequently more effective competitive strategies are available. While the evidence accumulates demonstrating the slow diffusion of more effective work arrangements, sympathy for any role for public policy or collective action to assist the implementation process, paradoxically, steadily decreases. Because of this disjuncture between evidence and practice, the second part of this book explores some of the ideas that most diverge from current practice and examines both the logic and the evidence suggesting that what currently passes for conventional wisdom and sound thinking is, for the most part, neither wise nor logical.

But, you may be thinking, aren't these trends in employment practices—contingent work; downsizing; substitution of employment security with "employability"; individual, performance-based pay; and eschewal of government or institutional involvement in the labor market—most pronounced in the United States? And aren't business organizations in the United States among the most competitive and innovative in the world? Aren't organizations around the world seeking to emulate these "new" employment practices? (I put "new" in quotes because, as we will see later, the current trends simply promise a return to the way employment was organized more than one hundred years ago.) The answer to these questions is generally yes, but don't make the mistake of confusing success that occurs "in spite of" some set of behaviors with success that results "because of" a set of practices. I first heard Marshall Goldsmith, a noted consultant on leadership, use this distinction in a seminar. He noted that when people reached high leadership positions, attainments that attested to their success, they tended to see *everything* they did as contributing to that success. Marshall pointed out that some of their success was "because of" particular behaviors, but some of their success occurred "in spite of" other behaviors that were actually counterproductive. A similar analogy holds for organizations. It is important to understand which practices actually contribute to success and innovation and which ones get in the way. It is imperative not to be seduced by glib generalizations based on either a too-aggregated or a misleading interpretation of the evidence.

Our understanding of the real effects of various management practices is also hampered by a tendency to see behavior as invariably adaptive or rational. This perspective leads to the assumption that if something is not being done, it must not be very useful, and, conversely, that if some management trend is accelerating, it must be because of its ultimate wisdom and effectiveness. But these assumptions are not always correct. Practices supported by evidence and logic, even some that appear in many instances to be common sense, may fail to be recognized and implemented. Simply put, in the world of organizational management, common sense is not always all that common.

For those of you who are tempted to say as you read this book, "but what you are proposing isn't what everyone else is doing," I will remind you that it is not likely that you are going to be able to achieve outstanding economic success simply by doing what everyone else does. Prosaically put, you can't be "normal" and expect to achieve "abnormal" returns. This suggests that success comes to those organizations that have the wisdom and courage to find their own path. In hindsight, it is easy to see how the decision at Wal-Mart not to outsource its transportation but to keep its trucking fleet in-house helped it to achieve competitive advantage through its distribution system. In hindsight, it is easy to see how Southwest Airlines's strategy of ignoring the hub-and-spoke system typical of other airlines—a system once described as optimally designed to bring the maximum number of unhappy people together at the same place at the same time—helped the airline to succeed. In hindsight, it is clear how Motorola's commitment to training as part of its quality process helped it to achieve substantial economic success. But at the time those organizations did what they did, many observers thought them foolish or foolhardy. Of course, being different may mean that an organization will do worse rather than better than most of its competitors. But, firms should not pay high executive salaries merely to find leaders who can copy what others are doing—imitation simply should not be that expensive to obtain. What organizational leaders should do is to cultivate the wisdom, knowledge, and courage to figure out the basis of competitive success and to implement that knowledge, regardless of what others are doing or saying.

A second fundamental idea relevant to adding value and profits to organizations is that just as a firm cannot achieve outstanding economic success by doing what everyone else is doing, it cannot achieve sustainable competitive advantage and exceptional results merely by making purchases on the market. What one organization can buy, others can, too. Any firm can call Manpower or Kelly Services for temporary help. Any firm can contract out. What provides long-term advantage are those things that are core to the firm and not readily duplicated by competitors—and purchases on the open market cannot be sources of unique or distinct capabilities.

The foregoing implies that to make the connection between people and profits, organizations are going to have to think a little differently and manage a lot differently than many of their competitors, at least in the United States. And that is exactly right. In the end, making the connection between people and profits entails confronting how we think about work, organizations, and the people in them. What matters is managers' point of view. When you look at your work force, do you see the source of your organization's sustained success and your people as the only thing that differentiates you from your competition? Or do you, like so many, see people as labor costs to be reduced or eliminated; implicit contracts for careers and job security as constraints to be negated; and mutual trust and respect as luxuries not affordable under current competitive conditions, to be replaced by some optimal compensation and incentive arrangements that attempt to make trust unnecessary? How we look at things affects how they look and what we do. A case can be made that with the right point of view and perspective, implementation of the practices that can help achieve enduring profits through a people-centered strategy is actually not that difficult. With the wrong perspective and point of view, implementation of these ideas may be almost impossible, regardless of how many programs are implemented or how many consultants are hired. So, it all comes down to how you and your colleagues view your organization and the sources of its success and whether you have the wisdom and courage to act on those insights.

I ◆ People-Centered Management and Organizational Success

1 ◆ *Looking for Success in All the Wrong Places*

TRY THE FOLLOWING EXERCISE in your organization. Ask your colleagues to name the firms that have enjoyed the largest stock market returns over the past twenty to twenty-five years and to state why. This question effectively uncovers individuals' views about what makes organizations successful over long periods of time and reveals how people think about the sources of sustained competitive success.

I have done this exercise many times, and the results have been amazingly consistent—respondents' conclusions about the source of long-term success often are not very accurate. The firms named in response to this question almost invariably have a number of elements in common. First, many are large, consistent with an implicit belief that success comes from having access to economies of scale and the associated cost efficiencies. This quest for size drives the incessant wave of mergers and consolidations, even though the available evidence indicates that most mergers not only do not generate the anticipated economic benefits, they also frequently fail to produce even positive economic returns.

Many of the companies named are global, consistent with the realization that we move in a global business world and that success comes from having a global presence. Many of the companies listed lead their markets. This follows the conventional view that a dominant market share is the key to success.[1] Many of the firms mentioned are in high-technology industries, because of the general belief that the road to riches is paved with technology and that the key to success lies in having some technological edge. Most of the firms have some distinct brand or product technology that precludes ready imitation. Belief in the importance of a brand or technology for outstanding and sustained performance is premised on the idea that to enjoy economic success over a protracted period, firms need some barriers to imitation so that economic returns cannot be eroded by new competition. Most people see such barriers to competitive imitation as residing in trademarks, patents, technology, or brand image. In addition, many of the companies mentioned in this exercise have sought success in part by becoming lean and mean, by cutting people and other costs as a way of enhancing profit margins.

