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BUILDING EFFECTIVE ORGANIZATIONS

Brent Schlender (2004) encouraged readers of *Fortune* to try the following thought experiment: "What are the most significant innovations of the past 50 years?" Answers that come to mind may include the following: the VCR, the personal computer, genetically engineered medicine, telecommunications satellites, fiber optics, cell phones, the Internet, the ATM, the microwave oven, the cardiac stent, and the bar code. All these innovations have added value to our lives. But Schlender noted that the innovation that has brought those "miracles" is the modern corporation—companies such as GE, Intel, Pfizer, Microsoft, IBM, GM, and so forth. He argued that "without them and their proven ability to marshal and allocate resources, organize and harness the ingenuity of people, respond to commercial and social environments, and meet the ever more elaborate challenge of producing and distributing goods and providing services on a global scale, we would have far less innovation—and less wealth" (p. 104). Companies that have become successful and leaders in their respective industries have mastered the art of managing people and resources. And that accomplishment, Schlender argued, makes the corporation "the latest jewel in the crown of human endeavour."

Jay R. Galbraith (1995), among the leading experts on organizational design and now at the Marshall School of Business, noted that organizational design decisions are critical to organizational effectiveness. That is, for companies to be truly effective requires that they be structurally aligned (see Figure 1.1). Misalignment among the building blocks of an organization is an impediment to organizational effectiveness. And designing effective organizations is a key task of the leader.

Michael Watkins (2003), a Harvard Business School professor, wrote that "the higher you climb in organizations, the more you take on the role of organizational architect, creating the context within which others can achieve superior performance. No matter how charismatic you are, you cannot hope to do much if the key elements in your unit are fundamentally out of alignment. You will feel like you are pushing a boulder uphill every day" (p. 130).

The focus in this module (and the seven cases) is on helping students to appreciate the importance of organizational design and to offer tools and ideas that will help them create effective units or organizations.

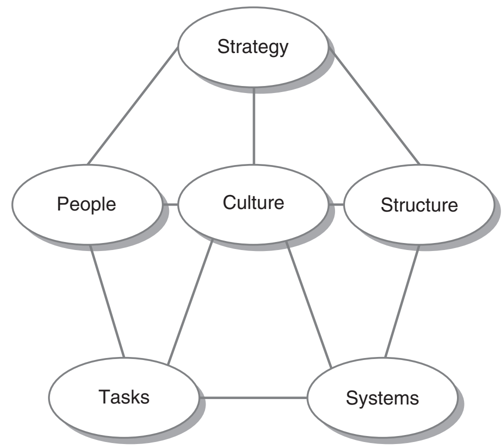

Figure 1.1 Environment

Leaders should start to think like organizational architects; their task is to create the context in which individuals can achieve their potential. Figure 1.1 identifies the six elements of organizational design.

- Strategy

Strategy refers to the chosen direction for an organization, or an organization's "formula for winning." Leaders should be concerned with the question, "What is our business, and how do we compete?" There are a multitude of strategies that organizations can adopt. Two examples include lowest-cost producer and differentiator. Organizational design experts have argued that in thinking about (re)designing organizations, we should always start with strategy. For example, how is our organization positioned vis-à-vis our competitors? How can we add value? What are our goals?

- Structure

Structure refers to the (in)formal system of task and reporting relationships that controls, coordinates, and motivates employees so that they cooperate to achieve the organization's goals. In essence, the organizational structure is the anatomy of the organization; it includes such things as organizational charts, the informal networks that exist, the differentiation versus the specialization dilemma, organizational forms, and decision rights.

- Systems

Systems are the processes and policies that complement the structure. Examples of systems include the ways data are shared, communication, human resources (HR) policies, and budgeting. The processes and policies that exist within an organization can be seen as the physiology of the organization.

- Critical tasks

Leaders have to define the jobs and role requirements that will help to achieve the organization's goals. Critical tasks also include the technologies and tools that are required for employees to complete their jobs or tasks.

- People

What characteristics—or knowledge, skills, and abilities—are required to accomplish tasks and achieve the organizations goals? This element of the organizational design module contains the human resources element—the pool of knowledge, skills, motivation, needs, values, and attitudes on the part of people.

- Organizational culture

Culture refers to the set of core values, norms, and assumptions that controls or guides the way people and groups in an organization interact with each other and with people outside the organization. Organizations often have different cultures, even those that operate in the same industries; the airline industry is a good example.

The various components of the organizational design model need to "fit" or be aligned with one another. There are two kinds of fit:

- External fit (environment—strategy)

External fit addresses the question, "To what extent is the strategy that the organization adopted a reasonable response to environmental demands?" For example, all things considered, does it make sense to enter new markets? The question of external fit is of interest to organizational strategists; it is not the topic of organizational behavior.

- Internal fit (among components of the organization)

Internal fit addresses the following three questions: (a) Do the components of the model of organizational design allow for the effective implementation of the strategy and to perform the core activities of the organization? (b) Do the components of the model of organizational design allow for the effective use of the organization's resources? (c) Is there a consistent message? For example, are the components of the model of organizational design reflective of the values underlying the organization?

Misalignment among the components will hurt organizational effectiveness. For example, a lack of fit among the various components can render even the best thought-out organizational strategies useless. John Kotter (1996) provided three common mistakes in the design of organizations.

The vision is to:	*The organizational structure:*
Give more responsibility to lower-level employees Increase productivity to become a low-cost producer Speed everything up	Layers of middle-level managers criticize and question employees Huge staff groups at corporate headquarters are expensive and constantly initiate costly programs Independent, functional silos do not communicate and thus slow everything down

There are at least four implications that the model of organizational design suggests. It is important that leaders understand these implications. First, a change in strategy affects all other components of the model. As one (or more) element(s) of the model change(s), so too must others to maintain fit or alignment. For example, the result of organizational change is more than just a refocus of strategies, business model, or goals. The entire design of the organization needs to be evaluated. Does the design still support the attainment of the organization's goals?

Second, there is no "one size fits all" organizational design that all organizations should implement. A "good" organizational design for a particular organization is one that has high external and internal fit. Companies within the same industries can have different configurations and yet be highly successful.

Third, leaders have a tendency to focus on the "formal" systems to facilitate behavioral change and make sure that tasks are performed. For example, rewards are often seen as a driver of behavioral change; in reality, they are a reinforcer. All components of the organizational design model should be used as levers of behavioral change or individual performance. Too often, however, leaders focus on structure and rewards in isolation of culture, tasks, coaching, communication, and so forth.

Fourth, culture affects, and is affected by, all components in the model of organizational design. A big impediment to creating organizational change is culture. Culture changes slowly and must be managed in the long term through appropriate changes in strategy, structure, systems, tasks, and people.

The seven cases in this module deal with organizational design issues. For each of these cases, I urge students to think about the following four challenges or questions:

- Analyze the design of the unit or organization. Is there a fit among the components of the organizational design model?
- Identify specific areas for improving fit.
- Design plans for correcting the lack of fit.
- Think about how to best implement those plans.

Some students may feel that issues of organizational design are not relevant to those who are not in leadership positions. This is an incorrect assumption. For example, Watkins (2003) noted that even those people who do not have the authority to lead change so that alignment is achieved should take an active interest in organizational design: "A thorough understanding of organizational alignment can help you build credibility with people higher in the organization—and demonstrate your potential for more senior positions" (p. 131).

A brief description of each case is provided next, and specific assignment questions are suggested.

Trojan Technologies Inc.: Organizational Structuring for Growth and Customer Service

A group of Trojan Technologies Inc. employees grappled with the issue of how to structure the business to effectively interact with their customers and manage the company's dramatic growth. The London, Ontario, manufacturer of ultraviolet water disinfecting systems believed that strong customer service was key to its recent and projected growth and had come to the realization that changes would have to be made to continue to achieve both simultaneously. Recent problems encountered included difficulties being experienced in training, career development, recruiting, customer service, and planned geographic and product line expansions. The group hoped to develop a structure to address these issues. The executive vice president was to lead the development and implementation of the new structure. The transition to the new structure was to coincide with the new fiscal year.

Assignment Questions

- Consider the organization's fundamentals in terms of products and customers. Describe the importance of customer service and support, and consider the implications for the company's

functions that directly interact with customers, given the historical and projected growth in the company.
- Given the decision to structure the company for growth using business teams, how would you decide the composition and delineation of the teams to achieve the growth and customer service objectives of the company?
- What concerns do you have with changing company structure, and how would you address them to ensure the new structure was successful?

Blinds to Go: Staffing Retail Expansion

Blinds to Go is a manufacturer and retailer of customized window coverings. The company has been steadily expanding the number of stores across North America. In the year 2000, the company was experiencing tremendous growth, with plans of adding 50 stores per year in Canada and the United States. The vice chairman is concerned with the lack of staff in some of these newly expanded stores. With plans of an initial public offering within the next 2 years, senior management must determine what changes need to be made to the recruitment strategy and how to develop staff that will help them achieve the company's growth objectives.

Assignment Questions

- Why is Blinds to Go having difficulty attracting and retaining retail staff?
- Are the elements of the organizational design at the retail store level "aligned" to facilitate the retention of new employees? Why?
- What recommendations would you give Blinds to Go to improve their staffing practices?

Five Star Beer—Pay for Performance

In June 1997, Tom McMullen (president of the Alliance Brewing Group) and Zhao Hui Shen (general manager of Five Star Brewing Co. Ltd.) met to discuss the "pay for performance" systems that Zhao had been implementing at Five Star's two breweries over the past several months. The president needed to determine whether these systems were properly designed to ensure that they are producing higher quality product at progressively lower costs. If not, he needed to consider how he might suggest that these and other systems be changed to achieve cost and quality objectives.

Assignment Questions

- Assess the organizational design of Five Star. In developing your assessment, consider the strategic, structural, human resource, and task elements at play, particularly as they relate to Zhao's performance-based compensation systems.
- Analyze Zhao's "bonus" compensation systems in detail. What likely impact will these systems have on quality at Five Star? What impact will they have on the sales force?
- As Tom McMullen, what suggestions would you give Mr. Zhao on how to improve these systems? What organizational design changes can realistically be made that will enhance quality and promote acceptance of the systems? How would you implement these changes?
- As an outside consultant to McMullen and Zhao, what would you recommend they do to change Five Star's culture from a "volume culture" to a "quality and profitability culture"?

JinJian Garment Factory: Motivating Go-Slow Workers

The case illustrates a typical labor-intensive industry that is characterized by furious competition and low employee loyalty. JinJian Garment Factory is a large clothing manufacturer based in Shenzhen with distribution to Hong Kong and overseas. Although Shenzhen had become one of the most advanced garment manufacturing centers in the world, managers in this industry still had few effective ways of dealing with the collective and deliberate slow pace of work by the employees, motivating workers, and resolving the problem between seasonal production requirements and retention of skilled workers. However, the owner and managing director of the company must determine the reasons behind the deliberately slow pace of the workers, the pros and cons of the piecework system, and the methods he could adopt to motivate the workers effectively.

Assignment Questions

- Is the piecework system the most suitable wage system for factories in the Shenzhen garment manufacturing industry?
- What are the pros and cons of the piecework system?
- What industry is most suitable for the piecework system?
- How do you solve the dilemma facing the garment industry—that of seasonal production requirements versus retaining skilled workers?
- Do you agree with the severe quality punishment policy prevailing in the Shenzhen garment industry? If not, is there a better way to deal with the quality problem?
- If you were Mr. Lou, what would you do to increase worker productivity?

S-S Technologies Inc. (Compensation)

The owners of S-S Technologies Inc. were concerned with the rapid rate of growth facing their company. The company had revenues of $6.3 million and employed 30 highly skilled workers. These numbers were expected to double or triple in the next couple of years. To determine how well the company was structured to achieve its future goals, they hired a consultant they had worked with successfully in the past. The consultant's major role was to make recommendations as to the appropriate organizational design (culture, people, layers of management and administrative systems) in the event that the company grew from 30 to 60 or even 120 employees. Among other issues, questions regarding compensation were surfacing, and the owners wanted to address these questions as soon as possible.

Assignment Questions

- What are the key success factors (things that the company has to do well) for S-S Technologies to attain high growth, high profits, and high morale?
- Describe S-S Technologies' compensation plan. Does it contribute to attracting and keeping key employees? What factors account for the highly skilled and committed workforce at S-S Technologies?
- How long can S-S Technologies continue with its existing compensation plan? Why?
- What recommendations would you make to Brock and the consultant regarding (a) base pay, (b) bonuses, and (c) "equity" for partners?
- What process would you recommend to obtain acceptance of the new compensation plan?

OP4.com: A Dynamic Culture

OP4.com, an Internet portal for teenagers, had just celebrated 6 months of existence. The cofounders of OP4.com knew that the internal culture had to reflect the identity of its Web site, so they wanted to cultivate a savvy, hip staff. They used unique methods to evaluate a prospect's fit into the company and some unorthodox training and feedback systems. With profitability being the next key step, they had to determine how to maintain this culture through the next stage of growth—one that would result in the creation of business units and formal reporting structures for staff.

Assignment Questions

- How would you characterize the organizational culture at OP4.com?
- How was this culture developed and maintained?
- What role, if any, does OP4.com's culture play in the organization's effectiveness?
- How should Ray Matthews and Stuart Saunders manage the transition to a new organizational design?

WestJet Airlines (A): The Culture that Breeds a Passion to Succeed

WestJet Airlines, a regional carrier that provides low-fare flights with exceptional service, has achieved remarkable success. It has made profits ever since its inception since 1996. Its market capitalization has surpassed that of Canada's national airline. The founders believe that the company's culture is the key to continued success and that they cannot afford to mismanage it. "We're in the hospitality business and our culture is everything to us," stated Don Bell, cofounder and senior vice president of customer service. However, three potential threats to WestJet's culture and its success emerged. First, industry watchers voiced concerns about WestJet's future, arguing that an economic downturn could hurt the carrier dependent on leisure travelers. Second, its expansive growth could make it hard, if not impossible, to keep the "fun" culture alive. In light of the tremendous growth, the founders must determine how WestJet could grow while maintaining its unique and vibrant culture. Third, other airlines had noticed the success of WestJet and were in the process of attempting to mimic its service.

Assignment Questions

- What is WestJet's competitive advantage? What are the sources of that competitive advantage?
- Is the culture at WestJet as important to the success of the organization as its management team believes it to be?
- How serious is the threat from conventional airlines that want to imitate the WestJet culture? What does it take to imitate organizational culture?
- What does WestJet need to do to keep its success going as it is expanding its fleet?

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Trojan Technologies Inc.: Organizational Structuring for Growth and Customer Service

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In March 1998, a group of Trojan Technologies Inc. (Trojan) employees grappled with the issue of how to structure the business to effectively interact with their customers and to manage the company's dramatic growth. The London, Ontario manufacturer of ultraviolet (UV) water disinfection systems believed that strong customer service was key to its recent and projected growth, and had come to the realization that changes would have to be made to continue to achieve both simultaneously. The group hoped to develop a structure to address these issues. Marvin DeVries, executive vice-president, was to lead the development and implementation of the new structure. The transition to the new structure was to begin as of September 1998 to coincide with the new fiscal year.

The Business

Technology

Since 1977, the company had specialized in UV light applications for disinfecting water and wastewater. In essence, Trojan's products killed microorganisms using high-intensity UV lamps. Water was channeled past the lamps at various speeds, based on the clarity of the water and the strength of the lamps, to achieve the required 'kill' rate.

Trojan's UV technology had proven to be an environmentally safe and cost-effective alternative to chlorination, and was gaining wider recognition and acceptance. Even so, a significant market remained to be tapped, as the company estimated "... that only five per cent to 10 per cent of municipal wastewater sites in North America use UV-based technology ... [and] of the approximate 62,000 wastewater treatment facilities operating worldwide, only 2,500 currently utilize UV disinfection systems."[1]

Trojan Technologies Inc.[2]

Trojan was established in 1977 with a staff of three with the goal of developing a viable UV wastewater disinfection technology. Following several years of work, the first UV disinfection system (System UV2000™) was installed in Tillsonburg, Ontario, in 1981. It took another two years, however, before the regulatory approvals were in place to market the technology for municipal wastewater treatment in Canada and the United States. During this time, the company generated revenues through the sale of small residential and industrial cleanwater UV systems.

By 1991, the company had sales in excess of $10 million, and had introduced its second-generation technology in the System UV3000™ wastewater disinfection system. As the company's growth continued, a staff of 50 was in place by 1992. The following year, due to capital requirements created by the company's strong growth, an initial public offering on the Toronto Stock Exchange was completed. Also in 1993, a branch office was established in The Hague, Netherlands, expanding Trojan's reach across the Atlantic.

1994 saw the launch of the System UV4000™, the construction of a new head office and sales exceeding $20 million. In 1995, a branch office was opened in California to service the enormous market for wastewater treatment in that state. Two years later, an expansion doubled head office capacity to house 190 staff and to meet the demand for sales of more than $50 million.

Well into 1998, the expectation was that sales would reach $70 million by year-end and continue to grow by more than 30 per cent per year over the next five years, reaching $300 million by 2003. The company was in the process of planning additional capacity expansion in the form of building and property purchases adjacent to head office, and expected to quadruple its headcount by 2003 to more than 1,000 employees.

Products

In 1997, 93 per cent of Trojan's sales were of wastewater products (System UV4000™ and System UV3000™). These systems were designed for use at small to very large wastewater treatment plants and more complex wastewater treatment applications with varying degrees of effluent treatment. The remaining seven per cent of sales were cleanwater products (primarily the System UV8000™ and Aqua UV™) for municipal and residential drinking water and industrial process applications. Growth in the coming year would be driven by increased sales of the wastewater disinfection products in both current and new geographic markets. In the longer term, new products such as the A•I•R• 2000™, which was to use UV light with an advanced photocatalytic technology to destroy volatile organic compounds in the air, were expected to further Trojan's sales growth.

Products were typically assembled from component parts at Trojan head office. The complexity of the product design, manufacture and service arose from the integration of skills in electronics, biology, controls programming and mechanical engineering. The company owned patents on its products and was prepared to defend them to preserve its intellectual capital.

Customers

Trojan sold its wastewater treatment products to contractors working on projects for municipalities or directly to municipalities. Typically, the process involved bidding on a project based on the Trojan products required to meet the municipality's specifications, and, therefore, engineering expertise was required as part of the selling process. Project sales typically fell in a $100,000 to $500,000 range, and given the large value of each sale, the sales and marketing function was critical to the company's success. However, for marketing to be effective, this new technology had to be well-supported. Municipalities purchasing the wastewater disinfection systems required rapid response to any problems, and expected superior service given the consequences of breakdowns for the quality of water being discharged from their facility. Municipalities also had the ability to discuss Trojan and their UV products with other municipalities before deciding to make their purchase, further underlining the importance of warranty and aftermarket service to customers to ensure positive word-of-mouth advertising.

Trojan's smaller product line, the cleanwater segment, focused on a different customer base from wastewater, and it was difficult to generalize about the nature of this segment's customers. These customers ranged from municipalities to industrial companies to individuals.

Interaction With Customers

The Process

The main points of customer interaction in the wastewater product line included:

1. Quote/bid process
2. Configuration of project structure
3. Project shipment and system installation
4. Technical support and warranty claims
5. Parts order processing

Each of these is described briefly below:

The quote/bid process was a major function of the marketing department, with support from the project engineering department. Although the marketing department took the lead role in assembling the appropriate bid and pricing, the customer would on occasion wish to speak directly to the project engineering department on specific technical questions related to the function of the UV unit within the particular wastewater setting.

After winning a bid, the configuration of project structure involved working with the customer on the detailed specifications for the project and applying the appropriate Trojan systems in a configuration that would meet the customer's needs. The project engineering department took the lead role in this work, and either worked through the marketing representative in transmitting technical information to and from the customer or communicated directly with the customer's technical personnel.

Once the project had been configured, it was scheduled for manufacture by the operations department. On completion, and when the customer was ready to integrate the UV system into their wastewater facility, the service department completed the installation and start-up of the unit. The service department would also be involved in demonstrating the proper use of the system to the customer.

