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Coming: The Self-Managing, Open-Book Plant?

Manufacturers are cutting supervisors and investing in self-managing teams. But how can employees make good decisions unless they understand the economics of the business?

By Bill Fotsch and John Case

Gary Hamel is not your typical ivory-tower professor. The *Wall Street Journal* calls him one of the world's most influential business thinkers. He's a consultant, management educator, author of several books, and the most widely reprinted writer in the history of the *Harvard Business Review*. When Hamel speaks, business leaders tend to listen.

And what's Hamel speaking about now? Self-management, for one thing. Employees running the show, with few or no supervisors. Power in an organization, says Hamel, should flow from the bottom up.

Self-management isn't as far-fetched as it might sound. Plenty of manufacturers have invested in self-managing teams, often with considerable success. Companies such as W.L. Gore, makers of Gore-Tex and many other products, take it one step further, pretty much doing away with direct supervision. (You're a leader at Gore if you have followers.) Hamel spotted another exemplar: California-based Morning Star, the nation's largest tomato processor. It's a "large, capital-intensive corporation whose sprawling plants devour hundreds of tons of raw materials every hour, where dozens of processes have to be kept within tight tolerances, and where 400 full-time employees produce over $700 million a year in revenues," Hamel writes. The company's goal: creating an enterprise in which all employees "will be self-managing professionals, initiating communications and the coordination of their activities with fellow colleagues, customers, suppliers, and fellow industry participants, absent directives from others."

Today's manufacturers may find the idea of self-management particularly appealing. Most have a highly skilled workforce—people who probably know more about how to do their jobs than any supervisor. And few manufacturers these days can afford the layers of supervisors and managers that used to inhabit American plants. The more self-management you can develop, the lower your costs. "We can learn much from nonbusiness squads such as firefighters and emergency-room crews, as well as from companies such as W.L. Gore, Brazil's Semco, steelmaker Worthington Industries, and Morning Star…," writes *Fortune* editor Geoff Colvin. "The most striking trait of these highly effective teams: They're radically self-managing. At all the companies mentioned above, for example, hardly anyone has a title; workers are empowered to make decisions without consulting (or courting) a boss."

But self-management of any sort, even at the team level, raises a critical question. Management, after all, is all about making decisions. People are considered good managers when they make good decisions. So will self-managing employees and teams make good decisions? Or will they turn out to be an old-fashioned executive's worst nightmare, the inmates running the asylum? Most important, how can a company organize itself to foster good bottom-up decision making—and to lower the chances that self-managing employees will somehow screw up?

In our view, the best answers to these questions lie in a related vein of business thought and practice: open-book management.

Open-book management dates back about 30 years, to the 1983 buyout of an International Harvester engine remanufacturing plant by a man named Jack Stack and his team of managers. The buyout was about as highly leveraged as you can get—89:1 was the company's initial debt-to-equity ratio—and Stack was naturally worried that the fledgling company would run out of cash, fail to make its monthly payment to the bank, and thereby go belly-up. His solution: circulate simplified financials to everyone in the plant and help them understand the critical importance of that cash line on the balance sheet. The message was stark: if we run out of cash, you don't have a job. The company tracked its cash week to week and month to month with all the intensity of people whose livelihoods were on the line.

SRC, as the new company came to be known, got past those early challenges. In the past three decades it has grown to about $400 million in revenue with more than a dozen different business units. But Stack's philosophy never changed: he continued to share the company's financials with employees and to help them understand the most important numbers. The idea began to spread, boosted by media articles, the occasional TV-magazine-show special, Stack's own best-selling book *The Great Game of Business*, and an annual conference sponsored by SRC. *Inc.* magazine christened the practice open-book management, and other companies began adopting it in one form or another.

Maybe because of its name, open-book management generated a host of misconceptions, which no doubt limited its appeal. Plenty of traditional company owners and managers were aghast at the idea of sharing financial statements of any sort with employees. Executives of publicly traded companies pointed out that they couldn't legally disseminate consolidated statements more than once a quarter, at the same time the statements were released to the public. Meanwhile, more than a few skeptics wondered: isn't this crazy? Does opening the books mean that everybody's salaries are going to be public? What happens if financial information leaks to a competitor?