When people do this exercise, many begin by thinking first about what industries have prospered. They assume that being in the "right" industry—an industry that has barriers to entry, limited rivalry, and market power with respect to its customers and suppliers—is important for success. Conventional wisdom maintains that industry matters a great deal and that choosing the right competitive niche, therefore, is one of top management's most critical tasks. Finally, many people think of firms known for their brilliant strategy. Again, conventional wisdom emphasizes the importance of strategy as a source of success.

Emphasis on strategy and market position as the basis of success has brought rapid growth to the strategy consulting industry. It has also fostered a frequently-espoused view that the chief executive's task is primarily concerned with formulating the right strategy for the firm. This process, presumably, depends on data and analysis, following a strategic direction established at the most senior levels in a firm or division. "Our mental image of the strategic process . . . is of decision makers sifting information received from lieutenants and gleaned from written reports."[2] Unfortunately, as we will soon see in this chapter, little evidence exists to show that being in the "right" industry matters much for firm growth or economic success. Further, we will find that the emphasis on strategy as the most critical activity is also somewhat misplaced. A study of Japanese manufacturing companies reveals that "executives in superior Japanese companies seem to do comparatively little of what is usually thought of as strategic planning. Instead . . . they spend more time overseeing organizational dedication to the 'basics' of competitive advantage."[3] Those basics are things such as product and service quality, customer satisfaction, and operational excellence—

the not-so-glamorous but essential elements of business process implementation. It is my observation that in many instances, senior managers of the most successful firms worry more about their people and about building learning, skill, and competence in their organizations than they do about having the right strategy.

The first task of this chapter will be to show that much of the conventional wisdom about the sources of sustained success is wrong—inconsistent with the available evidence. Companies do not have to be large, do not have to go through waves of downsizings, and do not have to be technologically sophisticated, the market share leader, or even global to enjoy substantial economic returns. More important than having a strategy is the ability to implement it.

The management issue is simple and compelling: If you seek success in the wrong places, you are likely to waste a lot of effort, focus on the wrong things, and, in the end, overlook some of the real sources of competitive leverage—the culture and capabilities of your organization that derive from how you manage your people. This is a more important source of sustained success than many of those so commonly mentioned, because it is much more difficult to imitate or understand capability and systems of management practice than it is to copy strategy, technology, or even global presence. This source of economic success is largely based on a perspective that sees the development of people-based strategies as crucial for long-term economic performance. The second important task of this chapter is, then, to illustrate how a firm's perspective on managing people affects both its approach to its business and, as a consequence, its economic performance.

HOW CONVENTIONAL WISDOM IS WRONG

A number of studies provide evidence that the conventional wisdom of business strategy—that industry matters a great deal in affecting economic success—is simply wrong.[4] One study related the creation of shareholder value, defined as the increase in stock price plus dividends, to both the firm's revenue growth and to industry growth rates. The research, covering more than 1,800 companies traded on U.S. stock exchanges with a market capitalization of more than $500 million in 1994 dollars, found that "industry growth rates are almost completely unrelated to the likelihood that a company will be able to create superior value for shareholders over a 10-year period. . . . [A]n analysis of the data shows that companies in slow-growing, more mature industries are somewhat more likely to create superior returns for shareholders than companies in fast-growing industries."[5] In fact, industry growth rate explained precisely *0* percent of the variation in the fraction of companies in an industry that were top performers in terms of creating shareholder value.[6] Even company revenue growth, although much more important than industry growth rate, had only a moderate effect on shareholder returns. Revenue growth, over a decade, accounted for about one-third of the variation in the firms' returns to shareholders.[7]

So much for the importance of being in the right industry. What about size as a source of competitive success? To examine this, I went to the *Value Line Investment Survey* and gathered, for the most recent year available, either 1995 or 1996, the following three pieces of information for each firm within a given industry (industry categories are defined by Value Line): size, as measured by total revenues; profits as a percent of the total capital employed; and profits as a percent of net worth or shareholder's equity. These latter two measures provide an indication of how effectively the firm employed its capital and what it earned on its equity. The investment survey covers eighty-three nonbank industries, with eighty industries of five or more firms included, enough firms to make the analysis meaningful. For each of these eighty industries, I computed the correlations between revenues and the two measures of profitability: percent earned on total capital and percent earned on net worth. Since industries differ greatly in many characteristics, analysis within industries offers a useful control for common industry factors such as overall industry conditions. The analysis permits one to answer the following question: Within each industry, what is the relationship between size and profitability?

What did this analysis reveal? In thirty-five of the eighty industries considered, that is, in about 44 percent of the total, a *negative* relationship existed between sales and the percent earned on total capital. The average correlation between revenues and the percent earned on total capital across the eighty industries was just .09, which means that, on average, less than one percent of the variation in returns on total capital can be accounted for by sales revenues. If we consider returns to shareholder equity, the results are only slightly more favorable for those who believe size matters. In this instance, only thirty-one out of the eighty industries exhibited a negative relationship between sales and the percent earned on net worth. The average correlation between revenues and the returns earned on net worth across the eighty industries was just .11, again indicating that a very small portion of the variation in returns, about one percent, can, on average, be explained by size.

One cannot conclude from this, of course, that size is never important. Some industries show relatively strong relationships between sales and returns to total capital and net worth, industries such as grocery stores, drug stores, and stores selling household products. But in many industries, the relationship between size and profitability is either negative (as in railroads, home appliances manufacturing, and homebuilding, for instance) or essentially zero (for instance, in the auto and truck industry, air transportation, and medical services). Other things being equal, big is probably nice. But as a source of success and profitability, size, in many instances, is simply not very important.

What do the data indicate about the importance to earning outstanding returns of being in a high technology industry? In 1996, *Inc.* magazine's list of America's 500 fastest-growing companies was headed by a consumer-products distributor, a toothbrush maker, and a human resources service company[8]—none of them high technology industries. From 1987 through 1995, ServiceMaster, a company in the low-technology business of providing cleaning and other services, such as facilities management, to hospitals, educational organizations, and companies as well as various home-care services to consumers, earned an average return on shareholders' equity of almost 82 percent, a much higher return than was earned by either Intel or Microsoft, or, in fact, by the two combined.

In spring 1996, two sources provided lists dramatically illustrating that high technology was not necessarily the route to success, although it could be, and that high returns could be made in industries that enjoyed little market power and were, in fact, quite competitive. First, the *Wall Street Journal* published a list showing how one thousand major corporations treated their shareholders, in terms of one-, three-, and five-year returns, and other lists showing the best and worst firms in terms of one-, three-, five-, and ten-year returns. The *Journal* article also included a ranking of eighty-eight industries based on five-year shareholder returns. Second, also in 1996, *World Link,* a magazine published by the World Economic Forum, listed the two hundred fastest growing companies (measuring growth in terms of earnings per share) from around the world. At the outset, let me note that even a five-year period is a fairly short span for assessing performance. In a five-year period, specific industry conditions or stock market fads can loom large, and one can profit simply by being in the right place at the right time. Returns over ten- or even twenty-year periods are probably more useful for examining sources of sustained economic success. Nonetheless, the results are still instructive.