After the system was in use by the customer, further interaction came in the form of technical support. The service department would deal with phone calls, site visits and warranty claims and was the primary contact point for the customer. By its nature, most service work at this stage of the process was completed on an 'as-needed' basis by the first available service representative. As a result, it was difficult or impossible to have the same service representative available to respond to a particular customer on every occasion. The service department, therefore, kept a detailed file on each UV installation and all customer contact to ensure the most informed response on each service call.

The final stage of customer interaction was the ordering of replacement parts by the customer after the warranty period was complete. This was handled by a call centre at Trojan head office in London that was separate from the other departments that had dealt with the customer. The call centre was staffed to receive orders for Trojan replacement parts, but not to provide technical support as with the service department, and would generally not access customer service files in taking the order.

In summary, customers would deal with as many as four different departments during their interaction with Trojan. During the early days of Trojan's growth, the 'close-knit' nature of Trojan's workforce allowed a seamless transition between 'departments.' However, as described below, the company's continued growth began to complicate the transition between departments.

Customer Support in the Early Days

In the 1980s and early 1990s, when Trojan had less than 50 employees and worked on a limited number of wastewater bids and projects during the course of the year, customer support was a collective effort across the entire company. In fact, it was not unusual that virtually everyone in Trojan knew the details of all the major projects in process at any given time. There was a common knowledge base of customer names and issues, which resulted, in DeVries' words, in an 'immediate connectivity' to the job at hand. At times, during those early days, there were as few as two employees in a 'department.' Under these conditions every project received immediate and constant attention from start to finish, ensuring the customer was satisfied and potential issues were addressed in a proactive manner.

Challenges Created by Growth

As the company grew, departments grew. Very quickly the number of projects multiplied and it became impossible for everyone to know all the customers and active projects, or even all the people in the organization. As departments grew from two to five to 10 people, communications became focused internally within the departments. This made it progressively more difficult to ensure timely and effective communication on project status between departments, and the 'immediate connectivity' described by DeVries began to break down. The situation was described by many as one where 'things began to slip between the cracks' in terms of customer service excellence, because it was no longer possible for employees to shepherd a project through the company from start to finish as had been done in the early days. Once a particular department had finished their component of a project, they immediately had to turn their attention to the other projects they had ongoing, creating the potential for a lag before the next department picked up the customer file.

Project Engineering

Project engineering was one example of a department that had begun to experience problems maintaining service levels to the end-customer as a result of growth. By 1997, there were seven engineers in the department handling the regular support to the marketing department and acting as 'specialists' for the various technical components of the products. When engineers were hired into this group, there was no formal training or apprenticeship program in place. The new hire would simply follow along as best he or she could and attempt to learn the complex product line through observation and assistance from others in the department. This type of training was strained by the demand for project engineering services brought on by Trojan's growth.

A 'specialist' role, in addition to their support of the marketing department's project bids, had evolved within the project engineering group. To handle specific technical requests, this informal addition to the project engineer's role had occurred somewhat spontaneously within the department. For example, if one of the project engineers had developed a detailed understanding of the electronics included in the System UV4000™ products, that employee acted as the reference point for most detailed queries on this subject and was considered the 'electronics specialist.' There was no specific training or support to develop these specialists for their roles in place in 1997, nor was hiring particularly targeted at filling the specialist roles described above, as it was a secondary role for the department. As a result of the dual roles and the company's rapid growth, project engineers could not take responsibility to guide a project from bid through customer queries to production and commissioning of the project. The demand for assistance on many bids, coupled with the need to respond to queries in their 'specialist' area on active projects prevented project engineers from acting as a steward on specific projects as they passed through the company. Instead, the department operated more as a pooled resource that was accessed as needed by the marketing department to support bids and by the service group to assist with product support.

Service

The growth of the company and the establishment of new product lines had caused an amplified growth in the service group, because for each new project installed there was a long-term source of potential queries and service needs. The service group covered a broad spectrum of needs, from the initial setup of UV systems to emergency responses to equipment problems or queries (which frequently required site visits). A formal training program had been instituted during early 1998 when the new service manager recognized the need to quickly develop new employees to ensure they could contribute a strong technical background and familiarity with the product. An existing service group member typically instructed new employees for approximately one week, and new employees learned the balance 'on the job' through observation and discussion of issues with other service employees. Again, company growth had caused some difficulty in ensuring that new employees received adequate training before they were needed to actively service customer inquiries.

There was a fundamental structuring conflict within the service area on how to best serve the customer. On one hand, customers appreciated the ability to contact one person whenever they had a concern or question. Also, customers frequently needed quick response times to their site for in-person assessments and action by the service employee. This appeared to suggest a need to place service employees physically as close to the end-customer as possible, especially given the company's expanded geographic marketing area. However, the timing of service work was very uncertain. Whereas the project engineering department had some ability to prioritize and schedule their workload, the service department typically had to respond to customer calls immediately, and the geographic distribution of calls was not predictable. Therefore, if Trojan received significant service requests in California, the company could be forced to respond by sending all available service employees there. The uncertainty of the timing and geographic distribution of service calls lent itself more to the centralized pooling of resources that Trojan currently used.

As Trojan had a significant geographic distribution of sales, service work involved substantial travel. In fact, the constant travel presented an additional risk of 'burnout' that was unique to the department. To address this, and to ensure a reliable response to calls for assistance from customers, a head office call centre was created in 1998. The call centre was staffed by service technicians who could respond to many customer situations over the phone and by using sophisticated remote monitoring of the UV installments in some cases. The call centre also provided a place where experienced service personnel who were at risk of 'burn out' from constant travel could use their expertise. Also, the call centre provided another opportunity to train new employees before dispatching them directly to customer locations on service calls.

Related Issues

Career Ladders

In a small company, career progression and satisfaction typically comes with successes achieved that significantly affect the organization. There was generally not the expectation or the possibility of significant promotion or role development, but this was offset by the potential for involvement of everyone in several major components of company activity. This was certainly the case at Trojan in the early days. As the company grew, however, a need to distinguish between and recognize the various levels of experience developed. The current department structure did not provide for much differentiation of job requirements within the departments, and, therefore, did not recognize the significant difference in experience levels between new and veteran employees.

Training Issues

As Trojan's sales continued to grow, the need to increase staffing was accelerating. In the early days, the addition of a person to the company was informal and supportive. The new employee would be introduced to everyone and would easily be able to approach the appropriate person to ask questions and to learn their role within the company. Given the rapid expansion of the company, this informal introduction to the company and its processes was rapidly becoming insufficient to allow new employees to become effective in their new position. Training, therefore, needed to be addressed in many areas.

Decisions

Given the issues developing as Trojan grew, the structuring issue was becoming steadily more important. The structuring team under DeVries envisioned a regional, team-based approach to customer interaction that would replicate the structure used by the company in the early days. One of the difficulties in implementing such a structure, however, would be ensuring that the groups still operated as though they were one company, sharing knowledge and resources as appropriate. Another would be determining what level of centralized support would be appropriate, bearing in mind the need to avoid duplicating activities at head office that should be handled by the regional teams. Employees were now aware that there would be a change in the company structure, and there was a need to come to some conclusions on the new structure quickly to reduce anxiety about the change within the organization.

Notes

1. From Trojan 1998 annual report.
2. The information in this section was primarily gathered from Trojan 1997 annual report.

Blinds to Go: Staffing a Retail Expansion

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Introduction

"Staffing stores is our most challenging issue as we plan our expansion across North America," exclaimed Nkere Udofia, vice-chairman of Montreal-based Blinds To Go (BTG). "There are locations now where we've got physical store buildings built that are sitting unstaffed. How are we going to recruit and develop enough people to meet our growth objectives? What changes should our company make?" It was August 2, 2000 and Udofia knew that if Blinds To Go was to continue to grow 50 per cent in sales and add 50 stores per year, the issue of staffing would be front and centre.

The Development of the Blinds to go Retail Concept

This retail fabricator of window dressings began as a one-man operation. Growing up in the Côte-des-Neiges district in Montreal, Canada, David Shiller, the patriarch of the Shiller family, started in business in 1954. Stephen Shiller, his son, joined the business in the mid-1970s, convincing his father to focus on selling blinds. Called "Au Bon Marché," as it was known in Quebec, the Shillers began to create the production system that allowed them to cut the normal six- to eight-week delivery time frame for custom blinds to 48 hours. The customer response was overwhelming and the business took off.

Stephen Shiller exclaimed:

> We gave them food, kept them busy while they waited for their blinds to be ready. The factory was literally next to the store and we offered our one-hour delivery guarantee, which kept our customers happy. Our St. Leonard store, the prototype for the current Blinds To Go stores, opened in 1991. Prior to that, people used to drive for up to 100 miles to come to our stores.
>
> At that point, in early 1994, we realized what a hot concept we had on our hands—our sales were higher for each consecutive store opened, and none of our competitors could replicate our model. They were either manufacturers or retailers: none were both. None could hope to deliver the 48-hour turn-around we promised, had our unique sales model, which is 100 per cent commission-based, or had our attention to customer needs.

By June 2000, Blinds To Go operated 120 corporate-owned stores across North America (80 U.S. stores, 40 Canadian stores), generating in excess of US$1.0 million in sales per store (having a staff of between six to 20 people per store). Blinds To Go expected to add an average of 50 new stores per year for the next five years, 80 per cent of which was targeted to be U.S. expansion stores.

Retail Operations

It was senior management's belief that quality of staff was even more important than store location, the surrounding customer demographics or advertising. Stephen Shiller, president, tested this belief with the East Mississauga, Ontario store.

In 1999, the East Mississauga store had experienced declining sales and high employee turnover. Analysing the demographic data surrounding the store left management with the impression that the store was a victim of poor location and cannibalization from another BTG store 10 miles away. However, Stephen Shiller, suspected that the real problem was in the quality of the store's staff. Stephen Shiller commented:

> We let the store continue on its downward sales trend as we trained a management team for this store. Although I was quite sure that the quality of people was at fault, I was determined to use this as a lesson to show the rest of the company how important it was to have first-class talent. After six months of waiting, we put in an 'A' management team and trained staff. In one week, we doubled our sales and we tripled our sales in one month. That was a lesson we must never forget.

There were four staff roles in the stores—the sales associate, the selling supervisor, the assistant store manager and the store manager. The sales associates were the most junior employees and their job was to follow a set plan to help walk-in customers purchase a set of blinds. If they proved to be consistent sales performers, they would be promoted to selling supervisors or assistant store managers. Selling supervisors were assistant managers in training and usually had been one of the best sales associates. Assistant managers were in charge of the store when the store manager was not scheduled to work. The store manager was directly responsible for overall store operations, including closing sales, motivating and developing staff, and handling customer service issues such as repairs and returns.

Generally, a very good sales associate was promoted to selling supervisor six to nine months after hiring date. To become a store manager generally took another six to 18 months. However, because of the enormous variation in personal potential, these progression targets were by no means fixed.

The BTG selling process involved a very high level of interaction with the customer, which set a very high level of service expectation. At the retail stores, the emphasis on customer satisfaction and sale closure led to a higher volume of orders relative to their retail competition. Outlined in the Blinds To Go University Manual (training program for new sales staff) were the following four operating guidelines:

- Service and Satisfy every Customer
- Never Lose a Sale
- Make the Customer Feel Special
- Bring the Manager into Every Sale to Give the Customer "Old Fashion Service"

Salespeople were expected to bond with a customer through a personal greeting, then ask open-ended questions about their product needs. The purpose of the next few minutes of interchange between associate and customer was to understand the customer's primary concerns and work towards a sale by resolving those issues. Next, associates emphasized to the customer the quality of the product, large selection and warranties. At this point, the associate would listen to any customer objections, and try to address them. The associate would price the product(s), then introduce the customer to the store manager. After walking the store manager through the order, the associate would deduct any relevant coupons, then attempt to close the sale.

All employees of BTG, even up to the president, prided themselves on being able to sell blinds to customers. During store visits, it was not uncommon to see senior management helping out the staff in dealing with an overflow of customers.

Compensation of Retail Staff

The commission-based structure fostered a high-energy, sales hungry culture at Blinds To Go. Todd Martin, the director of retail planning and operations explained:

> We know people come to us because they need blinds. An example of our culture in action is a manager who is unhappy with closing eight of 10 sales, because with the tools at his disposal, he should be able to close all 10. Even if the customer is just looking because they want to buy a house in six months, we can take their worries away from them. He should be able to sell to 10 out of 10 customers.

Todd Martin also believed there was a healthy competitive environment among sales associates. He offered:

> In the store, there are no rules on grabbing customers—in my two years here, I've never seen a problem with staff fighting for customers.

As BTG grew from a one-store operation, the Shillers kept a commission pay structure for its salesforce, believing that it best motivated performance. From experience, they knew that a suitable salesperson could, with the commission structure, make more money at BTG than at a comparable retail outlet. The focus had been on hiring energetic, personable people who loved the thrill of a sale.

A Change in Compensation Results in Sales Decline

In 1996, the Shillers decided to change the compensation system from full commission to salary. This change was the result of a recommendation from a newly hired vice-president of store operation who had been the vice-president of a major U.S. clothing retailer. Her intention was to attract more recruits for Blinds To Go's expansion phase by standardizing store operations and compensation. At that time, there were already 15 stores and expansion was underway. Based on her prior experience at the U.S. retailer, she led the change from full commission to paying sales associates a wage of Cdn$8 per hour. This was intended to make sales associates less entrepreneurial and more customer-service focused. Store manager compensation was also revised to reflect a higher base salary component relative to commissions. A more casual uniform was mandated in place of the business casual attire that was being worn at stores. In an attempt to differentiate the roles of sales associates and store management, it was decided that the store manager would no longer be involved in the sale. Though skeptical of this recommendation, the Shillers reluctantly agreed to proceed as suggested, rolling out these changes in 1996.

Sales declined between 10 per cent to 30 per cent in both new and existing stores from 1996 to 1997. Overall staff turnover increased to more than 40 per cent from a pre-1995 figure of 15 per cent. This problem was further exacerbated by the fact that rapid store expansion into Toronto, Philadelphia and Detroit had required the deployment of skilled store staff, thinning the ranks of existing stores. The Shillers attributed this decline in performance primarily to the change in the compensation structure.

BTG Reverts to Commission-Based Compensation

Unsatisfied with this turn of events, a change was made in the leadership of the stores' team. A variation of the commission-based compensation plan was brought back in May 1998 (see Exhibit 1). Udofia explained why he believed that commission was key to the sales culture of Blinds To Go:

> When we made the 1996 change, the base salary of $8/hour made it much easier to staff the store, but we were attracting a lower caliber of people—our best commission-based people did not like it and left. Having learned our lesson, we went back to our roots, brought back the old culture and experienced a sales turnaround. But, we've never 100 per cent recovered from it and are still playing catch-up today.

Corporate Formula	*Original*	*1995 to 1996*	*Current*
Sales Associate	\$3 to \$5/hr + 3% sales	\$8/hr	\$6 to \$8/hr minimum, OR 6% sales (whichever was higher)
Managers/Assistants	\$10,000 to \$20,000/yr + 1.5% – 3% of overall store sales	\$25,000 to \$40,000/yr + 0.25% – 0.5% of overall store sales	\$10,000 to \$20,000/yr + 1.5% – 2.5% of overall store sales

Actual Results	*Original*	*1995 to 1996*	*Current*
Sales Associate Top 20% of class (\$14,000/sales/week)	\$620/wk	\$320/wk	\$840/wk
Sales Associate Average Success (\$10,000/sales/week)	\$500/wk	\$320/wk	\$600/wk
Sales Associate Marginal Performer (\$6,000/sales/week)	\$380/wk	\$320/wk	\$360/wk
Sales Associate Poor Performer (\$3,000/sales/week)	\$290/wk	\$320/wk	\$240/wk

Manager Top 20% (2.5% of store sales)	\$75,000/r	\$52,500/yr	\$67,500/yr
Manager Average Success (1.2% of stores sales)	\$50,000/yr	\$40,000/yr	\$50,000/yr
Manager Poor Performer	\$35,000/yr	\$35,000/yr	\$40,000/yr

Exhibit 1 BTG Pay Structure History

Since the return to commission-based compensation in 1998, store sales improved across the board, and within a few months, stores were posting between 10 per cent to 30 per cent increases in sales from the previous year (see Exhibit 2).

This dramatic turnaround was accomplished with the aid of several other initiatives. First, all U.S. district sales managers (DSMs) were brought to Toronto to see top-performing stores, thus establishing a performance benchmark. Next, a BTG employee stock option plan for store employees (all full-time sales associates were made partners and given shares in the company) was implemented along with a sales award and recognition program. Also, weekly development

	Pre-1994	*1995 to 1996*	*1997 to 2000*
New stores/year	N/A	25	20
New store average sales	$1 million	$0.7 million	$1.2 million
Versus comparable store sales year ago	3%	−20%	+15%

Exhibit 2 Sales Turnaround

conference calls between senior management and the district sales managers and training managers were set up for the purpose of constant updates and to facilitate group learning. Finally, a manager/assistant training program was tested in the U.S. in early 1998.[1]

The 1998 shift back to commission caused another huge turnover in BTG stores. This was unfortunate, because, from a staffing perspective, BTG had still not fully recovered from the previous compensation change. The need for additional staff was further aggravated due to BTG's continued push for growth and the tight U.S and Canadian labor markets (four per cent unemployment) in which it operated.

Another concern was that a commission-based compensation structure would not work in the U.S. Martin explained:

> The U.S. folks seemed uncomfortable with 100 per cent commission. They seem to prefer a straight wage or salary. Thus, we have not figured out our compensation system, but for now, it's largely commission based. We know that for the people who are good, they will figure out what they need and go get it. Commission for us is like an insurance policy on our hires—the better you are the more you make. If you don't like servicing the customers, you leave.

Along with the reversion to the proven BTG compensation structure, Blinds To Go emphasized the practice of promoting their managers from within. Senior management believed that sales managers had to be properly motivated and provided them with a combination of store sales commission and opportunities for rapid advancement in the growing organization. However, being a top salesperson did not necessarily guarantee promotion, as Blinds To Go also looked at a matrix of sales, drive, presence, and people skills. Martin explained: "So even with the top salespeople, they have to be solid in their other attributes to be chosen for management. If the person is driven, he or she will ask for what it takes to be promoted."

Attracting Quality Retail Sales Candidates

BTG was looking for people who possessed certain sales-driven qualities. Martin explained:

> We look for people who have the 'gift of the gab,' no ego, are honest, like sales, are driven and hungry for an opportunity, and have good leadership and good people skills. People have to possess these core values. We're partners—we want other people who want to be our partners. We pay for performance. You bet on yourself. You get rewarded because you're performing. Entry-level sales associates get 1,000 stock options after 90-days. At another successful retailer start-up that has since gone public, their people only received 500 options each.

Having recognized that quality of staff was paramount, BTG devoted resources to ensure that it hired the right people as it was estimated that 80 per cent of their expansion needs would be for new U.S. stores. BTG store staff was very diverse. In terms of gender, it was a 50/50 split between men and women. Among associates, high school was the most common education level, followed by college students, then college graduates. In Ontario, Canada, 20 per cent of the associates were recent immigrants who had college or professional qualifications. The average age of associates was distributed over a typical bell curve between the ages of 18 to 50.

Over the last few years, BTG had tried several recruiting methods to varying degrees of success. There were several formal and informal programs that worked to entice qualified personnel to apply to BTG.

Employee Referral

Having current staff refer friends and family to BTG seemed to be the most effective way to attract a candidate already briefed on the BTG concept. A recent addition to create an incentive to refer was the "BMW" contest where staff could win the use of a BMW car for a year if they referred 10 eventual hires that stayed for at least three months. Employee referrals alone did not currently satisfy BTG's hiring needs.

Internet Sourcing

BTG used the Internet in two ways: BTG solicited résumés at its blindstogo.com site; DSMs and recruiters actively searched online job sites like Monster.com and other job sites to contact potential candidates.

