Open Book Management as a Source of Competitive Advantage for U.S. Firms

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Executive Summary

Achieving a competitive advantage in today's marketplace requires that firms demonstrate continuous improvement in quality, costs, innovation and speed to market. The generation of intellectual capital is essential if firms are to achieve these performance goals. Open Book Management is one approach that has potential in providing firms with the resources and capabilities to generate intellectual capital. U.S. firms are in a favorable position to successfully implement Open Book Management programs due to the United States' superior system of higher education and particular combination of cultural values.

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The goal of strategic management is to formulate and implement a strategy that will allow the firm to earn above average returns over a sustained period of time. Porter's early work (Porter, 1995) identified two generic strategies for the creation of value. Cost strategies seek to grow market share by being the lowest-cost producer. Differentiation strategies, on the other hand, add value by providing unique features, such as above average quality or innovative technology, for which customers will pay a higher price and be more loyal. But, in today's highly competitive, rapidly changing and global marketplace, firms must find ways to combine these two broad approaches. Customers want and expect the continuous introduction of high quality and technologically advanced products and services at low prices.

Achieving a competitive advantage in today's marketplace requires high levels and continuous improvement in quality, costs, innovation and speed to market (Lawler, 1996). Companies can achieve a competitive advantage by acquiring and developing resources and capabilities that allow for the efficient and effective implementation of a fundamentally sound strategic mission (Hitt. Ireland & Hoskisson, 1995). Resources that are valuable, rare, difficult to copy or substitute for, and exploited by the organization are predicted to provide a firm with a competitive advantage (Barney, 1995). Historically, such resources were access to raw materials, energy, capital and equipment. Physical and financial resources, however, are no longer sufficient for competitiveness.

According to Drucker (1994), the source of competitive advantage that now matters most is in the generation and application of knowledge. Firms must acquire and develop organizational resources and human capital resources that foster organizational learning. Firms must learn how to quickly and continuously become more effective, more efficient and more flexible. This explains why Stewart (1997) calls "intellectual capital" the one indispensable asset of corporations. Intellectual capital represents data, information and knowledge about products, services, customers and processes that have been formalized and leveraged to produce a higher-valued asset. With the coming age of the knowledge worker, the factors of production in high-value-added jobs are increasingly dependent on the ability, skill, expertise and motivation of people.

The challenge ahead is for managers to create organizations that are capable of generating intellectual capital. Management based primarily on economic principles is no longer sufficient. Management based primarily on simplistic behavioral science principles is ineffective.

Lawler (1996) calls for a new management paradigm that develops and exploits organizational and human capital resources in addition to financial and physical resources. In this new paradigm, employee ownership and involvement, not bureaucracy, are said to be the most effective source of control. Lateral processes, not hierarchical processes, are the keys to organizational effectiveness and efficiency. In such organizations, all employees add value, not just top management and technical experts.

The position taken in this paper is that the generation of intellectual capital is best achieved by increasing employee involvement in the operation of the firm. The philosophy and practice of "Open Book Management" holds considerable promise as a means toward effective employee involvement. Furthermore, in the global context, U.S. firms are in a favorable position to successfully implement employee involvement programs due to our superior system of higher education and our cultural values. The remainder of this paper will develop these ideas.

Employee Involvement

The so called "Top Down" and "Command and Control" models of management work well in simple, stable, and predictable environments. These methods were well matched to the competitive landscape of the early 20th century. Today, however, most businesses, operate in environments that are complex, unstable and unpredictable. The opportunity to add value now lies in the minds and motivation of specialized knowledge workers and other employees who take responsibility for achieving organizational goals and objectives rather than in programmed decisions created by senior managers who lack relevant skills that are enforced by inflexible bureaucratic policies.

Although many managers recognize limitations of the "command and control" approach, the research record on employee involvement programs doesn't readily identify this as an effective or popular alternative (Pfeffer, 1998). Individual level training programs do impact individual performance, however, companies that invest in training do not necessarily outperform their competitors who do not invest in training. Similar findings exist for employee suggestion systems, participative decision-making, and incentive pay systems. Behavior and productivity changes at the employee level do not necessarily result in changes at the organization level. Recent research, however, strongly suggests that it is the systematic use, or bundling, of several single-focus HR programs that in combination contribute to firm performance (Huselid, 1995).