Table 1-1 reproduces the list of the top fifteen industries in terms of shareholder return as reported in 1996. Although the top two in 1996, semiconductors and software, are, obviously, both high technology industries, most of the rest, except for biotechnology, office equipment, and communications, are in highly competitive industries in which technological advantage plays only a small role in ensuring success.

Table 1-1 THE FIFTEEN BEST-PERFORMING INDUSTRIES, BASED ON FIVE-YEAR AVERAGE SHAREHOLDER RETURN

Industry	Five-Year Average Return
Semiconductor	45.0%
Software and processing	39.8
Eastern banks	36.3
Recreation-toys	35.8
Western banks	33.9
Medical/Biotechnology	30.7
Securities brokers	30.4
Southern banks	30.0
Office equipment	30.0
Communications	29.4
Lodging	27.9
Diversified financial services	27.7
Money-center banks	27.5
Casinos	27.3
Industrial technology	27.1

Source: John R. Dorfman, "Surprise: The Entire Tech Sector Fails to Win Hands Down," *Wall Street Journal,* 29 February 1996, R4. Reprinted by permission of the *Wall Street Journal,* © 1996 Dow Jones & Company, Inc. All Rights Reserved Worldwide.

Many of the high performance industries were in finance and banking, in which, during the 1980s and early 1990s, rivalry was intense, product innovation and new entry was spirited, and firms had little market power with respect to customers or suppliers. Considering the entire list (not reproduced here), reveals other surprises. Restaurants (ranked twenty-sixth) provided a higher return to shareholders than did medical device manufacturers (ranked twenty-eighth). Footwear firms (ranked thirtieth) finished ahead of pharmaceuticals companies (ranked forty-seventh). The computer industry ranked seventy-eighth, behind industries such as automobile parts (thirty-fourth), heavy machinery (twenty-ninth), and even railroads (ranked thirty-third).

The *Journal* published the same lists in 1997, showing similar results. Once again the top performing industry was semiconductors, with communications technology ranked second. But the third best performing industry was lodging, with an average five-year return of 31.1 percent, followed by heavy machinery, Western banks, and oil drilling. The software industry ranked seventh, followed by money-center banks, Eastern banks, aerospace and defense, conglomerates, pipelines, and Southern banks. The fourteenth-best return was earned by diversified financial services, and auto manufacturers ranked fifteenth, with an average five-year return of 22.7 percent.[9]

The *Journal*'s listing in 1996 of the twenty-five companies with the highest ten-year returns included a number of high-technology companies such as Amgen (biotechnology, ranked second), Micron (semiconductors, ranked eleventh), and 3Com (computer networking equipment, ranked twenty-third). But it also included retailers such as Home Depot (ranked fourth), a shoe company (Nike, ranked thirteenth), and a number of medical service providers such as St. Jude Medical (ninth), Pacificare Health Systems (eighteenth), and United Healthcare (seventh).

Table 1-2 presents *World Link*'s list of the twenty-five international firms ranked in terms of five-year growth in earnings per share, compiled from a set of more than 11,000 publicly traded companies. The compilers noted that the list was constructed on the basis of five-year earnings per share growth because "revenue and profit figures are distorted by acquisitions or disposals, while market value is highly dependent on the fortunes of each individual market."[10] This list shows even less of a high technology dominance than does the *Journal*'s. Many of

Table 1-2 TWENTY-FIVE WORLDWIDE COMPANIES WITH HIGHEST FIVE-YEAR EARNINGS-PER-SHARE GROWTH RATES

Company	Country	Industry	Five-Year EPS Growth
Rogers Corporation	U.S.A.	Electronic parts	169.44%
Amgen	U.S.A.	Biotechnology	144.68%
Swiss Life Insurance	Switzerland	Insurance	130.84%
The Allen Group	U.S.A.	Electronics	127.62%
Chase Manhattan	U.S.A.	Banking	125.80%
Hudson's Bay Co.	Canada	Retailing	125.48%
Newbridge Networks	U.S.A.	Electronic equipment	119.83%
Clear Channel Com.	U.S.A.	Telecommunications	108.99%
Public Service of N.M.	U.S.A.	Electric utility	106.92%
Amagerbanken	Denmark	Banking	104.31%
CJ Vogel Draht	Germany	Financial services	100.94%
San Miguel Brewery	Hong Kong	Brewers	96.81%
Trak Auto Corp.	U.S.A.	Retailing	92.41%
Kolb & Schule	Germany	Apparel and textiles	91.09%
Lam Research Corp.	U.S.A.	Semiconductors	88.35%
Morgan Keegan	U.S.A.	Securities brokerage	85.27%
Natl. Western Life Ins.	U.S.A.	Insurance	81.64%
Designs Inc.	U.S.A.	Apparel retailing	80.83%
Volt Information Sci.	U.S.A.	Information services	78.12%
Sedlbauer	Germany	Electronic parts	75.53%
Astra Compania	Argentina	Exploration and drilling	74.94%
Metro-Richelieu	Canada	Grocery retailing	74.73%
Mines de la Lucette	France	Metal production	71.42%
United Dominion	Canada	Mining and manufacturing	71.29%
IHC Caland	Netherlands	Shipbuilding	70.40%

Source: "Profit Growth: The World's Top 200," *World Link* (March/April 1996): 46. Reproduced from *World Link,* the magazine of the World Economic Forum.

the firms operate in very competitive industries, providing services such as securities brokerage, insurance, banking, and retailing. Interestingly, a number of the firms are based in comparatively high-wage, Western European countries, such as Germany, the Netherlands, Switzerland, and Denmark. These companies' success, despite operating in highly unionized, high-wage countries, belies another element of conventional wisdom: that the only way to succeed in an era of global competition is to enjoy the benefits of a largely unregulated, non-unionized, and low-wage environment.

Another piece of today's conventional wisdom holds that the way to economic success is to cut costs, thereby improving profit margins and stock price and leading to other good outcomes. One of the quickest ways to cut costs is to cut people, so downsizing has become quite fashionable. Analysts Gertz and Baptista note that "Whether they call it cost cutting or downsizing or restructuring or reengineering, a great many U.S. firms have been actively pursuing strategies to make themselves smaller: fewer employees, fewer operating units, and fewer subsidiaries."[11] Again, a moment's reflection will suggest that this strategy is unlikely to provide sustainable advantage over any significant period of time. Laying off employees can be done by any organization with sufficient stomach for the task. Anyone can hire an investment banker to dispose of assets such as divisions or facilities. Downsizing does ensure that the resulting organization winds up smaller. But downsizing, by itself, cannot fix problems with products or services, with time lags in launching new products or services, with quality, or with any of the other myriad factors that help to determine success in the marketplace. In fact, as we will see in chapter 6, evidence exists that downsizing, with its significant costs in employee morale and motivation; potential quality problems; and diversion of attention to costs, job loss, and fear—and away from customer service, revenue growth, and innovation—does not even effectively reduce costs.