DSM Compensation Readjustment

To put more emphasis on staffing in early 2000, DSMs' incentive bonus was changed from a sales target to new staff quota target. Historically, district sales managers had received an incentive bonus based on sales. Thus, a large part of the DSM's role had evolved to include recruiting responsibilities—the DSM now had to hire 10 new sales associates a month.

BTG Retail Recruiters

Professional recruiters were hired in early February 1998 and had been paid annual salaries ranging from $30,000 to $60,000. Recruiters generate leads through cold calls (in-person and via telephone), networking referrals, colleges, job fairs, the Internet, and employment centres. Even though they were given some training and recruiting objectives, the initial recruiters had averaged around four hires per month (against the company objective of four hires a week). "Overall, the performance was sub-optimal," lamented Martin. "By paying them a base salary, we divorced performance from pay and they became administrators." For recruiters, a switch was made in early 2000 to a mix of salary and commission. "They will still need to average four hires a week—but we've increased our training and the 'per hire' commission will focus them on results," Martin concluded.

Newspaper Advertising

BTG used weekly newspaper advertising for nine months starting in mid-1998. Although this method generated a sufficient number of candidate leads, senior management believed that this medium did not generate the quality of candidates that it needed—newspaper advertising attracted people who did not possess the skills and core values that BTG was looking for.

Store Generated Leads

Each BTG had a "help wanted" sign on its window, and walk-in traffic, along with customer referrals, resulted in some sales associates becoming hired. Overall, this was very successful only in stores located in densely populated areas with foot traffic.

The Hiring Process at Blinds to Go

Once potential candidates were persuaded to apply, a store visit was arranged. The purpose of this visit was to acquaint the potential candidates with the BTG environment and for them to get an overview of the job of a sales associate. Subsequently, the DSM administered a telephone interview. If the candidates were selected to proceed beyond this screen, two additional face-to-face interviews awaited them—one with the DSM and another with the store manager. BTG hired associates against these six criteria:

1. "Gift for Gab"
2. Outgoing personality
3. Energetic and motivated
4. Honest
5. Likes sales or dealing with people
6. Positive

If the candidate was selected to be a sales associate, then references were checked and offers extended.

The Results of Hiring Procedures

Before collecting data, it was the impression of senior management at BTG that the most effective method of attracting quality candidates was employee referral, followed by Internet sourcing, and then DSM recruitment. To confirm their suspicions, BTG tracked the yield of different hiring methods for June and July 2000 and as of the end of July, had these results to show:

Recruiting Method	*June*	*July*	*Total (2 mth)*
Cold Call (Recruiters)	9	0	9
Walk-ins	31	16	47
Internet	9	3	12
Employee Referral	39	20	59
DSM hires (Direct/Rehires /College)	8	8	16
Total	**96**	**47**	**143**

Martin explained that the highest ratio of leads to hire was in the employee referrals. This was partially attributed to the fact that referrals generally pursued employment with BTG, excited by the opportunity that a friend or family member who was a BTG employee had recounted. Cold calling was thought to have the lowest close rate because the recruiter had to first educate, then convince potential recruits. But cold calling was thought to be time-efficient if the recruiter was good. Recruiters were focused on non-store sources (cold calling, Internet, schools, etc), store sources (store walk-ins and employee referrals) were handled by the DSM. Recruiters were now paid $20,000 a year with a bonus of $150 to $500 for each successful hire, defined as a hire who stayed at least three months.

Staff Turnover

BTG also began tracking staff turnover and had created a turnover list from existing data. A large percentage of staff voluntary turnover occurred in their first four months. The higher turnover after eight months was partly due to termination because of sales underperformance. Also, sales associates who were not progressing as fast as their peers would inevitably be dissatisfied, leaving for other jobs.

Blinds to go Future Needs

BTG needed these additional staff to proceed with its expansion plan of 50 stores per year and to fill current store requirements.

Number of staff leaving and length of stay (numbers from June and July 2000)

Length of Stay	*1 to 4 months*	*5 to 8 months*	*8+ months*
Total	**29**	**12**	**13**

Position	*Current complement*	*Extra personnel needed for expansion (per year)*
Sales Associate	1,000	500
Selling Supervisor	150	50
Asst. Store Manager	150	50
Store Manager	150	50

Udofia had one more pressing concern on his mind:

> We're planning an initial public offering in the next one to two years. The key to our success is our ability to recruit and develop enough people to meet our growth objectives.

He wondered what strategy he should follow to meet the staffing challenge ahead.

Note

1. This program eventually evolved into the Legends Training Program, where the best training managers at BTG were relocated to new regions to motivate, train and coach new store employees.

Five Star Beer—Pay for Performance

Tom Gleave

Brian Golden

 Version: (A) 1998–10–08

In June 1997, Tom McMullen (President—Alliance Brewing Group) and Zhao Hui Shen (General Manager—Five Star Brewing Co. Ltd) met to discuss the "pay for performance" systems which Zhao had been implementing at Five Star's two breweries over the past several months. McMullen needed to determine whether or not these incentive systems were properly designed to ensure that the breweries would produce higher quality beer at progressively lower costs. If not, he needed to consider how he might suggest that these and other systems be changed in order to achieve Alliance Brewing's cost and quality objectives.

Five Star's Asimco Connection

The majority owner of Beijing Asia Shuang He Sheng Five Star Brewing Co. Ltd. (Five Star) was the Beijing-based investment group, Asian Strategic Investments Corporation (ASIMCO). The primary shareholders of ASIMCO were Trust Company West, Morgan Stanley—Dean Witter Reynolds and senior management. The senior management team consisted of the following people:

> Jack Perkowski (Chairman and CEO)—a former investment chief at Paine Webber (New York City) and graduate of both Yale University (cum laude) and the Harvard Business School (Baker Scholar).
>
> Tim Clissold (President)—a physics graduate from Cambridge University who turned accountant with Arthur Anderson in the 1980s. Clissold had worked in England, Australia, China and Hong Kong for Anderson before entering London's School of Oriental and Asian Studies where he became fluent in both spoken and written Mandarin.
>
> Michael Cronin (Chief Investment and Financial Officer)—also worked as an accountant for Arthur Anderson throughout the 1980s in Australia, the UK and Hong Kong. Previously, Cronin had worked for over five years at 3i, Europe's largest direct investment organization.
>
> Ai Jian (Managing Director)—a Chinese native and graduate from Northwestern Polytechnical University in Xian, China. Ai's previous working experience included senior posts in the foreign relations department of China's Ministry of Foreign Trade and Economic Cooperation. He was a native Mandarin speaker and also fluent in English.

The motivations underlying ASIMCO's investment in the Chinese beer industry were twofold. First, the industry was experiencing high, sustainable growth rates. This high growth was spurred by the increasing levels of disposable incomes in China, to the point where it was expected that the Chinese beer market would become the world's largest (overtaking the U.S.A) within the next several years. Second, the industry was highly fragmented and was undergoing a significant restructuring. This high degree of fragmentation was a consequence of China's legacy of central planning. Given its increasing adoption of market-driven mechanisms, China's central government was encouraging (or passively allowing) the rationalization of certain industries, including the beer industry. The industry consensus was that the number of breweries was expected to be reduced from over 800 to less than 600 nationwide over the next several years while managing to steadily increase overall beer volume. This meant that surviving firms would need to seek economies of scale, maintain high quality production and ensure development of strong management teams as the competition intensified.

ASIMCO's investment strategy was to identify Chinese companies that had the potential to be globally competitive and to support these firms with capital, western management skills and leading-edge technologies. The partners they sought were expected to be aggressive, profit-oriented and industry leaders. Whenever a potential opportunity was discovered, ASIMCO would marshal its skills and international resources to perform due diligence, negotiate contracts and obtain necessary approvals. ASIMCO would subsequently provide capital, western management expertise and technological know-how to the joint venture and devise an exit strategy designed to realize the value created.

ASIMCO viewed itself as an agent of change in helping to transform formerly inefficient state-owned enterprises into market-driven and export-ready competitive firms. By June 1997, ASIMCO had entered into 13 automotive parts manufacturing, two automotive parts distribution and two beer manufacturing joint ventures. The sum total of these investments, all of which were majority positions, was about U.S. $360 million. All minority positions were held by various Chinese partners. The Five Star joint venture was ASIMCO's largest single investment in its portfolio with a total capital outlay of U.S. $70 million for a 63 per cent stake in the company. The minority interest partner was the First Light Industry Bureau (FLIB) with a 37 per cent stake. The FLIB was a division of the Beijing municipal government and had ownership interests in many diverse business activities. ASMICO's other joint venture in brewing was a 54 per cent interest in the Three Ring Beer Company, an investment

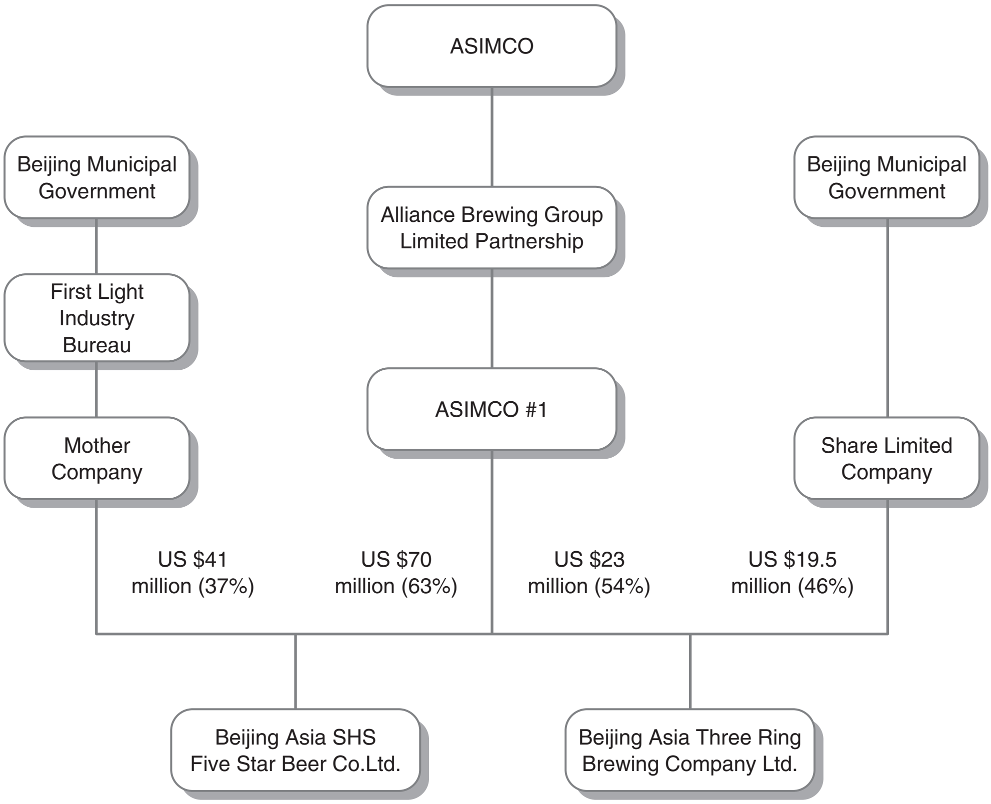

Exhibit 1 ASIMCO's Ownership in Brewing Joint Ventures

valued at U.S. $23 million. Both of the brewing joint ventures were formalized in January 1995. (See Exhibit 1—ASIMCO's Ownership in Brewing Joint Ventures.)

Alliance Brewing Group

Alliance Brewing Group (ABG) was a management services group which was specifically

Brewery	*Owner*	*Annual Capacity*
Shuang Sheng	Five Star	90,000 tons
Huadu	Five Star	180,000 tons
San Huan	Three Ring	130,000 tons

Note: Total production for the three breweries was currently running at about 250,000 tons per year.

established to provide support to both of ASIMCO's brewery joint ventures. This gave ABG the mandate to support three different, yet related, brewing facilities. These breweries were as follows:

ABG was organized into separate corporate level support functions which included marketing, brewing and quality control, operations services, financial control and new business development. The President of ABG was Tom McMullen, an American expatriate who formerly worked in the consumer packaged goods business in the U.S. after graduating from the Wharton School of Business. (See Exhibit 2—ABG Organization Chart.)

The overall goal of ABG was to help both brewing companies realize their return on invested capital targets. With respect to Five Star, this was expected to be accomplished through the achievement of five key objectives, which included (in order of priority) the following:

1. improved product and packaging quality.
2. reduced production costs in an effort to gain better margins.
3. the development of professional sales, marketing and distribution systems.
4. the development of a system which rewarded good performance and punished bad performance.
5. an increased understanding between Five Star's two breweries that separate production facilities did not mean separate companies. Rather, they were part of the same brewing company.

According to McMullen, one of the more meaningful signs of progress that ABG was able to make over the past year was the development of rational and integrated financial reporting systems. These new systems took more than one year to develop but eventually allowed both

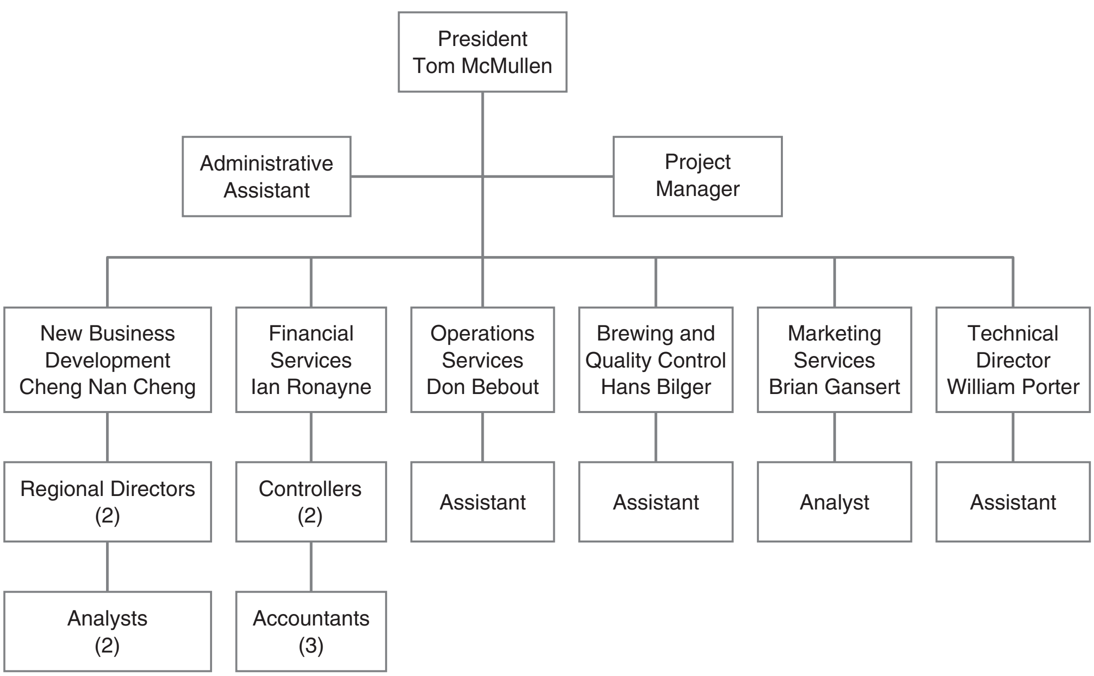

Exhibit 2 Alliance Brewing Group—Partial Organization Chart

Chinese and expatriate managers to "talk from the same page." As evidence of the importance of the need for reliable and timely financial information, particularly with respect to the need for Chinese management to understand the importance of meeting budgeted targets, ABG had installed its own financial personnel at both of its beer companies.

Five Star's Recent History

Five Star was one of the oldest brewing companies in China, with its origins dating back to 1915. Like most breweries in China, Five Star originally served its local markets, the main one being Beijing and the surrounding Hebei province. This focus on local markets developed as a consequence of competing interests from local governments which, in turn, led to the industry's fragmented structure. Over the years, however, Five Star was able to gain some market share in areas beyond the immediate region. This market penetration was accomplished through the establishment of licensing agreements between Five Star and other regional brewers throughout the country.

Prior to the early 1990s, the company enjoyed a majority share of the local Beijing market. This market position had developed because Five Star had a lengthy history in the region and, as a state enterprise which was wholly owned by the Beijing municipal government, was conferred special privileges. For example, in 1957, Chinese Premier Zhou Enlai decreed that Five Star was to be the exclusive beer supplied at all State banquets, thus bringing the company name to national prominence.

By the early 1990s, Five Star's market position began to deteriorate as it found itself competing in the same territories in the Beijing area with one of its largest licensees, Three Ring Beer. In 1993, Five Star entered into a licensing agreement which allowed Three Ring to produce and market Five Star beer for sale in specific territories on the northeastern outskirts of Beijing. However, Five Star soon found that Three Ring was "stealing" sales by deliberately encroaching on Five Star's exclusive territories within the core areas of the city. Three Ring was successful in securing significant market share due to its offer of lower pricing (for virtually the same products) and the lack of wholesaler and retailer loyalty. ASIMCO acquired a majority stake in both brewing companies in January 1995. This left ABG with the challenge of ensuring that the two companies refrain from directly competing with each other.

The progressive intrusion by Three Ring was compounded by the deteriorating quality of Five Star's products. It was only after it acquired ownership control that ASIMCO discovered that Five Star was experiencing greater quality difficulties than originally thought. Perhaps most disturbing of all was the consistently poor performance and apathetic attitude of Mr. Xu, Five Star's former General Manager. According to Tom McMullen:

> Xu was completely lacking in competence in virtually all respects. He was simply a victim of the old state-enterprise culture which encouraged senior managers to have a minimum of initiative and innovation. He perceived himself to be a king in his castle, while ABG in general, and me in particular, were seen as interlopers. Unfortunately for him, he discovered the hard way that his position was less secure than he believed.

Admittedly, McMullen had much less control than he originally expected when he signed on with Five Star. Having worked in the U.S for over 20 years, McMullen was accustomed to the idea that employees could be hired, disciplined and terminated as deemed necessary. However, in China, such activities were regulated to a much greater extent and often involved political considerations. For example, the person in charge of the human resource management and training functions at Five Star was Mr. Qi, resident member of the Communist Party of China. (See Exhibit 3—Five Star Organization Chart; See also Appendix: Labour Market Conditions and Human Resource Management in China.)