Lawler (1992) anticipated this finding in his conceptualization of employee involvement. In order to effectively leverage human capital, the firm must provide all employees with: (1) knowledge of the work, the business and the total work system; (2) information about business strategy, processes, quality, customer feedback, events and business results; (3) power to act and make decisions about the work in all of its aspects; and (4) rewards tied to business results, individual growth, capability and contribution. Employee involvement is determined by the multiplicative combination of all four practices. This implies that if any one practice is deficient, employee involvement will be ineffective regardless of the what is done in the other three areas. Upon reflection, this only makes sense. Employee participation in decision-making is not likely to be effective if employees lack a general knowledge of the business or information in key areas. Similarly, performance-based pay will have limited effects if employees have no power to act and make decisions. Employee involvement will only work when all four components are in effect.

Open Book Management

The philosophy and practice of Open Book Management (OBM) flows directly from Lawler's definition of employee involvement, although the two ideas have not been linked and appear to have developed independently. Lawler's ideas have their roots in behavioral science research while OBM was initially developed by Jack Stack in an effort to keep his company from going bankrupt.

Jack Stack, the president and CEO of Springfield Remanufacturing Corporation, is credited with developing the basics of OBM. John Case (1990, 1995, 1997a, 1997b) has done the most research on the topic and first coined the name "Open-book Management." Additional writings on the topic can be found in Schuster, Carpenter and Kane (1996).

Stack's book, "The Great Game of Business" (Stack, 1992) describes how the company, which remanufactures transmissions and diesel engines for the trucking and heavy equipment industry, went from a 89:1 debt to equity ratio with $6 million dollars in revenue, 119 employees and a stock price of $0.10 per share in 1983 to revenues of over $83 million dollars, 750 employees and a stock price of $18.30 ten years later. According to Stack, "The best, most efficient, most profitable way to operate a business is to give everybody in the company a voice in saying how the company is run and a stake in the financial outcome, good or bad." (Stack, 1992, p. 3). In order to do this, employees need to know how the company makes money and how the company generates cash. Sharing information from the balance sheet and the income statement with all employees on a regular basis, hence the name "open-book management" provides people with the knowledge and information to make sound business decisions that impact the "bottom line." Giving people an equity stake in the firm and participation in profit (and loss) sharing provides the incentive and motivation to make decisions that benefit the firm. This also establishes a direct connection between what employees do and the outcomes of those actions on the firm's critical numbers, which in turn contributes to a greater sense of "ownership" and accountability. Finally, employees are empowered to take action in accordance with their knowledge and information. Employees are encouraged to act like "owners," which in many cases they are.

Davis (1997) identified 10 principles that underlie most OBM applications:

First, turn the management of a business into a game that employees can win. In most companies, lower-level employees and even some managers are uninformed as to how the company makes a profit and generates cash. According to Stack (1992), this is like asking people to play baseball without telling them the rules. By turning the business into a game, employees and managers are on the same side working toward the same objective.

Second, open the books and share financial and operating information with all employees. Employees need to know how the company, division and department are doing. Information is power and it is important to share financial goals, budgets, income statements, forecasts, sales figures and operating costs widely throughout the firm.

Third, teach employees to understand the company's financial statements. Also called "business literacy" all employees must know how to read a P&L statement, analyze budgets for variances, appreciate how the firm's credit rating impacts profits, and so forth.

Fourth, show employees how their work influences financial results. Schuster, Carpenter and Kane (1996) refer to this is as establishing a “line of sight” between employee behavior and firm performance.

Fifth, link nonfinancial measures to financial results. There is growing evidence supporting a relationship between employee satisfaction, customer satisfaction and sales (Rucci, Kirn & Quinn, 1998). Understanding the links helps employees, and managers, do a better job. In fact, in a study at Sears, researchers found that it is important for employees to understand the firm’s business strategy and the connection between what they do and overall firm objectives (Rucci, et al., 1998).

Sixth, target priority areas and empower employees to make improvements. Jack Stack likes to say that a firm must identify one or two critical numbers that are essential to success at that point in time. Employees must know what those critical numbers are and be given the latitude to push those numbers in the right direction.

Seventh, review results together and keep employees accountable. Many companies doing OBM have developed effective ways of sharing information on a weekly or even daily basis. This information is critical for keeping score. How can you play the great game of business if you don’t know the score?

Eighth, post results and celebrate success. Consistent with the goal of sharing information, results are displayed in prominent locations, are readily accessible, warn people of adverse outcomes, reward people when things go well, and help keep people involved.

Ninth, distribute bonus awards based on employee contributions to financial outcomes. The important thing is to share in the financial gains and loses. The particular method or schedule of payout should be consistent with the firm's history and culture. Bonuses are something to be earned; they aren’t an entitlement.

Finally, share the ownership of the company with employees. Many companies doing OBM, but not all, have created employee stock ownership programs. If you want employees to act like owners, then they should be owners.

Davis (1997) goes on to list valid concerns and potential problems with OBM. He is upfront with the barriers to implementation. Case (1997b) also lists numerous issues that must be dealt with if OBM is to be successful. As Case notes (1997a), OBM is more of a philosophy of management than it is a specific technique such as re-engineering or management by objectives.