Does downsizing, in fact, provide great returns to the firms that do it? A study of one thousand large U.S. companies found that "investors place a much higher value on companies that improved their bottom lines through revenue growth than through cost cutting. . . . The reason for this clear preference . . . may be a recognition on the part of investors that gains made through cost cutting represent either a single event or one that can only be repeated a limited number of times."[12] The highest growth in absolute stock market value was achieved by companies that were able to increase both revenues and profits faster than average for their industry over the five-year period between 1988 and 1993. This study also found virtually no correlation between company size and revenue growth rate. It is not the case that companies must be small to grow, as the experience of Wal-Mart, Hewlett-Packard, and Motorola, among many others, attests. What about the importance of being in the right industry? This research also found *no* correlation between industry growth rate and the growth rates of companies within each industry. Rather, "the greater variation is between companies *within* industries, rather than among industries themselves. Within a given industry, the range of performance between the fastest-growing and the slowest-growing companies is greater than the range of performance between the fastest- and slowest-growing industries."[13]

Do you need to be global to be successful? It doesn't hurt, but it isn't necessary. Southwest Airlines is by far the best performing airline, but it operates only in the United States. Wal-Mart, the discount retailer, has provided exceptional economic returns, as have firms such as Home Depot (building supplies) and Staples (office equipment and supplies), even though these companies have only recently begun to locate any facilities outside of the United States. The number one ranked firm in the *Wall Street Journal*'s 1997 list of top performing companies over a ten-year period, with a total return to investors of an astounding 60.6 percent per year for ten years, was Concord EFS, a company in the business of providing payment-processing services, "which means handling credit- and debit-card transactions. . . . The company long has catered to small merchants and has carved out lucrative niches among trucking companies and grocery stores."[14] All of its business is in the United States.

These facts and analyses reveal the problems with our intuitions about the sources of success. Virtually no connection exists between organizational success and industry characteristics. Some very successful organizations operate in terrible industries. Wal-Mart has done quite well in an industry one-third of which was in bankruptcy in the early 1990s. Southwest Airlines produced a stock market return of over 21,000 percent between 1972 and 1992 and has been profitable in each of the past twenty-four years, a record unmatched by any other airline in the world except Singapore Airlines. After 1978, entry into the industry has been virtually unrestricted and there have been numerous new companies and intense competition. Meanwhile, between 1991 and 1992, some 40 percent of the U.S. airline industry either filed for bankruptcy (for example, Continental Airlines, America West, Trans World Airlines, and others) or ceased operations completely (as did Eastern Airlines). Furthermore, the evidence shows little or no connection between success over time and being a particular size or having a dominant market share. Southwest Airlines has enjoyed growth in revenue and profits that place it among the leaders in the airline industry. But it is far smaller than United, American, or Delta and holds a relatively small share of the national air traffic market. MBNA is smaller than Citicorp in its share of the credit card market, although it has enjoyed faster growth and better profitability. In the recent past, Chrysler has been more profitable than General Motors, in terms of return on sales, shareholders' equity, or total assets, even though it holds a smaller share of the automobile and truck market.

These facts about the sources of success are of more than just academic interest. The problem with looking for success in the wrong places is that organizational leaders take actions based on these faulty beliefs and, in the process, often cause irreparable harm to their organizations. They downsize—and do so in a mean-spirited fashion—thereby creating a death spiral for their organizations. They emphasize finding a magic strategic silver bullet to solve operational problems that come from how they treat their employees and the resulting level of innovation and performance. They seek economies of scale instead of economies of scope. In all of this, senior managers create economic damage that they, with their golden parachutes and generous severance arrangements, seldom pay for. By focusing on the wrong things, they pay too little attention to different, sustainable bases of competitive success, and thus are prone to managing their firms into economic decline.

STRATEGY OR IMPLEMENTATION?

Success comes from delivering value to your customers, and the ability to deliver value comes from having sound conceptions of what customers want and value and of how to organize and manage people to produce that value. Success frequently entails implementation rather than coming up with great ideas, simply because in the current world, implementation is much more difficult. As a senior officer at a major strategy consulting firm said to me, "*Finding* the answer is relatively easy; *doing* the answer is frequently impossible." Nonetheless, firms often pursue a strategic fix to what are fundamentally operational problems.

Consider, for instance, United Airlines. In the early 1990s, it faced a problem. Southwest Airlines had entered the intra-California marketplace and by 1994 had more than 50 percent of that market. United's concern was that much of its total profits came from its Asia Pacific routes. In 1996, for instance, United's revenue from that region constituted one-third of the firm's total revenues, and this market was experiencing substantial growth. Many of United's flights to the region departed from the gateway cities of Los Angeles and San Francisco. A strategic analysis led to the conclusion that the company needed control over its feeder traffic and could not simply cede the California market to Southwest. United came up with a "strategy"—imitate Southwest in its low fares, high levels of customer service, and even its look. Ground agents were put in shorts, athletic shoes, and golf shirts. Fares were slashed. The company used only Boeing 737s, the same plane that Southwest used. Finally, to be profitable and cut costs, United set itself the goal of turning its planes around in twenty minutes.

Unfortunately, executing that strategy proved to be a lot more difficult than coming up with it in the first place. My colleagues and I observed that United took more than thirty-five minutes to turn its planes around, meaning that initially it was always late and subsequently had to adjust its schedules. Service, delivered by flight attendants who were not part of the organization's employee ownership, was not always friendly or courteous. Indeed, in a move that some describe as bold, United recently embarked on an advertising campaign acknowledging the hassles of flying. I agree that the new advertising campaign is bold, but it also seems quite nervy—instead of trying to fix its service problems in what is, after all, a service industry, United is simply admitting its poor performance and making a joke out of it. As a consequence of its inability to match Southwest's costs (because of differences in asset utilization), on-time performance, or service, United has begun to pull out of many of the routes in which it directly competed with Southwest.