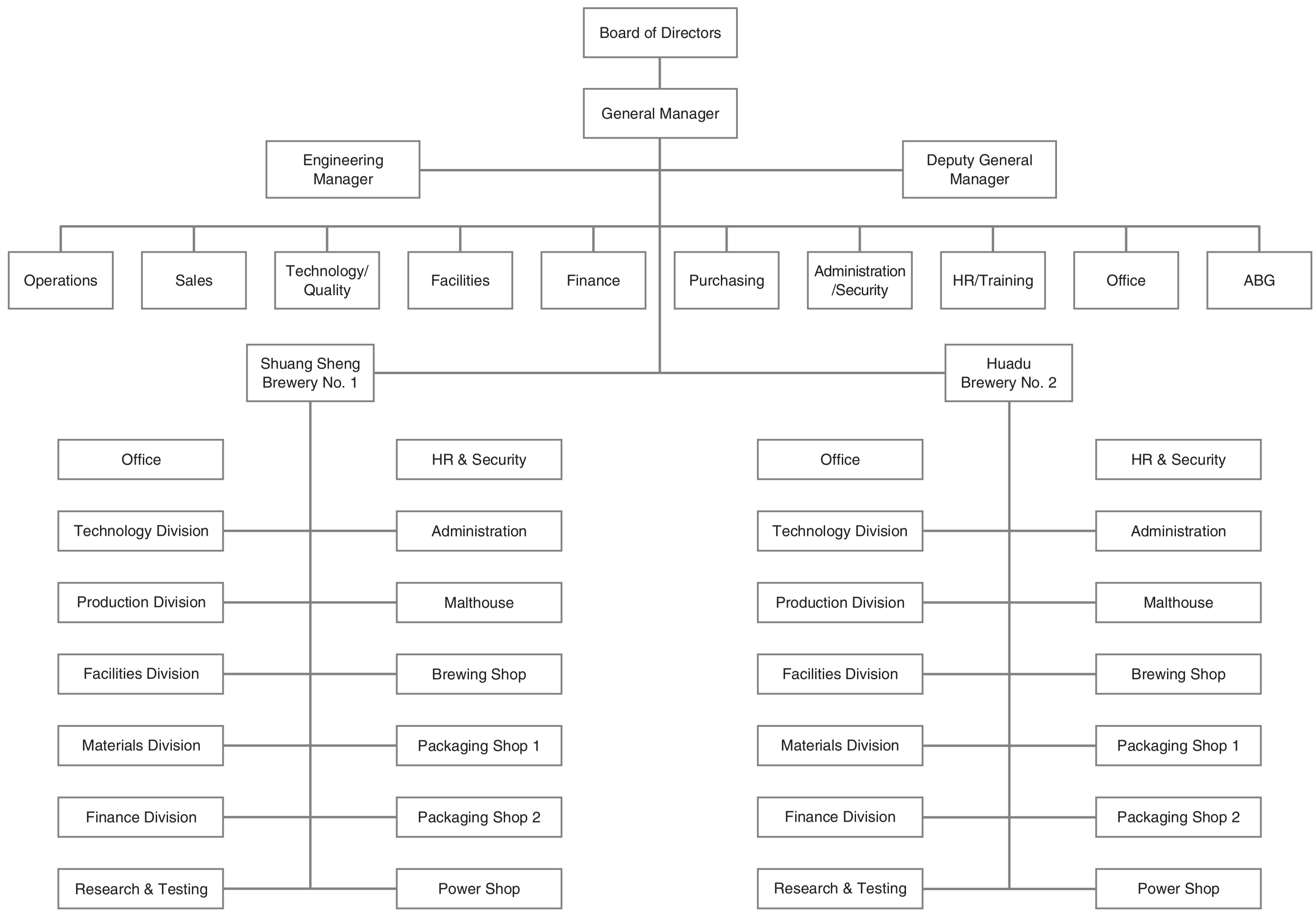

Exhibit 3 Five Star Beer Organization Chart

The Imperative for Quality

The high degree of industry consolidation, coupled with increasing Sino-foreign joint venture activity involving numerous world famous beer companies (such as Heineken, Beck's and Budweiser), meant that Five Star was beginning to experience greater competition from very capable rivals. This created a critical need for Five Star to provide higher quality beer and packaging. The common criteria by which product quality was evaluated included consistency in taste, clarity, carbonation, fill levels and labelling. The challenge of achieving consistency across all of these quality dimensions was great. Numerous documented incidences of foreign matter inside bottles, as well as unfilled or short-filled bottles and cans had been documented. Many packaging issues had also been identified and typically included poorly labelled or poorly sealed bottles and cans. One particularly poignant incident occurred shortly after the joint venture was formed and signalled to ASIMCO and ABG the need for drastically improving Five Star's quality. In this instance, a customer found a bottle which was half-full that had been released with a ripped label that was glued on sideways, despite having passed at least four inspection workers. Upon hearing the news of this episode, Tim Clissold (ASIMCO President) declared:

> It is beyond rational thought how our workers allowed this bottle to be sent out for public consumption. And when inquiries were made as to how this type of thing could happen, the line manager simply laughed with embarrassment. This is the result of the old central planning mentality in which there was no connection between reward and effort. These workers had no proper incentive or disincentive to ensure full product quality. The workers could not be fined or punished, nor were they entitled to extra wages for extra work completed.

The bottle in question was permanently displayed in ASIMCO and ABG's combined offices as a reminder of the need for ensuring diligence at every stage of the production and marketing process.

After realizing that quality issues facing Five Star were considerable, ASIMCO and ABG moved quickly to resolve the problems. ABG's professional staff was to focus on reducing costs, but a priority emphasis was placed on quality. Three key brewing professionals, the only non-Chinese to take an active role at any of the breweries, led the effort. They were:

> Don Bebout (VP—Operations Services), an American with over 19 years of experience working for Miller Brewing. He was particularly skilled in the areas of packaging and labelling.
>
> Hans Bilger (Master Brewer & ABG's Quality Manager) had a lifetime of brewing experience. In his native Germany, he grew up helping his father run a family-owned brewery before embarking for the U.S. where he spent nearly thirty years involved in a variety of positions, both with U.S. brewing giants and microbreweries.
>
> William Porter (Technical Director) was also an industry veteran from the U.S. where he worked for over 20 years at such breweries as Miller, Lone Star and Pabst. Although Porter's "home" brewery was with the Three Ring brewing joint venture, he was often called upon to offer technical advice to Five Star.

These three ex-pats were each provided with dedicated assistants, all of whom were fluently bilingual. This assistance was essential since none of the three ex-pats spoke Mandarin. Among the three assistants, Zhou Yue reported directly to Don Bebout and held a graduate degree in fermentology. She had previously worked for several years at China's National Institute for Food and Fermentology. Similarly, Bi Hong, assistant to Bilger, was a genetics technologist and had also worked for the National Institute for Food and Fermentalogy. She also received 13 months of brewery training while studying in France.

A major concern of ABG's operations and quality staff was the need to achieve higher quality targets while "milking" the existing equipment.

When ASIMCO took its majority stake in Five Star, the company was believed to possess some of the best equipment of any brewery in China, although some of it required refurbishing due to lack of regular maintenance. Given the recent influx of well-funded foreign brewers, Five Star appeared to be at a technological disadvantage when it came to ensuring product and packaging quality.

The Need for Management Control and Motivation

Regarding the level of management control and commitment that is necessary for ensuring consistent quality, Hans Bilger (Master Brewer) offered the following remarks:

> The skills needed to produce quality beer on a consistent basis are minimal. What you need are the monitoring procedures, the discipline to adhere to those procedures and the clear reporting of information to the appropriate people. The tasks of monitoring operations, recording data and communicating results on a regular basis are not sophisticated. The problems arise when management does not take control by ensuring that procedures are followed or that information is shared. For example, line workers are expected to regularly record the temperatures in the brewing vats. This is done often enough, but the results are frequently not communicated to the people who use this information. This is a symptom of the silo mentality around here. There really is no cross-functional coordination. And in the event that any results are communicated, you end up getting what you want to hear and not the real story, even when there is a problem. This shows that our quality problems are management-related and that the senior managers at the brewery need to become committed to quality.
>
> Quality is a way of life. It is a mindset. The senior managers at the brewery have yet to fully understand these concepts. Part of the problem could be that they are rewarded on volume output, not quality output. This is because brewing in China is a low margin business and, therefore, breweries need to pump out the volume in order to make any profits. This means that some managers are reluctant to take any measures which will impede their ability to produce as much as they can.
>
> Ideally, I would like to see Five Star have an independent quality department reporting directly to the General Manager, not to the Deputy GM and Chief Engineer as is now the case–despite what the formal organization chart suggests. Both the 'Number 1' and 'Number 2' breweries would have their own divisional labs which would feed their results to Five Star's quality assurance office on a regular basis. This quality assurance department would also be given policeman-like powers. Someone has to be able to say "this is not good enough," and then have the authority to take corrective action. Unfortunately, this type of arrangement goes against the strong tradition of hierarchical reporting in China.

Hiring Mr. Zhao

In response to the need to replace Mr. Xu, and after a thorough recruiting process, ASIMCO and ABG agreed to hire Zhao Hui Shen. Mr. Zhao, formerly a factory manager at a piano manufacturing plant where he had worked for over 20 years, came highly recommended by the FLIB. Clissold was skeptical about hiring Zhao due to his obvious lack of brewing industry experience. However, Zhao won Clissold's confidence when confronted about this apparent liability by stating that, "you will not hire me to make the beer, you will hire me to manage the people who make the beer."

Zhao was expected to work impartially for the Five Star joint venture company. He was also expected to draw upon the resources of ABG in an effort to improve the overall quality and productivity of Five Star's brewing operations. Within the joint venture company, Zhao reported to the Board of Directors. The Board's membership consisted of Jack Perkowski, Ai Jian, Tom McMullen, Mr. Zhao and a representative from the FLIB.

Zhao was viewed by many others at ABG and Five Star as representing a new generation of Chinese manager. This was because he had taken a very aggressive and hands-on approach to managing the business, a style which was a distinct departure from the state-owned enterprise culture of the past. Zhao commented:

> You have to change the way of thinking from traditional enterprise methods. Nowadays we must think of management by objective. I want people to think about how they can achieve their goals, not how to waste time thinking of excuses for not achieving them and then relying on the government for money.

Zhao's Performance-Related Pay Systems

One of ABG's key objectives was to help the breweries adopt a "pay for performance" culture. ABG believed that it must try to get people to care about their work and about themselves, particularly since jobs were taking on an entirely new role in Chinese life. ABG was seeking to instill a culture which would see employees take greater control over their destinies.

When it came time (in January 1997) to begin the development of specific pay for performance systems, Zhao requested the assistance of ABG. However, ABG was unable to offer extensive support at that time due to limited resources and its other priorities. In March 1997, ABG offered to assist Zhao in developing the systems, but Zhao then declined the offer because he did not want ABG to change what he had already initiated. He did, however, offer to reveal his key objectives to ABG. This led McMullen to acknowledge that the issue of establishing a pay for performance system may have been a higher priority for Zhao than it was for himself.

In developing the compensation systems, Zhao believed that monetary punishment could be used as a strong incentive for better performance, something McMullen referred to as "using more stick than carrot." One such example of this approach involved the bottle-filling line, where one of the key measures of quality was to ensure that all bottles were filled to the proper level. To ensure that properly filled bottles were distributed from the brewery, each filling line was assigned two people to manually check for empty bottles, while four additional people were used to manually check for short-fills. When the bottles were filled they were date-stamped and coded so that the product could be traced to its original filling and labelling lines. In the event that a empty or short-filled product was found in the marketplace (whether it be by Five Star's sales people, distributors or final customers), all six people on the originating filling line would be fined a total of 500 renminbi, or about 83 Rmb each.[1] This fine would be deducted from their salaries in which each line worker received an average compensation of about 1000 Rmb per month, an amount which was almost double that of similar positions in Chinese wholly owned breweries.

There was some debate in the plant as to whether or not this was an effective system. Hans Bilger (Master Brewer) felt that this approach was too harsh. He believed that, at a filling rate of 12,000 bottles per hour over a six-hour shift, the employees would become too tired to identify all empty bottles or shortfills. On the other hand, Yang Xiang, a bilingual technician working for the Operations Service group, felt that this type of system was "to some extent fair." He felt that somebody must take responsibility for these types of errors and that it might be more effective if the line supervisors were fined, not just the line workers.

Another example of a disincentive for poor performance involved a fine levied on the brew house for poor sanitation in the rice mill under its responsibility. The beer that Five Star brewed typically consisted of 30 per cent rice grain and 70 per cent malt. A rice mill was utilized on-site to provide the appropriate supplies. A common problem in the mill was the high level of dustiness, due primarily to the lack of care in cleaning, as well as an occasionally malfunctioning dust collection system. This presented a danger of insect infestation which, apart from affecting beer quality, also posed a threat of flammable explosion. In the spring of 1997, after Bilger submitted one of his periodic inspection reports which gave the mill a failing grade, seven line workers in the mill and associated brew house were deducted 100 Rmb each from their next pay cheque. As was the case in the previous example, the affected employees also earned 1000 Rmb per month.

One of Zhao's more widely discussed systems involved the sales force. Given that Five Star was seeking to re-establish its market position within the greater Beijing area, a strong emphasis was placed on boosting sales and thus increasing market share. Although sales people began by earning a starting salary of only 600 Rmb per month, they could earn up to 10 times this amount depending upon their sales performance. Unfortunately, Mr. Zhao had encountered some difficulty recruiting people who were prepared to receive compensation based largely upon their own efforts. Additionally, there were widely held suspicions among some of the ABG operations and quality staff that this particular system had invited abuse in the proper recording of sales. Although these staffers had "heard rumors" of this type activity, they had no concrete evidence. Any inquiries about the company's latest sales performance were met with "stony silence."

The implementation of Zhao's various performance-related pay schemes had given rise to a general debate among ABG's operations staff. The nature of the debate centered around which direction or approach would best motivate employees to strive for quality. The divergent views expressed by the operations staff were highlighted by the contrasting opinions between William Porter and Hans Bilger. Porter contended that cash payouts were a more effective incentive for improving performance than the recognition for a job well done. He believed that the employees would "far sooner have more renminbi in their jeans than a pat on the back." Bilger, on the other hand, suggested that pride of workmanship and the recognition of a job well done were more powerful motivators than cash rewards. His reasoning was that China was a status-conscious society where a high value was placed on securing the favorable opinion of one's peers and superiors. Despite a significant amount of spirited discussion, no clear consensus had emerged among ABG's operations staff as to whose view was more compelling.

Decision

The next Board meeting was scheduled for mid-July 1997, at which time McMullen wished to offer the members an update on the design and implementation of the pay for performance systems at Five Star. Therefore, as McMullen contemplated how he might suggest to Zhao different ways for improving these systems, he needed to consider several important factors. First and foremost, he needed to consider the cultural, historical, social and business contexts in which Five Star and ABG found themselves. McMullen was keenly aware that the receptivity to pay for performance systems was only beginning to be slowly accepted in China. Moreover, he needed to recognize the far greater knowledge that Zhao possessed about Chinese behavioral habits and culture. Therefore, he could not presume that what would be effective in North America would be effective in China. McMullen was also intrigued by the debates which had surfaced among his own operations staff. Did the notion of "punishments" have some merit in China? Would workers respond most to cash rewards or were they more likely to be motivated by some form of recognition? The only thing which seemed clear to McMullen was that the motivation and quality problems had no easy solutions.

Note

1. The June 1997 exchange rate was about 8.28 Rmb = U.S. $1.00.

Appendix: Labor Market Conditions and Human Resource Development Practices in China

China's labor market in 1997 was experiencing significant structural changes as market-oriented reforms took hold. State policy efforts to establish a new social welfare system and to implement state-owned enterprise (SOE) reform have had a profound effect on labor market conditions and human resource management practices in both domestic and foreign-funded enterprises. The first national labor law came into effect in 1995 and brought with it a lower level of government intervention in human resource management (HRM) at the enterprise level and more equal treatment for domestic and foreign enterprises. It is expected that this law will eventually allow all types of firms to acquire greater control over wage setting as well as the power to hire, discipline and dismiss workers, areas which have traditionally been highly regulated by government. In the meantime, China's labor market remains under-developed: labor mobility is restricted, and HRM is a new concept. Therefore, both domestic and foreign enterprises are now operating in a highly uncertain environment which reflects a combination of the old planned economy practices with those of newer western approaches to HRM.

In 1994, China's labor force totalled 615 million, or approximately 51 per cent of the country's total population of 1.2 billion. This labor force is expected to grow by an average of 20.9 million persons per year between 1995 and 2006. Importantly, no national social welfare system has been established in China. Social welfare has traditionally been the responsibility of the SOEs, the dominant form of industrial organization in the Chinese economy since the "liberation" of 1949. However, as market forces take greater hold in China, the SOEs will find it increasingly difficult to maintain these responsibilities for delivering a wide range of social services including subsidized housing, education and health care.

Until recently, HRM in China has been defined by the tenure employment structure of the planned economy. In the old SOE system, labor was regarded as a passive input in the production process rather than a productive factor. As a result, traditional human resource management included only personnel administration activities, such as registering the recruited workers, recording increases in wages and promotions (by seniority), filing job changes, and maintaining workers' files. Although training was provided, most of it involved indoctrinating workers with the Communist Party's prevailing policies. The focus was on the use of workers rather than their career development. Compensation was not directly linked to performance and served as little incentive for better performance. From an enterprise's overall performance perspective, it is clear that these practices were not aligned with a strategy to be productive and competitive in a market-oriented economy.

Source: The Conference Board of Canada, Opportunities and Risks for Canadian Business in China. 1996.

Jinjian Garment Factory: Motivating Go-Slow Workers

Tieying Huang

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Paul W. Beamish

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On December 15, 1999, at 11 p.m., Mr. Lou Baijin, the owner and managing director of Jinjian Garment Factory, was still in his Shenzhen office in deep thought and red-eyed from lack of sleep. In the adjacent workshop were more than 200 of his factory workers. Like Mr. Lou, they had been working 12 hours a day for seven days, non-stop, in order to finish in time a large Christmas order for an important European customer. From his experience, Mr. Lou could tell from the speed and sound of the sewing machines in the workshop that the workers had slowed their pace. Although they might be tired because of the long hours of overtime they had worked the last week, it was more likely that their slowness was deliberate. As a general practice in this industry, the workers had a tendency to slow their working pace in order to force management to increase the price of their piecework. If the orders were not delivered on time, Mr. Lou would have to ship the order by air freight at extra expense or risk losing valuable customers. The question of how to motivate workers, which had haunted Mr. Lou for a long time, became more urgent now. When he glanced at the entrepreneurship book, which had been on his desk for more than a month and which he had read several times, Mr. Lou forced a smile and painfully realized that the book had not provided a solution.

Lou Baijin and his Garment Factory

Mr. Lou was born in the town of Louta in Zhejiang province in 1956. He graduated from junior high school in 1973 and was expected to make his living as a farmer. In 1976, he became a mineworker in a neighboring province. Then, in the early 1980s, Mr. Lou returned to his home town and became a salesman. He travelled extensively in China to promote the use of raw chemical materials for the enterprise sponsored by his village.

In 1991, Mr. Lou came to Shenzhen (the most prominent special economic zone of China) and searched for jobs there. He wasn't very lucky at first. In order to save on living expenses, he lived on two boxes of fast food each day for half a year. Mr. Lou finally became a commission-based salesman for an electronic factory.

By 1996, manufacturing costs in Shenzhen for garments were very high; consequently, many factories migrated to the hinterland of Mainland China. Unlike those factories' owners, Mr. Lou saw an opportunity. He took his life savings and bought 30 secondhand sewing machines at a very low price and established his first factory in Shenzhen.

In the beginning, the factory employed about 50 workers. The main business came from taking small orders, as a subcontractor, from larger factories that had direct access to Hong Kong and overseas garment buyers. Mr. Lou's business grew very fast from that point forward. By 1999, Mr. Lou's factory had 150 sewing machines and more than 250 workers and had begun to compete directly with surrounding factories for the orders of Hong Kong and overseas customers.

The Garment Manufacturing Industry in Shenzhen

Shenzhen was one of the most advanced garment manufacturing centres in the world. Garments produced there were sold at department stores in many upscale locales, including Bloomingdale's and Nordstrom in the United States. The garment manufacturing industry had prospered along with the development of the Shenzhen special economic zone during China's broad economic reforms that began in 1980. Hong Kong was the centre of the world garment-manufacturing industry during the 1980s and 1990s. When China opened its economic door to foreign investment, Shenzhen was the first place in China for Hong Kong garment manufacturers to transfer this labor-intensive industry. Hong Kong had been gradually losing its competitive advantages to other Southeast Asian countries because of the increased production costs there.

Shenzhen was inexpensive in terms of land and labor but also manageable since it was a neighbor of Hong Kong, and people spoke the same language. Hong Kong business people could go to work in Shenzhen as commuters because of the location and convenient transportation.

In less then a decade, more than a thousand garment factories were established in Shenzhen. The majority of the garment factories were either owned or managed by Hong Kong residents. The Shenzhen garment industry was literally a direct extension of the Hong Kong garment industry.

Working Environment

Hong Kong was a capitalist society known in Mainland China for its minimal social welfare and labor protection laws. Because Hong Kong was the model of the Shenzhen garment industry, the management system of the garment industry in Shenzhen copied the factory environment found in Hong Kong in the 1970s. These were known as "sweatshops" by economists and sociologists.

