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Academy for Educational Development

ARMENIA ENERGY TRAINING PROGRAM

Contract No. LAG-I-00-98-00011-00, Task Order Two

Technical Report

Executive Seminar II

August 24, 1999

Submitted to U.S. Agency for International Development

Submitted by the Academy for Educational Development
with Hagler Bailly Services

ARMENIA ENERGY SECTOR TRAINING PROGRAM
Technical Report
Executive Training #2

USAID Strategic Objective 1.5	A more economically sustainable and environmentally sound energy sector
Intermediate Result 2	Increased economic efficiency in the energy sector
Participant profile	Armenia's energy companies, government ministries and regulatory entities with competence over the energy sector

A. Course Purpose

The second Executive Training Seminar was devoted to negotiations, transactions and contractual issues involved in attracting investment. The seminar instructors outlined the basic points associated with responding to, and negotiating with, foreign developers/investors in the power sector. Prior to the seminar, participant understanding and awareness of the approaches used by international investors, especially in the legal area, was quite limited. The Executive Training Seminar was designed to help the key officials who will be responsible for negotiating with international investors to improve their ability to do so effectively. At the participants' request, time was also spent during this seminar on the issues associated with the ongoing restructuring Armenian energy sector.

B. Dates/Trainers/Attendees

The course was presented by Constance Irland, Masoud Keyan, and Steve Tashjian on June 25-26, 1999. The target audience for the seminar was executive level company managers. Attendees included representatives from several of the energy sector companies, the Ministry of Privatization and the Ministry of Finance. Because of a last-minute scheduling conflict, Ministry of Energy representatives were unable to attend, and a separate seminar is to be provided for them before the end of the project. Table One shows the lists of attendees at the seminar.

Table 1: Participant List

#	Name	Employer
1	Vahan Mkrtchyan	Armenergo
2	Gourgen Amalbashyan	Armenergo
3	Rudik Zohrabian	Central Distribution Company
4	Meruzhan Hovsepyan	Central Distribution Company
5	Karen Harutyunyan	Yerevan Distribution Company
6	Ararat Hovhannisyan	Yerevan Thermo-Power Plant
7	Edvard Movsisyan	Hrazdan Thermo-Power Plant
8	Nune Khojoyan	Ministry of Privatization
9	Vahandukht Minasyan	Ministry of Privatization
10	Oleg Markosian	Ministry of Privatization
11	Naira Manukyan	Ministry of Privatization
12	Sahradyan Gagik	Ministry of Finance
13	Tokmajyan Gagik	Ministry of Finance
14	Galstyan Sergey	Seven-Hradzan Cascade

C. Material Covered

The principle topics for the second Executive Seminar included:

- *Review of First Seminar.* Since many of the course attendees did not attend the first Executive Seminar, major topics from that course were reviewed for their benefit.

- *Financial Management.* Participants received an introduction to a company's three major financial statements: the Income Statement, the Balance Sheet, and the Cash Flow Statement. The components of each statement and the importance of using these statements to manage a company were discussed. Financial Statements for a U.S. utility were presented and reviewed in detail.

- *Overview of Stock Markets.* Participants received an overview of stock markets, their origin, how they function, and how transactions are completed. Copies of Dow Jones industrial reports were provided and the participants discussed what drives stock prices to rise and fall.

- *Principles of Paradigms Video.* During the first Executive Seminar, the *Paradigm* video provoked extensive discussion. Attendees at this seminar saw the second in the *Paradigm* series of videos. This film discussed how paradigms effect the way we manage and used a number of business examples to show how difficult it is to overcome old paradigms. Participants were challenged to consider what paradigms they currently use to guide key decisions.

- *Status of Armenian Energy Sector.* The current restructuring of the Armenian energy sector was reviewed, including formation of separate generating, transmission, and distribution companies and plans for privatization of those companies.

- *Status of the U.S. Electric Sector.* The restructuring of the U.S. energy sector was reviewed, including the emergence of independent power producers, the move to competition, and the role of regulators such as the Federal Energy Regulatory Commission (FERC), state regulatory commissions, the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA).

- *Armenian Power Market.* At the request of several participants, the proposed structure of the Armenian power market was discussed in detail, particularly the allocation of revenues among energy sector companies.

D. Participant Evaluations

- Overall, the participants were extremely satisfied with the quality of the translated materials, and with the interpreter services provided.

- All of the participants agreed that they would be able to apply what they had learned to their work. Three quarters of the participants (75%) felt the training to be directly relevant to their work.

- The trainers were given good marks for their training ability, technical expertise and delivery by 75% or more of the participants. All of the attendees made arrangements to stay in touch with the trainers.

E. Anticipated Outcomes

The seminar provided participants with initial knowledge about general changes needed to manage energy companies in a more commercial environment. New management techniques that emphasize a more collaborative approach, better performance, and more efficient use of personnel will need to be implemented. Strategic planning, including the adoption of a vision and mission for the companies' and goals and objectives, will be essential in successfully guiding the companies through this transition period. Access to key financial information also will be critical to managers. Seminar participants will be able to apply the knowledge acquired to better manage the transition in the sector overall and in their organizations specifically.

F. Conclusions and Recommended Follow-up

The two Executive Seminars provided a general overview of each of the topics covered. Due to time limitations, no single topic could be addressed in detail. As a result, providing further training or advisory services would ensure that those managers who wish to implement the managerial and planning techniques that were introduced during the courses can do so successfully. One very effective approach would be to offer to work with one or more companies to provide similar training to the next level of managers. This training could include exercises that would lead to the development of a strategic plan or a financial management plan, for example. The training would be done in stages over the course of several months to allow time for gathering information and conducting analysis to form the basis of the plan. Instructors could facilitate the process and critique the plan during its development.

APPENDIX A

Seminar Outline

Executive Seminar #2

Executive Training Seminar #2
June 25-26, 1999
Course Outline

June 25, Friday

9:30 AM	Opening Remarks Introductions Review of Executive Seminar, Course1 Application of Principles from Course 1 Overview of Course 2
10:30 AM	Financial Management Financial Statements
11:00 AM	Financial management Exercise (Yo-Yo Company)
1:00 PM	Lunch
1:45 PM	Overview of Stock Markets Financial Reporting Capital Structure Dividend Policy Investor Relations Budgeting Controls Performance Standards Exercise
4:00 PM	Preparation for Next Class Adjourn

June 26, Saturday

9:30 AM	Discussion of Reading Materials Managing Employees Job Placement Negotiation Exercise Compensation Performance Evaluations Benefits
1:00 PM	Lunch

1:45 PM	Principles of Paradigms Video Career Development and Training Safety Programs Employee Communications Downsizing Employee Satisfaction Exercise
4:00 PM	Adjourn

APPENDIX B

Seminar Materials

Executive Seminar #2

Overview of Stock Markets

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Stocks

- Stocks are certificates of ownership in a company
  - Owners may receive a dividend or share of the company's profits
  - Stocks may be bought or sold
  - Stocks may increase or decrease in price depending on how buyers and sellers value the investment
  - Shareholders have limited liability for their investment

Bonds

- Bonds are certificates that promise to pay a fixed rate of interest
  - Bonds do not buy ownership in a company, but lend the company money
  - Bondholders are paid interest at regular intervals
  - Interest rates are based on the market
  - In the case of bankruptcy, bondholders are paid before shareholders

History of Stocks and Bonds

- Merchants combined their money to outfit ships and caravans to take their goods to faraway places
- Dutch East India Company formed in 1602 to take control of the spice trade
  - to raise money the company sold shares of stock and paid dividends
- Amsterdam stock exchange set up in 1611

Small Investors

- After World War I, increasing number of small investors began to invest in the stock market
- Huge rise in speculative stock trading during the 1920's led to a crash in October 1929, followed by the Great Depression
- After World War II small investors began to invest again

Stock Exchanges Today

- Largest stock exchanges
  - New York
  - London
  - Tokyo
  - NASDAQ (National Association of Securities Dealers Automated Quotations)
    - stock transactions made over computer terminals in many cities

New York Stock Exchange

- 1,000 members on the exchange
- Operates under a constitution and set of rules that govern transactions
- Also governed by rules set by the Securities and Exchange Commission
- Companies must report earnings and other financial information

How a Stock Exchange Works

- The Exchange does not buy, sell or set prices of any stocks
- The Exchange provides a marketplace in which stocks are bought and sold

Buying Stock

Buyer calls local stockbroker

Stockbroker sends order to the exchange

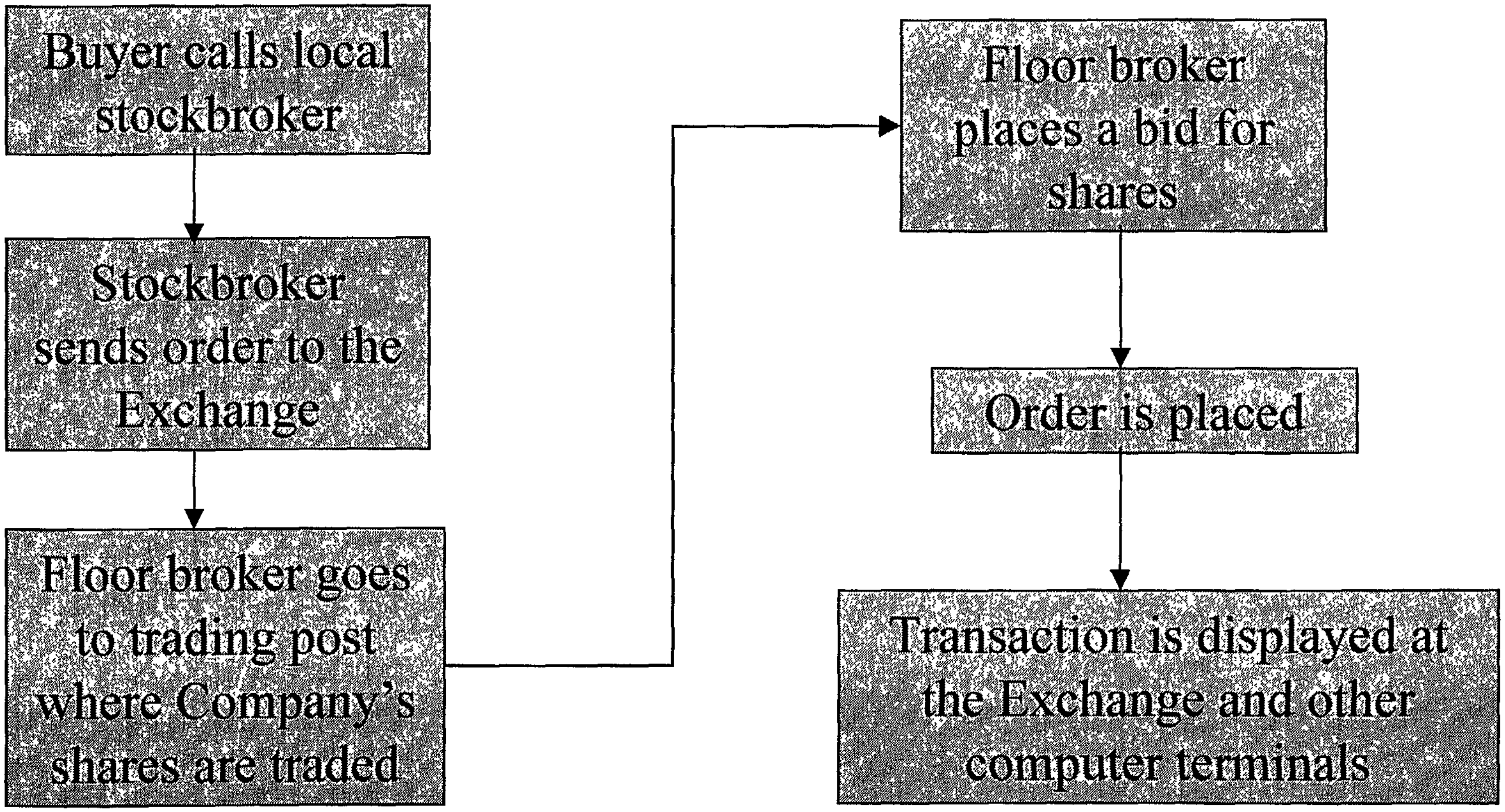
Floor broker goes to trading post where that company's shares are traded

Broker bids for shares and looks for best price

An order is placed

A record of the transaction is displayed at the Exchange

Buying Stock



FINANCIAL MANAGEMENT

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Financial Management Topics

- Financial Statements
- Financial Reporting
- Capital Structure
- Dividend Policy
- Budgeting
- Controls

FINANCIAL STATEMENTS

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Primary Financial Statements

- Income Statement
- Balance Sheet
- Cash Flow Statement

Purpose of Income Statement

- Measure level of income or loss from operations *in current period*
- Provide basis for management decisions
- Report financial status to investors and shareholders

Purpose of Income Statement

- Measure level of income or loss from operations *in current period*
- Provide basis for management decisions
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Components of Income Statement

- Revenues
- Operating expenses
- Depreciation
- Interest Expense
- Income taxes
- Net Income
- Dividends
- Earnings per share

Consolidated Income Statement

Central Maine Power Company

(Dollars in thousands) As of December 31:	1998	1997
Revenues		
Electric operating revenues	$ 938,739	$ 954,176
Other non-utility revenues	11,588	2,070
Total revenues	950,327	956,246
Operating expenses		
Fuel used for company generation	30,898	34,946
Purchased power - energy	369,411	419,144
Purchased power - capacity	85,321	112,810
Other operation	213,489	210,513
Maintenance	41,051	33,973
Depreciation and amortization	56,493	54,132
Taxes other than income taxes	27,783	28,303
Total operating expenses	824,446	893,821
Operating income	125,881	62,425
Total other income expense	24,683	10,726
Interest charges		
Long-term debt	43,276	44,346
Other interest	8,366	7,660
Allowance for borrowed funds during construction	(495)	(439)
Total interest charges	51,147	51,567
Income before income taxes and preferred dividends	99,417	21,584
Income taxes	41,698	8,162
Dividends on preferred stock of subsidiary	4,809	8,209
Net income	$ 52,910	$ 5,213
Weighted average number of shares of common stock outstanding	32,442,685	32,442,752
Earnings per share of common stock (basic and diluted)	$ 1.63	$ 0.16
Dividends declared per share of common stock	$ 0.90	$ 0.90

Purpose of Balance Sheet

- Measure financial status *at a point in time*
- Provide basis for management decisions
- Report financial status to investors and shareholders

Components of Balance Sheet

- Assets
- Liabilities
- Stockholders' Equity

Consolidated Balance Sheet

Central Maine Power Company

(Dollars in thousands) As of December 31:	1998	1997
Assets		
Current assets		
Cash and cash equivalents	$ 30,540	$ 20,841
Accounts receivable, less allowance for uncollectibles of $3,136 in 1998 and $2,400 in 1997		
Service - billed	81,169	84,323
Service - unbilled	53,296	46.807
Other accounts receivable	13,753	15,247
Fuel oil inventory, at average cost	5,879	5,390
Materials and supplies, at average cost	13,126	11,779
Funds on deposit with trustee	1	61,694
Prepayments and other current assets	10,268	9,110
Total current assets	208,032	255,191
Electric property, at original cost	1,750,837	1,674,876
Less: accumulated depreciation	694,410	634,384
Electric property in service	1,056,427	1,040,492
Construction work in progress	19,538	15,105
Nuclear fuel, less accumulated amortization of $9,316 in 1998 and $9,035 in 1997	1,147	1,157
Net electric property	1,077,112	1,056,754
Investments in associated companies, at equity	71,880	76,509
Net electric property and investments in associated companies	1,148,992	1,133,263
Total deferred charges and other assets	905,860	910,512
Total assets	$ 2,262,884	$ 2,298,966
Total current liabilities and interim financing	451,419	383,657
Total reserves and deferred credits	891,857	921,693
Long-term debt		
Mortgage debt	117,683	259,563
Other long-term obligations	228,598	141,360
Total long-term obligations	346,281	400,923
Redeemable preferred stock	18,910	39,528
Stockholders' equity		
Common stock	162,213	162.214
Other paid-in capital	285,835	277,168
Reacquired common stock	(827)	-
Retained earnings	71,668	48,212
Preferred stock	35,528	65,571
Total stockholders' equity	554,417	553,165
Total stockholders' equity and liabilities	$ 2,262,884	$ 2,298,966

Purpose of Cash Flow Statement

- Show change in current period in cash position of company
- Identify reasons for change
- Forecast and plan for cash flow requirements for the next period

Components of Cash Flow Statement

- Net income
- Non-cash items
- Changes in current asset and liability balances
- Construction expenditures
- Financing
- Dividends

FINANCIAL REPORTING

Purpose of Financial Reporting

- For management information needed to operate company
- To retain shareholders
- To meet regulatory requirements
- To attract new investors

Reports to Shareholders

- Quarterly statements to shareholders
- Annual report to shareholders
- Annual proxy statement

Components of Annual Report

- Summary of statistics about the company
- Executive Director's letter to shareholders
- Management discussion and analysis
- Financial statements and notes
- Detailed statistics about the company
- Names of company executives and directors
- Recent price and dividend data

Components of a Proxy Statement

- Nomination of Board members
- Financial report
- Amendments to charter or by-laws

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CAPITAL STRUCTURE

What is Capital Structure?