> After 16 months, Shuttle by United has retreated from many Southwest routes and admits it hasn't gotten as close as it had hoped to Southwest's low costs. And Southwest has not only regained traffic lost initially to the Shuttle but also *increased* its California business. . . . One year ago, the two competed directly on 13% of Southwest's routes. Now United overlaps on only 7% of Southwest's routes. Southwest says California . . . now has fuller planes, better revenue and stronger profit than the rest of its system.[15]

Or, consider the case of Kaiser Permanente, a very large, old, health maintenance organization with a large base in California and a national presence. Competition in the provision of medical services has intensified substantially over the past several years. Kaiser was traditionally much less expensive than its fee-for-service competition and even than other HMOs. Kaiser, however, owns its own hospitals and buildings and, as a consequence, could not always offer lower prices than contracting networks that basically purchased excess capacity in the medical system at above marginal cost but well below the average cost of building and providing those services. Kaiser, however, did have one potential advantage: Most of its doctors were also partners, and because the system was completely integrated, no bureaucracy blocked access to care. Getting a referral to see a specialist or being admitted to the hospital did not require pre-authorization. Presumably, this permitted the organization to save money by not having the myriad clerks who now virtually run U.S. medical care, and it should also have permitted Kaiser to offer a more patient-friendly service. Finally, the system had a quality emphasis and a database that made measuring and managing quality feasible, as well as a strong social mission and a committed, long-term work force. These human assets and cultural values should be important strengths in the fierce competition for patients.

When Kaiser began to confront competitive stress—it was no longer the least expensive provider of medical services, in part because some of its competitors were trying to buy market share by aggressive pricing—the organization's response was unfortunate. Instead of focusing on implementing systems and practices that would permit it to generate the skills and behaviors required for competitive success, it responded by laying people off in an effort to cut costs and by reorganizing. Layoffs simply demotivated people and produced turnover—easily accomplished in a health-care environment in which strong administrative talent is in short supply. Reorganization made work for the consulting firm that recommended it, but it did not solve the basic issues of service implementation that would actually address issues of costs and quality.

Kaiser and United both sought solutions to operational issues in strategic “fixes,” neither of which were completely successful. But it is easy to see why they did so. Many firms sell strategy analysis and consulting, and it is obviously tempting for an organization facing competitive challenge to seek help outside itself. Moreover, the strategic solutions always look so good. They have a precision and logic that is often compelling. Seldom asked is whether or not the strategy has much chance of being successfully implemented or whether the strategic solution solves basic operational problems or merely diverts attention and effort into new markets and new structures. It is often easier and substantially more seductive to manage something—a strategy—that is analyzable and can be reasonably readily changed, as contrasted with dealing with the day-to-day details of operations and implementation. Those problems are less glamorous, less interesting, but most importantly, much harder to solve.

Successful organizations understand the importance of implementation, not just strategy, and, moreover, recognize the crucial role of their people in this process. Consider, for instance, Norwest, a diversified financial services organization. In 1997, the company ranked twenty-second on the *Business Week 50,* a ranking of all Standard and Poor’s 500 companies based on eight financial criteria: revenue growth, earnings growth, and total shareholder returns measured over both one- and three-year periods; net margin; and return on equity. Also in 1997, Norwest was named in the annual *Fortune* magazine survey of customer satisfaction as the best bank, tying Keycorp for the top spot. Between 1988 and 1996, the company achieved a 21 percent compounded annual growth in revenues and 24 percent compounded annual growth in net income. Richard Kovacevich, the CEO, had this to say about the relative importance of strategy and execution: “I could leave our strategic plan on a plane, and it wouldn’t make any difference. No one could execute it. Our success has nothing to do with planning. It has to do with execution.”[16] And what is the basis of Norwest’s effective execution? Knowing the business, having good shared values, implementing advanced technology? “They’re all important. But none are as important as talented, professional, motivated people who care. That’s our real competitive advantage.”[17]

A similar point of view is held by Tom Farmer, the founder and CEO of Kwik-Fit, the market-leading supplier of automobile repair services in the United Kingdom and the Netherlands, with a total of 726 stores and sales of $461 million at the end of the 1995 fiscal year. Between 1991 and 1995, earnings per share increased 55 percent in the difficult and competitive business of supplying tires, batteries, mufflers, brakes, and similar services. I had the opportunity to meet Tom Farmer when we were both on a program in London. Waiting to give our talks, I chatted with him about his philosophy and perspective on strategy. Tom disdained the common obsession with finding some magic strategic "fix." He said, "In a service business, there is only *one* successful strategy—to provide your customers outstanding value and service—customer delight." And, he recognized that customer service depended on having people who felt good about the organization and would, therefore, care about the customers. He has built the business on his recognition that people are the company's most valuable asset—the all-important contact with the customers—and the key to success.

Robert Waterman has provided an important insight on the connection between strategy and effectively managing people. He recognized that organization—people, culture, capability—are important sources of competitive advantage. People *are* the strategy.

> Organizing to anticipate and respond to customer needs . . . seems like a simple idea . . . it's at the heart of what we ought to mean by *strategy*. . . . For many managers, strategy . . . has meant either coming up with a brilliant idea or slamming the competition. . . . The companies I researched *do* look for sustainable competitive advantage. . . . They get a sustained advantage from the way they organize, not from the brilliant idea. Because they persist where others give up, they accomplish the most difficult part of strategy . . . implementation, that is, getting what is often a simple idea done and getting it done right.[18]

Success comes from successfully implementing strategy, not just from having one. This implementation capability derives, in large measure, from the organization's people, how they are treated, their skills and competencies, and their efforts on behalf of the organization. Fixing an organization's management practices may be more difficult than readjusting the strategy, but the payoff is often much greater. Managers are always well-advised to solve the real problem—not the one they would prefer to solve or are able to solve. This obvious recommendation is, unfortunately, all too often violated in practice.

MANAGEMENT PERSPECTIVE AND IMPLEMENTING PEOPLE-CENTERED STRATEGIES

How leaders diagnose and think about competitive conditions and business opportunities affects how their organizations manage people and, as a consequence, economic performance. An example drawn from banking in the United States and in Germany dramatically illustrates how different ways of responding to increased competition—in one instance centering the response on maintaining people and developing their skills and competencies and in another instance seeking to eliminate people and thereby reduce labor costs—produced very different results.

German and U.S. Banks' Response to Increased Competition

Suppose you were the chief executive of a bank at the beginning of the 1980s and could readily foresee the increased competition that was coming because of the deregulation of financial markets and the entry of new competitors. How would you respond? If you were like many bank executives in the United States, what you saw when you looked at your organization were costs—branches and people—fixed assets that would burden the organization in the coming competitive environment. You probably thought the best way to succeed was to become the lowest cost provider of financial services and, therefore, became cost driven. Since many of your costs were people costs, it seemed reasonable to attempt to reduce those costs as much as possible. Moreover, because some fraction of your costs were incurred in providing customer service, you might try to figure out how to deliver these services less expensively through automation, reduce or eliminate services, or charge for each service provided. On the other hand, if you were a senior bank executive in Germany, unionization, codetermination laws, and various labor regulations—as well as social custom—made the wholesale elimination of people virtually impossible. "Stuck" with your people, what you needed to do was to turn what to many may have looked like a cost or a liability—your people—into an important competitive asset. This could be accomplished by pursuing a high service, relationship-based strategy that involved cross-selling more financial services to your existing customer base—competing on the basis of service and economies of scope rather than on the basis of price and economies of scale.