Workers in the Shenzhen garment industry were willing to work overtime during the peak season, and the average workday was more than 12 hours. The workers rested for only one or two days each month during the six-month peak season because they were able to work only four to five hours per day, if at all, during the slow season. Over 90 per cent of the wages were based on piecework performance, which closely linked individual effort and reward. Because the other 10 per cent of wages given by the employers, (such as food subsidy, holiday allowance and special bonus for overtime) barely covered the living expenses for workers themselves, the piecework wage fostered strong motivation for workers to work long and fast. The laws for minimum wage and labor protection in China had been established for less than a decade and had not been strictly adhered to because of the difficulty of enforcement, especially in private sectors such as the garment industry. In particular, 95 per cent of the garment workers in Shenzhen were peasants who did not have permanent residency status in the city. (China was one of the few countries in the world with a resident permit system among its citizens.) If a person was not a permanent resident, it was virtually impossible to get social welfare or labor protection from the local government.

The average monthly income for a skilled garment worker in Shenzhen was US$150 during the peak season. The average living accommodation for each person was three to four square metres, with usually eight or more people sharing one room. In spite of such conditions, the promise of a job in the industry still attracted many peasants to Shenzhen. In fact, some workers even gave monetary deposits to their factory just to retain the opportunity to work. Once they found a job in Shenzhen, most did not choose to raise a family there since they could not afford the high living cost. Instead, they went back to their home province after eight to 10 years of hard work in Shenzhen, and their savings enabled them to build a new house and live a relatively easy life.

Garment Manufacturing

Shenzhen garment manufacturing was a labor-intensive industry with a relatively low capital investment required for entry. About 90 per cent of the garment-making equipment in Shenzhen was imported from Japan, but even with the most advanced garment manufacturing equipment, the work still involved a lot of manual labor (sewing, ironing and button tacking, etc), that could not be automated, especially with ladies' clothing, which required more dedication than men's clothing. In most garment-making procedures, workers had to operate the machine by hand. Usually the work was divided into more than 10 procedures to efficiently produce even a simple shirt. Hence, a garment factory needed many workers.

The capital requirement of garment manufacturing was very low compared to the labor requirement. "You can be a boss for only US$5,000," said Mr. Lou. Setting up required a small amount of capital to buy several sewing machines, rent a house (even an apartment) and hire several workers. The industry continued to attract numerous new entrepreneurs.

Seasonality and High Workforce Turnover

Although the supply of garment workers was unlimited, some of the workers were unskilled as they were peasants coming straight from the farm. Skilled workers were a valuable and scarce resource during peak time, September to February.

The need for work in the factories was seasonal. During peak time, garment factories in Shenzhen usually work 12 hours a day, 28 days per month to produce clothing for Christmas and spring seasons when consumers purchased most of their wardrobes. During other times of a year, even skilled workers did not have sufficient work.

During the peak season, proficient workers were so scarce that factories would do almost anything to keep them. The factories knew that having more skilled workers would make them more competitive. Therefore, retaining skilled workers was one of the most pressing problems the factories faced. Because of insufficient orders and furious competition in the slow season, factories were usually unprofitable, even when paying minimum wage to workers and this usually meant a bottom-line loss for the company. Large factories with long-term views usually could keep a minimum stable work force during the slow season, while small factories usually closed in order to save costs. The tricky part was that no one could tell for sure whether the losses in the slow season would be recovered during the coming peak season since 90 per cent of the garments produced in Shenzhen were exported to foreign markets, and garment factories in Shenzhen had little knowledge or control over demand.

Many workers had a long holiday during the slow season when they usually went back to their home town. When they came back at the beginning of the peak season, some might find a new job in a different factory if they were not satisfied with the existing one. The turnover rate of the workers was very high because of the unstable nature of the garment industry.

Effective Management of Workers

Production costs, which were derived from cutting, manufacturing and trimming a garment, were known in the trade as CMT. Because of competition within the industry in Shenzhen, the CMT of Shenzhen had decreased almost by half in the past 10 years. Foreign garment buyers usually imported the fabric and provided design patterns for the factories to produce apparel for a particular foreign market. The cost of the fabric was usually higher than the CMT. This put the garment manufacturers in Shenzhen at risk because the expensive fabric could sometimes be destroyed in the process of making a garment, and CMT received from the order was usually not enough to recoup such losses.

Because of the labor-intensive nature of the industry, normally the wage of the workers was about 60 per cent of CMT of a garment, which meant that 60 per cent of the revenue of a garment factory went to workers as wages. Mistakes such as destroying fabric in the garment making process or late shipments meant the owners did not make a profit, since they had to bear the cost of the fabric and high air transportation costs when a job was not completed on time for sea shipment. Therefore, effective management of workers, who not only accounted for 60 per cent of the revenue but who also decided the fate of an order, had become central to survival in the garment-making business.

Because of the nature of the export-oriented garment business in Shenzhen, the normal order size was relatively small, while the number of orders was large. The typical size of a Shenzhen garment factory ranged from 100 to 200 employees, and a typical factory could produce about 200 orders per year. In order to satisfy the most current fashion, most designers liked to alter their patterns at the last minute, which gave the manufacturers very short production leadtimes. This meant that the garment factories in Shenzhen had to be able to produce a new style of clothing on an average of every three to four days.

In spite of such a short production time, the factory had to achieve two aims: (1) produce the garment according to a quality standard acceptable to customers, and (2) ship the product on time. (Late fashion is no fashion!) These two factors were also essential for a garment factory to survive.

The Piecework System

The piecework system employed by the factories in Shenzhen was well suited to the nature of the work. For example, the retail price of a lady's dress might be US$30, and the cost of CMT (cutting, making and trimming) for it in Shenzhen might be US$3 (the fabric, accessories and patterns were supplied by the customer). The manufacturing process of this dress had more than 15 procedures, and the three dollars was distributed to the workers first. The price of sewing the collar might be five cents, the price of fitting on a sleeve might be three cents, the ironing of the dress might cost four cents, etc. Each worker was assigned to a specific job and earned an exact amount derived from the number of finished pieces times the price of that particular job to finish the procedure (piecework). One's pay was strictly linked with one's performance. Normally, more skilled and more industrious workers earned more than average workers did.

Due to the nature of division of garment-making processes, a garment factory was made up of several self-contained work units, called production teams, which usually contained 10 to 15 sewing workers and were able to produce a garment independently. A team leader, appointed by management, had absolute authority to assign the different working procedures of making a garment among the team members. Besides the unit price of piecework and the efficiency of a worker, production team leaders might also have some influence on the income of workers, as they could assign good jobs, more often, to their favored team members at the cost of jeopardizing the morale of the teams. This situation was more severe in Shenzhen's garment factories than in other cities because Shenzhen was a migrant city and many factory workers might come from the same village town or may even be related to each other.

After the deductions of the workers' cost, the balance of the US$3 CMT was distributed to the overhead of the factory. What was left was the profit for the factory owner.

Determining the Price of Piecework

Because each procedure for making a particular style was unique, the price of the same procedure when making a garment could vary. For example, the work required to make a round-shaped collar was different from that of a square-shaped collar so the prices for these two jobs were different. The same worker might earn $0.03 for making one round collar and $0.02 for a square one, although the two jobs belonged to the same production procedure.

Even for the same style of garment, if the order size was different, the price of making the garment might also vary. Generally speaking, productivity was increased when workers became more familiar with a particular garment. Larger orders were easier to produce than smaller ones owing to the learning curve associated with each order. Thus, owners and management (customers also required lower CMT price for larger orders) would lower the piecework price for each production procedure of a larger order and increase the prices when the order was small. The prices might also be different based on different fabrics for the same orders. For example, silk garments were normally more difficult to make than polyester ones.

In theory, if garment factories had enough time and resources, it was possible to accurately predetermine the piecework price of every procedure for every style based on the complexity, average daily salary of workers and the manufacturing efficiency of average workers. This was similar to what Frederick Taylor did in the early 1900s in the United States when he objectively measured the actions necessary for each work task. In reality, until the production of a garment order was finished, it was impossible for a garment factory to make an accurate and fair determination on the piecework price for a procedure due to the nature of the fashion business. This was because the quantity of most of the garment orders was relatively small (which was uneconomical to measure accurately), the short production lead-time of garment manufacturers offered no time for accurate measurement, and non-standard products for each fashion season had too many different styles, which were too difficult to measure reliably.

Therefore, it was a general practice for garment factories in Hong Kong and Shenzhen to decide the piecework price after the completion of an order. Usually at the end of the month, when workers received their salary, they knew the exact price of the piecework for a particular order they had finished.

Though it was difficult to know the exact price of piecework for an order before production, both management and workers, owing to past experience, would have a rough idea of the range for the prices before they began. Thus, how to divide the slim CMT fee of a garment among them was a prime focus of workers and owners, and each side tried to get a larger share because a few cents difference on a piecework price would make a big difference, both to owners and workers.

Because of the norm of "work first; pay later" in this trade, disputes over piecework prices between workers and factory owners happened quite often. Workers always believed management would take advantage of them by lowering the price of their piecework if they worked too fast since no owner was willing to pay more to workers than their market salary.

Yet, the piecework system still did not necessarily favor the factory owners. Workers knew they might offer more work for less pay if they worked too fast. They were too smart to be cheated. Sometimes the workers deliberately and collectively slowed their working pace in order to get management to increase the piecework price because of their low productivity. Therefore, factory owners often found themselves in the dilemma of either being late for sea shipment, which led to an expensive airfreight fee, or paying more to workers by increasing the price of piecework.

Severe Punishment Policy of Quality Assurance System

Stern punishment policies prevailed in Shenzhen to control for quality problems arising from the process of garment manufacture. Because the income of the workers mainly came from piecework, to increase their income, they had to work longer hours at a faster pace. But increases in production efficiency, could to some extent, decrease quality because it tended to increase the occurrence of errors. So, to assure the quality of the garments, factories in Shenzhen adopted severe punishment systems (such as deduction of a worker's own salary) to compensate for the damage induced by the worker. This policy played a crucial role in assuring quality, on-time delivery and low waste rates.

To avoid punishment for errors, workers usually tried to cover their mistakes and avoid responsibility. Whenever a mistake was discovered, the parties involved blamed each other. When the workers were caught, the factory could then deduct the wages to compensate the loss to the company.

Quality problems could not always be easily traced to the responsible parties. In fact, the management of a factory usually caused more mistakes due to mismanagement. Workers, owing to the piecework salary system, had no way of receiving compensation for the loss of their working time due to management mistakes. That was one of the major reasons the job satisfaction among garment workers was among the lowest and turnover rate the highest of all industries in Shenzhen.

What Can Mr. Lou do to Motivate His Workers to Work Faster?

Mr. Lou's factory was a typical Shenzhen garment factory. He had the same agonizing experiences in managing workers as others in the industry. As he listened painfully to the slow pace of the sewing machines, Mr. Lou knew that he would be responsible for a US$15,000 air freight cost to this customer because there was no way for his factory to catch up to meet tomorrow's deadline for this order. What a waste! US$15,000 was one-fifth of his total profit last year. Mr. Lou had to do something to change the deliberate slowing down of his workers. Otherwise he would have to consider selling the factory and changing to another profession. What could he do about this?

S-S Technologies Inc. (Compensation)

Al Mikalachki

 Version: (A) 2002–10–11

In January 1994, Rick Brock and Keith Pritchard, owners of S-S Technologies Inc. (SST) were concerned with the rapid rate of growth facing their company. SST had revenues of $6.3 million in 1993 and employed 30 highly skilled workers. These numbers were expected to double or triple in the next couple of years. To determine how well SST was structured to achieve its future goals, Brock hired a consultant he had worked with successfully in the past. The consultant's major role was to make recommendations as to the appropriate organizational design (culture, people, layers of management and administrative systems) in the event that SST grew from 30 to 60 or even 120 employees. Among other issues, questions regarding compensation were surfacing, and the owners wanted to address these questions as soon as possible.

Company Information

S-S Technologies Inc., incorporated in 1992, was a 100 per cent Canadian-owned company, which focused on industrial software and hardware development. Previously, the same business had operated for 12 years as a division of Sutherland-Schultz Limited, a large integrated engineering and construction company. When Sutherland-Schultz changed ownership, the new owner sold the SST portion of the company to Brock. Ultimately, SST was owned by its CEO Rick Brock, former president of Sutherland-Schultz, and by Keith Pritchard,[1] president of SST. A brief organization chart is provided as Exhibit 1.

SST had considerable expertise in the factory automation market. The company brought together

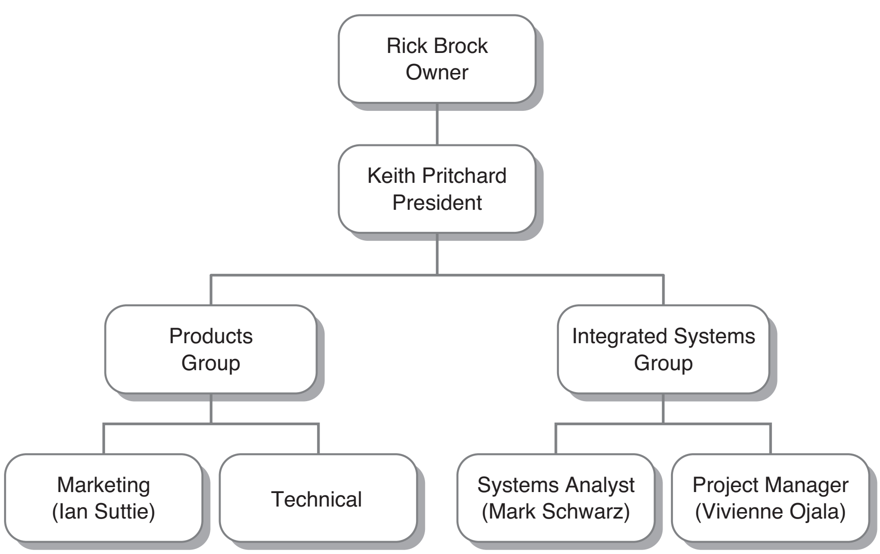

Exhibit 1 S-S Technologies Organization Chart

engineers and technicians with different but synergistic expertise to focus on projects that other systems integrators were unable or unwilling to handle. Out of these efforts, several unique communication and simulation products evolved. The company recognized the opportunities these products represented, and expanded its capabilities to successfully bring these products to the global automation market. Over the last three years, SST had grown an average of 33 per cent per year (the Products Group had grown an average of 64 per cent, and the Integrated Systems Group an average of 30 per cent), as shown in Exhibit 2.

Operating Groups

As Exhibit 1 indicates, SST was divided into two distinct operating groups: the Products Group (PG), and the Integrated Systems Group (ISG), each with its own characteristics.

Products Group

PG was involved in the development and marketing of the company's hardware and software products. The products were sold around the world through licensed representatives, distributors and direct sales. There were two key types of products:

- **Direct-Link Interface Cards** were totally programmable interfaces designed to make it easier and quicker to exchange data between personal computers and industrial computers/ programmable controllers. In layman's terms, the product allowed office computers to communicate with factory floor computers (commonly termed PLCs, or Programmable Logic Controllers). SST designed and manufactured the interfaces for both the factory floor computers and desktop computers, as well as complementary diagnostic software to ensure the computer networks were performing optimally. The Direct-Link cards received the *Canada Award for Business Excellence in Innovation* from Industry, Science and Technology Canada in 1991.
- **PICS (Programmable Industrial Control Simulator)** was a hardware and software package that allowed a personal computer (PC) to simulate, in real-time, an automated factory floor environment. To use PICS, a PC (running the PICS software) is connected directly to a PLC via a Direct-Link card. An experienced software developer then programs, under the PICS environment, a set of routines that send input to and receive output from the PLC, allowing the PC to act as if it were one or more automated factory machines. The PLC is, in essence, "tricked" into thinking it is

Year	*Integrated Products*	*Systems*	*Total**
1990	$931,000	$1,100,000	$2,685,202
1991	$1,638,000	$1,200,000	$3,570,797
1992	$2,763,000	$1,300,000	$4,521,987
1993	$4,036,000	$2,270,000	$6,306,000
1994**	$5,200,000	$3,500,000	$8,700,000

Exhibit 2 S-S Technologies Revenue

*Includes other sources of income and expenses

**Projection

actually running the automated factory floor, allowing the user to ensure that the PLC software is performing properly. The system can be used for debugging new industrial software, retooling, and employee training, all of which result in substantial time and cost savings for the user.

These products, developed by SST, were often the result of a solution to a technical problem no other company could solve. PG also had a number of other products and ideas under consideration for possible launch in 1994 or 1995.

PG's key success factors were applied research, product service and marketing. New products were needed to maintain pace with a rapidly changing plant electronic environment. In case of faulty products, a replacement had to be provided quickly. Also, product awareness by system integration engineers, complemented by an efficient and effective distribution network, was vital for PG's growth.

Integrated Systems Group

ISG was involved in three distinct, yet often interrelated areas of services: consulting, system engineering and customer support. ISG employed computer professionals and engineers who were assigned to the development of software and hardware solutions for complex factory floor systems. Clients were provided with tested, reliable and sophisticated solutions for data collection, custom control software, batching systems, diagnostic systems and programmable controller simulation. ISG also implemented and commissioned packaged control software, and provided project management for large and technically complex projects. ISG customers included industrial manufacturers and institutional organizations.

ISG's key success factors were to complete projects on time, on budget and of high quality. To date, ISG had received excellent feedback from clients. ISG's performance depended highly on the quality of its employees. Its goals were for manageable growth, focusing on projects within the company's scope and skills.

Environment

In early 1990, the North American economy was in a recession. Although recovery was widely predicted, some results of the recession were permanent. Companies sought to maintain margins during this recession through downsizing and reducing production costs. SST's Products Group benefited from this trend because PICS and Direct-Link cards offered ways of reducing the cost of automating a plant, a move which often reduced production costs. The market for PG grew despite the recession. The recession also meant that many companies eliminated or drastically reduced their in-house engineering capabilities and sought to subcontract this work, a trend that benefited ISG.

SST's Top Management and Human Resources

SST was directed by its two owners:

- Richard R. Brock, P.Eng., was the CEO of SST. During his eight years as president of Sutherland-Schultz Limited, Brock recognized and nurtured the potential of the Products Group (PG) and Information Systems Group (ISG), which eventually formed S-S Technologies Inc. He continued to be involved in all aspects of the new company, and brought to it his extensive knowledge of business management and development.
- Keith Pritchard was the president of SST. Pritchard had risen through the company ranks, starting as a systems analyst, becoming project manager, then group manager, and finally, president in 1992. Pritchard also developed the PICS product that accounted for $500,000 of company sales. His unique set of skills in both management and technical areas made him an excellent leader for the company.

SST had a flat organizational structure that allowed it to respond quickly to technical and market changes. Anyone who had a door left it open; employees felt free to take their concerns to whomever they believed could help. Decisions were often made using a consultative approach that empowered those involved, which led to "ownership" of problems and their solutions.

Projects were assigned to individuals or teams, depending on the size. The individuals and teams were self-managed. Responsibility for project scheduling, budgeting and execution was left largely in team members' hands. Such responsibility created commitment to the project for those who worked on it and led to the high motivation evident within the company.

Overhead resources, such as marketing and administration, were kept to a minimum. For example, there were only four people on the marketing team, which managed over $4 million in revenues. Administrative support was provided by two or, at times, three people. Even the controller (Doug Winger) shared his time with two other related organizations (SAF and Wilson Gas). SST was truly a lean organization.

Resources—PG

PG had highly competent, highly motivated technical teams. The technical people were leaders in their respective fields, with extensive and varied educations and backgrounds. They worked well together to meet Research and Development (R&D) challenges, and to respond quickly and effectively to customers' inquiries. Many team members were involved in the original product development and expressed a personal commitment to PG's continued market success.

- Linda Oliver, B.Math., the lead programmer for the PICS product, had worked on the project as a designer and programmer since its inception.
- Bruce Andrews, Ph.D., was involved in the ongoing development of the PICS product, especially the communications tasks and testing; he also wrote the manuals.
- Lorne Diebel, C.E.T., developed a reputation as a communications "guru." Lorne often travelled to far-off sites, on a moment's notice, to debug a customer's application problem.
- Jonathan Malton, B.Sc., a talented hardware designer, had been instrumental in advancing the Direct-Link cards from the old "through hole" format to the new "surface mount" technology.