- Capital structure is the total of all funds that have been invested in the business, categorized by type
- Typical components include *debt* (long and short term) and *equity* (common and preferred stock)

Definition of Debt

- *Debt* is an obligation to pay back borrowed amounts at a specified interest rate (or type of interest rate, if variable) within a specified time period
- Examples of types of debt include loans, bonds, leases, commercial paper, medium term notes, etc.

Characteristics of Debt

- Investors have no voice in management of company
- Have first claim on company assets in event of bankruptcy
- Fixed rate of interest normally
- May have special features such as being callable, convertible

Definition of Equity

- *Equity* has at least 2, and sometimes 3, components
  - Common stock
  - Preferred stock (optional)
  - Retained earnings

Common Stock Equity

- *Common stock equity* includes funds paid by investors for the purchase of shares of stock as well as earnings retained by the company from operations
- Shares of common stock can be owned both by investors and companies

Characteristics of Common Stock Equity

- Investor becomes an owner of the company
- Investor may vote on issues brought up at shareholders meetings
- Investor can sell owned shares on open market
- Company does not have to repay investor for amounts invested
- Company *may* pay dividend on shares (not required)
- Dividends are not tax deductible
- Investors have last claim on company assets in event of bankruptcy

Preferred Stock

- Normally, shares of preferred stock have no voting privileges on issues that are brought before the common shareholders at their annual meeting
- Dividend rate is usually a fixed %
- Dividend must be paid before any dividend is paid to common stock shareholders
- In the event a company becomes bankrupt, preferred stock shareholders have rights to a claim on company assets before common shareholders do

Example of Capital Structure

Component	Amount	% of Total	Cost Rate %	Weighted Cost Rate %
Debt	702	52.4	7.0	3.7
Common Stock	491	36.7	12.0	4.4
Preferred Stock	146	10.9	8.0	.9
Total	$1339	100.0		9.0

General Comments on Capital Structure

- Combined cost of capital is 9%
- It is a function of amounts and rates
- Opportunity to manage company's capital structure to obtain optimum levels
- Diversification of capital sources is favorable
  - Need to maintain a "balanced" capital structure

Capital Structure Development Considerations

- Current and projected company retained earnings
- How much and when do you need funds-need financial plan
- Current and projected costs of funds
- What is normal structure for the industry and location
- Income tax effects
- Availability of property for mortgage bonds
- Price and marketability of stock - and effect on existing shareholders

Managing Capital Structure

- Capital structure can be managed for best results
- Company that is well run should have lower investor fund costs
- Companies need to pay attention to optimizing their capital structure and related costs as well as to the costs of normal company operations

DIVIDEND POLICY

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Why is dividend policy important?

- It is part of shareholder return
- It may impact the price of stock
- It directly impacts retained earnings

Goal of a dividend policy

- Appeal to the greatest number of shareholders over the long term
- Balancing needs
  - Paying dividends
  - Retaining cash for the company

Pay dividends or keep cash?

- Depends on
  - Financial strength
    - Weak companies may not be able to pay dividends
    - Strong companies may not need cash
  - Corporate life cycle
    - Start up companies need much cash
    - Growth companies need cash
    - Mature companies have less need for cash

Reasons for retaining earnings

- Retained earnings don't incur financing costs
- Investors can decide if they need cash (sell some of their stock)
- Company may have a high need for cash

Reasons for paying dividends

- Dividends are certain - stock appreciation is not
- Some investors require dividends to buy stocks
- High yields during tough times may help bolster stock price
- Steady dividends can help stabilize stock price as earnings fluctuate

When should you consider issuing debt?

- When pre-tax earnings as a % of assets is more than proposed interest rate % charged on new debt
- When future appears to show stable or increasing earnings
- When % of capital structure that is debt does not increase financial risk to unacceptable levels

When should you consider issuing stock?

- When debt is high % of capital structure
- When market price of stock is at or above book value
- When seeking higher credit rating
- When company's capital structure is significantly different from other comparable utilities

When should you seek equity investors?

- When other alternatives are not available
- When company can offer investor attractive terms
  - reasonable assurance of return of investment
  - possibly a position on Board of Directors

What are investors looking for?

- Good return on funds loaned
- Lowest possible risk of losing invested funds
- Good company management
- Favorable sales and income prospects for the future
- Favorable regulatory climate
- Strong current financial position
- Minimal threat from competition

Maintaining Good Investor Relations

- Satisfy all regulatory disclosure requirements
- Identify ways to work with investors so that investing in your company is made as simple as possible
- Identify opportunities for you to instill confidence in investors about information provided about your company

Communicating with investors

- Employees who talk to investors need to be informed about company events immediately
- Develop process to answer investor questions
- Management team should schedule visits to major investment companies and provide information about the company and future plans
- Management should stay in contact with brokerage companies and promote the sale of its stock
- Required financial reports are issued on time to regulators and to investors and potential large investors

BUDGETING

Why budget?

- A formal process for proposing work and allocating resources to support goals
- Sets financial and resource priorities
- Requires collaboration among managers
- Tracks expenditures against targets
- Facilitates reallocation of resources to meet changing needs

Overview of the budget process

June - July

- Draft vision, goals and objectives
- Set high-level, multi-year spending targets
- Prepare forecasts
  - Economic forecast
  - Load forecast
  - Energy price forecast
  - Financial plan

Overview of the budget process

July

- Prepare budget instructions and send to departments

August - September

- Departments prepare detailed budgets

Overview of the budget process

October

- Compile all budget data for management review, including
  - Operation and maintenance budget
  - Capital budget
  - Revenue forecast

November

- Final budget approved by Board of Directors

Budget Evaluation Criteria

- Regulatory
- Safety
- Environmental
- Reliability
- Economic
- Operating Performance
- Customer Service
- System Expansion
- Timing

Organization of budget reports

- Management Projects
  - Routine Duty
  - Regulatory
  - Training
  - Construction
- Cost Elements
  - Labor
  - Supplies
  - Company Vehicles
- Cost Locations

Example of a Cost Location Budget

As of: 31/3/1999

Business Unit: 11
Report Request Name: BUD_CMP
Report Title: Resource Utilization Report
Total by Management Project
Cost Location: 441 PORTLAND DISTRICT LINE

Managemen Project	Description	CURRENT MONTH Actual	Budget	Variance	YEAR-TO-DATE Actual	Budget	Variance	1999 TOTAL Budget
238510	Field Planning	874	1,500	-626	2,987	4,500	-1,513	20,000
238540	Line Inspection	2,768	3,000	-232	8,956	9,000	-44	24,000
238610	Line Production	3,989	4,000	-11	11,532	12,000	-468	68,000
238615	Trouble Calls	2,288	2,200	88	7,321	6,600	721	16,600
238630	Transformer Install-Re	2,000	2,050	-50	5,783	6,000	-217	24,000
238710	Meter Reading	4,596	5,000	-404	15,352	16,000	-648	70,000
238730	Meter Install-Remove	2,711	3,000	-289	8,444	9,000	-556	36,000
247410	Credit + Collections	1,989	2,700	-711	3,657	8,875	-5,218	48,000
250010	Routine Administration	1,948	2,500	-552	5,126	7,500	-2,374	30,000
250030	Safety Activity	1,175	1,200	-25	3,677	3,600	77	14,500
290000	Training	2,221	2,475	-254	7,208	7,000	208	18,000
333620	Routine Maintenance	9,430	8,000	1,430	25,659	24,000	1,659	106,000
333655	Storm Related Maint	4,631	3,750	881	13,855	10,000	3,855	40,000
	TOTAL	40,620	41,375	-755	119,557	124,075	-4,518	515,100

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Example of a Cost Location Budget

1999-03-31

Business Unit: 11
Report Request Name: BUD_CCE
Report Title: Resource Utilization Report

Total by Cost Element

Cost Location: 441

C/E #	Description	CURRENT MONTH			YEAR-TO-DATE			Full Year
		Actual	Budget	Variance	Actual	Budget	Variance	Budget
001	Labor-Regular	24,988	25,000	-12	72,340	75,000	-2,660	300,000
005	Labor - Overtime	400	1,000	-600	3,155	3,000	155	20,000
015	Meals	30	100	-70	435	400	35	2,000
051	Company Vehicles	478	500	-22	790	1,500	-710	6,000
061	Personal Auto	20	50	-30	20	0	20	500
076	Inventory - Stock Cod	1,590	2,000	-410	5,683	6,000	-317	30,000
080	Supplies	422	175	247	708	525	183	2,000
135	Outside Services	0	0	0	0	0	0	4,000
248	Small Tools	198	50	148	256	150	106	600
995	Labor Overhead	12,494	12,500	-6	36,170	37,500	-1,330	150,000
		40,620	**41,375**	**-755**	**119,557**	**124,075**	**-4,518**	**515,100**

CONTROLS

General Accounting Principles

- Revenues minus expenses = net income
- Assets minus liabilities = shareholders' equity
- Capital expenses are handled differently than operations and maintenance expenses

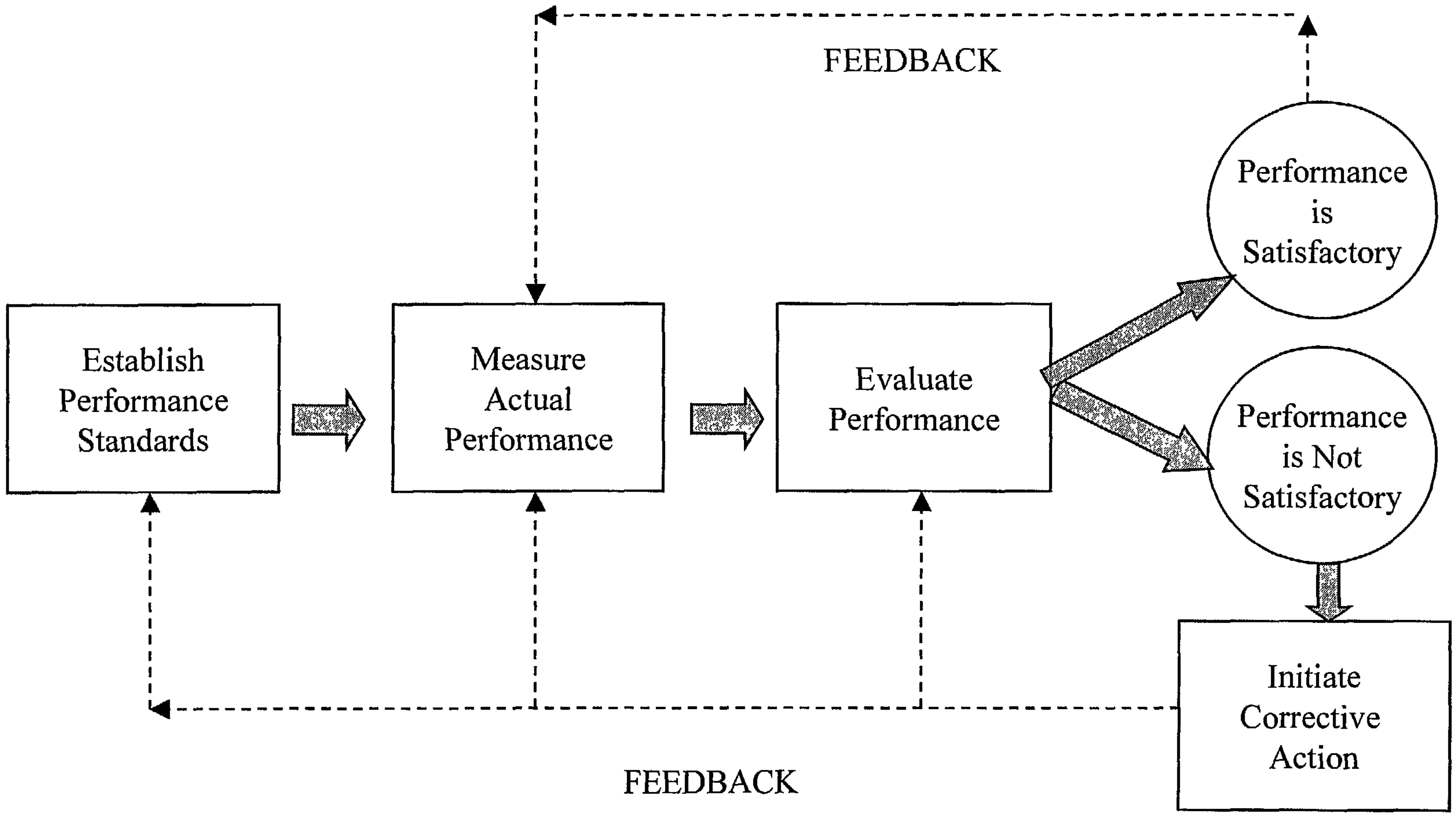
International Accounting Standards

- Adoption of International Accounting Standards by Armenian energy companies (Decree #740)
  - 16 international accounting standards adopted
  - 10 more standards to be adopted by year end
- Financial reports
  - 1999 - report in old and new formats
  - 2000 - report under new Armenian standards
- New Chart of Accounts drafted by Ministry of Finance

Establishing Management Controls

- Control is necessary to measure and evaluated the company's performance
- Control is dynamic and an on-going process
- Effective control requires the involvement of all facets of the organization

Management's role in the control process



Key Performance Standards

- Earnings
- Reliability
- Safety
- Station Availability
- Cost/kWh
- Number of employees
- Customer Service

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Setting Performance Standards

Standards must be

- realistic
- behaviorally oriented
- measurable
- quantifiable

Standards can be compared to

- past performance
- industry performance

Drafting your own performance standards

- Pick two areas of performance
  - Customer Service
  - Finance
  - Accounting
  - Reliability
  - Safety
  - Employees
- Draft a standard and describe how and when it will be measured

Auditing as a control function

Audits can take several forms

- financial
- data processing
- operational
- compliance
- environmental
- managerial

Purpose of a financial audit

- Verify that disbursements are actually going where the records indicate
- Ensure that adequate controls and safeguards are in place to avoid fraud and theft

Purpose of a data processing audit

- Ensure the security and accessibility of company data, computer hardware and software
- Safeguard confidential information from unauthorized access

Purpose of an operational audit

- Ensures that company policies and procedures are being met
- Ensures compliance with laws and regulations

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Purpose of a managerial audit

- Determines whether the operations of the company are being conducted efficiently and effectively
- Usually done by an outside consulting firm
- Uses a pre-agreed on set of criteria against which the company is evaluated

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MANAGING EMPLOYEES

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Employees are the Company's most valuable resource

- The men and women employed by utilities are ultimately responsible for its success or failure
- Companies must attract, train, support, develop, retain, and fairly compensate their employees
- Companies must provide a safe and pleasant work environment for employees.

The Elements of Human Resource Administration

- Job Placement
- Compensation Administration
- Employee Performance Evaluation
- Benefits Administration
- Career Development and Training
- Safety Programs
- Employee Communications
- Downsizing

Job Placement Administration

It takes a variety of skills and experience to run a utility:

- Engineering
- Finance and Accounting
- Computer Operations
- Power Plant Operation
- Business Management
- Electrical & Electronic Technology
- Environmental Sciences
- Line Construction & Maintenance
- Automotive Maintenance
- Law

Getting the right people for the right job

- Employees represent a wide array of skills, and are recruited from universities, technical schools, and other industries
- Many of the employees hired by the utility come with excellent skills which are then turned into specific applications
- All positions should be filled by workers based on their qualifications
- Technical, managerial and people skills should be balanced

Creating position descriptions for each job classification

- Describe the tasks to be performed
- Outline the interactions the position has with other departments
- List the education and experience required
- State the title of the position reports to
- State the number and classification of employees who report to the position
- State the salary range

Compensation Administration

- Employees may be paid on an hourly or salaried basis
- All employees must be paid at competitive levels
- Internal and external wage comparisons must be made at regular intervals
- Work hours and overtime policies must be in place

Compensation Administration

- Most pay levels are graded from entry level to the most experienced levels
- Different positions may fall within the same salary range
- Pay is often controversial
- Compensation is an art not a science!