The story of the two different paths pursued by German and U.S. banks during the 1980s is told in a brilliant doctoral dissertation by Brent Keltner[19] that ought to be read by all banking executives and by managers in any industry who have become accustomed to viewing technology and simply cutting costs, particularly people, as the road to competitive salvation. Keltner found that the strategy of eliminating people and service in what is, after all, the financial *services* industry was a prescription for losing market share. German banks, and those in the U.S. like Norwest that took a different approach, profited from developing and implementing more people-centered strategies.

The dominant approach of U.S. banks—to compete on the basis of price and convenience rather than on the basis of developing a financial relationship—was at best questionable as a foundation for long-term success.

> Customers attracted to a bank by promises of price discounts or other one-time offers can be expected to be the least loyal and thus constantly in search of a better offer. Product strategies based on continuous customer acquisition require high levels of expenditure on product development and advertising to compensate for customer churn.[20]

Moreover, since other providers had networks of distribution comparable to those of banks, when customers were pushed out of the branch—some banks charge extra to deal with a teller[21]—and the banks stressed convenience, they found it substantially more difficult to cross-sell other products to those customers. The problems with this approach can be seen by contrasting the dominant response of most banks with that of Norwest, a company that sees its branches as stores: "We like customers in our stores. Do you know of a successful retailer that doesn't? We believe we can do a more effective job of understanding our customers' financial needs when we meet them face to face."[22]

With a perspective that saw people as costs, U.S. banks invested heavily in technology and made extensive use of part-time help, minimized training, and used outside recruiting to fill positions that required higher level skills. The consequence of these employment policies was, not surprisingly, high turnover rates. Keltner reported that annual turnover across the commercial banking sector as a whole was 22 percent in the United States compared to 7 percent in Germany, 8.4 percent in Japan, and 10 percent in France.[23] Overall turnover masked much higher levels of turnover in specific positions, such as tellers and new account employees, which had turnover rates between 35 and 40 percent in most U.S. banks. With turnover among commercial credit officers at 33 percent and turnover among consumer credit people at 50 percent, the concept of relationship banking is reduced to a one-night stand; the odds of seeing the same person twice are not too high.[24]

With an undertrained and uncommitted work force and a basic business strategy almost destined to produce customer churn and disloyalty, it was nonetheless the case that some U.S. banks in the 1980s did manage to enjoy a measure of financial success because their cost cutting and consolidation efforts bore fruit even as their market shares in almost every segment declined. But this erosion in market position bodes ill for the future, when the strategy of consolidation and shrink-

Table 1-3 U.S. BANKS' CHANGING MARKET SHARES DURING THE 1980s

Product Segment	Market Share Development
Demand deposits	Decline from 32 to 22 percent of U.S. household assets
Investments	Minor share, with just 17 percent of mutual fund market
Life insurance	Negligible share with few sales of life insurance
Credit cards	Decline from 80 to 60 percent of market; two of three largest credit card companies (Dean Witter and AT&T) are non-banks
Consumer loans	Lost one-quarter of market, with 25 percent of consumer loans now controlled by retailers and finance companies

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age will have reached its limit. Table 1-3 illustrates the decline in U.S. banks' overall market share in the consumer or retail banking segment. U.S. banks also lost market share in the wholesale or business market segment. The net result was to change where and how U.S. banks made their money: "By 1992, only 58% of the total revenues of U.S. money-center banks were being generated through interest-earning business, with over 40% of revenues coming from fee-based activities."[25]

By contrast, German banks took a very different approach to their people and a different strategic approach to their customers. For the most part, they invested heavily in human capital and organizational capabilities to pursue strategies founded on relationship banking. Training in the German banking sector was some 250 percent of the level of training in the economy as a whole, and people in banking were twice as likely to attend further training seminars after their apprenticeship programs.[26] German banks built a multi-skilled work force and used those people to sell multiple products to the bank's customer base, a strategy based on economies of scope and customer service rather than economies of scale and customer acquisition. "By offering their customers high levels of financial advising, quality service, and the convenience of consolidating financial service products with one provider, German banks managed to retain their competitive appeal."[27]

Table 1-4 provides evidence on the results of those policies in the retail market segment during the 1980s. Compared to their U.S. counterparts, German banks retained a much higher market share in retail deposits and actually gained market share in credit cards while maintaining a significant share of the consumer loan market and the investment market. In the business market segment, the trend for large firms to rely for financing more on the capital markets than on banks was counterbalanced by the German banks' success in cultivating small and mid-market borrowers. As a result, German banks enjoyed much more stability in how they earned their income. "For the banking sector as a whole . . . the percentage of business generated through lending activities remained at 82% of total revenues in 1991."[28]

Keltner's research provides substantial evidence that these differences in the evolution of banking in the United States and Germany were not simply the result of differences in regulatory or competitive circumstances. Rather, the differences occurred because of differences in strategy and how the banking sector in the two countries treated their people as a result of adopting very different perspectives on what those people could do for the firms. One only needs to consider the strategy and success of Norwest in the United States to see the plausibility of this argument.

How Mismanaging People Creates a Downward Spiral

We saw in the example of U.S. and German banks that a people-centered strategy can be a source of success in the market, as long as leaders can resist the temptation to see their people solely as costs, technology as salvation, and customer service as a burden. A people-centered strategy facilitates higher levels of customer service and enables firms to compete on the basis of knowledge, relationships, and service, not just price. By the same token, inattention to people as a source of competitive advantage and implementing poor, low commitment management practices can contribute to organizational decline. In both the positive and negative cases, important feedback processes create either a virtuous circle of management practices that build high commitment and performance, high levels of skill, motivation, and

Table 1-4 GERMAN BANKS' CHANGING MARKET SHARES DURING THE 1980s

Product Segment	Market Share Development
Demand deposits	Shrinking market share, from 60 to 48 percent of household assets
Investments	Maintained control, holding 66 percent of the share of bond sales to private individuals
Life insurance	Rapid growth from an initial 8 percent market share
Credit cards	Rapid growth from 25 to 80 percent market share
Consumer loans	Virtually the sole provider, with just limited competition from automobile producers

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loyalty, and, as a consequence, good results, or alternatively, a downward performance spiral in which the wrong management responses to organizational problems destroy motivation and contribute to the loss of talent, thereby ensuring continued poor performance.