Newer members were added to PG as the pace of R&D increased and customer support became more demanding. Newcomers brought their own areas of expertise, and worked alongside the more senior team members, whose enthusiasm for their work was infectious.

As a result of its progressive and applied R&D program, the technical team members were advanced on the learning curve. This allowed SST to keep ahead of the competition. As a result, large PLC vendors often came to SST to solve their communication and simulation problems, rather than investing in the learning curve themselves.

The marketing team had grown over the past few years as PG revenues grew. People from both a marketing and a technical background combined to create a well-rounded, effective marketing department:

- Ian Suttie, P.Eng., a leader in the market group, was involved in design review, marketing, distribution and sales of all products. His main function was to set up a network of distributors and representatives to reach all major markets in the United States, Europe and beyond.
- Colleen Richmond had experience in marketing with other high-tech firms. She handled all the trade shows, promotional material and advertising activities.
- Steve Blakely was the inside salesperson, and came to SST with a technical background. He responded to enquiries for information, and was the first contact within SST for customers having technical difficulties.
- Colleen Dietrich was recently hired by SST to determine the extent to which leads generated through the various advertising media used by PG eventually resulted in sales.

The marketing team worked well together, buoyed by PG's success. However, they were stretched to the limit, and team members admitted they were unable to do everything they wished to do because of personnel constraints. All known product complaints were acted upon; however, there was no formal audit of customer satisfaction.

Resources—ISG

ISG's most important resource was its people. The engineers and technicians were not only technically competent, but were highly motivated and loyal. The following is a brief summary of ISG people and the skills they brought to the company:

- Mark Schwarz, P.Eng., an accomplished systems analyst and leader in the group, wrote sales proposals, estimated projects, and did most of the marketing for ISG. He was very good at business development, seeking out large, extremely complicated projects, and often helping the customer define the scope and approach to the project. Convincing a customer that you could handle their large, technically complex job was tricky business, but Schwarz exhibited a talent for it. Schwarz also had a talent for scheduling personnel and was interested in ensuring that everyone had something interesting to do.
- Vivienne Ojala, P.Eng., an experienced and talented project manager, designer and programmer, as well as leader in the group, was more than capable of handling all aspects of design and project management for the $2 million-plus projects ISG hoped to attract. She was excellent with customers who preferred her "straight" talk to the "techno-babble" others gave them. Ojala made the customer confident that the project was in good hands, which is very important when you have asked a manufacturer to give you a production system that could determine business success or failure. Ojala was also good at training those who worked on her projects, as well as developing people in general.
- Peter Roeser, P.Eng., was a systems analyst with special skills in the area of communications and various operating systems.
- Brian Thomson, P.Eng., was an expert in the area of real-time software development. He also managed projects.
- Ted Hannah, P.Eng., was a project manager and systems analyst with extensive skills and experience.
- Bruce Travers, who marketed ISG capabilities in Ontario and provided technical direction for projects, had over 20 years' experience with industrial applications of information systems.

Due to the diverse skills of its people, ISG was able to tackle large, complex systems integration projects that most of the competitors could not. ISG had in-house expertise covering nearly every technology that would be applied to a project. Also, because ISG was not tied to a single supplier of PLCs or PCs (as many competitors were), it was able to be more flexible and innovative in the solutions that were presented to customers.

Another important ISG resource was its excellent reputation and relationship with a large Canadian manufacturer, which had given ISG substantial repeat business. As well, ISG had completed many projects for several large North American companies and had never failed to deliver on its promises.

ISG was advanced on the learning curve. New customers benefited from the fact that ISG had faced many challenges before, and solved them successfully. ISGs experience was more rounded, and, hence more innovative and current than an in-house engineering department that had only worked in one type of factory.

Consultants' Interviews

The consultant interviewed all SST employees. Some of the observations, which resulted from his interviews, are grouped below by issues:

i. Hierarchical Structure

Pritchard viewed Suttie, Schwarz and Ojala as group leaders. However, PG members generally saw themselves as reporting to Pritchard and saw

Suttie as performing the marketing function. When apprised of this situation by the consultant, Pritchard said it would take time for Suttie to establish his position.

The ISG situation also proved somewhat confusing. A number of ISG members saw Schwarz as a leader. However, there was some confusion as to his position vis-à-vis Ojala, who had recently returned to SST after leaving to work for a much larger technology company in Montreal. Ojala tells the story of Pritchard begging her to return to SST, a story that Pritchard confirms. Ojala saw herself as reporting to Pritchard (and so did Pritchard). Her "formal" relationship to Schwarz had to be worked out.

Before Ojala left SST (she was away for five months), both she and Schwarz reported to Pritchard directly. When Ojala left, many of her responsibilities, such as some of the proposal writing and personnel scheduling, were given to Schwarz. Now that Ojala was back, to everyone's relief, there was the question of how to structure her role, particularly in relation to Pritchard and Schwarz. Ojala would not report to Schwarz, and Schwarz would not report to Ojala.

In a short period of time, Schwarz and Ojala took on leadership positions in ISG. Informally, they divided the tasks of scheduling, hiring, training and managing customers. They worked in different industrial sectors and tended to deal with different groups of ISG engineers. However, they jointly made management decisions that affected ISG goals and maintained a free flow of people and ideas between the ISG groups related to each of them.

ii. Commitment and Motivation

The consultant was overwhelmed by the high commitment to SST and the task motivation expressed by employees. The people loved the work environment, the lack of politics, the quick response to their technical needs (equipment and/or information), and the lack of talk-for-talk's-sake meetings. They were confident in their future and happy to come to work. For the consultant, this was a refreshing contrast to the downsizing gloom and doom that permeated many other companies he worked with in the 1990s.

The employees set their own working hours. They had to put in 40 hours per week, but could do this at any time. The flexible working hours allowed them to engage in other activities that occurred between 9:00 a.m. and 5:00 p.m., such as their children's school events. Employees kept track of their overtime and were paid either straight time or took the equivalent in extra holidays. Each employee recorded his/her overtime weekly, and passed on the information to Pritchard. Previously, employees had noted the overtime information mentally. Pritchard had them write it out and report it weekly, because he observed that their mental calculations erred on the side of the company (they remembered fewer hours than they worked overtime).

iii. Personnel Function and Communications

New employees were generally assigned to a project manager, who informally took on the induction and training role. In that way, new employees immediately tied into a task, and it was left to them to learn the culture and expectations of SST by osmosis. Should the employees not perform well, or fit into the culture, their employment was terminated.

Periodically, Pritchard would have a meeting of all employees to inform them of SST's progress, success and direction. Given these meetings, Pritchard was surprised to learn that only a few employees were aware of SST's goals and strategy.

One issue mentioned by a couple of employees dealt with performance appraisal and company benefits. Performance appraisal was conducted by Pritchard; however, he did not keep a record of the meeting, and it was not done at regular intervals. Also, anyone interested in learning about benefits or salary ranges for various jobs did not know whom to contact. In contrast, all employees knew whom to contact for technical information. In fact, performance appraisal, compensation and benefits were managed in an ad hoc manner.

iv. Compensation

Compensation, base pay and bonuses, was the most contentious issue that arose from the interviews. Base pay tended to be at the low end of the spectrum for engineers. New engineers joining SST compared their salaries to those of other graduates and, also, to statistics provided by engineering associations, which published comparative data. They believed that the comparison showed them as significantly underpaid.

Bonus payments also generated concern. Historically, when SST was part of Sutherland-Schultz, the company had a few good years and generous bonuses were paid. However, when the recession hit, the construction side of Sutherland-Schultz slumped considerably and, although PG and ISG held their profitability, the company as a whole could not afford to pay bonuses. In fact, SST people were laid off, and some of those who remained felt cheated. Now that SST was on its own, there was an opportunity to tie bonuses directly to the company's performance. Management wanted the bonus system to achieve the following goals:

- To develop a cooperative team spirit.
- To foster cooperation between ISG and PG, and to limit interpersonal competition.
- To provide extra reward for unique contributions.
- To not reward weak performance.

v. Partnering

Given the experience of losing Ojala to another firm (albeit temporarily), Brock was anxious to develop a "partnering" system in which those crucial to the company's success could participate. He wanted to make people like Suttie, Schwarz and Ojala feel like owners or partners committed to the company, so they would not be lured away by the promise of greener pastures; after all, the job market for people of this calibre was extremely promising. This was true not only of those in management positions, but also of the best systems analysts and programmers: people like Linda Oliver and Lorne Diebel.

Brock contemplated having part of the partners' bonus to consist of stock in the company. The problem was that these people were all young, with growing families, and could not afford to have their money tied up in stock when they had mortgage payments and day-care costs to worry about. Generally, their immediate concern was cash flow, as they knew their long-term earning potential was excellent. Brock's concern was how to structure the partners' compensation to keep key people on-side, while allowing room for more partners to be brought in as the company grew. The company had recently hired a half-dozen talented engineering and computer science students, all of whom had the potential to become the next Schwarz, Suttie or Ojala. On top of all this, Brock still had his own return on equity to consider.

Culture	*People*
• Open communications at all levels • Flexible working hours • Few policies • Profit-sharing at all levels • Quick decision-making • Encourage initiative, not bureaucracy	• Highly motivated • Highly skilled (Tech) • Entrepreneurial • Team players • High performers • Committed to SST

Exhibit 3 S-S Technologies' Desired Culture and People

Where do we go from Here?

Brock, Pritchard and the consultant wanted to design a compensation system that would contemplate an expansion to double or triple SST's existing size. They knew the existing SST culture attracted and nurtured highly motivated and committed employees who expanded the company successfully and rapidly. The trio's task was to design a compensation system that would support the existing SST culture and the kind of people they wanted to attract (Exhibit 3). They also wanted to develop an action plan that would ensure buy-in to the new compensation system.

Note

1. Pritchard had a minority share in SST.

OP4.Com: A Dynamic Culture

Ken Mark

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Introduction

Feeling full of energy after having a productive company meeting that focused on updating OP4.com's vision statement, Ray Matthews, co-founder and Internet chief executive officer (iCEO) of OP4.com paused to reflect on the growth that his company had achieved. It was May 30, 2000 and Vancouver-based OP4.com, an internet portal for teenagers, had just celebrated six months of existence. With the goal of creating the Internet's leading portal for teenagers, Matthews knew that OP4.com's internal culture had to reflect the identity of its Web site: hip, cool, spontaneous, witty.

Now that OP4.com's Web site activities were gaining momentum and media attention, Matthews wanted to maintain this unique culture through the next few crucial months of rapid growth and change. Tom Pressello, co-founder and business chief executive officer (bCEO) explained the impetus for change:

> Content sites in general are becoming more closely scrutinized by investors. To facilitate a drive towards profitability, we have recently divided the company into four divisions, each responsible for generating revenue. In addition, we've got to start thinking about revenue streams on content—wireless, syndicated content, models for sustaining our business. I'm sure that because of this change, our culture has to adapt to this reality.

The Internet And The Development Of Teen-Oriented Web Sites

With the advent of instant messaging tools, communities of Internet interest groups began forming around the world. Web companies like TheGlobe.com, iVillage and Lycos began developing virtual communities where like-minded individuals could congregate. Communication between people became even more advanced with the development of chat capabilities—a mini-industry comprised of companies like iChat and ICQ began facilitating real-time conversation transmitted electronically. Aside from sheer novelty, a significant driver of this change was cost—these services were often provided free of charge to anyone with an Internet connection, often as a means to develop loyalty amongst users. Because many of the early pioneers and adopters of Internet technology were teenagers, companies focusing on the teenaged demographic began to target this niche market. The goal of community sites was, in general, to gather a particular target group in large numbers such that the collection as a whole became attractive to advertisers. Relative to other media such as television, print or radio, it was inexpensive to set up a Web site and as a consequence, large numbers of community sites sprang up in the mid 1990s, attempting to develop into full-fledged business entities by catering to the consumption needs of their audiences and or by selling advertising.

The percentage of U.S. teenagers online aged 12 to 19 would jump from 11.5 million to 20.9 million between 2000 and 2002.[1] During that same period, conservative estimates indicated that the percentage of children and teenagers online (more than once a week) as a segment of the teenaged population, would jump from 26 per cent to 47 per cent.

Without a doubt, the teenaged North American population was more Internet-enabled than any other demographic group. This demographic group had virtually grown up with the Internet and was very at ease with its technology. They had gained a powerful communication tool with e-mail, and could be in constant, real-time communication with their friends anywhere in the world.

The Creation of the Youth Portal OP4.Com: Our Place 4 Everything

OP4.com was the brainchild of Stuart Saunders and Ray Matthews, both in their early thirties. Saunders, a full-time motivational speaker, had worked directly with thousands of teens across Canada and the United States. Based in London, Ontario, Saunders was the co-founder in 1990 of Leadership Innovations, a leadership company that provided leadership training and motivational speakers to the North American high school market. Vancouver-based Matthews was a former school teacher, award-winning educator, author and entrepreneur.

Wanting to attract the attention of teenagers and provide them with a place to voice their opinion, OP4.com's objective was to build itself to be a portal, an Internet site that would attract and retain a large percentage of its visitors by providing multiple communication and information functions and products (see Exhibit 1). OP4.com allowed teenagers to discuss topics with each other through electronic chat rooms, use e-mail and bulletin boards and submit articles. The OP4.com concept would need to have immediate appeal to this demographic group in order for its business model to work. OP4.com wanted to position itself as the premier youth-oriented site in North America, with proprietary content as a cornerstone.

Saunders commented: "I started this to have a positive Web community for kids. I had the vision but not the dollars and cents—I was thinking strictly of the kids." Saunders' vision for the site led to the creation of three content sections: expression, entertainment and empowerment. Saunders felt that these sections represented all facets of teenaged life and the issues that teenagers faced.

Expression—This section allowed users to voice their opinion and for others to read and critique them by submitting responses. Spontaneity was encouraged and there was a relatively short span of time between article submission and posting on the site. This was a forum where youth could write off-the-cuff but personal pieces on spirituality, coping, activism and more. These pieces were limited to 300 words or less and OP4.com's content editors reviewed these pieces, checking for major spelling or grammatical errors. This editing process allowed OP4.com to screen out hate postings and overtly vulgar, undesirable articles.

Entertainment—This section contained reviews of movies, music, books, sports, television and Internet sites of interest to teenagers. Aimed at keeping visitors updated on the North American entertainment scene, reviews were both written by OP4.com staffers and submitted by members.

Exhibit 1 OP4.Com Site Screen Capture

Source: www.op4.com; November, 2000

Also included were interviews of music bands conducted by OP4.com staff.

Empowerment—This section included self-help, motivational pieces—articles which were meant, in the words of OP4.com staffers, to change their world. For example, there were articles titled A Call to Action, People Doing Good, AIDS and Teams Doing Wonderful Things. The content of this section was generated internally by interviewing selected role models in the youth community. In some cases, articles were solicited from featured youth leaders.

According to Saunders and Matthews, two key factors differentiated OP4.com from other teen sites. The first was the fact that their consumer aggregation model was unique: it relied on Leadership Innovations' speakers to market to its audience. Since Saunders' other company, Leadership Innovations, reached hundreds of thousands of students each year through a combination of motivational speeches, summer leadership camps and weekend leadership conferences, there existed the opportunity to promote OP4.com via speech mentions and bookmarks that were handed out at the end of every speech or event. Saunders felt that Leadership Innovations' endorsement of the site would encourage his audience to visit it.

The second point of differentiation was the quality of its written content: it published its own staff articles and monitored the quality of solicited content on its site with the goal of developing a consistent, wholesome brand image.

The business viability of content sites had been called into question in mid 2000, with business analysts declaring that content sites were unlikely to survive as business entities unless these sites showed investors a tangible path towards profitability.

THE SENIOR STAFF AT OP4.COM

The three founders of OP4.com complemented each other's personalities. Between Saunders, Matthews and Pressello, there was a mix of vision and attention to detail and a range of different skills that each brought to the company, including financial management, people management, idea development and project execution.

Stuart Saunders, iPresident, Co-Founder and Director of Aggregation

Beginning as a high school motivational speaker in the late 1980s, Saunders had built the largest youth-oriented leadership company in North America (in terms of youths reached). Currently managing a speakers' bureau of motivational speakers, leadership summer camps, running seminars and workshops, Saunders and his London, Ontario-based team estimated that they reached over 10 million students per year in Canada and the United States.

"Although I am currently the president of OP4.com," Saunders offered, "I know that sometime soon, OP4.com will have to bring on someone more experienced to help run this company. Currently, I spend about 30 to 40 hours a week on this project, aside from the time I spend promoting the site during my speeches."

Ray Matthews, Co-Founder and iCEO

Forming Balance Fashions Inc. in 1986, Matthews grew the small company into a multimillion dollar direct sales fashion company that had since expanded to include more than 1,000 sales representatives across Canada.

The concept of direct sales with Balance Fashions took off and by January 1990, Matthews had his Balance National Program counting over 140 sales representatives nationwide. Matthews wrote "The Dirt on Success," a strategic entrepreneurial seminar series that was presented to more than 250,000 individuals in North America. Most recently, Matthews was the founder of villagenetwork.com a virtual community site for artists that was sold to Art Vision International.

Matthews commented:

> In my position as iCEO, I aim to be the visionary, always encouraging my team and multi-tasking. I'm not strong at linear patterns and minute details—that's why we have Tom Pressello, the bCEO, who handles the corporate financing, chief financial officer-type decisions. He starts at 'no, it can't be done,' then works to 'yes.' I'm the opposite, starting at 'yes, it can be done' then working to 'no.'

Tom Pressello, Co-Founder, bCEO and Chief Financial Officer

Prior to joining OP4.com's Vancouver head office, Pressello, aged 31, was a consultant in the strategic planning and corporate finance areas for technology start-ups and turn-arounds. A graduate of the Business Administration program from a prestigious Canadian business school, Pressello had also been the vice-president of finance for a generic pharmaceutical company and had worked in merchant and corporate banking.

> As bCEO, I'm like the stereotypical 'Dad' in the family, keeping a tight control over business and finances, and Ray is the stereotypical 'Mom'—motivating, nurturing, cheerleading. We butt heads, but that tension keeps us working well with each other. At OP4.com, my job is to lead the company from a financial viewpoint—I challenge all our suppliers on their costs to us. They know that they cannot squeeze me for extra profits and I think they respect me for that.