Focusing on Pay for Performance

- The time one spends in an assignment should not be the basis for pay
- Employees should work smarter and not necessarily harder
- Pay increases can be made on specific dates as established in the corporate plan
- Pay can change if an employee changes jobs, and it can go up or down

Rewarding Excellent Performance

- Incentives are an important part of compensation
- Characteristics of incentives
  - cash, stock, material goods or other tangible products
  - long or short term
  - paid to people who perform beyond expectations and usually achieve mutually agreed upon targets
  - extra pay and not part of salary
- Publicly acknowledge outstanding performers

Goals of Incentive Pay

- Motivate and reward performance
- Align management and employee goals and measures
- Focus on department goals
- Create link between company, department and individual goals

Employee Performance Evaluation

- All employees receive an annual performance evaluation
- The manager serves as the employees' coach
- The results of the evaluation are weighted heavily in determining pay

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Evaluating an Employee's Performance

- Review performance against agreed upon goals and objectives
- Focus on objective, job-related behaviors
- Make it a two-way form of communicating
- Give constructive feedback
- Interim evaluations may be required
- All evaluations are placed in the employee's file
- All employees files should be private and confidential

Benefits Administration

- Utilities offer comprehensive benefits to employees
- Some benefits are provided when there are no national programs such as medical or retirement programs
- Benefits can be provided directly by the company or through an outside provider

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Types of Benefits Offered

- Retirement Income Plan
- Medical Plan
- Savings and Investment Plan
- Dental Plan
- Life Insurance
- Long Term Disability
- Workers Compensation
- Stock Purchase Plan

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Types of Benefits Offered

- Holidays - 12 in USA
- Vacations with pay based on years of service up to a maximum of 5 weeks
- Educational assistance
- Leaves of Absence
- Child Care Leave
- Bereavement Leave
- Other miscellaneous benefits

Career Development and Training

- All employees must be included in these activities in order to develop their potential to the fullest
- Ensures smooth efficient operations by competent employees
- Broader or more diverse assignments can be beneficial to the employee and the company
- Training should be specific, defined and measurable

Why is Career Development important?

- To retain valuable employees
- To allow the employee to his/her potential and provide quality services to the company
- To develop skills that will aid the employee's ability to perform
- To provide training that is consistent with the employee's personal career goals

Developing an Corporate Training Program

- Coordination is accomplished through a corporate training group
- Managers must inventory all employees' skills and provide development as necessary
- Each functional area has specific needs
- Accurate records must be maintained
- Training should be interactive, with questions and answers, challenges, and opportunity for realistic case studies
- Recognition of successful trainees is critical

Assessing an Employee's need for training

- May identify unknown employee skills
- May also identify significant weaknesses
- Both must be addressed

Using the right method of training

- In-house training
- Lateral moves
- Commercially available courses
- Apprenticeships
- Educational assistance

Safety Programs

- Utilities have a solemn obligation to provide safe electrical service to customers and a safe work environment for all employees
- Employee receive continuous training on working safely
- All facilities, vehicles and equipment must meet certain standards and be checked regularly
- There can be <u>no</u> safety shortcuts

Communicating Safety Issues to Customers

- Customers regularly receive safety information
- School programs for students
- Electricity can and does kill people
- Contractors must work by company safety rule

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Employee Communications

- Reinforces employee support of company goals and objectives
- Extremely important during difficult periods
- Maintains management credibility
- Leads to improved customer service
- Communication must be two ways

Ways to Communicate with Employees

- Employee newsletters
- Videos
- Executive briefings
- Surveys
- Posters on company progress
- Direct supervisors briefings
- Regular feedback and updates
- Direct mailings (broadens audience)

Establishing an Effective Employee Communications Program

- Strive to inform all employee first, before they hear from an outside source
- If the above isn't possible, explain why
- Inform everyone about good news
- Be even more timely to give bad news
- Be accurate, thorough and explain the impact of changing scenarios

Downsizing

- Determine what services will be provided
- Identify the skills required to meet the needs
- Look for comparable organizations to establish a reference point
- Communicate the process throughout the organization

Downsizing

- Assess all employee skills to match needs with expertise
- Make no assurances to employees to avoid future problems
- Choose key people first, then include them in the process

Downsizing

- Adjust staffing as necessary, but not too quickly
- Give the new organization a real test
- Clearly communicate goals and objectives and measure all activities

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Downsizing Approaches

- Staff Reductions
- Attrition
- Reallocation of Staff
- Sale of Some Business Units
- Insure compliance with all laws and contractual obligations
- Timing - immediate or phased approach

THE OPEN-BOOK REVOLUTION

By John Case

More and more CEOs have discovered what was missing from all the past decade's management cures—and have Invented a new way of running a company that overturns a hundred years of managerial thinking. The new system gets every employee to think and act like a businessperson—to compete—and it gets astonishing results. It's called open-book management, and this is how it works.[1]

POKE YOUR HEAD INTO ENOUGH COMPANIES THESE *days* and you come away with a sense that American busmesspeople are earnestly, diligently, maybe even desperately searching for a new way 10 run their companies.

Even tradidonahscs—if there are any left—will recognize the buzzwords. Total quality management! Teams! Empowerment! Reengincenng! The old top-down, chain-of-command style of management is out; today's boss is supposed to walk around, involve die troops, and encourage participation. Gone, too, is the notion [hat employees are no more than qny cogs in 2 machine. 'Workers are now supposed to take on big responsibilities—to solve problems, cui costs, and reduce defects. The language of business reflects the new ideas. Tiendy companies don't have employees, they have *associates.* They don't have managers, they have *coaches.*

All this experimentation and exploration should come as no surprise. The old way of running a business was born a cencury ago, and it's showing its age. (See "Ending the Hundred Years' War," page 32.) And there's no comparison between today's white-hot global competition and the Stable markets of even 20 years ago. In the past, businesses needed people who would show up for work every morning and do what they were told. Now they really do need employees who work sman as well as hard—and who are looking out for the company, not just for themselves.

Trouble is, the best-known of the new managerial methods have a pretty spony record.

Quality efforts, for example, often improve quality. They don't always improve the business. At Varian Associates Inc., a maker of scientific equipment, employees got so obsessed widi quality-related measures that dicy quit returning customers' phone calls. "All of the quality-based charts went up and to the right," a Var-ian vice-president confesses. "But everything else went down."

Reengineering can help companies cut costs—except that it's usually seen as a euphemism for layoffs, with • predictable effects on morale and productivity. "Reengineering is in trouble," admits one of the consultants who coined the phrase.

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[1] *Adapted from the book Open-Book Management: The Coming Business Revolution, by John Case, published this month by HarperBusiness ©John Case*

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Teamwork and empowerment programs have their success stories—so long as you catch them before they fade

away. "We used to do a lot with teams," one small-company chief executive told me sheepishly. "We should probably get back to that."

Meanwhile, people who think about these things for a living argue that even after a decade and a half of experimentation, something is still missing. A new paradigm. A central organizing idea. "The fundamental principles of a new managerial paradigm are far from clear," observes David H. Freedman in *Harvard Business Review.* Rosabeth Moss Kanter, one of the nation's best-known business thinkers, agrees. Each of the "management buzzwords and fads of the last decade," she argues, is like "a way station" on the road to a comprehensive rethinking of the business organization.

But what the pundits haven't yet caught sight of is the growing number of companies that have been getting a lot farther down diat road. I recently spent 18 months visiting many of those companies, and what they're coming up widi seems to me to be as close to a new paradigm or a comprehensive rethinking of

management as we're likely to get.

They're calling it *open-book management.*

The beauty of open-book management is diat it really *works.* It helps companies compete in today's mercurial marketplace by getting everybody on the payroll thinking and acting like a busi-nessperson, an owner, radier dian like a traditional hired hand.

The open-book companies are all over the map, in every kind of industry and business situation. Bob Frey, owner of a small Cincinnati packaging manufacturer called Cin-Made, turned his business around with open-book principles. So did Bob Argabright, manager of Chesapeake Packaging's big corrugated-box plant in Baltimore. Manco, an immensely successful consumer-products distributor headquartered near Cleveland, has built the open-book approach into its operations for years. Acumen International, a small but growing personnel-assessment company in San Rafael, Calif., adopted it just last year.

The best-known practitioner of the new approach is Springfield Remanufac-turing Corp. (SRC), in Springfield, Mo., which calls its system die Great Game of Business. SRC's Great Game has spawned hundreds of emulators—who now gather once a year to swap stories and tips about implementing die open-book approach. (The diird of die annual get-togediers is coming up in September.) Every mondi, anodier 30 to 35 companies send representatives to Springfield (at $950 a pop) for a two-day seminar on SRC's system.

By now die game-playing group includes some sizable organizations: All-states business-insurance unit, Sprints Government Systems Division, Amoco Canada, and even—as of last year—die giant ZCCM copper mine in Zambia, a 50,000-employee enterprise diat is die economic mainstay of diat struggling African nation. It also includes plenty of small everyday companies, as you can discover by visiting SRC's Springfield neighbors. Walk into die Ponriac-Cadil-lac dealership or into a local building-supplies store. Talk to die guy who runs die area's fastest-growing commercial-cleaning service or to die brodiers who own a hearing-systems manufacturer. Open-book partisans, all.

Nearly all die open-book companies can boast some starding business accomplishments. SRC transformed itself from a small, money-losing division of Intemational Harvester (now Navisrar) into a moneymaking minicongloraerate with revenues near $100 million. The sales of Mid-States Technical, a staffing company headquartered in Davenpon, Iowa, rose 79% in the two years after CEO Steve Wilson adopted the new approach; profits nearly tripled. Kacey Fine Furniture, in Denver, saw return on assets jump from the 1%-to-2% range all the way to 9%— an astonishing figure for a retailer in a traditionally low-margin business.

Not surprisingly, the practitioners tend to wax evangelical about the management model behind the numbers. Kacey's Leslie Fishbein pronounces open-book management "the key to our competitive advantage in the marketplace." Others credit it with changing employee attitudes, widi building trust, and even widi reducing stress. Outside observers don't disagree. Chris Lee—managing editor of *Training,* a magazine for corporate-human-resources professionals—visited several open-book companies last year and came away dazzled. Open-book management, she wrote admiringly, is "some sort of lightning in a bottle."

Granted, we've heard big claims before, especially from the TQMers and the reengineers and all diose other mavens of modem management. But the practitioners of open-book management argue—convincingly, I have to say— that they have something the other approaches don't. Open-book management not only gees people to act differently but gees them to *think* differently. It changes—fundamentally—the link between the employee and the company. Yet you don't have to rip up your whole organizational chart and send everyone to some faraway training institute just to get started.

Anodier diing: open-book management comes widi a built-in self-regulator that ought to still the hearts of owners who fear letting go—who worry diat empowered employees will make stupid decisions and send the business south. The most important checks and balances—die numbers—are part of die system. If somebody makes a bad decision, its effects on die bottom line are right up where everybody can see diem—and react accordingly.

There is no standard set of rules for implementing open-book management. But diere are a few basic principles and, by now, a lot of people who have experience putting diose principles to work in companies.

In die next few pages, I'll share some of dieir experiences with you. And I'll sketch out a blueprint for action that might just transform your business, too.

What Is Open-Book Management?

Open-book management is a way of running a company diat gets everyone to focus on helping the business make money. Nothing more, nothing less.

It throws out die old approach to management, in which bosses run the show and employees do what they're told—or what they can get away with. It takes those trendy new management ideas—empowerment, TQM, teams, and so on—and gives them a business logic. In an open-book company, employees understand *why* they're being called upon to solve problems, cut costs, reduce defects, and give the customer better service. And they have a reason to do so.

If you could tear apart an open-book company and compare it with a conventional business, you'd see three essential differences.

• *Every employee sees—and learns to understand—the company's financials, along with all the other numbers that are critical to tracking the business'! performance.* That's why it's called "open book." The numbers are up on the wall, in the handouts, on the computer network. Training courses and regular meetings teach everybody what they mean. So employees know whether they're making money. They know how much. They know why.

• *Employees leam that, whatever else they do, part of their job is to move those numbers in the right direction.* They may be salespeople or software designers, machine operators or telephone operators, engineers or stock assistants. They are also part of the business and are accountable to one another for their unit's performance.

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• *Employees have a direct stake in the company's success.* If the business is profitable, they get a cut of the action. If it's not, they don't.

In effect, open-book management teaches people to quit thinking of themselves as hired hands (with all that implies) and to start realizing that they are businesspcople (with all *that* implies). Their job security, their chances for advancement, their hopes for the future all depend not on the whims of some boss or department head but on the company's success in the marketplace and each persons contribution to it.

Those are the bare bones. The stories of open-book management flesh things out; they show how the principles are implemented in real situations. Bob Frey told one such tale not long ago in the august *Harvard Business Review.*

Frey and a partner had bought Cin-Made in 1984. The little Cincinnati company was not what you'd call high tech: it made mailing tubes and other cardboard-and-meial containers on antiquated machinery. Nor was it a model of progressive labor relations. The previous owner, seeing profits dwindling to the vanishing point, had told her unionized workforce she couldn't afford the generous contract she had signed two years earlier. The response: Tough luck. No givebacks.

Not that Frey helped much when he took over. He stood around with a stopwatch, timing employees' moves. He once declared that the work looked like something a moron could do. By noon that day, he remembers, all the employees on the shop floor "had heard that I thought they were mentally retarded."

A few months later the contract expired. Frey said he'd have to have hefty wage cuts. The union went out on strike.

Frey and his partner tried to keep the factory going. That caused no end of mirth on the picket line. The obvious joke made the rounds: "Now there really was a moron running the machines." Before long, though, the strikers got scared. When Frey threatened to hire permanent replacements, the union advised its members to return.

So Frey had won the batde—a 12.5% wage cut. But the war was raging as furiously as ever. The disgrunded workers "stuck to their job descriptions like glue," he recalls. They filed grievances at die drop of a hat. Peeved, Frey quit buying dinner for diose working overtime, ending a long tradition. Morale plunged.

At some point, says Frey, he wised up.

The constant skirmishing and bickering were making him miserable. If they didn't stop, his business would be in jeopardy. He began to see that the company really needed the loyalty and cooperation of its employees. He began planning a change.

First he started holding monthly "state of the business" meetings, at which he showed everyone Cin-Made's financials and explained what the numbers meant. Then he instituted a generous profit-sharing program. The adversarial era was over, he said. Thenceforth everyone would get involved in helping the company succeed.

The employees were dubious—wasn't dlis die guy who had cut their pay? Periodically, Frey would ask them how they'd solve one or another problem and they'd shoot back, "That's not my job." He'd lose his temper. "People had to understand that diose were words they weren't allowed to utter."

But slowly—*very* slowly—the face-offs grew less frequent. Employees began paying attention to the numbers Frey kept showing diem. They learned quality-control techniques. They began tracking scrap rates and labor efficiency. Before long, Frey and his employees were spending their meetings discussing year-to-date sales and operating efficiencies and profit projections. An employee committee took over scheduling. People began to solve problems on dieir own.

Half a dozen years after Prey's acquisition ofCin-Made, a new spirit was permeating the place. "I couldn't see how '

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going to protect ourselves and keep our jobs if the company went under," reflects Ocelia 'Williams, a shop steward. "And I couldn't see how the company could work unless we all took our share of responsibility." Responsibility, indeed. Hourly workers now do all of Cin-Made's purchasing and have a voice in every hiring decision. They schedule their own hours, hire and supervise all temporary employees, oversee the company's safety program, and administer its skill-based-pay system. Productivity has more than doubled since Prey bought the company. Profit sharing accounts for about 35% of everyone's compensation. As for Frey, he admits to "having a hell of a lot of fun."Granted, any thousand-dollar-a-day TOM or reengineering consultant can tell similar war stories. But what makes for lasting change? After all, workers in

those famous Hawthorne experiments in the 1920s upped their output when the lighting was turned up—and again when it was turned down. Trouble was the improvements didn't last.

TQM and virtually every other ho new management idea suffer from! common failing. "We've gotten pretty] good at teaching the 'how-to,' " says Mark Miller, an executive with the Chick-fil-A chain of restaurants in Atlanta. "But we forget about the 'want-to.' " TQM often peters out because nobody but the managers really cares about it. Once the first burst of enthusiasm wears off, why bother?

Open-book management, by contrast, teaches the want-to. Instead of telling employees how to cut defects, it asks them to boost profits—and lets them help figure out how. Instead of giving them a reengineered job, it turns them into businesspeople. They experience the challenge—and the sheer fun and excitement—of matching wits with the marketplace, toting up the score, and sharing in the proceeds. As Bob Prey discovered, there's no better motivation.

Open-book management by itself isn't enough to turn a company around. Frey says he still needed a better product strategy and better marketing as well as better people management. No company can succeed without good leaders, adequate financial resources, and the ability to deliver a combination of price and value that appeals to customers.

But open-book management—"lightning in a bottle"—changes the essential logic of how people work together. No longer are those at the top trying to haul everyone else along. Everyone pulls in the same direction—because all can see where they're going.

How to Implement It

There isn't any cookbook-style recipe for open-book management. "It's more a philosophy than a how-to-do-it, step-by-step program," says Ronnie Miller, a plant manager at Pace Industries' Cast-Tech Division, in Monroe City, Mo. Still, if you put all the open-book practitioners into a room and asked them what they do, I think they'd come up with four precepts—four steps you have to take before open-book management can work.