No clearer example of this downward spiral exists than Apple Computer. The Apple story is well known, but most accounts have stressed either strategic mistakes, such as not licensing the Macintosh operating system, or leadership issues, such as the succession to CEO by John Sculley and others. Some data about what happened at Apple, however, illustrate how management responses to performance issues divorced from a people-centered perspective can create a downward spiral and even more severe performance issues. Thus, the Apple story illustrates the negative case of what happens when a firm, the success of which derives fundamentally from its people, fails to put people first.

Founded in 1976 by Stephen Wozniak and Stephen Jobs in Jobs' garage, Apple's vision was to bring the power of the computer to the individual user. The Macintosh operating system, introduced in 1984, was (and many would maintain, still is) a leading technology in terms of ease of use. A column on personal computers in the *New York Times,* for instance, noted, "I have never seen a normal human being compare the Mac OS [operating system], Windows, and Unix systems side by side and come away saying, 'Gee, I really prefer the way Windows and Unix work.'"[29] Apple's laser printers and associated bundled software (from Adobe) launched the desktop publishing movement, and the company's emphasis on networks and connectivity among machines was also ahead of its time.

Apple was a company largely built on a unique culture. The Macintosh design team worked in a separate building with a pirate flag flying over it. The company built a cult-like commitment among its employees. People were recruited to Apple with the idea that they would be helping to change the world. Apple was more than a company, it was a cause. Its strategy of being an innovator in designing user-friendly personal computers that would make people more productive required a highly talented, creative, and innovative work force. When it took actions that resulted in the loss of that work force, its ability to implement its business strategy and to regain market leadership was irreparably harmed.

Obviously, not all of Apple's problems can be traced to how it handled its people. Even though its competitive advantage lay in its unique operating system, employing a mouse and a graphical user interface, the company consistently failed to license the operating system to other manufacturers, thereby limiting its share of the personal computer market. Because its culture emphasized technological innovation and being in the forefront of technology, Apple would occasionally introduce products, such as the Newton, the personal digital assistant, that were either far ahead of their time or had some remaining hardware or software bugs, or both, thus occasionally suffering commercial flops. But, a case can be made that its handling of its people made both its technical and market problems and its recovery from them much worse.

The *Apple Employee Handbook* espoused the importance of people to the firm's success.

> We've managed to succeed—year after year—in leading the personal computer industry largely because of the talent, tenacity, and spirit of our employees; how we work to communicate with each other openly and honestly; and how in the midst of constant change we still treasure our core values such as designing friendly products for people, innovation, quality, and teamwork.[30]

The handbook also spelled out many of the company's cherished cultural traditions, such as management accessibility and open communication, mementos of significant company events, celebrations of important life events of employees, and bagels and cream cheese on Friday mornings. In some sense, this publication, the culture of the company, and its traditions gave it an edge in recruiting talent but also set expectations for what working for Apple would be like. When these expectations were dashed, the resulting letdown was severe.

Apple has always had significant elements of an individualistic culture even as it talked about the importance of teams and teamwork. After the first round of layoffs in 1985, Apple really pioneered in articulating what has come to be called "the new employment contract." Consistently, and with increasing frequency over the years, the company maintained that its responsibility to its employees was not to give them any security or a career with a progression of jobs, but rather simply to provide a series of challenging job assignments that would permit employees to learn and develop so as to be readily employable. In a booming local job market, this encouraged people to develop talent and skills at Apple and then to use them elsewhere. The individualistic culture could also be seen in the language used to talk about people; they were characterized as "A," "B," or "C" players—the idea being that individuals were of varying quality (not that their performance was affected by how they were organized and managed)—and Apple wanted to attract and retain more "A's" and get rid of the "C's."

In 1985, Apple under John Sculley laid off 20 percent of its work force to cut its costs and return to profitability when its sales did not meet expectations. In 1991, another layoff occurred, this time of about 10 percent of the work force. In 1993, Michael Spindler replaced John Sculley, who had been seen as a visionary leader, and continued the cost cutting by laying off 2,500 people, about 14 percent of the company's work force, in July of that year. In 1997, another round of layoffs, this time comprising almost a third of the remaining people, occurred. More damaging than the layoffs themselves was the way they occurred in waves over time, making people unsure of their futures and tempting the best people to leave. Moreover, the layoffs were handled crudely, to detrimental effect in a company that had formerly held up open communication as an important cultural norm. One employee in Information Systems and Technology (the internal management information systems department) reported:

> The dismissal process occurred on a single day. Each employee was told to be at their desk at 9:00 A.M. in the morning. Those that received early calls into their managers' offices were laid off. They were given pink slips, final checks, and severance information. They were then escorted back to their desks by security to gather their things and then to the door. The remaining employees were gathered into a room at around 11:00 A.M. to discuss their new jobs, since restructuring immediately followed.
>
> Very little work was done within the organization from the time that layoffs were rumored, which was approximately two months in advance, and for months afterward. . . . The early word was that subsequent severance packages would not be nearly as sweet. Rumor has it that some of the best employees, including managers and directors, asked to be laid off to take advantage of other opportunities.[31]

The spirit of cost-cutting extended to salaries, which had previously been excellent to attract the best people, and to many of the amenities that had made working at the company special.

> Now, all that management worries about is cutting costs. But at what price? For example, they no longer buy bagels and cream cheese on Friday mornings. It's ridiculous. Those bagels brought people together for much needed communication. It also made people get to work earlier than they otherwise would have. The twenty dollars they spent on bagels was easily made up in additional productivity.
>
> Also, management doesn't seem to be concerned about rewarding employees for a job well done any longer. They are not allowed to give us a raise. There is no profit sharing. Offsites are gone. Project completion parties are a thing of the past. And you have to beg for a bonus, if you get one at all.[32]