STAFFERS AT OP4.COM

Saunders ran OP4.com's office in London, Ontario and oversaw a staff of six "seeders," who were hired as facilitators in OP4.com's chat

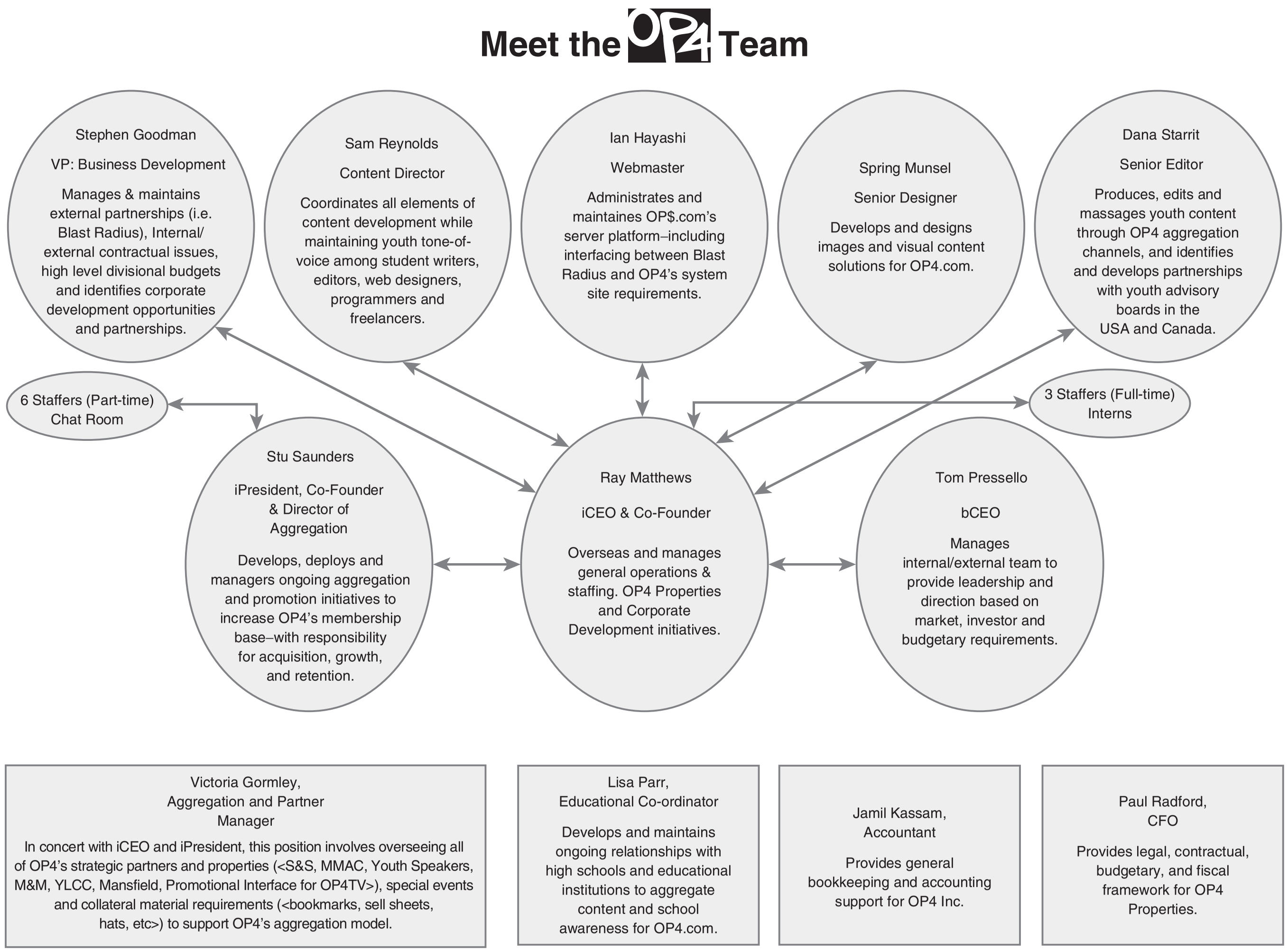

Exhibit 2 Organizational Chart

Source: Company files.

rooms. Consisting entirely of part-time, high school-aged staff, the seeders would be present at all chat room discussions, mediating any disruptions, answering questions, bridging conversation gaps. Since London was located several thousand kilometres away from Vancouver, Saunders wondered if he would continue to run the seeders from his London office. OP4.com had been split in this fashion at the beginning due to the fact that Matthews was located in Vancouver and Saunders had his company located in London.

Matthews knew that, in order to cater to the interest of teenagers, it was critical that someone close to that age group managed the site's content. OP4.com wanted to display through its Web site a young, dynamic image of itself. Matthews' first hire was Sam Reynolds, 24, as content director, or as she was commonly called, "Content Queen." He then hired the three members of the content team—Dana Starritt, Libby Shumka, Jessica Cowley and next the marketing staff. Last, he hired Web administrator, Ian Hayashi, and Spring Munsel, the senior designer to support the site for Flash, HTML and Java (these were the programming languages that enabled Web site creation).

Matthews located his employees by using his network of contacts, preferring to seek out people he already knew and trusted. One issue he faced was finding good Web talent who had experience in programming languages, were fluent in Internet-style communication and had a proven track record. Also needed were people with contacts who would be able to solicit advertising and business.

Reynolds commented:

> There's lots of recruitment at this stage of our company. It's who you know, personal contacts and referrals. Personal contacts are great—everyone knows at least someone and you know that if someone comes recommended, there will be no problem.

By offering university internships, OP4.com found many of its younger writers. This was not only due to the fact that OP4.com as a start-up had limited cash resources, but also because the interns were close to the age demographic it was trying to reach. Two interns were aged 19 and 20.

Matthews knew it was critical to bring people in who fit into the dynamic culture he was trying to build. By asking them a series of questions during their interview, such as what was their favorite movie and why, he was able to determine their fit. Matthews also looked for people who would thrive in a changing environment. Dana Starritt was the senior editor. Her first interview with Matthews was supposed to be at the office but, due to unforeseen circumstances, the venue changed twice more from a downtown bookstore to the Cactus Club (a downtown Vancouver bar). Through his observation of her cool reaction to these changes, Matthews was able to determine that Starritt would be a good fit for his company since she felt comfortable with spontaneity and change.

In Matthew's search for staff for OP4.com's Vancouver office, he was specific on the mix of people he would hire. "There are four 'styles' that we look for," said Matthews, "and we wanted to build OP4.com with a balanced staff." Using popular American icons to describe these styles, he continued, "There is the Analyzer, much like Mr. Spock (Star Trek), the Driver, embodied by Donald Trump (businessman), Socializer, for example Meg Ryan and Robin Williams (actors), and Relators, like Oprah Winfrey (talk show host)."

Over time, it became clear that any new hires would need to fit with the young dynamic culture that was developing and that this culture was critical for the success of OP4.com

Sam Reynolds observed:

> It's an uncomfy oxymoron if we're pitching a site to youth from a stuffy, stagnant corporate culture. Here, there is no break between the culture of youth in general and the culture of our team. In the Internet industry, it's an employees market and one can't assume that people will come begging for jobs. On the other hand, these people will spend long hours at work—you will not be invited to play on our team unless your vision is synchronous with ours. We want to make people as comfy as they can be.

Developing a Youth-Oriented Culture at OP4.Com

With his first few hires, Matthews knew that he had created a solid foundation upon which to build a company. Reynolds and Starritt embodied the youth culture he was seeking to build and Matthews knew that he could count on them to train his next hires.

"We want to ensure that everybody is accessible to the team and vice versa," Matthews stated. "We share our musings constantly, have weekly strategic action plan discussions and celebrate the results achieved that week. I want to keep my team well-informed." Given that OP4.com had ramped up very quickly, Matthews felt that it was imperative the vision statement was revisited every six months in order for the staff to feel that their involvement and ideas were important.

Matthews' approach to managing was one of "managing by walking around." He wanted to be involved with his people at the ground level, to find out what they were working on, to get a sense of the whole operation by being in the "trenches," so to speak. To make new employees feel that they were part of the team, OP4.com had a welcome letter when the employee first arrived, appreciation cards, flowers and beer were sent, and weekly meetings were held to make sure the employee adjusted well.

A ritual that had been instilled from the beginning was the "robust discussion," used to welcome team members to OP4.com. Jessica Cowley, staff writer, was "honored," along with two other new members, with a team-bonding session where each team member shared their personal thoughts. No topic was taboo and this exercise was aimed at creating a sense of trust amongst team members. The objective of the session was to develop emotional relationships between team members and foster the feeling of trust within the team. "There's a real sense of safety, security and acceptance of differences at OP4.com," Cowley stated. "You can feel the culture through the variety of ways in which we treat each other, approach each other, support each other. It's all very forward-looking—from the rituals we have, weekly meetings, running jokes, socializing outside of work time, we really enjoy each other's company."

To provide examples of leadership ideals, incidences of successes were passed down to new members. The valiant efforts of the company secretary who drove to the airport to ensure that the courier package would be submitted in time had become a company legend. Matthews believed that the lack of a formal employee training program was, in part, made up by these anecdotes which served the purpose of culture building at OP4.com.

"We're also empathic as a company and this is definitely reflected through our Web site as our users see us as an anonymous and safe forum for 'coming out of the closet,' for example," remarked Reynolds. "No one needs to use his or her real name on the site. To help our staffers appreciate this aspect, we had our team write a secret on a postcard—their deep and darkest secret—and drop it, addressed to 'The Postman,' in the mailbox."

OP4.Com's Unorthodox Training And Feedback Systems

As in most other start-ups, OP4.com's management team worked long hours to develop the site, often trouble-shooting minor problems which arose on a constant basis. The many demands on everyone's time meant that very few formal meetings could be set and it was up to new employees to learn from observation, by making mistakes or from a combination of both.

When asked about formal training Reynolds laughed (hard) and replied:

> Training? It's been off the cuff. Just jump off the deep end and we'll see you in two weeks! No, seriously, there's tons of support. Personally, I sit people down and go through priorities and long-term goals. Here is something interesting. There were four people who started on May 1. I wanted to teach them that the Web site needs to be cared for on a permanent basis and to illustrate that point,

> we went on a field trip to a home furnishing store. Each person picked out plants and we let them know that they had to care for the plants, just as they would for the Web site.
>
> On another occasion, we got the staffers buying postcards, writing five personal goals on them, addressing and sending the postcards to themselves. When we wanted them to get used to thinking quickly—in this business, you have to be quick on your feet—as a second assignment, we gave them three words, hammer, velvet, emancipation, and told them to write a creative piece in one minute, then send it to a team member. Along with creative writing, this exercise also served to cultivate their peer editing skills.

Public recognition was used as a mechanism to provide feedback to OP4.com employees. At the end of team meetings, Matthews would take the time to publicly recognize someone worthy of praise. Matthews felt that "dramatizing what success looks like" was far more powerful than monetary rewards. It was his belief that this affirmation of good work performed meant more to his employees because they were publicly recognized for it.

Rewarding Initiative With Responsibility

Matthews knew that in a start-up situation, opportunities for new business partnerships or new online ventures could arise at any time. Because of his preference for spontaneity, he was open to employee suggestions about new project ideas. Thus, Matthews allowed his employees to approach him with ideas for projects and if the ideas were deemed feasible, it was likely that Matthews would hand over to that employee direct ownership of the project.

When an employee suggested exploring co-marketing initiatives with a wireless company, Matthews endorsed her proposal and re-arranged her duties to reflect this new focus. On another occasion, Reynolds allowed an intern to assume content production and publishing duties when he sought to assume this responsibility.

Matthew's Reaction in the Face of Employee Mistakes

Matthews realized that not all ventures would work out and that employees would be prone to making mistakes of various magnitudes. He was comfortable with this risk and made it clear to his staff that he trusted them to make the right decisions. However, when pressed about how he would deal with staffers if serious mistakes were made, Matthews responded:

> Here is a story I read in a newspaper once. Things had gone wrong at a large software corporation and an engineer, through his mistakes, had just cost the corporation $5 million. Being also the head of the research and development department, the engineer paid a visit to the president and tendered his resignation. The president listened to the engineer's announcement, thought about it for a few moments and replied; 'Why would I fire you if it just cost me $5 million to train you?' That, in a nutshell, explains how I would handle potential mistakes by my fellow staff members.

Rewarding Staffers at OP4.Com

OP4.com, like most Internet start-ups, had a pool of stock options for their employees, believing that providing the potential for rich rewards was a key motivating factor for employees. Options allowed an employee to purchase company stock at a very low price, often less than 10 cents per share. The whole notion behind stock options was that at the initial public offering or in the event the company was purchased, the vested options would be worth hundreds if not thousands of times of the amount initially paid for them. Because of this potential payout, stock options were intended to encourage employees to put in more effort. Ideally, they would feel a bigger sense of ownership and, along with the rest of their co-workers, work hard to increase the value of their company.

OP4.com was still a small company with under 20 people and no formal promotion processes were in place. Promotion was an ad hoc process—people who took the initiative and developed a new program were rewarded for it with more responsibility, but not necessarily a title which conferred more seniority (though another perk of working at this start-up was the option of choosing your own work title—examples of which were "Code Samurai" (Ian Hayashi), "Community Hactivist" (Dana Starritt) and the aforementioned "Content Queen" (Sam Reynolds)).

Reynolds observed, "If there is something new, do it, then find someone to replace what you were previously doing. We're taut and stretched and at this stage of growth, we need to bring people on."

Maintaining the Culture Through the Next Stage of Growth

From meetings with OP4.com's investors, Pressello knew that their next major goal had to be profitability. To achieve this, the founders began to draft formal reporting structures to manage their staff and prepared to divide the company into business units that would be responsible for generating their own revenue streams—content/wireless, OP4 media projects, OP4 marketing, OP4 Web site and education program/community programs. OP4.com anticipated that it would start to hire more people as their programs developed.

Steve Goodman, vice-president of corporate affairs offered:

> We may put together a magazine, or explore other projects in television, radio or wireless. At this stage, it's like having a bank account with no job—the advertising revenues we have will not sustain us long-term. This restructuring into business units is our first step towards generating self-sufficient revenues.

What was also very important to Matthews was that the unique culture he had built up at OP4.com remain intact as the company grew. Matthews had just finished his Tuesday morning session on building culture where the team had

Business Unit (all Vancouver)	*Purpose*	*Staff Members*
Content/Wireless	Produce content for site and seek out/manage wireless partnerships.	1 director (Sam Reynolds), 4 editors, 1 designer
OP4 Media Projects	Develop new concepts in media to generate excitement amongst target audience with the objective of youth aggregation.	3 staffers
OP4 Marketing	Market OP4.com to youth market.	2 staffers to Toronto
OP4 Web site	Manage the 'look and feel' of the OP4.com Web site and chat.	Matthews, Saunders, Pressello and 6 staffers
Education Program/Community Programs	Working with high schools to solicit content.	2 staffers

revisited the vision statement. The upcoming weeks would be crucial because Matthew wondered if the still-nascent state of OP4.com's culture at its Vancouver head office would survive this restructuring.

NOTE

1. Source: Jupiter Communications, 2000.

WESTJET AIRLINES (A): THE CULTURE THAT BREEDS A PASSION TO SUCCEED

Ken Mark

Gerard Seijts

 Version: (A) 2004–07–09

INTRODUCTION

It was April 17, 2001, and WestJet's market capitalization had just surpassed that of Air Canada's, the country's leading airline. "We're in the hospitality business and our culture is everything to us," stated Don Bell, co-founder and senior vice-president of customer service of Calgary-based WestJet Airlines. Bell was adamant on maintaining WestJet's culture in the face of increased company growth and competition. All of WestJet's founders believed that culture was the key to their airline's continued success and that they could not afford to mismanage it. However, Bell knew that the tremendous growth at WestJet would put pressures on its unique culture. He wondered how WestJet could grow and maintain its vibrant culture.

THE HISTORY OF WESTJET AIRLINES[1]

The roots of WestJet Airlines go back to 1994, when entrepreneur Clive Beddoe (president of the Hanover Group of Companies) discovered that it was cost-effective to purchase an aircraft for his weekly business travels between Calgary and Vancouver. During the time his company was not using this aircraft, Beddoe made it available for charter to other cost-conscious business people through Morgan Air, owned and operated by Tim Morgan. The response to this venture caused Morgan—along with Calgary businessmen Don Bell and Mark Hill—to realize that there was an opportunity to satisfy the need in Western Canada for affordable air travel coupled with good service by starting an airline.

Beddoe, Bell, Hill and Morgan believed that there was not only a market for a low-fare carrier in Canada, but that they could succeed at bringing this service to the country. Through researching other successful airlines in North America, the team examined low-cost carriers throughout the continent, including the primary examples of Southwest Airlines and Morris Air (which later became part of Southwest Airlines), both operating in the United States. David Neeleman, president of Morris Air, was contacted for assistance on writing a business plan, and along with Morgan, Hill, Bell and Beddoe, became the founding team of the concept that became WestJet Airlines.

Over the next months, the team worked with Neeleman to develop a comprehensive business plan and financial model. This information was the blueprint for the start-up of a three-aircraft, low-cost, low-fare, short-haul, point-to-point airline to serve markets in Western Canada. With the business plan in hand, a number of local business people were approached, and within 30 days, the needed capital (Cdn$8.5 million) was raised.

After this, developments moved quickly in bringing WestJet to life. In July 1995, WestJet's first staff members moved into the company's first office in downtown Calgary. In November of that year, the team purchased two Boeing 737–200 aircraft and added a third to the fleet in January 1996. In late January of 1996, the team completed a second offering to retail and institutional investors and raised over Cdn$20 million to commence operations on February 29, 1996.

The airline started operations flying to the cities of Vancouver, Kelowna, Calgary, Edmonton and Winnipeg. Since then, the company has continued to expand, bringing more Western Canadian cities into WestJet's world. In March of 1996, WestJet added Victoria to its route network.

WestJet was started in an "ideal" environment—Western Canada—where the main competition came from Canadian Airlines, which had experienced financial troubles. Although Canadian initially tried to match WestJet's rock-bottom fares (and attempted to compete in various other ways), it could not afford to compete against the upstart's low-cost structure (e.g., WestJet provides no meals, offers no frequent flier programs and has incredible turnaround times at the gates).

In June 1996, the airline purchased its fourth Boeing 737 aircraft and added service to the new market of Regina. In August that year, Saskatoon was added. In June 1997, Abbotsford-Fraser Valley was added, making WestJet the only scheduled carrier to operate at that airport. March 1999 saw the addition of the two new destinations of Thunder Bay and Prince George, and in September 1999, WestJet added Grande Prairie to its service area.

WestJet met a major business goal when, in July 1999, it completed its initial public offering of 2.5 million common shares. The share price at closing was Cdn$10. It was an exciting day for all WestJetters, representing the achievement of a major goal and raising the necessary capital for expansion of the company in the coming years. The capital raised from the offering, Cdn$25 million before post-closing adjustments, would be used for the purchase of additional aircraft, as well as the building of new head office and hangar facilities in Calgary, in order to meet the needs of the company's expanding workforce.

In 1999, unprecedented changes and restructuring were seen in the airline industry in Canada (e.g., plans for a merger between Canadian Airlines and Air Canada, small carriers that discovered viable market niches, and carriers that failed within a short time-span), offering a window of opportunity for WestJet to expand its service beyond its existing route structure. In December 1999, WestJet announced that it would be extending its successful low-fare strategy across Canada. Steve Smith, WestJet's president and chief executive officer in 1999, justified the expansion by stating:

> Our success over the past four years has proven that the travelling public will embrace any expansions to our airline's route network and schedule, while continuing to maintain the low-fare structure and exceptional customer service that has become synonymous with the WestJet name.

In March 2000, WestJet added services to Hamilton and began to build the John C. Munro Hamilton International Airport as it's eastern hub. In April 2000, WestJet added Moncton to its network and in June 2000, Ottawa was also added. Bill Lamberton, WestJet's vice-president of marketing and sales, noted that these schedule enhancements included services added as a result of the addition of the third-generation aircraft for 2001. He stated:

> This new aircraft will allow us to enhance our long haul schedule to provide greater connections between our Western hub in Calgary and our Eastern hub in Hamilton. As we continue to expand our airline, we will look for new cities to add to our

network, new niche routings, as well as better connections, so that more and more Canadians will be able to benefit from our low-fare, high-volume service.

Hamilton was chosen as the Eastern hub for several reasons. First, it was a niche route, meaning no other airline operated from the airport, hence making WestJet the airline of choice for people who lived in this Southern Ontario area. Second, costs were an issue. For example, landing fees for Toronto were steep. Third, efficiencies were a consideration. For example, WestJet could land an aircraft in Hamilton, deplane and board guests, refuel, restock and load and unload bags within 20 minutes. At Pearson International Airport in Toronto, it would be hard to taxi to the gate in this time! The more time in the air, the more efficient and profitable airlines can be. Moncton was also a niche market. Halifax had significant competition, whereas Moncton had little.

The Founders

Clive Beddoe, Don Bell, Mark Hill and Tim Morgan founded WestJet and, in April 2001, remained part of the executive team. Beddoe was the president and chief executive officer as well as chairman of the board of directors. Bell and Morgan were senior vice-presidents, and Hill was vice-president. Bell was responsible for the airlines' customer service areas including reservations, information technology (IT), customer service, and frontline services including flight attendants and airports. Bell and Beddoe were credited with creating the carrier's bottom-up management structure and energizing the staff. Morgan, a former pilot with Canadian Regional Airlines, was responsible for maintenance and flight operations. Hill was in charge of strategic planning.