STEP ONE

GET THE INFORMATION OUT THERE

Tell employees not only what they need to know to do their jobs effectively but how the division or the company as a whole is doing.

Every company has some pivotal operational numbers: On-time shipments. Customer returns. Most managers understand that employees have to see and track diose numbers if they're going to affect them. Operational numbers alone, though, won't get anybody to diink like an owner. Employees may keep a wary eye on the charts. But they're likely to feel as much resentment—"Big Brother is watching us"—as motivation. People aren't lab rats; if they don't understand why they're supposed to lower the defect rate or take those calls faster, they soon figure it isn't worth die trouble.

Open-book management is about the why—and in a business, die why is told by die financials. So along with die operational figures, show people die income statement, the cash-flow statement, and die balance sheet.

Will they understand those documents? Not until you explain them, a subject we'll take up later. But numbers alone send a powerful message, even if they don't yet make sense. Everybody is a pan of the company. Everybody sees the same information.

Then too, chances are good that employees will readily understand *some* financial figures—the ones that are most important to your business. • At Commercial Casework, a Fremont,

Calif., furnishings and cabinetry company, the crucial number is variances on each job. So CEO Bill Palmer posts "Job Cost, Over and Under" up on the lunchroom wall. No one needs an M.B.A. to know which direction is good. • At Acumen International, the personnel-assessment company, employees keep a hawkeye on the company's weekly cash. "What hits everybody's gut? How much money we have in the bank," says one manager.

• At Sprint's Government Systems Division—it has operations in Kansas City Mo., and Herndon, Va.—revenues pei employee is one of several critical finan-cial gauges. "It's one way of looking at how well the organization is doing," explains Rick Smith, director of service; for state and major local government Again, no M. B. A. required.

How do you get the information out there? Put up scoreboards. Distribute it at meetings. Or avail yourself—this is the information age—of any number of high-tech methods.

When you walk into the lunchroom at Manco, for example, the first things that catch your eye are the big charts on the wall. The charts tally yesterday's sales, year-to-date revenues and expenses, year-to-date profits, return on operating assets, and a dozen odier key numbers, each compared with figures from the budget and from the previous year.

And at Wednesday-afternoon managers' meetings at Foldcraft, a manufacturer of institutional seating in Kenyon, Minn., every manager reports the week's numbers and projections. Every number

goes into the computer as it's reported, creating an income statement on the spot. "Then our cost accountant takes die disk out and has copies run," explains'company president Chuck May-hew. "In half an hour everybody has a copy. They take it back to their units and review it in their staff meetings."

As noted, this is the information age. Anderson & Associates, an engineering firm in Blacksburg, Va., puts its financials on its computer network. Herman Miller, the big furniture maker based in Zeeland, Mich., distributes videos detailing and explaining the company's numbers. Commercial Casework always has some of its employees out on job

sires. They can't come to meetings, so Bill Palmer's brother Tom calls them on their cellular phones and walks them dirough the company's weekly income statement.

STEP TWO

TEACH THE BASICS OF BUSINESS

It's amazing how little most Americans know about business. Some believe that *revenues* are the same as *profits.* Or that profits are whatever a company has in die bank. Not many employees can tick off the expenses a company must pay. Not many know how little is often left at the bottom line.

Companies pay for that ignorance in at least three ways.

It spawns resentment. "When you're doing well, the question everyone asks is, 'Gee, that money must be stacked up in the basement—we want more of it,' " says Clarke Kawakami of Black Diamond Equipment, a Salt Lake City maker of mountaineering hardware.

It leads to bad decisions. Should we throw out this part or remachine it? Does that customer deserve a refund? Should maintenance check the funny noise in the truck motor or just wait till it breaks? Companies these days expect employees to make those decisions, not to run to a supervisor (who has probably been let go, anyway). But if workers don't understand die financial impact of decisions, how can they make smart ones?

Finally, ignorance takes the fun out of business. Every entrepreneur knows that little secret: business is *fun.* It's a game. You take on the competition. Obstacles and opportunities crop up as frequently as in a video game. Every month or quarter you tally up the results and see how you did. What's more, there's real money at stake. Employees can share in the excitement—and once they do, they'll give your company a kind of turbocharge. But not many people get excited about a process they don't understand.

How do you teach business? Start in a classroom—maybe the way Foldcraft's Mayhew does. He developed a six-hour course in the basics, which he teaches to employees in groups of 30 or 35 at a time.

First Mayhew focuses on employees' personal finances. The class compiles personal "income statements" and "balance sheets." It's an easy way to learn financial language.

Then he creates a fictional chocolate-chip-cookie company, with simplified financials. Like Foldcraft, die company has bills of materials—ingredients—and routings, or the steps in die recipe. The class figures out standard costs and the effect of variances in, say, the price of flour, and compiles income statements and balance sheets for die cookie company.

Mayhew next brings out Foldcraft's actual financials and shows how the company's numbers correspond to the cookie company's simplified ones. At this point he delves into more complex matters, such as inventory costs. He explains the effect of purchasing variances, usage variances, and labor variances.

Finally, he brings it all home. "I go around the room and try to get an understanding of who's in there and what jobs they have. I actually try to talk to them individually in the classroom about what their jobs are and how they see them impacting profitability."

Classroom lessons won't stick, of course, unless they're reinforced every day—on the job.

That's why Web Industries, a West-borough, Mass., converter of roll materials, often asks a frontline employee to explain the income statement at the monthly plant meeting. The designated teacher, usually a machine operator, sits down with someone in accounting a day or two before and, like any teacher, must know the material better than the scu-dents do.

And learning by doing is why Jim Jenkins of Jenkins Diesel Power, a Springfield, Mo., truck dealership, might give homework to his 18 service technicians. One recent exercise went something like this: You've learned how much the company bills for your time. You've learned what costs have to come out of the revenues you bring in. Now calculate how much more the company could earn if you could do in 59 minutes what now takes you 60. (The answer:
$21, 000—"right to the bottom line.")

What reinforces the learning best, of course, is the open-book system itself. When people see important information regularly, they find ways to learn what it says. If part of their income depends on that bottom line (see step four), you can bet they will soon understand which numbers have the biggest impact on it.

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STEP THREE

EMPOWER PEOPLE TO MAKE DECISIONS BASED ON WHAT THEY KNOW

Plenty of companies give lip service to the concept of empowerment, or employee involvement. They want participation! They call meetings! They set up project teams, cross-functional teams, self-managing work teams—so many teams, a wag once remarked, that companies these days could be mistaken for bowling leagues. But since they don't share financial information, not many employees know how their work affects the bottom line.

That's like empowering someone to drive a truck—without giving that person a map or a destination. Open-book management provides both.

Of course, you can't just announce that people are now empowered, any more than the Founding Fathers could just announce that the United States would have a democratic government. You need structures and procedures.

One approach, pioneered by SRC and widely adopted by others, is the so-called huddle system.

Representatives from SRC's departments and divisions meet once every two weeks to report their numbers and their

opinions about die upcoming weeks and months. As at Foldcraft (no coincidence—Foldcrafr modeled itself after SRC), they generate an income statement, a cash-flow statement, and a forecast, which people take back to their own units.

In the units is where the work gets done. Managers help employees address problems. Every unit is accountable for its own numbers—and every man and woman in that unit shares in the accountability. The units report new numbers to the corporate offices each week. If they're on target, fine. If they're off, those same men and women had better have an idea of why, and of how to fix it. A second path to empowerment: turning the company into a collection of smaller but identical companies.

Published Image, a financial-newsletter publisher in Boston, has established teams that founder Eric Gershman calls "little Published Images." Each has its own editor, an director, and salesperson, and a couple of junior staffers. Unlike traditional teams, Published Images act like self-contained businesses. They line up clients and negotiate prices. They take responsibility for producing their clients' newsletters, start to finish. They collect their own accounts receivable and

are learning to keep their own books.

Gershman and other veteran managers oversee the teams, coach and train their members, and set companywide policies on matters such as compensation. But the teams' autonomy encourages members to think like businesspeople rather than like hired hands.

A third option: turning departments into business centers, so that every department becomes a company within a company. The units still have specialized tasks, unlike the teams at Published Image. But they're responsible for satisfying their customers, whether internal or external, and for their finances.

The exemplar of this approach' is Chesapeake Packaging Co.'s Baltimore box plant, which has eight so-called internal companies. The flexographic-printing department is run by a "company" called Bob's Big Boys. Customer service is the province of a "company" called Boxbusters.

Like any business, die internal companies manage their own affairs. They track and measure output and figure out how to improve it. They watch costs. If they need new equipment, they order it—or prepare their own capital-authorization requests for die corporate office. They get involved in the annual planrwide planning-and-budgeting process. The members of a company review one another's performance and take part in hiring and disciplinary decisions. Like businesspeople.

STEP FOUR

MAKE SURE EVERYONE— EVERYONE!— SHARES DIRECTLY IN THE COMPANY'S SUCCESS, AND IN THE RISK OF FAILURE

If you want people to think like owners, they must be rewarded like owners. That isn't a controversial proposition: thousands of companies already have some kind of profit-sharing bonus system or employee stock ownership plan. But most of those plans don't have the motivational effects the management wants, for the simple reason that employees cither don't understand or don't trust them.

Maybe the profit sharing is determined each year after the fact, at the management's discretion. Since employees don't know how the company is doing, any bonus that materializes might as well be pennies from heaven. Or maybe the stock-ownership plan puts a few shares every year into employee accounts. But workers don't know how many they'll get from year to year, they don't know what the shares may be worth in the future, and they don't have a clue how their own work affects that share value. That isn't what you'd call a world-class incentive.

An open-book company is different. Employees know what they're working for when they Start the year. Like businesspeople, they track their progress by watching the numbers. At the end of four quarters, they know if they have been successful—and they know why or why not.

Manco, for example, sets annual targets for net earnings and return on operating assets. If employees hit both targets, the company "makes bonus," meaning that employees collect payouts ranging from 10% to 50% of their total compensation. Want to know the prospects? Check out that lunchroom wall.

A bonus is a reward; it's also a powerful educational tool. So a lot of open-book companies use die bonus to reinforce key business lessons. Engines Plus, a Springfield, Mo., company that buys diesel engines and converts them to stationary power plants, pays bonuses that are pegged both to profit before taxes and to inventory accuracy. The latter is a critical operational number for die company, and CEO Eric Paulsen wants employees to focus on keeping it high. Kacey Fine Furniture paid a bonus in 1993 based on net profits and return on assets. Last year die company included a factor designed to minimize customer returns.

What about stock ownership? Open-book management can work without an equity stake—I've seen it—but it works better when employees own stock in die company.

The reason: business is always a game of trade-offs between the short term and the long. Do we raise everybody's wages and salaries, or do we invest more in expansion? Do we pay a big profit-sharing bonus, or do we hold on to the cash and thus raise our share value? Long-term payoffs, of course, redound primarily to a company's owners.

"Equity is the basis for all long-term thinking," writes Jack Stack, CEO of SRC, in his book, *The Great Game of Business.* "It is the best reason for staying the course, for sacrificing instant gratification and going after the big payoff down the road. If you have equity and understand it, you know why it's important to build for the future. You can make the long-term decisions. You still pay attention to the day-to-day derails, but you're doing it for the right reason:
because it's the best way to achieve *lasting success."*

WHEN YOU BOIL IT ALL DOWN, THE GOAL of open-book management is to create what Chick-fil-A's Mark Miller calls "a business of businesspeople."

Most U. S. companies are companies of hired hands. Hired hands aren't just hourly workers. The category includes all employees, whatever their jobs, who assume that it's somebody else's concern whether their company succeeds in the marketplace.

Hired hands do as they're told. Businesspeople figure out what needs to be done and do that.

Hired hands don't bear full responsibility for their actions. Businesspeople do. They know they're accountable to the marketplace and to one another.

Hired hands aren't expected to see or understand the big picture. Businesspeople know they have to.

It's really pretty amazing when you stop to think about it. American employees live in a democracy. They're free, independent, responsible citizens. They raise families, manage their finances, and elect the people who govern them. Yet they go to work at companies at which the assumption is that they can't understand the big picture, can't take responsibility for making money, and probably can't do much at all other than what die boss tells diem to do.

It's also amazing how many hoops some companies jump through to get their employees to stop thinking like hired hands. They preach ownership and responsibility. They teach quality and teamwork and empowerment. They really try.

The new open-book companies do much more, though: they teach *business.* They provide employees with die tools they need to be businesspeople.

These are die companies that will succeed in the brutally competitive marketplace of today—and tomorrow. •

OPEN BOOK, ATTACHMENTS

SCENES FROM AN OPEN-BOOK WORLD

Who Do You Think You're Talking To?

You can't judge businesspeople **by ihe** color of their collars. Like everyone new to open-book management. **Bill** Fotsch had to learn that lesson.

Fotsch is now a business adviser working with Jack Stack of Springfield Remanufacturing Corp., but not so long ago he was vice-president for business development at Case Corp., the big farm-machinery company. One day he flew down to visit SRC, which his boss had described to him as a "small but innovative supplier."

Fotsch had heard that SRC employees knew the business inside and out, but he was skeptical. When he came across a guy who was polishing crankshaft journals, Fotsch figured he would ask him a crucial question.

"Good morning," said Fotsch "My name is Bill Fotsch. I understand that most SRC employees really understand their business I'm curious—What is the price of that crankshaft you're working on?" ^

At Case, thought Fotsch, such a question would probably provoke a grievance for trying to embarrass a " union worker He figured he'd get no . answer and that he'd probably wind up explaining the difference between price and cost.

The guy looked up. "List price or dealer net?" he inquired.

Then he went on to explain both prices, how they compared with SRC's cost, and what his own component of the cost was.

"At that moment," says Fotsch, "I became a convert."

SCENES FROM AN OPEN-BOOK WORLD

Worry About Profits? I'm in Sales, for Pete's Sake

Salespeople who understand the *cost of* what they sell? Nah—pinch me. But Charlie MacMillan swears it's true.

MacMillan is the controller of Manco, a fast-growing distributor of tape and other consumer products based near Cleveland. Manco sells to • Wal-Mart and a dozen other big customers. In the past its salespeople—like salespeople everywhere—competed for top-line revenues. Profitability? That was somebody else's worry.

Then Manco began producing and distributing monthly account books that broke the company's numbers down by every conceivable category—including profits generated by each salesperson's accounts. Meanwhile, the sales-compensation system was rejig-gered to take profitability into account. Surprise! Suddenly, the salespeople were thinking of ways to improve the bottom line as well as the top.

"Now the sales guys ask me things like why their freight expense is up," says MacMillan. "And it's like, 'Well, let's take a look at your freight bill. Hey—you're shipping minimum-poundage loads to the West Coast! It's going to cost more money than if you're shipping a whole truckload or if you're just shipping it to the Midwest.' So they say, 'Oh—we've gotta get more on the order.'" In one year, the West Coast salesman cut his freight bill by 14%.

To Tom Corbo, Manco's president, sharing that information is a no-brainer. "People make better decisions once they know what they're being charged for."

Ending the Hundred Year's War

Employees and managers have dwelled in separate camps since the dawn of the Industrial Revolution. Sometimes the schism between the two shows up as hostility—in union disputes, For instance Mostly, it's [just a matter of the different assumptions people bring to work every day A manager's job is to run things. An employee's **is** to do as he or she is told.

Maybe you could trace those assumptions back to the era of feudal lords and serfs But they were crystallized in the early years of large scale industry, a century or so ago The engineers of the day found they could boost output by bringing in new machinery and breaking production down into ever simpler tasks That **was** fine with plant managers, who had to cope with what by modem standards were astronomical quitting rates (One year Ford's Highland Park plant had to hire 54, 000 to maintain a workforce of 13, 000) The simpler the tasks, the quicker a new hire could get up to speed. •

An engineer named Frederick W. Tay-lor turned the trend toward specialization into a national movement dubbed scientific management. He and his followers scrutinized every worker's every motion, calculating time and output with a stopwatch. They set up central planning departments to standardize production methods, job descriptions, and pay rates. Workers were to do exactly as they were instructed. Managers were responsible for decision making and supervision. Over time, the two groups came to occupy separate worlds They hod different jobs, wore different clothing, kept different hours They were paid by different methods, hourly wages versus salaries Often, they ate in different cafeterias

When employees formed unions, not surprisingly, they wanted nothing to do with management They wanted more money and shorter hours They wanted formal job classifications, so they wouldn't be at the mercy of abusive foremen Running the business[2] Someone **else's** problem "The products to be manufactured, the location of plants, the schedules of production, the methods, processes, and means of manufacturing are solely and exclusively the responsibility of the corporation," read a typical contract between the United Auto Workers and General Motors Corp.

For nearly 15 years companies have been nearing from the gurus of management reform that they must break down that split—they must get employees involved in solving problems, making decisions, taking responsibility for their work.

