

**BUILDING HIGH
PERFORMANCE
ORGANIZATIONS AND
CULTURES IN TOUGH
TIMES**

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Overview/Outline

- What most companies do when faced with adversity—and why
- The evidence—does this work, and if not, why not
- How to gain competitive position on your rivals

Typical Responses to Economic Stringency

- Cut employees—layoffs, reduce hours
- Cut wages and benefits—the costs of the employees you do retain
- Cut what you deliver to your customers—research and development, product and service quality, product and service innovation

The Logic

- Cutting people, wages, benefits, and services reduces costs—and reducing costs increases profitability
- It's what everyone else is doing—and if everyone is cutting, this must be the right thing to do (because everyone is doing it—the “wisdom of crowds” idea)
- Hard times provide an opportunity to make difficult, but previously postponed, decisions

Conventional Wisdom About Managing in Tough Times is Mostly Wrong

- It ignores feedback effects—the consequences for customer and employee behavior
- Copying others can not provide any organization with long-term competitive advantage—if you do what others do, you will basically get the same results
- Ignores the evidence about the sources of company, and country, success

The Evidence on the Effects of Downsizing

- A study of S & P 500 companies from 1982-2000 reported that there was no increase in profitability (measured as return on assets or stock returns) for firms that downsized
- A SHRM study found that only 32% of respondents indicated that layoffs improved profits
- An AMA survey of 700 companies that had downsized during the 1990s found that in 34% of the cases productivity rose, but it fell in 30%.

The Evidence on the Effects of Downsizing

- A study by the NBER of plant-level productivity found that plants that expanded employment had as large increases in productivity as those that downsized
- A 1996 AMA survey reported that only 35% of responding companies increased product or service quality after downsizing

Evidence on the Effects of Downsizing

- A Right Associates survey reported that 70% of senior managers who remained in downsized firms reported that morale and trust declined
- A survey of “survivors” found that:
 - 54% felt overworked
 - 59% lacked time for reflection
 - 45% reported having to multitask too much

Evidence on the Effects of Downsizing

- A study of 300 large and midsize firms found that stress-related disorders among employees at downsizing companies (including mental health and substance abuse, high blood pressure, and other cardiovascular problems) increased between 100% and 900%.

Evidence on the Effects of Downsizing

- Downsizing/unemployment kills people
 - A Swedish study found that mortality increased 44% among men following job loss
 - A study of plant closings in New Zealand observed a 2 1/2 times higher risk of suicide
 - A study in the U.S. found that job displacement led to a 15%-20% increase in death rates during the following 20 years
 - Another study reported that being fired or laid off increased the odds of reporting fair or poor health by 80%.

What Happens When You Cut Wages and Benefits?

- People leave—and often leave the industry
- People don't work as hard or effectively. When in the mid-1990s, Bridgestone (Firestone) cut pay for new hires, reduced incentive pay, cut vacation, and increased employee contributions to health care costs at its Decatur, Illinois plant
 - Tires were 376% more likely to prompt a complaint to the National Highway Transportation Safety Admin.
 - Customers were 250% as likely to seek compensation for property damage or injury from faulty tires

What Happens When You Cut Wages and Benefits?

- Discretionary effort disappears
- Unfair labor practice and employment law litigation goes up
- You are able to attract a less able work force

What Happens When You Cut the Customer Experience?

- Customers defect to competitors
- Customers complain—including filing legal complaints to regulatory authorities
- Customer satisfaction and loyalty decreases

A Case Study: The U.S. Airline Industry

- The “conventional wisdom” is that the U.S. airlines’ problems come from a) unionized workforces that are paid too much; b) high fuel prices; and c) a bad air traffic control system that results in delays
- What does the evidence show?

Where Are The Customers?

- According to the July 1, 2008, *New York Times*, a survey by a travel industry trade group showed that travelers avoided 41 million trips in 12 months because of “deep frustration” with air travel, costing the airlines an estimated \$9.6 billion
- According to an article in the June 17, *NYT*, between 2000 and 2007, the number of premium passenger trips fell from 79 million to 42 million (46.8%)
- In 2007, there were 17 million one-way trips on business aircraft (40% of the total of premium trips on the commercial carriers)
- U.S. airlines have low (and falling) customer satisfaction scores—they are driving business away

Why Are the Planes Late?

