PEOPLE + PROFITABILITY:

The Open-Book Solution

The World's Shortest Guide to Better Business Performance and More Engaged Employees

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OPEN-BOOK COACHING

A better way to a strong, sustainable, profitable business

How would you like to run a company that performs at a high level year after year? A company whose employees pitch in every day to help it succeed?

I know hundreds of companies that fit that description. They are strong, sustainable, and profitable. They hum along without much oversight from the founders. If the time comes when the owner wants to retire, there are usually plenty of prospective buyers—including, often, the management team or the employees themselves.

This white paper explains how you can begin to build such a company—**starting now**. *-BF*

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Where I'm coming from

First let me tell you how I came to learn about and work with so many of these remarkable companies. (That's me on the right.)

I graduated from Harvard Business School, spent a few years as a consultant for Bain & Company, and then held a variety of operating roles with large corporations. In 1989 I was working for J.I. Case, the big equipment manufacturer. My boss suggested I fly down to Springfield, Missouri, to meet with a company called Springfield ReManufacturing Corp. (SRC). He described it as a "small but innovative supplier." He suggested that SRC employees understood a lot about their business, including the financials.

I have to say, I was skeptical. So when I came across a shop employee polishing crankshaft journals, I decided to ask him a question.

"Good morning," I said. "My name is Bill Fotsch. If you don't mind, I have a question for you. I'm told that most SRC employees really understand their business. I'm curious: What is the price of that crankshaft you are working on?"

At Case, I thought, asking such a question would probably provoke a grievance for trying to embarrass a union worker. Here, I figured I'd get no answer, and I'd probably wind up explaining the difference between *price* and *cost.*

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

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

That's when I became a convert…

Wow. This employee wasn't just engaged or empowered. He was thinking like a businessperson. He understood the economics of his work. That enabled him to make better decisions and to think like an owner. And as I soon learned he wasn't alone. Nearly everyone at the company could talk intelligently about sales forecasts, margins, marketing costs, and the other daily details that make up business management. Maybe you have read SRC's story in Jack Stack's and Bo Burlingham's terrific book *The Great Game of Business*.

Not long thereafter I joined the staff of SRC as head of its coaching business. We began helping others learn the open-book system that CEO Stack and his colleagues had pioneered. (*Inc.* magazine eventually christened the system "open-book management.") Over the years, I worked with nearly 400 companies to improve their business results and the lives of their employees by engaging people in the business through open-book management. Among our clients were Southwest Airlines, Kinko's, Harley-Davidson, Roadway Express, Green Mountain Coffee Roasters, and many, many small and midsized companies.

Most of the companies we worked with have left their competitors far behind. SRC itself grew from 100 employees to more than 1,000 today. It has many different divisions, several of them led by people who came up through the ranks. Its sales are 20 times what they were in 1983, and the value of a share of stock has increased by more than 2,000 times. For SRC and all the other companies we worked with, having employees who are fully engaged in the business through open-book management gives them a competitive advantage that rivals can't touch. It was a privilege to work with each of them, particularly SRC itself. Jack Stack opened my eyes to this principled, pragmatic approach to running a business.

In late 2012 SRC and I came to an amicable parting of the ways, and I created my own firm, Open-Book Coaching. There are no secrets in our open-book approach, only common sense. In this paper you will learn exactly what we do, how you can get started, and how you can use these methods to drive results and create a great company.

Am I giving away the store here?

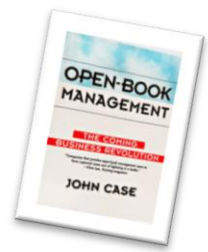
If I am, it's all right with me. I believe that open-book management not only works better, it's the right thing to do. It improves business performance, sure, but it also improves people's lives. I'd like nothing better than to have hundreds of companies try it out just from reading this paper.

Granted, Open-Book Coaching is a for-profit business, and I hope to sell plenty of coaching services along the way. We have found that many companies can benefit from our experience; they implement the methodology faster and more effectively, and they avoid some common pitfalls. Maybe you noticed our slogan:

Do Good | Have Fun | Make Money

We value all three goals. So I'm not worried about giving away the store.

I could go on about open-book management—and you may want to get a copy of my colleague John Case's classic book *Open-Book Management* to learn more—but the easiest way to understand what it involves is to plunge right in. So let's look specifically at what you would do if you were going to implement an open-book system.