First come *In Search of Excellence,* in 1982, a book that taught a startled publishing industry just how eager business-people were for new management ideas Tom Peters and Robert Waterman offered all sorts of good advice in the book, but they emphasized the need to redefine how people worked together Treat people as „ partners," they preached Treat them with dignity; treat them with respect."

Next came the quality movement, culminating in what's now known as total quality management. TOM might have been just a technical fix—new techniques and procedures, implemented by specialist But most of the gurus seemed to understand that quality systems don't work -„ unless frontline employees get involved "It Isn't enough to design a whiz bang assembly operation," wrote Philip **Crosby** in *Qualify Is Free* "You have to help people want to participate in running it." ^

The third great wave of management reform in recent years is reengineering— and the reengineers, too, argue for a redefinition of work. "At the points in a process where workers used to have to go up the managerial hierarchy for an answer, they [must] now make their own decisions," explain Michael Hammer and James Champy in *Reengineering the Corporation,* another runaway best-seller.

Change has been in the air, in other words, for more than o decade, and businesses have begun reshaping themselves accordingly. But how successful have they been[2] Sometimes quality programs and the like have helped transform companies Often they have bumped into business obstacles or just sort of petered out Meanwhile, some experts argue that oil we've really been doing is tinkering with Taylorism. We haven't yet abolished that fundamental split between the people who think about whether the company is making money and the people who think about picking up this week's pay check

Open-book management, say its practitioners, provides the missing element: it -gets people to think about the business as their business, and thereby turns Tay-lorism on its ear By that reckoning, it's -truly a revolution—but a revolution with a century of history to overcome.

SCENES FROM AN OPEN-BOOK WORLD

Before I Start, OK If I Check Out Those Financials?

Charlotte Eckley got open-book fever and proceeded to infect a company halfway across the country.

Eckley's first job was in customer service at Springfield Remanufactur-ing Corp., where she learned SRC's system of open-book management. Then her husband was commissioned into active duty with the marines, and the couple moved to North Carolina. There, she was offered a job with a small aftermarket-parts company.

Great, she said. But first, would you mind if I looked over your financials?

The owner burst out laughing. Sorry, he said, we don't let *anybody* see our financials.

Pity, thought Eckley, who was all of 24. Without seeing them, she wouldn't know what shape the company was in or have any idea how to help it do belter. But jobs are scarce for military wives, so she took this one anyway.

Once on the payroll as a marketing and new-accounts manager, she found she had more latitude than she'd expected. So she put together an incentive package for her 13 employees:

sales targets, gross-margin targets, modest rewards if they hit them. The owner OK'd it—at least it didn't reveal his bottom line. Then Eckley prepared a daily scorecard to show everybody how the company was doing.

So maybe it wasn't completely open-book management. Still, two years after her arrival, Eckley's charges had increased sales 35%, held margins steady, and earned themselves some nice rewards.

What are you afraid of?

Great Fear Number One *of* open-book management is simple: you're terrified of letting go. The day employees see the financials and start making decisions, you figure, is the day catastrophe strikes.
OK—read the main article and see if you still think that. In the meantime, let's take up Great Fear Number Two, which is that the numbers themselves will somehow be used against you.
But whom, exactly, are you afraid of?
Your *employees,* maybe. In companies in which labor hates management's guts, yes, a union might take advantage of the figures. The whole point of open-book management is to get beyond that enmity.
If you run a closely held company, you may be worried about something else, which is that employees will figure out how much you take home. If the number is large, you'll feel awkward and defensive—and that it's none of their business.
Hate to tell you this: it's already their business.
They talk about you. They speculate— probably inaccurately—about how much you're making. Says Mike Chiles, co-owner of Heatway, a heating-systems manufacturer, "If they don't know what's going on and they see a $50, 000 shipment go out, they think, 'Golly, Mike and Dan Chiles are making a lot of money out Of, this'—not realizing that at the end of the year there might be 3% left after faxes."
But what about the logic of earning a fair—even large—return on the investment and the risk you or your family took in setting up the company? If you don't think you can explain that logic, you're ?'; doing your employees an injustice. Americans believe that risk takers are entitled to a reward. They believe company presidents should earn more—a lot more— than receptionists and machine tenders.. Listen to Jim Sandstrom, former owner of Sandstrom Products, who says he has no trouble explaining a healthy profit: "There's money invested here! The investor has a right to a return. If the net return gets so low he can take the money and go buy T-bills at 7% with no risk, what is he entitled to get here, with risk?
"I'm willing to debate that with anybody, including the employees. The/re not a bunch of fools. So we share the financials. Yes, ifs an ongoing learning process. But they learn, and they learn fast."
Or maybe it's your customers you're afraid of. If they find out your margins, they'll beat you down on price. And maybe you're right. On the other hand, you're presumably delivering value at a price they're prepared to pay; other- ' wise they wouldn't be your customers And presumably, they have an interest in keeping their vendors healthy Manco, a distributor of tape and other consumer products, keeps books that track its costs customer by customer—and actually shows the figures to customers so each can See exactly what Manco makes on its business. Ifs a competitive advantage, explains president Tom Corbo—customers can see they aren't paying for somebody else's freight.
Finally, maybe your biggest fear has to do with *competitors. On* this score, ifs OK to be a little paranoid. Many companies have a few numbers they don't want competitors to know. If employees see those numbers, you must explain why they need to be kept confidential—and how badly you'll all be hurt if they leak out.
But don't be naTve enough to think that everything needs to be stamped *classified,* either. How many secrets do you really have? Your competitors are in the same business. They know your technology and your costs. They watch what you're doing with prices. So ihey probably know your key numbers anyway. Here's what Leslie Fish-bein, president of Kacey Fine Furniture, has to say:
"In furniture retailing, all you do is take your number of salespeople, multiply that number by the published— and generally accepted—averages of what a retail furniture salesperson sells every month, and you can tell the volume of almost any store in the country.*
Mostly, though, open-book managers don't worry about competitors; they figure competitors will be too busy worrying about them. Says Patrick Kelly, CEO of:;

Physician Sales & Service, which posts. sales and profit figures inside every facility: "I *want* the competition to know. we're eating their lunch."

SCENES FROM AN OPEN-BOOK WORLD

And You Think You Have a Suggestion Program...

If's easier to get workers to "think like owners" when they are owners—and when they understand the business, thanks to open-book management.

Phelps County Bank, in Rolla, Mo., is owned by its employees through an employee stock ownership plan. Not long ago CEO Emma Lou Brent set up The ESOP Challenge"—a monthly contest for the best suggestion. Just another suggestion system, you might think, except that Phelps County's employees are versed in the financials and hence see things a little differently.

An eager loan assistant in a regular bank, for example, might suggest the bank offer electronic tax filing. Good idea, right? Peggy Laun at Phelps County thought it might be— until she analyzed costs and revenues. Her recommendation: not yet.

And an earnest customer-service representative might propose a marketing program aimed at senior citizens. Surely *that's a* good suggestion.

Well, yes. Except that before Patti Douglas dropped her senior-citizen suggestion in the box, she spent nearly *two years* doing research. She dug up demographic statistics. She checked what every other financial institution in the area offered seniors. She tracked the bank's experience with its existing elderly customers. She costed out her proposal.

Today Douglas's program has 325 customers over age 55, who belong to a club that gives them a special bank account and a variety of social activities. "It's a big success," says Brent.

How to get started

So you think there might be something to thFs open book stuff[3] Here's what some companies advise to get the boll rolling Announce the end of annual raises

"OK, ladies and gentlemen, this company will pay no more across the board raises, even *tor* cost of living Starting now" Statements like that have a way of getting peoples attention

Unless you want a wholesale rebellion on your hands, of course, you II have to offer something in return In place of an nual raises, president Bob Frey of Cm Made set up a generous bonus tied to profit sharing Eric Gershman, CEO of Published Image instituted a bonus tied to team performance (See main story)

Joe Jenkins, co owner of Jenkins Diesel Power, added a couple of steps of his own First he asked each of the 10 employees in his parts department to come up with 15 suggestions about how they'd improve the department and the company In return, he gave them $50 apiece Next he asked them to rank the suggestions Together, they boiled the list down to the most important ones—such as frequent checks of physical inventory to make sure the computerized records were accurate "An $8, 000 overhaul can be held up for lack of a $17 part," Jen kins explains.

Then he posted a target number the revenues the department had to bring in , to cover its expenses There would be no raises, he announced. But 25% of any revenues over the target would be divided up among the department's employees

Talk about teaching employees to be businesspeople: the next year, the parts department had a 65% profit increase And its employees made about $1 an hour more than they would have made with a raise.

Quit solving people's problems for them. That was the strategy of Rick Hart-sock, who recently bought Sandstrom Products, a specialty-coatings manufacturer (See "Before and After," page 44). Hartsock remembers a worker coming to him and telling him that the company's pay system stank. Hartsock said. Gee, he thought his pay was pretty good So it wasn't really his problem Whose problem did the guy think it should be?

The guy was silent "He said, 'I don't know I don't know what you're getting at It's certainly not my problem,' " recalls Hartsock Hartsock asked the guy if anybody else felt the way he did A lot of people did, the worker told him

Good, said Hartsock. "You get those people and form a pay-plan committee " He added that he would approve any reasonable plan that the committee came up with. The complainer actually stopped complaining and got to work He and a few others spent seven months coming up with a new, customized pay-for-knowledge system—which Hartsock promptly implemented It allows people to work up from $10 an hour to $15 by learning new skills.

Hartsock believes that experience helped prepare his employees for the responsibilities of open-book management. Today if they want a new machine, the/re expected to prepare a cost justification. And when the company began a profit-sharing program, an employee committee devised a plan for divvying up the pool

Play a business game. Like most professional-service firms. Smith & Co Engineers makes its money on the billable liable hour But in 1993 its billable hours were low Smith & Co was barely breaking even

So the company's president, Samuel Smith, set up a game First he asked each professional how many hours he or she
wanted to shoot for in a month He toted up the responses, multiplied the sums by people's billing rates, and came up with a goal so many dollars of revenues for each engineer, so many for the company as a whole Hit the goal, he said, and we'll pay a bonus

In the first month—it was December— the firm played for $100 a head Everyone saw the weekly chart of hours billed, so all the employees knew where they stood Presto billable hours suddenly rose, up to and even beyond what people had said they would do The company made money. People got their C-notes In January 1994, Smith upped the ante" now the bonus would be 5% of salary. In the first six months of the year, that worked so well—the firm made so much money—that he raised the payoff to 10%. The company hit its profit goal for the whole year in November.

For More Information

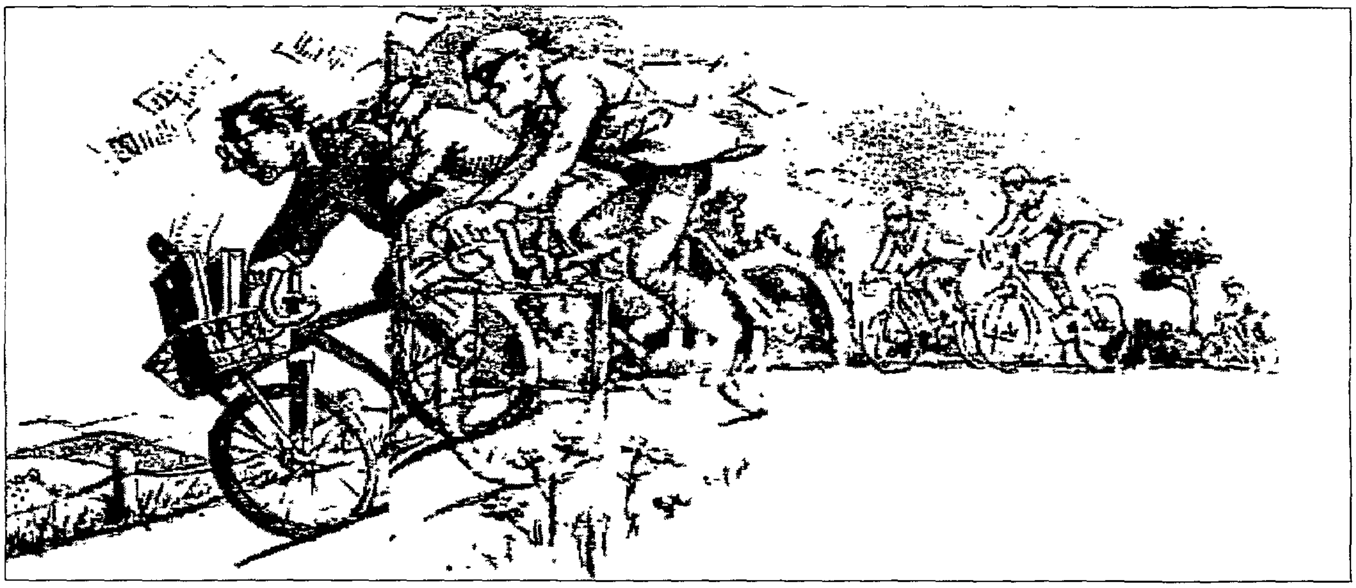
Books on Open-Book Management

Open-Book Management: The Coming Business Revolution, by John Case, HarperBusiness, 1995. Available at bookstores, or from the publisher at 800-331-3761 (hardcover; $22 plus shipping, quantity discounts available).

The *Great Game of Business,* by Jack Stack, with Bo Burlingham, Doubleday/Currency, 1992. Available at bookstores, or from SRC at 800-386-2752 (paperback; $15 plus shipping, quantity discounts available).

For an up-to-date listing of other resources—videos, newsletters, business-training games, and so on— please fax your request to *Inc.* at 617-248-8090, attention: Open-Book Management.

How one executive put his imagination to work to combat complacency.



Why I Race Against Phantom Competitors

by Peter T. Johnson[1]

Complacency is a problem in any organization. But it's especially problematic when you don't have competitors breathing down your neck to discipline your decisions and keep you alert. I know because I've faced that problem twice in my career.

The first time, I was the CEO of This Joist Corporation, a manufacturer of structural components for residential, commercial, and industrial buildings. Our proprietary products dominated their markets, sales were rising nicely, and it would have been the easiest thing in the world to settle back and devote our energies to protecting our advantage. Instead, we geared up and went after a new $500 million market, which required us to rethink just about every aspect of our operation from R&D to distribution. What made this effort possible was an undertaking that sounds more like a kid's game than a management technique: we *imagined* we had a phantom competitor challenging our every move.

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[1] From *1981 to 1986, Peter T. Johnson was administrator of the Bonneville Power Administration. Before that, he spent ten years at* This Joist *Corporation of Boise, Idaho, where he was president and then CEO. Currently, while on sabbatical, he serves on the board of directors of the Standard Insurance Company and writes a regular column for the* Idaho Statesman.

Topflight runners often train by conjuring up an invisible competitor at their heels every step of the way. At Trus Joist, since we had no identifiable competitor to focus on, my senior executives and I did the same thing to fend off complacency. Then when I was named administrator of the Bonneville Power Administration, a $2 billion legal monopoly, I found the technique just as effective in the public sector. The problems at BPA were a lot more serious, however, and complacent thinking was a lot more deeply entrenched.

When I arrived in Portland, Oregon in May 1981 to take up my appointment as administrator of BPA, the agency had a reputation as a fine, stable, professional organization. In fact, it was on the verge of disaster because of the enormous amounts of financial anil institutional capital it had invested in nuclear power plants. But that wasn't apparent to anyone there. Nor was it immediately apparent to me. What I saw-anil was troubled by-was the deep-seated complacency of BPA's staff, who believed that the agency's past sue - cesses could easily be repeated, and that an organization so big couldn't possibly fail.

That kind of thinking wouldn't have been justified even if BPA's operations involved nothing more than they always had-the sale of power generated from the federal dams on the Columbia River and its tributaries to more than 120 public and private utilities in Washington, Oregon, Idaho, and Montana. But hydro-power was not the only source of electricity to be marketed by BPA.

In the early 1970s, the agency had agreed to purchase the output of three of the five nuclear power plants to be built and owned by the Washington Public Power Supply System. BPA had also guaranteed payment of the indebtedness of the first three plants, Washington Nuclear Projects 1, 2, and 3. By 1982, construction costs for these plants had ballooned from an original estimate of $3 billion to a projected $14 billion. The annual debt service costs on our existing obligations had also skyrocketed to more than $700 million. These costs, combined with a weak economy in the Northwest, had put the agency shamefully in arrears on its amortization and interest payments to the U. S. Treasury for $8 billion it had borrowed years before to construct the Columbia River Power System.

Events outside BPA were sending strong signals that complacency was dangerous. By far the most dramatic was Washington Public Power's decision in 1981 to halt construction of WNP 4 and 5 (the two nuclear plants BPA hadn't guaranteed) because it could no longer obtain financing for them. That decision, as most people doubtless remember, turned WPPSS into WHOOPS (as it was called in financial circles) and led to the largest commercial bond default in U. S. history, after a sympathetic Washington State Supreme Court ruled that the contracts under-girding the plants' bonds were unenforceable.