All four entrepreneurs were substantial shareholders in the company—2000 data indicated that, combined, they owned nine per cent of the airline, a stake worth Cdn$85 million.

Company Performance

Since the beginning, WestJet had been consistently ranked among the most profitable airlines in North America. WestJet had been profitable since its inception in 1996. In an industry where 90 per cent of startups fail financially, WestJet grew from two planes in 1996 to 21 in 2000. Revenues in 2000 were Cdn$332.5 million, and expected revenues in 2001 were Cdn$460 million. Despite more competition, higher fuel costs and a slowing of the North American economy, the airline's earnings per share for the first quarter of 2001 increased to 13 cents from 10 cents during the same period in 2000.

All employees shared in company profits. WestJet's generous profit sharing plan allocated bonuses based on profit margins: if the airline's profit margin was 10 per cent, then 10 per cent of the net income would be spread among employees, prorated to salary. This profit sharing plan had a ceiling of 20 per cent of net income, and cheques were handed out twice a year.

In November 2000, more than Cdn$8 million was handed out to employees, with the average cheque amount being Cdn$9,000. One manager quipped, "That's why we have motivated people." But Beddoe insisted it was not just about money, saying, "They know their contributions have gone above and beyond anything we've asked of them, and that's what generated the profits."

In addition, right from the start, many of WestJet's employees owned equity in the company. WestJet matched every dollar their employees invest in company stock. For example, in 2001, 83 per cent of the airline's staff members were shareholders. Many of the original employees invested prior to WestJet's initial public offering and have more than Cdn$400,000 in stock value. The first 20 pilots at WestJet became millionaires.

In exchange for profit sharing and the stock purchase program, WestJet's employees worked for 95 per cent of the industry's median salary in their job category.

WestJet took pride in the customer service it provided to its guests. Since the Air Travel Complaints Commission began tracking passenger complaints in 2000, it had received only two from WestJet guests. In the same time period, the Commission logged 769 complaints from Air Canada passengers. This translates into 24,000 guests flown per complaint for Air Canada versus one million guests flown per complaint for WestJet (all data pertain to domestic flights).

Satisfaction with the job and colleagues among the 1,700 people working for WestJet was high. Bell explained:

> As for reality versus expectations, I found that, in general, an employee's actual experience on the job is better than what he or she had anticipated. For example, call centre customer service associates said that they found their job experience better than expected, and their colleagues warmer, kinder and more willing to help than expected. Most of them rate eight or nine out of 10 for pride in the organization. That shows me that we have to remind people how good we are. It's the one or two per cent that causes a cancerous environment. The day we find that employees' on-the-job experience is worse than what we believe it is, we're finished.

Culture

Beddoe insisted that WestJet's corporate culture was the primary reason for the airline's superb performance. "The entire environment is conducive to bringing out the best in people," stated Beddoe. "It's the culture that creates the passion to succeed."

Siobhan Vinish, director of public relations and communications, described the culture as a very relaxed, fun, youthful environment in which creativity and innovation are rewarded. For example, in the call centre where people take bookings (called the "Sales Super Centre"), the representatives had the authority to override fares, make decisions not to charge fees for cancellations and bookings, and waive fees for unaccompanied minors, on a case-by-case basis. People were trained to understand the ramifications of the decisions that they made. Senior management trusted the representatives in looking out for the interests of the company, customers and shareholders. Nevertheless, overrides were tracked and monitored each month. Additional training and coaching were provided if patterns emerged (e.g., overriding change fees on a consistent basis).

Pilots were considered to be "managers," and were encouraged to think with the executive team. One example of WestJet implementing a suggestion from its pilots came from significant fuel savings as a result of taxiing with one engine instead of two.

Prior to launching WestJet, Beddoe and his colleagues had no experience running a scheduled airline. One of the industry's biggest problems was dealing with a largely absentee workforce, spread all over the country, working at airports, hangars or in the air. Beddoe stated, "What occurred to me is we had to overcome the inherent difficulty of trying to manage people and to hone the process into one where people wanted to manage themselves."

Thus, the founders set out to create a company that was managed from the bottom up. WestJet gave workers a high degree of latitude to perform their jobs without interference from supervisors. Beddoe continued, "I don't direct things—I just try to persuade. We set some standards and expectations, but don't interfere in how our people do their jobs."

Vinish explained:

> The flight attendants are asked to serve customers in a caring, positive and cheerful manner; how they do that, however, is left up to them. Resource books are provided for them to refer to, and there is a team of people who continually updates these books.

In addition, Bell offered:

> A lot of the stuff is intuitively obvious—we don't focus on culture. We believe that culture is defined by the actions of executives. I may focus on empowerment and trust, Clive on profit sharing, and another one focuses on fun. This forms

> the circle of influence. It's very fragile—all our combined actions contribute and form part of our brand—whenever we start to do things offside, it affects the culture. We think of our customers as guests. We have agreements and partners, as opposed to contracts and employees. Profit sharing and stock purchase plans are important, but that's the icing on the cake. They're critical components of our company, but they don't define the culture.
>
> People with a great attitude always see the glass as half full. We're an opportunity culture versus an entitlement culture. We create opportunities for people. For example, lots of people have made a lot of money but have given WestJet a lot in return. In contrast, at Air Canada, a lot of money is paid to get a little work done. This is because unions stripout opportunity. We're creating wealth and sharing that wealth.

In a feature article in Canadian Business, December 25, 2000, it was noted that:

> Some executives entertain lavishly on the company dime. If Clive Beddoe tried to, he would probably get lynched. Consider what happened when the president and CEO of WestJet Airlines Ltd. threw a catered barbecue one weekend for the company's senior and middle managers at his private fishing lodge on the Bow River, downstream from Calgary. News of the party spread quickly through the company, and when Beddoe returned to work the following Monday, a WestJet maintenance worker stormed into his office. Pounding on Beddoe's desk, the employee demanded to know why the boss was blowing company profits on hamburgers and beer for the folks at head office. WestJet has a generous profit-sharing plan, and the maintenance guy figured his cut was being squandered on a soiree he wasn't even invited to. Beddoe told him not to worry. "I pointed out that I paid for the party out of my own pocket," says Beddoe, grinning. "He was a little humbled, but I congratulated him on his attitude. He's like a watchdog, and he hates inequities. That's the spirit of WestJet."

The company's accountants (located in WestJet's head office under the sign "Beanland") said that profit-sharing plan was front and centre and transformed each employee into a "cost-cop," constantly scouting for waste and possible savings.

Derek Payne, treasury director, boasted, "We are one of the few companies that has to justify to employees its Christmas party every year."

All employees had a sense of humor and played practical jokes on one another. Morgan, vice-president of operations, was also a pilot for WestJet. For new people who had never worked at an airport, Morgan would send them to "run and get the keys for the airplane." Of course, an airplane does not need keys, but the attendant would rush into the office, pick up the key with a huge tag that said "airplane" and rush back through the aisles to loud applause from passengers.

Another quality that set WestJet apart from its competition was the team spirit of its management and staff. On a visit to the night shift in the maintenance department, CEO Beddoe, dressed in coveralls, offered to go outside in sub-zero temperatures to change an airplane tire. He had to push the toolbox across the tarmac in–30-degree weather, check the tire pressure and change the tire. Eventually, Beddoe succeeded at the task. WestJet's people tended to give for the collective well-being of each and all, and there was an egalitarian spirit. It also showed that work at WestJet is a team effort. These values began at the top and trickled downward.

Bell, who oversees customer service at WestJet, routinely helped out the representatives in the Super Sales Centre when there was high call volume.

Sandy Campbell, the chief financial officer stated, "There's peer pressure among the employees. They recognize who buys into this program and who doesn't, and peer pressure is an amazing thing."

The culture is so customer-centred and so well defined that, at WestJet, employees sometimes joked that WestJet is more "Southwest" than even Southwest.

Beddoe concluded:

> We have a philosophy of trust here. Sometimes you get burned when you trust people, but most times you don't. Workers have pride in what they do because they are the ones making the decision

> about what they're doing and how they're doing it. They are not just functionaries. They actually take ownership of their jobs.

Overall Productivity

The benefits of creating WestJet's type of environment appeared substantial. WestJet avoided the cost of a significant layer of supervisory people. Next, it achieved a higher level of productivity per person. WestJet operated with about 59 people per Boeing 737 aircraft, compared with more than 140 at a typical full-service airline such as Air Canada.

The airline's focus on controlling costs and its specific cost-cutting measures had been well publicized. It flew only one type of aircraft, the 125-seat Boeing 737, offered a single class of service, utilized the Internet as much as possible to sell tickets, operated without paper tickets, offered no frequent flyer programs, provided no meals and minimal in-flight service, had no airport lounges or link-ups with other airlines, and aggressively hedged against rising fuel costs. This can be contrasted, for example, with Air Canada and its 16 different planes from nine different manufacturers, which resulted in much higher maintenance and training costs. WestJet's cost-cutting measures resulted in operation costs being almost half those of Air Canada's.

To reinforce its cost-cutting strategies, the company stressed teamwork. With no unions to insist on job descriptions, all employees had wide discretion in their day-to-day duties. WestJet's pilots often went into the cabin and tidied up between flights. Even Beddoe would help out when he was aboard. Job behaviors such as these meant annual savings of up to Cdn$2.5 million in cleaning costs and facilitated quick turnarounds, often within a half-hour. The record was an incredible six minutes.

Striving towards savings, Bell added:

> Once, I created a 'report card' for the company with two or three colors in the design. Employees asked me why it was not in newsprint. Most important of all are the actions of the executive team. People trust the executive in doing a good job. I need to link the impact of savings onto profit sharing. Cdn$8 million in savings does not mean anything to employees until you link it to their pocket book.

Because of these strong cost-cutting measures, WestJet could make money with ticket prices 50 per cent below the industry average. In an interview with the Financial Times, November 21, 2000, WestJet officials stated that its low costs meant it could break even when its planes were just 63.3 per cent full. In the second quarter of 2000, WestJet averaged 76.2 per cent capacity.

WestJet increased fares three per cent at the start of 2001, but resisted the temptation to raise prices even further or reduce the number of its cheapest seats, even though it flew at near capacity. Rather than fight for market share with larger carriers, WestJet's strategy was to use low prices and unrestricted tickets to lure people who would otherwise drive, take the bus or train or stay home. "To move our pricing higher quickly just means our whole philosophy of market stimulation doesn't work," said Bill Lamberton. It would also mean that there would be more room for a new competitor such as CanJet Airlines or Royal Airlines Inc. to enter the market with lower prices in an effort to capture the market segment that WestJet is pursuing.

Hiring

WestJet received between 3,000 and 4,000 resumes every week. Most of the new hires were new to the airline industry. "We prefer it that way," stated Beddoe. "This is a new culture, a new vision. It's better to start with a clean slate."

WestJet looked for two character traits—enthusiasm and a sense of humor. This was a theme borrowed from Southwest Airlines, which was known for its practical jokes and free spirit. It was common aboard WestJet's Boeing 737s for the flight attendants to crack jokes, hold contests (e.g., singing contests and aisle bowling games) with the passengers. Most passengers did not seem to mind the jokes and, in fact, most came to expect it.

The specific hiring process varied from department to department. Behavioral interviews were used to assess a fit between the person and the WestJet culture. WestJet made a conscious effort to provide realistic job previews to job applicants. Job simulations were also part of the hiring process. For example, WestJet held group interviews for flight attendants, in which it explained what WestJet was about, what WestJet stood for and what in particular WestJet was looking for. One interview session included making a lighthearted, creative presentation to the group, describing what the person would bring to WestJet.

Vinish and Bell stressed that the hiring and orientation period is of critical importance to WestJet. Bell offered:

> People by nature are negative, but there are some who are criminally enthusiastic. I do things called fireside chats. I talk to new hires about culture and what makes us tick. This is their orientation into our culture, our mission and our values. I want to find out what company people want to work for.

Maintaining A Union-Free Workforce

WestJet did not have a union. Instead, WestJet's senior management team created the Pro-Active Communication Team (PACT), an employee association that allowed management to keep in touch with it's employees, addressing their concerns before they became a problem. PACT provided WestJet employees with the services they might want to receive through a union, without the hassles, rules and adversarial environment that a union typically brings.

PACT covered the entire company with a number of chapters representing the different work groups. Each chapter had at least one representatives who sat on a council. Besides dealing with personnel issues, PACT aided in setting salary scales. Said Beddoe, "It takes away the opportunity for conflict because the employees are part of the solution, not the problem."

If an employee group, such as the flight attendants, wanted to leave PACT, it has to get approval from 75 per cent of its members. Beddoe added:

> It ensures we have a successful relationship with our people on a long-term basis. It took me two years to convince our people to embrace the concept of PACT because everyone here is so anti-union. But the staff voted 92 per cent in favor of it. We have since had some extremely successful resolution to issues that have cropped up.

Commitment to Maintaining the Culture

A vibrant corporate culture was so central to WestJet's success that preserving it was Bell's and Beddoe's main obsession. Not fitting in with the WestJet culture could have dramatic consequences. The sudden resignation of Steve Smith in September 2000 was a case in point. Smith was hired in early 1999 to take over Beddoe's job as CEO. Beddoe stayed on as chairman of the board, but wanted someone to take over the day-to-day operations and represent the carrier as it evolved from a private concern into a public company. Smith was running Air Canada's regional airline, Air Ontario, at the time, and WestJet's board of directors liked his amiable, energetic personality.

But it became apparent almost immediately that Smith did not fit with WestJet's culture. For example, Smith would override decisions made by WestJet employees who were "empowered" for over four years. Company sources said that Smith had a top-down management style and was accustomed to dealing with hostile unions. Beddoe stated:

> Steve got off on the wrong footing with PACT. He treated PACT like a union and they resented that

> immediately. He came from a background where you weren't open and straightforward, where you don't play all your cards at once. Well, we don't do that. We tell it like it is. We tell the employees what our issues are, and we try to work to a solution. We don't hold back half the deck.

Beddoe maintained that Smith's interaction with PACT improved over time, but the bad feelings lingered. There were other issues. According to one source, Smith locked horns with Beddoe and the board over how quickly the airline should grow. In his first business plan for WestJet, Smith called for revenue and earnings to grow at 27 per cent per year. The board ordered him to maintain the airline's current growth rate, in the 45-per-cent to 50-per-cent range. A source from WestJet stated, "When he first arrived, Steve had no sense of how much momentum the company had and how aggressively to grow it. You'd have to dismantle the thing to grow at only 27 per cent."

Employees became agitated, morale suffered and the culture that built the airline was at risk.

Vinish had spoken to Beddoe about how he would communicate the sudden resignation to WestJetters and the public. Beddoe did not want to announce that Smith was "moving on to better things." If he had said that, and if he had not mentioned anything about culture, Beddoe believed he would lose credibility with his employees. After all, he was the one who was the foremost proponent of open communication, and candid communication is what the executive team expected from its employees. Thus, Beddoe decided to talk candidly about the differences between Smith and the WestJet culture. Beddoe believed that this would show that management had credibility to "say it like it is." He explained:

> There is no question in my mind that if I had left it three or four months or even six, it would have been a precipitous event, because then we would have lost the core of the executive team, and by that I mean the senior management team of the company.

Beddoe was greeted with high-fives, hugs and hurrays from everybody once he walked back into the executive office to take over Smith's responsibilities.

Steve Smith denied that a cultural rift led to his departure and "vehemently disagrees" with WestJet's assessment.

Competition and Expansion

As recently as 1999, Beddoe was content to be in Western Canada. But the merger of Air Canada and Canadian Airlines changed the situation for him. WestJet's board decided to expand eastward before new carriers, such as Halifax-based CanJet, cornered the low-fare market. WestJet started flying out of Hamilton, Ontario, in the spring of 2000, and served Ottawa and Moncton and had plans to enter Montreal.

By using Hamilton as a hub, WestJet avoided head-to-head route competition with Air Canada as it tried to establish itself in the East. CanJet, in comparison, was fighting Air Canada on its home turf at Toronto's Pearson International Airport, and it admitted in late 2000 that it was struggling. One industry insider predicted that CanJet would not even be around in 2002.

Other airlines noticed the success of WestJet and were in the process of attempting to mimic WestJet, that is, its culture and operations. Canada 3000 merged with Royal and CanJet in April 2001. Air Canada intended to enter the discount market through forming a strategic partnership with Toronto-based Skyservice to fend off competition from WestJet and Canada 3000. Skyservice owned 80 per cent of Roots Air. However, WestJet appeared not to be too worried about other airlines introducing no-frills versions. Vinish explained:

> Air Canada would have to reduce their costs in order to be successful. This game is all about costs—Air Canada has operated for many years in their current state—for them to go into the low-cost market is difficult. Air Canada has many operational

> requirements. For example, we don't hire cleaners. If I decide to fly to Saskatoon, my promise to my fellow employees is that I help to clean the plane. We don't have a mentality that says, "That's not my job, I'm not prepared to do that." Air Canada has a union—an employee would not be able to get up and serve coffee to passengers even if he or she wanted to. Such behaviors are not encouraged at Air Canada because serving coffee is somebody else's job. Low fares need low costs. Low costs need concessions from people in order to do that.

Historical data indicated that setting up a competitive, profitable low-fare subsidiary had proven to be a problematic endeavor for the conventional airlines. Several of these airlines had tried and failed.

Beddoe was more blunt, stating that Air Canada's plan "is another disaster in the making."

Continued Growth

Beddoe continued, "We fly only five per cent of the available seat miles in Canada. We've only just started. Look at Southwest Airlines. It's still growing, and its stock today is the highest it has ever been."

Amid the vast changes taking place in the airlines landscape in Canada, WestJet had big expansion plans. In August 2000, it ordered 36 of the next-generation Boeing 737–700 series aircraft, with an option to pick up 58 more. That would give the carrier a fleet of 94 aircraft. With the new planes, WestJet intended to start flying non-stop from Calgary to Hamilton. This plan would enable WestJet to add frequency and non-stop flights to its schedule, further enhancing customer service.

Other possibilities included a future alliance with JetBlue, the discount airline launched in 2000 by Neeleman, who built and then sold another successful Southwest clone, Salt Lake City-based Morris Air, before becoming one of WestJet's founding shareholders. Neeleman's latest venture, JetBlue, is active in the northeastern United States. WestJet co-founder Hill observed, "They're in New York, and we're in southern Ontario. We operate off the same reservation system. We know each other well. Anything is possible down there. I wouldn't discount it."

Concerns

Industry watchers voiced concerns about WestJet's future, arguing that an economic downturn could hurt a carrier dependent on leisure travellers, and its expansive growth would make it hard, if not impossible, to keep the "fun" culture alive. Beddoe countered by saying that WestJet was prudent as well as ambitious. It had protected itself against rising fuel prices with hedging contracts. He also noted that British Columbia had been one of the fastest-growing markets, even though the province had been in a recession.

Moreover, because 58 of its 94 new jets are optional orders, the growth rate can be slowed to a rate equal to two new jets a year once its older jets are retired. The management team at WestJet believed that, in a depressed economy, it could manage performance expectations by communicating openly with its people, by being honest with them.

As for the corporate culture, Beddoe offered that Southwest, on which WestJet was based, has kept its culture alive 25 years even as its workforce swelled to 30,000. He agreed that protecting the culture is essential. "It's focus No. 1. Our risk, in my view, is internal, not external, and that's why we put so much emphasis on it."

Vinish added:

> What is the impact on our culture as we continue to grow? We all could fly into Calgary and find the WestJet culture. How can we perpetuate the culture in Moncton? We've thought about that. We need to send WestJetters to go and spread the feeling out there.

Bell concluded by saying that culture was paramount at WestJet, that as it grew, it was essential it kept its unorthodox, irreverent feel. He was concerned about not overextending WestJet so that its success would come to a halt. It would be unfortunate, he thought, if WestJet developed into a big and bureaucratic organization, unable to sustain its culture because of its success.

Note

1. Taken from www.westjet.com, April 15, 2001.