But open-book management isn't some wild-eyed notion of complete transparency. Rather, it's a rigorous, disciplined method of engaging employees by helping them understand the economics of the business and then acting on that knowledge. Companies rarely start the process by sharing financial statements, since the numbers wouldn't mean much to most employees at the outset. They may or may not decide to make public what each person earns (the vast majority of open-book companies keep salary information private, though a few, such as the Whole Foods chain of grocery stores, go for the Full Monty.) But what all open-book companies do is share some essential financial data, enough that employees begin to see how the business makes money and how they contribute to that objective.

That by itself leads to a host of positive outcomes, as we'll see in a moment. But first let us describe how one typical manufacturer implemented the open-book approach. As you'll see, once a company makes the commitment it's really pretty simple.

Boardman Inc. fabricates large-scale pressure vessels and other products, primarily for the energy and chemicals industries. The company employs roughly 100 people at plants in Oklahoma City and Wichita, Kansas, and does roughly $25 million a year in sales. A couple of years ago, co-owners Roger Grommet and Jim Hageman came to believe they could take the company to the proverbial next level by engaging their employees more intensively in the business. Learning about open-book management, they began to implement it.

Step 1 was to assess the company's situation. The management team launched confidential surveys of employees and managers. Among the questions: *What can the company do to improve its relationship with customers and grow sales? What are the primary challenges we are facing? Where is the biggest opportunity to improve profits?* The team also reviewed the company's financial trends for the past five years, highlighting strengths and weaknesses and looking closely at variances to budget in the most recent year. People began calling up customers to assess their experience doing business with Boardman, a process that provided a wealth of market and competitive data. The purpose of all this information gathering in an open-book situation is twofold: on the one hand, to pull in as much data as possible about the business (instead of relying on what you think you know); and on the other hand, to help managers and employees learn to think like owners—like businesspeople—rather than like hired hands.

Step 2 at Boardman was to sit down with employees and managers in groups, review the data, and develop a consensus on a single performance metric that would serve as a yardstick of progress going forward.

This is a common open-book approach—and often a sticking point with conventional managers. “We watch dozens of metrics,” they say. “You can’t judge a business on just one.” In the long run, of course, every business has to succeed on a variety of measures. But the goal of this exercise is to get employees engaged and to build economic literacy. Most companies find that focusing on a single, easily understood number makes a huge difference. Suddenly employees know what *winning* means: making that number move in the right direction.

What’s the right number? That depends on the company, of course, but we typically look for a metric that satisfies at least three criteria:

- *It emerges from group discussions* of the company’s situation, and thus links directly to the key issues the company currently faces.
- *It ties in with key financial indicators*. In other words, an improvement in the key number will lead to greater profitability, higher return on assets, or some other financial benefit.
- *It’s easily understood*: it makes sense to people on the shop floor.

Note that this isn’t a “forever” number. On the contrary, the company should review and very likely change its key number as part of next year’s planning process. Focusing on a new metric each year helps the company build its financial strength—perhaps more revenue in one year and lower COGS the next. It also increases everyone’s financial literacy.

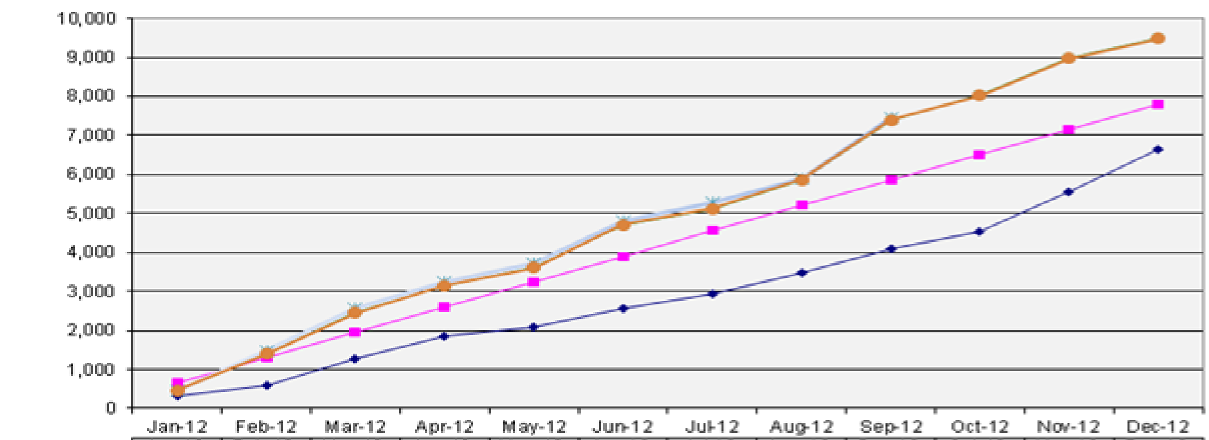
The performance metric that Boardman initially decided on was job margin dollars per month, defined as revenue minus material and direct labor costs for each job shipped in a given month. The metric linked directly to some of the company’s critical issues, including on-time shipping, labor efficiency, rework, and material costs. A review of the past 12 months’ worth of data showed that the company’s profits tracked closely with monthly job margin.