Like a runner in training, we imagined a competitor at our heels every step of the way

BPA wasn't directly involved (since we weren't participating in the financing), but we were deeply affected: soon after, Wall Street stopped providing any more conventional financing for WNP 1, 2, and 3.At the same time, our customers were expressing their unhappiness with our rates more and more vocally. BPA's rates were among the lowest in the nation, and they had not risen much during the agency's first 40 years. But they shot up during the late 1970s and early 1980s under the combined pressures of inflation and the huge costs of WPPSS's nuclear projects. In response, angry ratepayers formed protest groups and vigorously resisted further increases.

To make matters worse, there were signs that the assumptions that had gotten the region into such an ambitious nuclear construction program were no longer valid. The ever-mounting demand for electricity that local utilities had forecast during the 1970s was failing to materialize. On the contrary, it appeared that BPA and the whole Northwest region might face a large energy surplus and not the dire shortage that had been predicted. Nevertheless, Bonneville and the other regional utilities continued to pursue these enormous nuclear construction programs as though nothing had changed. Managements felt locked into commitments they had made -even if that meant driving their organizations to the brink of insolvency.

My first reaction to all this was acute anxiety because I knew that complacent organizations were setups for forced change. And I doubted that things were any different in the public sector. So I decided to try the planning technique that had worked for me at This Joist-the creation of a phantom competitor.

You can't spend 25 years in business without becoming aware of the role competition plays in stimulating improvements in an organization's products and services. In many cases, however, natural market pressures either don't exist or are too weak to spur innovation. That was our situation at 'This Joist in the early 1970s.

Back then, the fledgling company manufactured and marketed roof and floor structural systems throughout the United States and Canada. We sold our customized products to architects through a 120-

person direct sales force. And thanks to the genius of our inventor-cofounder, Art Troutner, we had products no other company could match. Naturally, we were pretty proud of what we had accomplished. Too proud, I feared, because we were also beginning to show the telltale signs of self-satisfaction. That's why I began to experiment with the concept of a phantom competitor.

At our long-range planning session in 1974, 1 invited my managers to engage in some constructive imagery. I asked them to imagine that we were in a road race with all the other companies that made steel and wood trusses and beams, and that we had only a short lead over our nearest competitor. I told them our edge was equivalent to the distance between two. curves on a climbing mountain road and each curve represented a breakthrough or advantage. We would have to gear down to negotiate those turns successfully. And we would have to make sure that we were always at least one turn ahead of our hungry competitors. Otherwise, we'd be run right off the road.

At first the response was pretty unenthusiastic. I could see that people were having trouble taking my suggestion seriously. But then they added details to my description, and before long we could feel our phantom competitor crowding us from behind. It had the same resources we did-right down to an in-house genius just as smart as ours. And the curves that lay ahead were becoming clearly marked

At Trus Joist, we would hove overlooked the new market- but our aggressive competitor forced us to confront it.

with a host of potential improvements we'd never thought about seriously before. The way we realized one of them - a state-of-the-art, all-wood alternative to the traditional 2x10 for residential construction - will give you an idea of how the phantom competitor worked.

At the time, Trus Joist's lead was built on four unique structural products including the TJI series of floor joists-wooden I-beams, in depths ranging from 12 to 24 inches, used in commercial and multifamily construction. A potential $500 million market in residential structures teased us. But it wasn't a market we had considered going after because nothing about it fit "the way we do things around here." We were a specialty producer; 2xl0s were a commodity item. We had a large sales force that dealt directly with architects; 2xl0s were sold through lumber yards to general contractors. These explanations (and all the others we had always given ourselves) sounded eminently reasonable *until* we envisioned an aggressive competitor a lot less set in its ways. Then they began to sound pretty lame.

It didn't take long for us to conclude that any competitor worth its salt would try to penetrate this market with a better product. We decided to get there first. By the end of the planning session, we had accepted the challenge of adapting our technology to this new application. We had also allocated the resources we thought the effort would require.

From one perspective, everything we did thereafter was unremarkable. We talked at length with both potential customers (lumber yards, contractors, and framers) and potential constituents (building inspectors and fire code officials) to determine this market's needs. We analyzed and tested everything from materials and manufacturing processes to marketing methods and prices. And we anticipated - and lived through - the organizational unrest that almost always accompanies momentous change (like the decision to mass-market the new product through established lumber dealers instead of working through our sales force).

But the impetus to carry through on all this "best practice," to ask the "what ifs" and "why nots" that good strategic thinking requires, came from the pressure generated by our phantom competitor. That happened in two ways.

First, our phantom competitor made the specter of a real competitor very compelling. If we could see the potential in this market, so could other people-people we might never know enough to worry about until it was too i late. We had, after all, blindsided some successful companies when our TJI series appeared. And it suddenly became very clear that we would have to bring the best possible product to market quickly if we didn't want to be blind-sided ourselves.

Second, our phantom competitor gave us a very practical yardstick for making choices and testing conclusions. I call it "best value," but that's simply my name for ideas that are just as basic to good business practice as competition itself.

In my experience, companies succeed because they routinely offer products and services that meet their customers' needs better than those of any other organization, real or imaginary. That means their managers do two things very well. They manage and allocate resources *efficiently* to give their customers the greatest value at the lowest cost. And they stay in close touch with their customers and constituents in order to respond *effectively* to their perceptions and needs. Making trade-offs between efficiency and effectiveness is obviously a large part of any executive's job. But unless both criteria are part of the decision-making process, the choices made will be inferior in the long run.

To illustrate the way this concept worked in our decision making, here's how the new TJI floor joist reflected those criteria. Efficiency was straightforward: our new floor joist was optimally engineered, 9 1/2 inches high, easy to install, readily cut in any length to meet the customer's needs, and competitively priced. Effectiveness took more imagination because it drove us to think about constituents other than our customers. Sometimes that meant groups that influenced our customers indirectly, like mortgage bankers, who appreciate solid, quiet floors because they help keep a home's resale value high. But it also meant thinking about the secondary impact of our product, for example, its environmental effect.

"I mean it, young lady. Until you see fit to clean this room, your allowance will be held in escrow!"

The design we finally chose for our substitute for a 2x10 used 50% less wood fiber to do the same amount of structural work as traditional floor joists. It also allowed us to raise the yield of the forests we cut from because it incorporated an innovative manufacturing process enabling us to use wood veneer and smaller logs. The societal benefits of these changes were evident. But the changes were also good for company morale and good for business, since they gave us a marked advantage in our promotional efforts.

"he introduction of the phantom competitor to Bonneville took some doing-but not nearly as much as I had feared when I heard how the agency's managers were defining their mission and directing their efforts. My question, "What market needs do electric utilities serve?" was answered mostly with puzzled expressions. There was much talk about protecting ratepayers but little discussion of how. Indeed, "protecting the ratepayers" had become an excuse for some very questionable decisions.

For example, reliable service and adequate supply are basic to prudent utility management. But I found that these considerations *always* outweighed the cost of power in the staff's decision making. Incredible as it may seem, most utility executives believed that price had no effect on demand for electricity. Secure in their ability to pass on horrendous costs without restraint, they brushed aside simple economic truths. Their huge thermal projects had made these executives captive.

Moreover, though everyone worked hard, there was no coherence or common focus to the agency's efforts. It had been years since BPA had engaged in any comprehensive businesswide planning, and it showed. We urgently needed to agree on a new direction for the agency and on an agenda for coming to grips with our compounding problems. Our first strategic planning session held in September, four months after my arrival, gave us a start on both.

One of the first things we discussed was the value of competition-and the value of phantom competitors. Since BPA was both a public agency and a legal monopoly, we had trouble coming up with any real-life organization that we could envision as a likely threat. Much more appropriate was the idea of a shadow staff that possessed the same authority and controlled the same resources we did. We could easily imagine members of this staff sitting at our side, evaluating our choices and challenging our decisions. And we knew they would be eager to take away our jobs if we failed to make the best use of our resources.

At BPA, a shadow staff threatened to take away our jobs if we didn't make the right decisions.

That may sound like an idle threat, given the way any large bureaucracy (not just the government) works. But if BPA hadn't begun to change in response to its problems, it would have been changed by Congress, with consequences that were likely to be almost as unpalatable for staff members as the loss of their jobs. Something like that had already happened in 1980, when the Northwest Power Act set up a four-state council to oversee the agency's decisions in response to public concern about WPPSS. And it was clear to me that wider reaching "reforms" would follow if we didn't take the initiative.

So at that first planning meeting, I urged my managers to look at every decision as though it were a bid opening where they either won or lost the privilege to continue. I encouraged them to look outside the utility industry to find other organizations that had achieved superior results. (We weren't about to become a private marketer, to be sure. But there was no reason we couldn't learn from other companies' experience.) And I told staff members that whenever they presented a program or policy, they would have to be prepared to explain how their phantom counterparts would assess its merits and risks.

Before long, people knew they had to go through this exercise for all presentations. If they didn't, one of my colleagues or I would play the part and grill them rigorously. That sounds unpleasant, I know. But in fact it wasn't, because these were all bright people who enjoyed having a chance to show the quality of their thinking to me and to their peers. Moreover, it was thinking to good effect, as our new approach to forecasting shows.

At our planning session we set two strategic priorities: reestablishing BPA's fiscal integrity and harnessing WPPSS. An accurate forecast of the region's power needs was critical for both. But for years the Pacific Northwest utility community (including BPA) had relied on a regional forecast that simply added the individual forecasts of many utilities together. The results of this sum-of-the-players methodology were obviously questionable. But there had been no incentive for BPA to change, even though this forecast drove important agency decisions ranging from capital expenditures to rate setting.

Now, however, confident that our shadow competitors would understand the importance of an accurate forecast, we undertook our own comprehensive survey, beginning with a detailed end-use analysis of loads. For the first time, BPA seriously studied price elasticity and calculated the correlation between price and demand for each customer group. We also eliminated the duplications that had crept in over the years, as every utility assumed that it would get the next big load.

Our forecast, completed in early 1982, showed load growth lower than had been projected-so much lower that for many years there would be no need for the power from two of the BPA-backed WPPSS nuclear power plants under construction. This was an unsettling revelation, and a timely one. For shortly thereafter, WPPSS announced that it would need $1.5 billion more in April to maintain its fast-track construction schedules for the three plants.

With more than 90 cents of every revenue dollar prespent on fixed expenses, BPA was already excessively leveraged. Interest rates, driven by inflation, were near their peaks. And the WPPSS bonds we had guaranteed had been forced to pay premium rates of up to 15%, even though they were AAA rated and tax-exempt. Nevertheless, public and private utilities with interests in the projects were urging BPA and WPPSS to proceed. And our investment bankers seemed willing to go to the market, despite some apprehension about the size of the financing A new BPAwas emerging, however, bent on providing the best possible value to its markets and constituents. I didn't need any nudging from my shadow administrator to begin a careful evaluation of WPPSS's capability to construct the plants. Nor to face up to what we found, wracked by cost overruns, fines, and labor strife, WPPSS would be hard-pressed to finish all three plants. It would be much wiser, we believed, to build one plant at a time, or at most two.

Where keen creative competition exists, you can trust that products and services will mesh reasonably well with market needs over time But where that stimulus is missing, as it was at BPA, there's obviously no such assurance So the task of defining customers' needs and constituents' expectations is absolutely essential. It's also much more complex.

Important changes had occurred in BPA's environment during the late 1970s Not only had social and economic forces redefined the region's energy needs but a new and unheralded option was also emerging in the marketplace efficiency in the use of electricity. In fact, efficiency purchased in the form of conservation was rivaling generation in meeting some utilities' loads) Pressed by our imaginary counter parts, we began to pay attention to these changes and to how people felt about them

We had already developed a comprehensive data base and analytical framework that allowed us to study alternative power sources (including conservation) ranked for cost effectiveness Now we listened to consumers and to constituents including Congress the Northwest governors, environmentalists, business executives and labor officials We also initiated surveys, analyses, and field trips that took us outside our own four walls

For example several of BPA's top managers and I began to attend public meetings where ratepayers voiced their criticism and frustration On one occasion, I sat through an entire day of hearings attended by hundreds of small business owners and home owners, many on fixed incomes Angry and frightened, they explained in detail how they had been ravaged by BPA's skyrocketing rates

We also began to pay close attention to our biggest industrial customers, seven large, energy intensive aluminum plants that represented 30% of the agency's load These companies had been complaining loudly about rates and threatening to abandon their facilities if rates didn't stabilize But we had no information that would have let us assess their statements. How did rising rates affect their business' How would a

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competitor, similarly situated, define their needs and serve these loads[7]

To answer these questions, we needed to make our own independent analysis. As soon as we had, we realized that the companies' managers weren't bluffing. BPA was in real danger of losing these loads. We had to stop the rates from rising and make them predictable again.

Decision time was fast approaching. I directed my staff to take these findings, analyze WPPSS's request for more funding, and come up with a recommendation. From the ratepayers' perspective the best choice was clear: turn WPPSS down to start controlling costs. But we couldn't be confident that this was the best decision until we assessed its effectiveness as public policy Staff members analyzed the impact of our alternatives on construction and industrial employment, on the region's tax bases, and on the environment.

Our imaginary counterpart pushed us to acknowledge the end of BPAs nuclear obsession.

Whatever the outcome, the days when BPA was obsessed with completing three nuclear plants were long gone.

In early April, after talking with other utilities, important customers, and government officials, I announced my tentative decision to halt construction of WNP 1, then 60% complete with more than $ 1 billion in sunk costs The events that followed proved that BPA's staff had planned well and had chosen a strategy that could take the heat of competition

We scheduled two public meetings to explain our findings and hear comments At the first meeting, held in Hanford, Washington, the site of WNP 1, more than 6, 000 construction workers marched to protest the proposed shutdown. We needed a police escort to get us safely to the meeting. And later that day, I was burned in effigy downtown and invited to come and pick up my ashes.

On April 28, the second meeting took place in Seattle, accompanied by more vitriolic protests. Nevertheless, at a formal WPPSS board meeting that afternoon, I followed through on my staff's recommendation and disapproved the budget for WNP I. Some months earlier, BPA's general counsel had described this course of action as "a weapon too heavy to wield." At the tune, he may have been right. But in context, there was no choice: our strategic goals and best-value thinking pointed clearly to the decision to mothball WNP 1. Moreover, if I were seen as talking a competitive game but acting otherwise, the whole exercise would have become a sham. As it was, my action helped to internalize and institutionalize a competitive mindset among BPA's staff.

Mothballing WNP 1 was only the first of many steps necessary to restore BPA's fiscal health and contain its threatening nuclear program. But stimulated by the artificial competition we had created, and guided by the logic of best value, we moved ahead with the same intensity to improve our forecasting and resource planning.

In 1983, after further hard analysis - and much less opposition—we mothballed WNP 3 (then 65% complete). With two plants on hold and its organization and costs once again under control, the WPPSS staff could devote its attention to the nearly completed WNP 2. BPA supplied direct revenue financing (since debt financing was no longer available), and WPPSS solved the project's technical and regulatory problems and brought it into operation.

By 1984, BPA was regaining financial strength. The agency was current in its payments to the U. S. Treasury,

and rates had stabilized. Equally important, the outlook of its professional staff had brightened considerably; the staff felt invested in BPA's mission, and people had a much clearer understanding of what they were doing and why. They also stopped believing that they couldn't compete with their peers in the private sector. As one of my key managers commented to me after our third annual strategic planning session, "The phantom competitor made each of us remember all the times we'd competed as individuals and won."

The successes we achieved at This Joist and BPA were the work of motivated people who used imagination and intelligence to overcome complacency. Imagination to visualize a keen competitor pushing them at every moment to better their efforts. Intelligence to keep asking - and answering - three simple questions: What needs are we trying to serve? What are the best alternatives for serving those needs efficiently and effectively? What objective tests can help us make sure we're on the right track?

Success in the knowledge economy comes to those who know themselves-their strengths, their values, and how they best perform.

MANAGING ONESELF

by Peter F. Drucker

TORY'S GREAT ACHIEVERS - A Napoleon, a da Vinci, a Mozart-have always managed themselves. That, in large measure, is what makes them great achievers. But they are rare exceptions, so unusual both in their talents and their accomplishments as to be considered outside the boundaries of ordinary human existence. Now, most of us, even those of us with modest endowments, will have to learn to manage

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ourselves. We will have to learn to develop ourselves. We will have to place ourselves where we can make the greatest contribution. And we will have to stay mentally alert and engaged during a 50-year working life, which means knowing how and when to change the work we do.

What Are My Strengths?

Most people think they know what they are good at. They are usually wrong. More often, people know what they are not good at-and even then more people are wrong than right. And yet, a person can perform only from strength. One cannot build performance on weaknesses, let alone on something one cannot do at all.