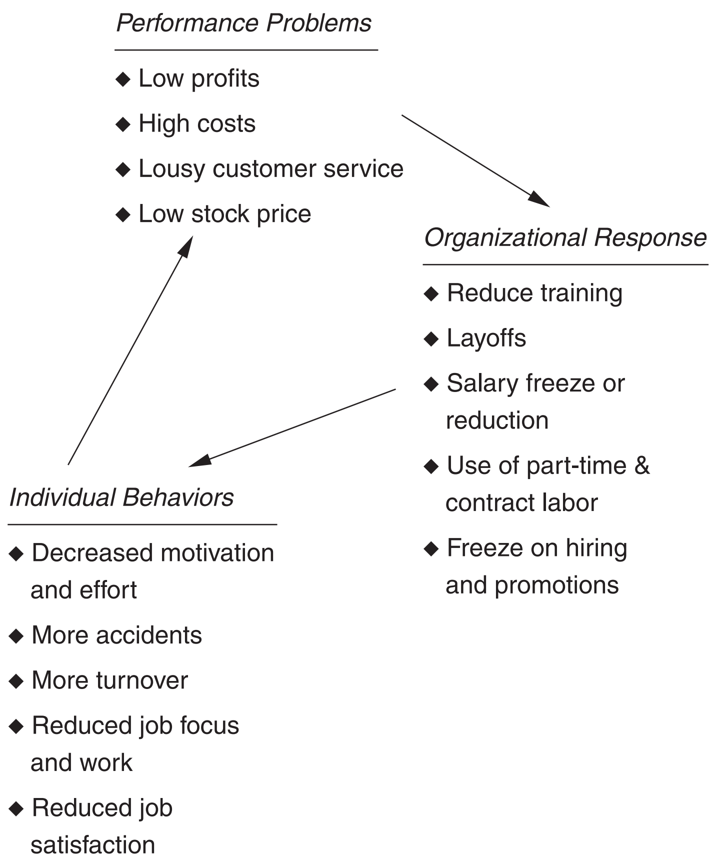
Other Apple people noted that because of the fear of losing one's job when a project was over, many people slowed their progress substantially to delay finishing. Also, Apple's treatment of its people caused few to want to put in extra effort. Try to imagine turning around an organization facing substantial competitive stress with employees who shared the following perspective:

> Overall, employees no longer feel valued here. Before, people were considered the biggest asset of the company. Management still says it, but we don't believe it anymore. In one of his addresses to employees, Michael Spindler made the comment that those employees that didn't like the situation here could go elsewhere. He basically told us that we were expendable.[33]

Although the last chapter of the Apple story has yet to be written, the loss of key technical and marketing personnel over time because of how they were treated has made the firm's prospects even worse than they had been or would otherwise be.

The pathologies at Apple Computer are all too common and result in a downward spiral of performance. One version of this downward spiral is depicted in Figure 1-1. A company, initially having problems with its profits, costs, or share price, takes quick action to raise profits and lower costs. Since employee costs are typically the most quickly and easily changed, the following actions are common: Training is curtailed; pay may be frozen or cut; promotions are held up; the use of part-time or temporary help increases; and people are laid off or forced to work reduced hours. These measures logically and inevitably reduce motivation, satisfaction, loyalty to the company and intentions to remain with it, and focus on the job (as contrasted with discussing rumors and sharing complaints with coworkers). Cutting training cuts skill and knowledge development and dissemination. Attention focused on unhappiness at work can create a climate in which job related accidents and associated worker compensation costs as well as poor customer service flourish. But poor customer service, high accident rates, increased turnover and absenteeism, and the resulting productivity problems adversely affect sales, profits, and costs. So the cycle continues. In the short run, some firms may be able to cut costs and thereby increase profits to a greater extent than the resulting problems cut profits and productivity. In some cases, cuts can be made in ways that do less rather than more damage to the long-run viability of the organization. Nevertheless, the downward spiral just described, while not inevitable, is all

Figure 1-1 DOWNWARD PERFORMANCE SPIRAL



too common and, in fact, characterized Apple. Clearly, not enough organizations take a people-centered view of the source of their performance and success.

The decimation of the furniture industry in North London, in which a local industry employing about 16,000 people was reduced in less than twenty years to one firm employing fewer than 600, provides another dramatic illustration of this downward spiral in action.

> Faced with increasing competition, the firms sought to maintain market share by cutting prices and costs. They perceived their problem to be excessive wages and competition from neighboring firms, and they reacted by hiring less-skilled workers, automating or increasing the intensity of work, and cutting prices in an effort to drive other firms out of business. These responses, however, left the North London firms with worsening relations with their workers, slimmer margins, and eventually, insufficient financial capacity to survive. They were thus less able to respond to the real problem, which was . . . the emergence of foreign competitors organized around new principles.[34]

CONCLUSION

In this first chapter we have seen that the conventional wisdom about the sources of success—that it's important to be in the right industry, to be large, to be global, to engage in downsizing and cost cutting, and to have some technological or brand equity barrier to competition—turns out not to be consistent with the evidence. Substantial returns are possible even in low technology industries with few barriers to entry and even for relatively small organizations—if they are actually able to implement strategies that provide customer value. Of course, some very successful firms have achieved outstanding technological success. In many instances, this success has been derived from how they manage people, and as we saw in the case of Apple, losing their people advantage can make other problems worse. The management issue is scarcity of time and attention. An emphasis on technological or strategic fixes can divert management action and concern away from the people management practices that develop sustained success. In fact, often, the common response to performance problems creates a downward spiral, as capabilities and motivation are destroyed by short-sighted palliatives.

Seeking success through technology, or strategy, or size, or global positioning somehow seems more complicated or sophisticated. Success achieved by doing the right thing with your people seems simple—but, of course, it does require consistent implementation and a point of view on the sources of success that appears to be in short supply today. Nonetheless, people often ask: If you are about to tell us how to achieve economic success through people, and if, in fact, much if not most of this is well known, how can this be a source of competitive leverage?

My answer is simple: I have come to call it the one-eighth rule. One-half of the people, at most, in spite of the large amount of evidence to be presented both in the next chapter and throughout this book, won't really believe the connection between how organizations manage their people and the profits they earn. Few business schools, management courses, or management books emphasize the importance of people and management practices as contrasted with those that maintain that success comes from strong executive leadership, technological or strategic fixes, or financial engineering. One-half of those who do see the connection will do as many organizations I have seen do—try to make a single change to solve their problems, not realizing that the effective management of people requires a more comprehensive and systemic approach.

Finally, of the half of the firms that will make comprehensive changes to enhance how they manage their people, probably only about one-half of those will persist with their practices long enough to actually derive economic benefits. We live in a world in which long-term thinking is the exception rather than the rule. Managers face demands to make next quarter's numbers, both for the external capital markets and for internal management evaluation and control systems. But it obviously takes time to achieve benefits from training, from reorganized work, and the other practices of high performance management. Not many firms invest the time required. Since one-half times one-half times one-half equals one-eighth, at best a small fraction of organizations will actually do what is required to build profits by putting people first. Those that do will enjoy the benefits. The rest will continue to search for economic success in the wrong places.

The examples, data, and logic presented in this first chapter, although extensive, do not constitute overwhelming evidence for the validity of the claims about the importance of managing people right. We have talked about where success *doesn't* come from, and now it is time to see where it *does*. Managers want hard, scientific evidence about the effects of management practices on organizational performance—the business case for managing people effectively. It so happens that a great deal of such evidence exists, and we will review a substantial portion of it in the next chapter.