- A report in the *Wall Street Journal* noted that one of the largest factors affecting whether airlines flew on time was the priority management placed on being on time
- In 2004, more than half of all of Continental Airlines' flights from Europe to Newark arrived in a 2-hour period—airlines set their own schedules!
- Flying through congested hubs increases delays and missed connections
- Many U.S. airlines have old fleets—more mechanical troubles and more late and cancelled flights

Which Pilot Hourly Wage Goes With Which Airline (2004)?

- | | |
|--------------|---------|
| ■ United | ■ \$194 |
| ■ US Airways | ■ \$175 |
| ■ Southwest | ■ \$151 |
| ■ Alaska | ■ \$149 |
| ■ Frontier | ■ \$143 |

Description of the Most Successful U.S. Airline

- Pays more than 50% more for pilots with comparable years of service flying the same aircraft than most competitors, and has paid more for years
- Has never had a layoff—even after September 11, 2001
- Does not charge customers extra for bags, snacks, or to talk to a human being
- Has consistently had the best service record—on time performance, lost bags & customer complaints—and the highest customer satisfaction scores in the industry

PEOPLE PRODUCE HIGH
PERFORMANCE

Employee Engagement in 18 Countries as Assessed by Towers, Perrin

- Survey of 90,000 employees found that just 21% are engaged in their work, with 38% partly to full disengaged
- Firms with the highest percentage of engaged employees increased operating income 19% year to year, while firms with the lowest percentage of engaged employees showed year-to-year declines of 33% in operating income
- (www.towersperrin.com)

Similar Results Reported by Other Surveys

- Conference Board reports job satisfaction is at an all time low (and has declined consistently since the mid-1980s—this is not about the recession)
- Employee distrust of management is high
 - E.g., from the TP study, only 38% of employees felt senior management communicates openly and honestly
- More than half of the U.S. workforce reports that their first response to an upturn in the economy will be to look for another job

What Companies Do Matters

- Great Place to Work data
- Studies in many industries (automobile manufacturing, apparel, electronics, telephone call centers, financial services, aerospace, oil refining, semiconductor manufacturing) and in many countries (Korea, Germany, U.K., Japan, Spain) tell the same story

FORTUNE 100 BEST PLACES TO WORK—SHAREHOLDER RETURN 1998-2007



High Performance Work Practices

- Employment security and a policy of mutual commitment
- Selective hiring for cultural fit, not just skill
- Sustained and substantial investment in training and development
- Widespread sharing of information

High Performance Work Practices

- Delegation of decision making authority, often to self-managing teams
- Pay that is contingent on company and/or group, not just individual performance
- An egalitarian culture
- Promotion from within

THE EVIDENCE: SOURCES OF
SUCCESS AND THE
IMPLICATIONS FOR HOW TO
MANAGE IN TOUGH TIMES

Bad Assumptions and Theories, Not Confronted with Data, are Driving Bad Decisions

- Does cutting labor rates make companies more competitive?
 - Pathmark Supermarkets
 - Wal-Mart v. Costco

Pathmark Supermarkets

- When John Whitney took over this failing chain in the 1980s, he
 - Increased the wages of managers
 - Promised no more layoffs
 - “How can you turn around a failing enterprise if people are headed for the door?”

WAL-MART v. COSTCO

- Average Costco employee earned \$15.97 an hour in 2004, 39% more than the average Sam's Club employee who earned \$11.52
- Costco provides benefits such as health insurance (82% of employees covered), Sam's does not (47% covered by a less generous plan)
- Which discount chain is more profitable?

WAL-MART v. COSTCO

- Turnover is 6% in the first year at Costco v. 21% at Sam's
- Costco generated \$795 sales per square foot, Sam's Club \$516.
- Therefore, profit per employee was \$13,647 at Costco v. \$11,039 at Sam's Club
- Labor rates do not equal labor costs or profits!

Country Competitiveness: According to the WEF, Which Country Goes with Which Global Competitiveness Rank?