When implemented properly, OBM has potential to generate intellectual capital. Remember, intellectual capital represents data, information and knowledge about products, services, customers and processes that have been formalized and leveraged to produce a higher-valued asset. OBM provides a method for sharing information, an incentive for generating knowledge, and a compelling reason for formalizing and leveraging information and knowledge to produce a higher-valued asset.

Work is being redefined. Simple repetitive jobs are being automated or shipped to low-wage countries. High margin, value-added work, in both manufacturing and services, requires that employees undertake complex tasks and solve unexpected problems (Case, 1990). Because OBM provides a supportive context for the generation of intellectual capital, it has potential to give a firm a competitive advantage in today's highly competitive marketplace where customers want and expect the continuous introduction of high quality and technologically advanced products and services at low prices.

OBM and Global Competititveness

U.S. firms are in a favorable position to successfully implement employee involvement programs due to our superior system of higher education and our cultural values. These national resources are valuable, somewhat rare, and difficult to copy or find a substitute for. U.S. firms must exploit these resources in the global market.

First, in order for OBM to work, employees must be capable of understanding complex information and acting on that information. Problem solving, decision-making, creativity, critical thinking and other cognitive skills come to the forefront in OBM organizations. Reich (1991) refers to people who do these types of jobs as "symbolic analysts" and concludes that Americans excel in these jobs. He also believes that our competitive advantage will continue for two reasons: First, no nation in the world has as many symbolic analysts already in the workforce and ready to generate intellectual capital. Second, no nation has a system of higher education equal to ours so we will continue to lead the world in the production of symbolic analysts at least for the near future. Other countries may have superior elementary school and high school systems in teaching math and science proficiency, but the college and university system in the

U.S. is superior in skills of abstract thought, system thinking and experimentation (Reich, 1991).

The second advantage that U.S. firms have in the global market has to do with cultural values. Hofstede (1991) has studied differences in national cultures on the dimensions of power distance, individualism, uncertainty avoidance, and masculinity. The first three are relevant for OBM.

Power distance refers to dependence relationships in a country. When power distance is small, there is a greater interdependence between managers and employees and the latter are more likely to approach and even contradict their bosses. When power distance is large, an autocratic or paternalistic management style is preferred. OBM favors a small power distance culture. The U.S., along with Denmark, Sweden, Great Britain, Canada, New Zealand, Israel, Germany and the Netherlands have small power distances compared to Japan, South Korea, the Philippines, Indian, Mexico, France and the Arab nations.

Uncertainty avoidance refers to the extent that members of a culture feel threatened by unknown situations. In high uncertainty avoidance cultures, emphasis is placed on rules and hierarchical control. OBM would fit better in low uncertainty cultures because of the constant search for information and the resulting demands on problem solving and decision making. Low uncertainty cultures include the U.S., India, Denmark, Sweden and Hong Kong. High uncertainty cultures include Japan, South Korea, France, Mexico, and Greece.

Individualism pertains to cultures where the social ties between individuals are weak and people are expected to look after themselves. Collectivism, on the other hand, places value on group membership, cohesiveness, and unquestioned loyalty to the group in return for protection. There is no question that OBM fosters a team orientation and values group cohesiveness. However, OBM, with the notions of ownership and personal accountability, also values individual responsibility. The company is not there to protect the employee. OBM, therefore, would favor individualistic cultures such as those found in the U.S., Great Britain, Canada, Australia and the Netherlands as compared to the collectivist cultures of Indonesia, Pakistan, South Korea and Thailand.

Because OBM was developed in the U.S., it would be expected that it would be consistent with U.S. cultural values. What is relevant, however, is that if OBM is an effective way for generating intellectual capital, countries with strong power distance, high uncertainty avoidance, and collectivistic values will, on average, have a more difficult time adopting that management philosophy. Or, they will have to develop a substitute system. However, the very nature of generating intellectual capital may fit less well in those cultures, which would put them at a competitive disadvantage.

The above comments about education and culture are subject to many qualifications, including the great degree of variability within nations, between and within companies, and between individuals. Nevertheless, at the macro level of analysis, the implications are non-trivial.

Conclusion

Achieving a competitive advantage in today's marketplace requires that firms demonstrate continuous improvement in quality, costs, innovation and speed to market. The generation of intellectual capital is essential if firms are to achieve these performance goals. OBM is one approach that has potential in providing firms with the resources and capabilities to generate intellectual capital. U.S. firms are in a favorable position to successfully implement OBM programs due to the United States' superior system of higher education and particular combination of cultural values.

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