Throughout history, people had little need to know their strengths. A person was born into a position and a line of work: the peasant's son would also be a peasant; the artisan's daughter, an artisan's wife, and so on. But now people have choices. We need to know our strengths in order to know where we belong.

The only way to discover your strengths is through feedback analysis. Whenever you make a key decision or take a key action, write down what you expect will happen. Nine or 12 months later, compare the actual results with your expectations. I have been practicing this method for 15 to 20 years now, and every time I do it, I am surprised. The feedback analysis showed me, for instance –

To stay mentally alert and engaged during a 50-year working life, one must know how and when to change the work one does.

and to my great surprise-that I have an intuitive understanding of technical people, whether they are engineers or accountants or market researchers. It also showed me that I don't really resonate with generalists.

Feedback analysis is by no means new. It was invented sometime in the fourteenth century by an otherwise totally obscure German theologian and picked up quite independently, some 150 years later, by John Calvin and Ignatius Loyola, each of whom incorporated it into the practice of his followers. In fact, the steadfast focus on performance and results that this habit produces explains why the institu tions these two men founded, the Calvinist church and the Jesuit order, came to dominate Europe within 30 years.

Practiced consistently, this simple method will show you within a fairly short period of time, maybe two or three years, where your strengths lie-and this is the most important thing to know. The method will show you what you are doing or failing to do that deprives you of the full benefits of your strengths. It will show you where you are not particularly competent. And finally, it will show you where you have no strengths and cannot perform.

Several implications for action follow from feedback analysis. First and foremost, concentrate on your strengths. Put yourself where your strengths can produce results.

Second, work on improving your strengths. Analysis will rapidly show where you need to improve skills or acquire new ones. It will also show the gaps in your knowledge-and those can usually be filled. Mathematicians are born, but everyone can learn trigonometry.

Third, discover where your intellectual arrogance is causing disabling ignorance and overcome it. Far too many people - especially people with great expertise in one area-are contemptuous of knowledge in other areas or believe that being bright is a substitute for knowledge. First-rate engineers, for instance, tend to take pride in not knowing anything about people. Human beings, they believe, are much too disorderly for the good engineering mind. Human resource professionals, by contrast, often pride themselves on their ignorance of elementary accounting or of quantitative methods altogether. But taking pride in such ignorance is self-defeating. Go to work on acquiring the skills and knowledge you need to fully realize your strengths.

It is equally essential to remedy your bad habits-the things you do or fail to do that inhibit your effectiveness and performance. Such habits will quickly show up in the feedback. For example, a planner may find that his beautiful plans fail because he does not follow through on them. Like so many brilliant people, he believes that ideas move mountains. But bulldozers move mountains; ideas show where the bulldozers should go to work. This planner will have to learn that the work does not stop when the plan is completed. He must find people to carry out the plan and explain it to them. He must adapt and change it as he puts it into action. And finally, he must decide when to stop pushing the plan.

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At the same time, feedback will also reveal when the problem is a lack of manners. Manners are the lubricating oil of an organization. It is a law of nature that two moving bodies in contact with each other create friction. This is as true for human beings as it is for inanimate objects. Manners-simple things like saying "please" and "thank you" and knowing a person's name or asking after her family-enable two people to work together whether they like each other or not. Bright people, especially bright young people, often do not understand this. If analysis shows that someone's brilliant work fails again and again as soon as cooperation from others is required, it probably indicates a lack of courtesy - that is, a lack of manners.

Comparing your expectations with your results also indicates what not to do. We all have a vast number of areas in which we have no talent or skill and little chance of becoming even mediocre. In those areas a person -and especially a knowledge worker-should not take on work, jobs, and assignments. One should waste as little effort as possible on improving areas of low competence. It takes far more energy and work to improve from incompetence to mediocrity than it takes to improve from Hrst-rate performance to excellence. And yet most people - especially most teachers and most organizations-concentrate on making incompetent performers into mediocre ones. Energy, resources, and time should go instead to making a competent person into a star performer.

How Do I Perform?

Amazingly few people know *how* they get things done. Indeed, most of us do not even know that different people work and perform differently. Too many people work in ways that are not their ways, and that almost guarantees nonperformance. For knowledge workers, How do I perform? may be an even more important question than What are my strengths?

Like one's strengths, how one performs is unique. It is a matter of personality. Whether personality be a matter of nature or nurture, it surely is formed long before a person goes to work. And *how* a person performs is a given, just as *what* a person is good at or not good at is a given. A person's way of performing can be slightly modified, but it is unlikely to be completely changed-and certainly not easily. Just as people achieve results by doing what they are good at, they also achieve results by working in ways that they best perform. A few common personality traits usually determine how a person performs.

Am I a reader or a listener? The first thing to know is whether you are a reader or a listener. Far too few people even know that there are readers and listeners and that people are rarely both. Even fewer know which of the two they themselves are. But some examples will show how damaging such ignorance can be.

When Dwight Elsenhower was commander in chief of the Allied forces in Europe, he was the darling of the press. His press conferences were famous

It takes far more energy to improve from incompetence to mediocrity than to improve from first-rate performance to excellence.

for their style-General Elsenhower showed total command of whatever question he was asked, and he was able to describe a situation and explain a policy in two or three beautifully polished and elegant sentences. Ten years later, the same journalists who had been his admirers held President Elsenhower in open contempt. He never addressed the questions, they complained, but rambled on endlessly about something else. And they constantly ridiculed him for butchering the King's English in incoherent and ungrammatical answers.

Elsenhower apparently did not know that he was a reader, not a listener. When he was commander in chief in Europe, his aides made sure that every question from the press was presented in writing at least half an hour before a conference was to begin. And then Elsenhower was in total command. When he became president, he succeeded two listeners, Franklin D. Roosevelt and Harry Truman. Both men knew themselves to be listeners and both enjoyed free-for-all press conferences. Elsenhower may have felt that he had to do what his two predecessors had done. As a result, he never even heard the questions journalists asked. And Elsenhower is not even an extreme case of a nonlistener.

A few years later, Lyndon Johnson destroyed his presidency, in large measure, by not knowing that he was a listener. His predecessor, John Kennedy, was a reader who had assembled a brilliant group of writers as his assistants, making sure that they wrote to him before discussing their memos in person. Johnson kept these people on his staff-and they kept on writing. He never, apparently, understood one word of what they wrote. Yet as a senator, Johnson had been superb; for parliamentarians have to be, above all, listeners.

Few listeners can be made, or can make themselves, into competent readers - and vice versa. The listener who tries to be a reader will, therefore, suffer the fate of Lyndon Johnson, whereas the reader who tries to be a listener will suffer the fate of Dwight Elsenhower. They will not perform or achieve.

How do I learn? The second thing to know about how one performs is to know how one learns. Many first-class writers-Winston Churchill is but one example - do poorly in school. They tend to remember their schooling as pure torture. Yet few of their classmates remember it the same way. They may not have enjoyed the school very much, but the worst they suffered was boredom. The explanation is that writers do not, as a rule, learn by listening and reading. They learn by writing. Because schools do not allow them to learn this way, they get poor grades.

Schools everywhere are organized on the assumption that there is only one right way to learn and that it is the same way for everybody. But to be forced to learn the way a school teaches is sheer hell for students who learn differently. Indeed, there are probably half a dozen different ways to learn.

There are people, like Churchill, who learn by writing. Some people learn by taking copious notes.

Do not try to change yourself-you are unlikely to succeed. Work to improve the way you perform.

Beethoven, for example, left behind an enormous number of sketchbooks, yet he said he never actually looked at them when he composed. Asked why he kept them, he is reported to have replied, "If I don't write it down immediately, I forget it right away. If I put it into a sketchbook, I never forget it and I never have to look it up again." Some people learn by doing. Others learn by hearing themselves talk.

A chief executive I know who converted a small and mediocre family business into the leading company in its industry was one of those people who learn by talking. He was in the habit of calling his entire senior staff into his office once a week and then talking at them for two or three hours. He would raise policy issues and argue three different positions on each one. He rarely asked his associates for comments or questions; he simply needed an audience to hear himself talk. That's how he learned. And although he is a fairly extreme case, learning through talking is by no means an unusual method. Successful trial lawyers learn the same way, as do many medical diagnosticians (and so do I).

Of all the important pieces of self-knowledge, understanding how you learn is the easiest to acquire. When I ask people, "How do you learn?" most of them know the answer. But when I ask, "Do you act on this knowledge?" few answer yes. And yet, acting on this knowledge is the key to performance; or rather, not acting on this knowledge condemns one to nonperformance.

How do I perform? and How do I learn? are the first questions to ask. But they are by no means the only ones. To manage yourself effectively, you also have to ask, Do I work well with people or am I a loner? And if you do work well with people, you then must ask, In what relationship?

Some people work best as subordinates. General George Patton, the great American military hero of World War n, is a prime example. Patton was America's top troop commander. Yet when he was proposed for an independent command. General George Marshall, the U.S. chief of staff-and probably the most successful picker of men in U.S. history-said, "Patton is the best subordinate the American army has ever produced, but he would be the worst commander."

Some people work best as team members. Others work best alone. Some are exceptionally talented as coaches and mentors; others are simply incompetent as mentors.

Another crucial question is, Do I produce results as a decision maker or as an adviser? A great many people perform best as advisers but cannot take the burden and pressure of making the decision. A good many other people, by contrast, need an adviser to force themselves to think; then they can make decisions and act on them with speed, self-confidence, and courage.

This is a reason, by the way, that the number two person in an organization often fails when promoted to the number one position. The top spot requires a decision maker. Strong decision makers often put somebody they trust into the number two spot as their adviser-and in that position the person is outstanding. But in the number one spot, the same person fails. He or she knows what the decision

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should be but cannot accept the responsibility of actually making it.

Other important questions to ask include, Do I perform well under stress or do I need a highly structured and predictable environment? Do I work best in a big organization or a small one? Few people work well in all kinds of environments. Again and again, I have seen people who were very successful in large organizations flounder miserably when they moved into smaller ones. And the reverse is equally true.

The conclusion bears repeating: do not try to change yourself-you are unlikely to succeed. But work hard to improve the way you perform. And try not to take on work you cannot perform or will only perform poorly.

What Are My Values?

To be able to manage yourself, you finally have to ask, What are my values? This is not a question of ethics. With respect to ethics, the rules are the same for everybody, and the test is a simple one. I call it the "mirror test."

In the early years of this century, the most highly respected diplomat of all the great powers was the German ambassador in London. He was clearly destined for great things - to become his country's foreign minister, at least, if not its federal chancellor. Yet in 1906 he abruptly resigned rather than preside over a dinner given by the diplomatic corps for Edward VII. The king was a notorious womanizer and made it clear what kind of dinner he wanted. The ambassador is reported to have said, "I refuse to see a pimp in the mirror in the morning when I shave."

That is the mirror test. Ethics requires that you ask yourself. What kind of person do I want to see in the mirror in the morning? What is ethical behavior in one kind of organization or situation is ethical behavior in another. But ethics are only part of a value system-especially of an organization's value system.

To work in an organization whose value system is unacceptable or incompatible with one's own condemns a person both to frustration and to nonperformance.

Consider the experience of a highly successful human resources executive whose company was acquired by a bigger organization. After the acquisition, she was promoted to do the kind of work she did best, which included selecting people for important positions. The executive deeply believed that a company should hire people for such positions from the outside only after exhausting all the inside possibilities. But her new company believed in first looking outside "to bring in fresh blood." There is something to be said for both approaches-in my experience, the proper one is to do some of both. They are, however, fundamentally incompatible -not as policies but as values. They bespeak different views of the relationship between organizations and people; different views of the responsibility of an organization to its people and their development; and different views of a person's most important contribution to an enterprise. After several years of frustration, the executive quit-at considerable financial loss. Her values and the values of the organization simply were not compatible.

Similarly, whether a pharmaceutical company tries to obtain results by making constant, small improvements or by achieving occasional, highly expensive, and risky "breakthroughs" is not primarily an economic question. The results of either strategy may be pretty much the same. At bottom, there is a conflict between a value system that sees the company's contribution in terms of helping physicians do better what they already do and a value system that is oriented toward making scientific discoveries.

Whether a business should be run for short-term results or with a focus on the long term is likewise a question of values. Financial analysts believe that businesses can be run for both simultaneously. Successful busmesspeople know better. To be sure, every company has to produce short-term results. But in any conflict between short-term results and long-term growth, each company will determine its own priority. This is not primarily a disagreement about economics. It is fundamentally a value conflict regarding the function of a business and the responsibility of management.

Value conflicts are not limited to business organizations. One of the fastest-growing pastoral churches in the United States measures success by the number of new parishioners. Its leadership believes that what matters is how many newcomers join the congregation. The Good Lord will then minister to their spiritual needs or at least to the needs of a sufficient percentage. Another pastoral, evangelical church believes that what matters is people's spiritual growth. The church eases out newcomers who join but do not enter into its spiritual life.

Again, this is not a matter of numbers. At first glance, it appears that the second church grows more slowly. But it retains a far larger proportion of newcomers than the first one does. Its growth, in other words, is more solid. This is also not a theological problem, or only secondarily so. It is a problem about values. In a public debate, one pastor argued, "Unless you first come to church, you will never find the gate to the Kingdom of Heaven."

"No," answered the other. "Until you first look for the gate to the Kingdom of Heaven, you don't belong in church."

Organizations, like people, have values. To be effective in an organization, a person's values must be compatible with the organization's values. They do not need to be the same, but they must be close

What one does well-even very well and successfully-may not fit with one's value system.

enough to coexist. Otherwise, the person will not only be frustrated but also will not produce results.

A person's strengths and the way that person performs rarely conflict; the two are complementary. But there is sometimes a conflict between a person's values and his or her strengths. What one does well-even very well and successfully-may not fit with one's value system. In that case, the work may not appear to be worth devoting one's life to (or even a substantial portion thereof).

If I may, allow me to interject a personal note. Many years ago, I too had to decide between my values and what I was doing successfully. I was doing very well as a young investment banker in London in the mid-19 3 os, and the work clearly fit my strengths. Yet I did not see myself making a contribution as an asset manager. People, I realized, were what I valued, and I saw no point in being the richest man in the cemetery. I had no money and no other job prospects. Despite the continuing Depression, I quit - and it was the right thing to do. Values, in other words, are and should be the ultimate test.

Where Do I Belong?

A small number of people know very early where they belong. Mathematicians, musicians, and cooks, for instance, are usually mathematicians, musicians, and cooks by the time they are four or five years old. Physicians usually decide on their careers in their teens, if not earlier. But most people, especially highly gifted people, do not really know where they belong until they are well past their mid-twenties. By that time, however, they should know the answers to the three questions: What are my strengths? How do I perform? and, What are my values? And then they can and should decide where they belong.

Or rather, they should be able to decide where they do *not* belong. The person who has learned that he or she does not perform well in a big organization should have learned to say no to a position in one. The person who has learned that he or she is not a decision maker should have learned to say no to a decision-making assignment. A General Patton (who probably never learned this himself) should have learned to say no to an independent command.

Equally important, knowing the answer to these questions enables a person to say to an opportunity, an offer, or an assignment, "Yes, I will do that. But this is the way I should be doing it. This is the way it should be structured. This is the way the relationships should be. These are the kind of results you should expect from me, and in this time frame, because this is who I am."

Successful careers are not planned. They develop when people are prepared for opportunities because they know their strengths, their method of work, and their values. Knowing where one belongs can transform an ordinary person-hard-working and competent but otherwise mediocre - into an outstanding performer.

What Should I Contribute?

Throughout history, the great majority of people never had to ask the question, What should I contribute? They were told what to contribute, and their tasks were dictated either by the work itself-as it was for the peasant or artisan-or by a master or a mistress, as it was for domestic servants. And until very recently, it was taken for granted that most people were subordinates who did as they were told. Even in the 1950S and i96os, the new knowledge workers (the so-called organization men) looked to their company's personnel department to plan their careers.

Then in the late i96os, no one wanted to be told what to do any longer. Young men and women began to ask. What do *I* want to do? And what they heard was that the way to contribute was to "do your own thing." But this solution was as wrong as the organization men's had been. Very few of the people who believed that doing one's own thing would lead to contribution, self-fulfillment, and success achieved any of the three.

But still, there is no return to the old answer of doing what you are told or assigned to do. Knowledge workers in particular have to learn to ask a

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question that has not been asked before: What *should my* contribution be? To answer it, they must address three distinct elements: What does the situation require? Given my strengths, my way of performing, and my values, how can I make the greatest contribution to what needs to be done? And finally, What results have to be achieved to make a difference?

Consider the experience of a newly appointed hospital administrator. The hospital was big and prestigious, but it had been coasting on its reputation for 30 years. The new administrator decided that his contribution should be to establish a standard of excellence in one important area within two years. He chose to focus on the emergency room, which was big, visible, and sloppy. He decided that every patient who came into the ER had to be seen by a qualified nurse within 60 seconds. Within 12 months, the hospital's emergency room had become a model for all hospitals in the United States, and within another two years, the whole hospital had been transformed.