- China
 - South Korea
 - Finland
 - Sweden
 - Switzerland
- #1
 - #2
 - #7
 - #22
 - #27

MISPERCEPTIONS ABOUT COUNTRY SUCCESS

- World Economic Forum 2010-2011 competitiveness rankings
 - Switzerland ranked #1
 - Sweden ranked #2
 - Singapore, the U.S., Germany, Japan, Finland, the Netherlands, Denmark, and Canada complete the top 10
 - South Korea ranked #22
 - China ranked #27
 - India was *not* in the top 30

SWISS BUSINESS SCHOOL IMD'S 2010 COMPETITIVENESS SCOREBOARD

- #1 Singapore
- #2 Hong Kong
- #3 U.S
- #4 Switzerland
- #5 Australia
- #6 Sweden
- #7 Canada

FORBES GLOBAL COMPETITIVENESS RANKINGS

- #1 Switzerland
- #2 Finland
- #3 Sweden
- #4 Denmark
- #5 Singapore
- #6 United States
- #7 Japan
- #8 Germany
- #9 Netherlands

The Loyalty Equation

- Frederick Reichheld, *The Loyalty Effect*, reported that
 - Customer retention was strongly positively related to profitability (because it is more expensive to acquire new customers than retain existing ones, and also less costly to deal with long-time customers)
 - “On average, U.S. corporations now lose half their customers in five years, half their employees in four, and half their investors in less than one”

Some Principles for Practice

- Take feedback effects into account
 - The Circuit City story
- Understand interdependence and systems thinking
 - How Xerox lost half its market share in 7 years during the 1980s (described in *Fumbling the Future*)

Circuit City: Ignoring Feedback Effects

- An electronics retailer that, in late March, 2007, laid off 3,400 of the company's most experienced sales clerks (to save money by hiring less expensive replacements); sales associates are paid in part on the basis of how much they sell.
- Can you guess what happened?

Circuit City v. Best Buy, 2006-2007

Circuit City

- **-77.9% TSR**
- **-5.5% sales decline**
- **EPS went from \$0.47 to <\$1.25>**

Best Buy

- **-14.1% TSR**
- **11.4% increase in sales**
- **EPS grew 11.5% (\$2.79 to \$3.11)**

Some Principles for Practice

- Understand interdependence and systems thinking
 - How Xerox lost half its market share in 7 years during the 1980s (described in *Fumbling the Future*)
 - Difficulty in implementing “answers” from DemandTec

Some Principles for Practice

- Research shows that companies that do not cut R & D and marketing during a recession outperform their competitors subsequently
- As A. G. Lafley, former CEO of Procter and Gamble has noted, the best time to gain ground on the competition is when they are retreating

How to Manage in Tough Times

- Pay attention to the evidence (e.g., James Surowiecki, April 20, 2009, in *The New Yorker*)
 - In the Great Depression, Post cut expenses and advertising; Kellogg doubled its advertising budget and pushed a new cereal, Rice Krispies. By 1933, Kellogg's profits were up 30% and when the Depression ended, it was the largest cereal company

How to Manage in Tough Times

- Pay attention to the evidence (e.g., James Surowiecki, April 20, 2009, in *The New Yorker*)
 - A study of advertising during the serious recession of 1981-1982 showed that sales at companies where advertising held steady or increased grew very fast over the ensuing three years compared to only slight increases for companies that had cut their budgets

How to Manage in Tough Times

- Pay attention to the evidence (e.g., James Surowiecki, April 20, 2009, in *The New Yorker*)
 - A McKinsey study of the 1990-1991 recession found that companies that either remained market leaders or moved up increased their R & D, advertising, and acquisition budgets

How to Manage in Tough Times

- Pay attention to the evidence (e.g., James Surowiecki, April 20, 2009, in *The New Yorker*)
 - A 1927 study found that firms that kept advertising stable or increased it during the recession of 1921-1922 saw their sales hold up significantly better than companies that did the opposite.

Two Challenges

- For businesses, building a culture of evidence-based decision making and action—running experiments and acting on facts
- For scholars, understanding why there is surprisingly little implementation of the knowledge about how to make companies more effective