Once you have identified your key number, you naturally want to track it. So a Boardman team moved on to step 3: creating a scoreboard, which combined existing reports into a master spreadsheet indicating job margin dollars. It’s a cliché to say that you manage what you measure—but at Boardman, that was the case. Employees began to self-manage what they were measuring. With monthly job margin available for everyone to see, people began figuring out how to lower material costs, squeeze in an extra job, or get a shipment out the door. At the outset, for instance, rework due to production errors was running at 5%. When shop employees started focusing on getting the job done right the first time, rework dropped to less than 1%, improving on-time delivery and lowering material costs. Similarly, a negative variance to budget became an occasion for reviewing the previous month’s performance, determining what went wrong, and coming up with a plan to correct it. Boardman’s managers could act more like coaches than like supervisors, because the people they once supervised were now reading off the same sheet music and marching to the same tune.

Boardman also began to *forecast* its monthly results. Forecasting—step 4 in the process—is an essential part of the open-book approach: it allows people to take action in advance, thus reducing or avoiding those negative variances. It also demonstrates to employees that business isn't wholly random, that you can predict results over the short term and plan your efforts accordingly. Like any managerial art, forecasting takes some practice, but in our experience people tend to get better at it over time. (It hasn't happened at Boardman yet, but we know a couple of open-book companies where employees organized small betting pools around the accuracy of each month's forecast. Talk about being engaged in the business.)

Boardman's results for 2012 and 2013 far exceeded expectations (see chart). Job margin rose from $6.6 million in 2011 to $9.5 million the following year, far above budget. This increase translated into incremental profits of roughly $3 million. This magnitude of improvement is

Job Margin Dollars ($1,000's)



	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12
2011	319	594	1,266	1,841	2,099	2,560	2,933	3,492	4,107	4,521	5,568	6,642
Budget	651	1,302	1,953	2,603	3,254	3,905	4,556	5,207	5,858	6,509	7,159	7,810
Forecast	471	1,403	2,452	3,146	3,616	4,713	5,129	5,876	7,390	8,025	8,979	9,480
Actual	471	1,488	2,578	3,243	3,723	4,807	5,273	5,901	7,471			
Sales Forecast	471	1,403	2,452	3,146	3,616	4,713	5,129	5,876	7,390	8,025	8,979	9,480

fairly typical for open-book implementations. Mining company BHP Billiton saw a $4 million boost in profits from increased production during the first year, for example, and Capital One's production services division achieved first-year annualized savings of about $3 million. But the intangible payoffs—people learning to think and act like owners—are as important as the tangible ones. "I don't have employees in my plant anymore," said Boardman co-owner Roger Grommet. "I have entrepreneurs who are looking to find ways to make more money."

Boardman is a relatively small company, but we have seen open-book principles implemented in multibillion-dollar enterprises as well. The trick is to focus on the *local* economics—one plant, say, or one business unit. And the system always works best when companies arrange their incentive compensation to reflect improvement in the key numbers. Boardman, for example, linked bonuses directly to improvement in job margin dollars. When the company blew away its targets in 2012, workers received a bonus of 10 weeks' worth of pay and the company enjoyed its most profitable year to date. Extra pay on that scale has a way of focusing people's attention on how they can make the business even more profitable this year.

A company that merely raises its employees' pay will have happy workers—for a time. But if employees don't understand how the company makes money, and how they can contribute to it, they will come to regard their higher pay as something they're entitled to just for showing up. Imagine instead that you create an ongoing conversation with your employees about how everyone can do better because the business is doing better. That creates what Stephen Covey called interdependence—a company of mutual respect centered on the common good of working toward the same goal. This kind of company learns faster than competitors and becomes a formidable force in its industry. At some point, management theorists such as Gary Hamel may stop by to see what's behind its success. What they'll see is a company where people have learned to manage themselves, because they understand the economics of the business.

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