As this example suggests, it is rarely possible-or even particularly fruitful -to look too far ahead. A plan can usually cover no more than 18 months and still be reasonably clear and specific. So the question in most cases should be, Where and how can I achieve results that will make a difference within the next year and a half? The answer must balance several things. First, the results should be hard to achieve-they should require "stretching," to use the current buzzword. But also, they should be within reach. To aim at results that cannot be achieved-or that can be only under the most unlikely circumstances-is not being ambitious; it is being foolish. Second, the results should be meaningful. They should make a difference. Finally, results should be visible and, if at all possible, measurable. From this will come a course of action: what to do, where and how to start, and what goals and deadlines to set.

Responsibility for Relationships

Very few people work by themselves and achieve results by themselves - a few great artists, a few great scientists, a few great athletes. Most people work with others and are effective with other peo

Knowing where one belongs can transform an ordinary person-hard-working but otherwise mediocre-into an outstanding performer.

ple. That is true whether they are members of an organization or independently employed. Managing yourself requires taking responsibility for relationships. This has two parts.

The first is to accept the fact that other people are as much individuals as you yourself are. They perversely insist on behaving like human beings. This means that they too have their strengths; they too have their ways of getting things done; they too have their values. To be effective, therefore, you

have to know the strengths, the performance modes, and the values of your coworkers.

That sounds obvious, but few people pay attention to it. Typical is the person who was trained to write reports in his or her first assignment because that boss was a reader. Even if the next boss is a listener, the person goes on writing reports that, invariably, produce no results. Invariably the boss will think the employee is stupid, incompetent, and lazy, and he or she will fail. But that could have

Knowing where one belongs can transform an ordinary person – hard-working but otherwise mediocre – onto an outstanding performer.

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been avoided if the employee had only looked at the new boss and analyzed how *this* boss performs.

Bosses are neither a title on the organization chart nor a "function." They are individuals and are entitled to do their work in the way they do it best. It is incumbent on the people who work with them to observe them, to find out how they work, and to adapt themselves to what makes their bosses most effective. This, in fact, is the secret of "managing" the boss.

The same holds true for all your coworkers. Each works his or her way, not your way. And each is entitled to work in his or her way. What matters is whether they perform and what their values are. As for how they perform-each is likely to do it differently. The first secret of effectiveness is to understand the people you work with and depend on so that you can make use of their strengths, their ways of working, and their values. Working relationships are as much based on the people as they are on the work.

The second part of relationship responsibility is taking responsibility for communication. Whenever I, or any other consultant, start to work with an organization, the first thing I hear about are all the personality conflicts. Most of these arise from the fact that people do not know what other people are doing and how they do their work, or what contribution the other people are concentrating on and what results they expect. And the reason they do not know is that they have not asked and therefore have not been told.

This failure to ask reflects human stupidity less than it reflects human history. Until recently, it was unnecessary to tell any of these things to anybody. In the medieval city, everyone in a district plied the same trade. In the countryside, everyone in a valley planted the same crop as soon as the frost was out of the ground. Even those few people who did things that were not "common" worked alone, so they did not have to tell anyone what they were doing.

Today the great majority of people work with others who have different tasks and responsibilities. The marketing vice president may have come out of sales and know everything about sales, but she knows nothing about the things she has never done-pricing, advertising, packaging, and the like. So the people who do these things must make sure that the marketing vice president understands what they are trying to do, why they are trying to do it, how they are going to do it, and what results to expect.

If the marketing vice president does not understand what these high-grade knowledge specialists are doing, it is primarily their fault, not hers. They have not educated her. Conversely, it is the marketing vice president's responsibility to make sure that all of her coworkers understand how she looks at marketing: what her goals are, how she works, and what she expects of herself and of each one of them.

Even people who understand the importance of taking responsibility for relationships often do not communicate sufficiently with their associates. They are afraid of being thought presumptuous or inquisitive or stupid. They are wrong. Whenever someone goes to his or her associates and says, "This is what I am good at. This is how I work. These are my values. This is the contribution I plan to concentrate on and the results I should be expected to deliver," the response is always, "This is most helpful. But why didn't you tell me earlier?"

And one gets the same reaction-without exception, in my experience-if one continues by asking, "And what do I need to know about your strengths, how you perform, your values, and your proposed contribution?" In fact, knowledge workers should request this of everyone with whom they work, whether as subordinate, superior, colleague, or team member. And again, whenever this is done, the reaction is always, "Thanks for asking me. But why didn't you ask me earlier?"

Organizations are no longer built on force but on trust. The existence of trust between people does not necessarily mean that they like one another. It means that they understand one another. Taking responsibility for relationships is therefore an absolute necessity. It is a duty. Whether one is a member of the organization, a consultant to it, a supplier, or a distributor, one owes that responsibility to all one's coworkers: those whose work one depends on as well as those who depend on one's own work.

The Second Half of Your Life

When work for most people meant manual labor, there was no need to worry about the second half of your life. You simply kept on doing what you had always done. And if you were lucky enough to survive 40 years of hard work in the mill or on the railroad, you were quite happy to spend the rest of your life doing nothing. Today, however, most work is knowledge work, and knowledge workers are not "finished" after 40 years on the job, they are merely bored.

We hear a great deal of talk about the midlife crisis of the executive. It is mostly boredom. At 45, most executives have reached the peak of their business careers, and they know it. After 20 years of doing very much the same kind of work, they are

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very good at their jobs. But they are not learning or contributing or deriving challenge and satisfaction from the job. And yet they are still likely to face another 20 if not 25 years of work. That is why managing oneself increasingly leads one to begin a second career.

There are three ways to develop a second career. The first is actually to start one. Often this takes nothing more than moving from one kind of organization to another: the divisional controller in a large corporation, for instance, becomes the controller of a medium-sized hospital. But there are also growing numbers of people who move into different lines of work altogether: the business executive or government official who enters the ministry at 45, for instance; or the midlevel manager who leaves corporate life after 20 years to attend law school and become a small-town attorney.

We will see many more second careers undertaken by people who have achieved modest success in their first jobs. Such people have substantial skills, and they know how to work. They need a community-the house is empty with the children gone-and they need income as well. But above all, they need challenge.

The second way to prepare for the second half of your life is to develop a parallel career. Many people who are very successful in their first careers stay in the work they have been doing, either on a full-time or a part-time or consulting basis. But in addition, they create a parallel job, usually in a nonprofit organization, that takes another ten hours of work a week. They might take over the administration of their church, for instance, or the presidency of the local Girl Scouts Council. They might run the battered women's shelter, work as a children's librarian for the local public library, sit on the school board, and so on.

Finally, there are the social entrepreneurs. These are usually people who have been very successful in then-first careers. They love their work, but it no longer challenges them. In many cases they keep on doing what they have been doing all along but spend less and less of their time on it. They also start another activity, usually a nonprofit. My friend Bob Buford, for example, built a very successful television company that he still runs. But he has also founded and built a successful nonprofit organization that works with Protestant churches, and he is building another to teach social entrepreneurs how to manage their own nonprofit ventures while still running their original businesses.

People who manage the second half of their lives may always be a minority. The majority may "retire on the job" and count the years until their actual retirement. But it is this minority, the men and women who see a long working-life expectancy as an opportunity both for themselves and for society, who will become leaders and models.

There is one prerequisite for managing the second half of your life: you must begin long before you enter it. When it first became clear 30 years ago that working-life expectancies were lengthening very fast, many observers (including myself) believed that retired people would increasingly become volunteers for nonprofit institutions. That has not happened. If one does not begin to volunteer before one is 40 or so, one will not volunteer once past 60.

Similarly, all the social entrepreneurs I know began to work in their chosen second enterprise long before they reached their peak in their original business. Consider the example of a successful lawyer, the legal counsel to a large corporation, who has started a venture to establish model schools in his state. He began to do volunteer legal work for the schools when he was around 35. He was elected to the school board at age 40. At age 50, when he had amassed a fortune, he started his own enterprise to build and to run model schools. He is, however, still working nearly full-time as the lead counsel in the company he helped found as a young lawyer.

There is another reason to develop a second major interest, and to develop it early. No one can expect to live very long without experiencing a serious setback in his or her life or work. There is the competent engineer who is passed over for promo-

There is one prerequisite for managing the second half of your life: you must begin doing so long before you enter it.

tion at age 45. There is the competent college professor who realizes at age 42 that she will never get a professorship at a big university, even though she may be fully qualified for it. There are tragedies in one's family life: the breakup of one's marriage or the loss of a child. At such times, a second major interest-not just a hobby-may make all the difference. The engineer, for example, now knows that he has not been very successful in his job. But in his outside activity-as church treasurer, for example -

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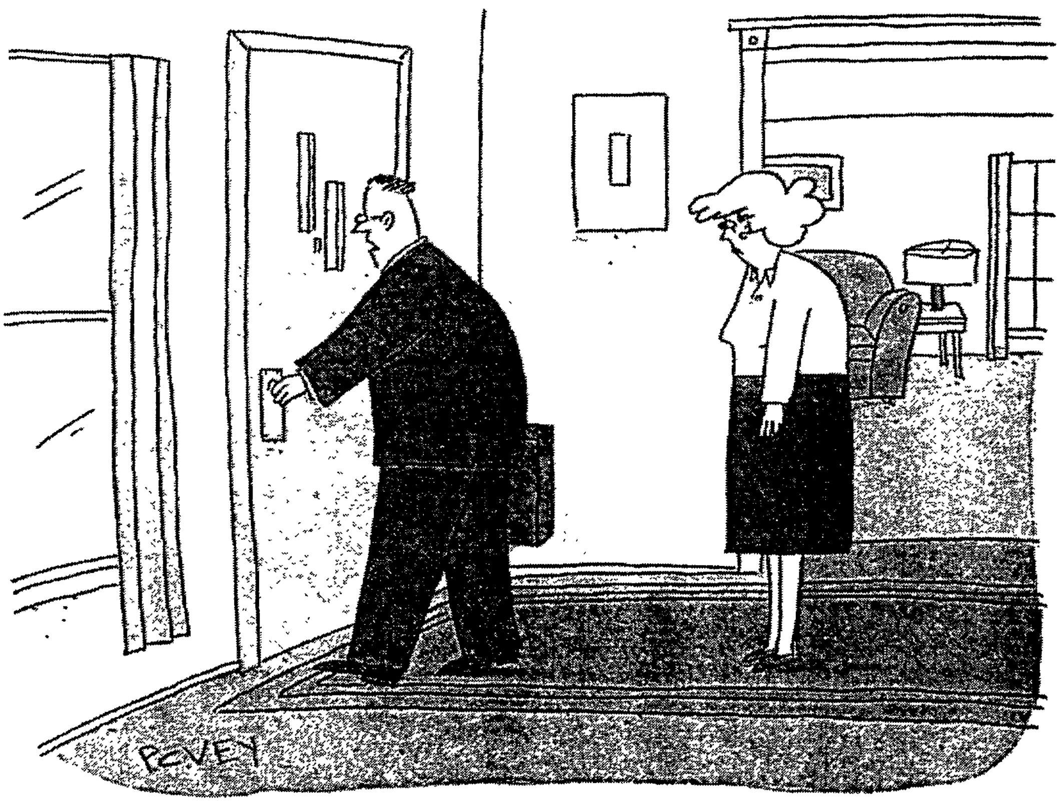
he is a success. One's family may break up, but in that outside activity there is still a community.

In a society in which success has become so terribly important, having options will become increasingly vital. Historically, there was no such thing as "success." The overwhelming majority of people did not expect anything but to stay in their "proper station," as an old English prayer has it. The only mobility was downward mobility.

In a knowledge society, however, we expect everyone to be a success. This is clearly an impossibility. For a great many people, there is at best an absence of failure. Wherever there is success, there has to be failure. And then it is vitally important for the individual, and equally for the individual's family, to have an area in which he or she can contribute, make a difference, and be *somebody.* That means finding a second area-whether in a second career, a parallel career, or a social venture-that offers an opportunity for being a leader, for being respected, for being a success.

The challenges of managing oneself may seem obvious, if not elementary. And the answers may seem self-evident to the point of appearing naive. But managing oneself requires new and unprecedented things from the individual, and especially from the knowledge worker. In effect, managing oneself demands that each knowledge worker think and behave like a chief executive officer. Further, the shift from manual workers who do as they are told to knowledge workers who have to manage themselves profoundly challenges social structure. Every existing society, even the most individualistic one, takes two things for granted, if only subcon-sciously: that organizations outlive workers, and that most people stay put.

But today the opposite is true. Knowledge workers outlive organizations, and they are mobile. The need to manage oneself is therefore creating a revolution in human affairs.



"If I'm not back in 15 minutes, it means I probably got on the train and went to work."

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NEGOTIATION SKILLS

(MUTUAL AGREEMENT)

Negotiating is a necessity in all facets of business. This Test has been developed for self-evaluation to see how effective you are at counter offers, sales objectives, or making a deal.

Instructions: Circle your answers and transfer them to the answer sheet
(Individual and team answers).

1.Before you begin negotiating, you should:
a. Question everything.
b. Determine that you are right.
c. Figure out how to win.

2. Consistency in negotiation is not considered a positive act because:

a. It shows you are predictable.
b. It shows you are inflexible.
c. It shows you are not creative.

3. When you are negotiating issues relating to money, always keep in mind that:
a. The higher the stake, the tougher the negotiation will be
b. The money involved may lead to high emotions.
c. You are dealing with money as if it were your own.

4. The difference between selling and negotiating is:
a. Selling is the relationship-building and negotiation might cause the relationship to be discounted
b. There is no difference.
c. Negotiation is the end game of the sales process.

5. Of all the competencies that are signs of a good negotiator, the one that can make you stand out from the crowd is:
a. Knowledge.
b. People skills
c. Competitive personality
c. Competitive personality.

6.While you may not have perfected every negotiating skill, it is important for you to:
a. Recognize your liabilities.
b. Focus on skills that work for you.
c. Know your greatest strength and exploit it.

7.When you are dealing with a client who seems to be adversarial in every way, you should:

a. Walk away immediately.
b. Work around the person by going above him or her
c. Stay in the game if at all possible.

8.When the major negotiating points are handled and the client asks for something minor, you should:

a. Pay equal attention to the minor points.
b. Realize major points are most important
c. Try to keep emphasis on those things within your control.

9.When negotiations take a ninety- degree turn, you should:
a. Restate the existing position
b. Realize that circumstances can change and render all previous agreements mute.
c. Scramble to improvise and salvage what you can

10. Patience in negotiations is a:
a. Weapon if you can outwait the other side
b. Weakness viewed by the other side a indecision
c. Tactic to be used to be sure you are correct in the processes.

Answer to the negotiation skill's test.
Each correct answer is worth ten points.

1.a.Healthy skepticism is important in negotiation. Question any rules and assumptions. Don't let past situations lull you into thinking the same way you won last time might work this time. No two negotiations are alike, so stay fresh in your thinking.

2.a. In business, consistency is considered a virtue; in negotiations, consistency makes you too predictable. Your adversary can too easily determine your next move.

3.c. If you think in terms of your own pocket being affected, negotiating toughness will be easy. In reality, the company's money certainly affects your bottom line and you play to win every time.

4. There is a fine line between selling and negotiating. The selling process involves identifying customers and raising their interest in your product or service, and finally persuading them to act on that interest. Negotiating is the the process of getting the best terms once the other side starts to act on their interest.

5.a. While all three are important, knowledge is power. Know as much as possible about the company and the person handling the negotiation.

6.c. Very few people are perfect negotiators. If you recognize your overriding strength and learn how to exploit it, chances are you will be successful. One of the strengths most often cited as setting a person above others is the willingness to work *with* the client rather than *against* the client.

7.c.If there is any way to save the deal and stay with the customer without being a pest, the negotiation may eventually work. There are times when the person with whom you are negotiating leaves the position and you can regain your relationship with a fresh start. On the other hand, if you get a firm answer of "no", it's time to move on.

8.a. Ironically, it's usually the minor issues that can kill a deal. If a client inserts a request at the last minute, pay attention. Ask why this is important. What seems to be a small thing to you may be important to the client.

9.b. Never be shocked when things change in midstream. This is just part of the deal.

10.a. Patience is always a virtue. Learn how to use it to your advantage.

TEST SCORING.	
Your score:	
80-100	You know how to win integrity. Stay on track with these skills and winning will come easily.
60-70	These techniques are within your grasp. Pay attention and try them out.
Below 60	Negotiating doesn't need to be complicated. Now that you know what you don't know, ask lost of questions and use common sense.

Test Score Sheet

Question No	Individual Answer	Team Answer
1.		
2.		
3.		
4.		
5.		
6.		
7.		
8.		
9.		
10.		