Step 1: Define "Winning" — with just one number

If you were to ask one of your managers or front-line employees whether your company was *winning* right now, what would you hear? Most likely, you'd get a blank look. Maybe someone would say, "Well, I guess business is OK these days" or something similar.

That's not good enough. After all, how can people get in the game if they don't understand what it would mean to win? How can they get excited about winning if they don't even know whether they are winning or losing?

When I sit down with company owners to ask about winning, they tend to mention key financial figures as a gauge of whether they are winning. They talk about net profit, for example, or maybe the company's market value. I'm all for improving those numbers, but that kind of improvement is usually the *result* of a series of actions, not something that anyone affects directly. What I'm looking for instead is one single number that everyone can understand and affect, and that is absolutely critical to reaching your business objectives given the company's current circumstances. If that number is headed in the right direction at the right speed, you *know* you're winning.

Here's an example. SRC started life as a failing division of International Harvester. Stack and a dozen other senior managers went deep into debt to buy it out. They borrowed $8.9 million at what was then a *deal* interest rate of 22%. (This was 1983. Even with that rate, the bank fired the loan officer for taking such a risk.)

Now, what do you suppose SRC's critical number was? You guessed it: the cash balance in the company's account. If the company didn't make the loan payment each month, it would go belly up. So all the managers naturally focused on that one goal. They learned to understand all the actions that contributed to generating cash. They also explained the situation to their employees, so that the employees, too, would understand the urgency of generating cash. Suddenly people were pulling together. Internal bickering nearly vanished. Everyone worked hard toward making that monthly payment. Their jobs—and their company's survival—were at stake.

Determine your critical number

If you're uncertain as to what *your* critical number might be, that's good. I have found that the process of developing the critical number is just as important as the number itself. In the process outlined below, I suggest getting the employees, management, finance, and even your customers involved.

- **Start by asking your employees.** What do they see as the key issues the company faces right now? Asking for input through an anonymous survey is a great way to start open-book management, because it begins the process of engaging people and encourages candor.

- **Managers.** It’s also important to get the input of the management team. Again, an anonymous survey is a great way to get candid input on what they see as the company’s biggest opportunities and challenges. Find out whether they have similar perspectives as the employees or different ones. See whether they’re on the same wavelength as you.

- **Financial data.** Now get out your financials for the last five years. Plot the trend lines on numbers that you think are important. We often find that detailed study of the financials reveals problems that managers and even owners may be only dimly aware of. If you have developed a budget, look at the variances between budget and actuals for the current year. Perhaps gross margins have been declining or overhead has been creeping up. Maybe sales costs are rising faster than revenues, or some of your product lines are unprofitable. You’ll uncover such issues from close inspection of the financials.

- **Market research.** Finally, get input from your customers. Would they recommend you to others? Why or why not? What companies do they see as your competitors, and what do they think your competitors’ relative strengths and weaknesses are? Many companies hesitate to do this, but I have found that interviewing customers not only produces market input, it also strengthens your relationship with customers. That typically leads to more repeat and referral business.

These four perspectives—employees, management, financials, and customers—almost always provide you with a sound, fact-based understanding of the issues facing your business. The likelihood that you will miss some critical problem or opportunity is small. And you can do all this data gathering in just a couple of weeks.

Now summarize the key issues that emerge

Maybe it's excess capacity due to a shortage of sales. Maybe it's a cost structure that's higher than that of competitors. Perhaps your employees are unhappy, and turnover is driving up the cost of hiring and training. For example, here is a summary of the positives and negatives facing one company we worked with, a manufacturer of specialty gears:

Employees:

- Low morale; wages had been cut 10%
- Generally still committed to the company
- Little or no understanding of the business's financials

Customers:

- Generally pleased with company's quality and price
- Not satisfied with on-time delivery performance

Financials:

- Mounting losses, due partly to high scrap rates
- Excessive overtime, creating high costs
- High inventory levels, hurting cash flow and requiring a lot of debt

Understanding the key issues enables you to develop just one or two metrics that will define winning for the next six to twelve months. For the gear manufacturer, the critical number turned out to be manpower efficiency, defined as:

$$\frac{\text{Gears Shipped} \times \text{Standard Hours}}{\text{Total Paid Hours}}$$

Why was this number critical? Look again at the issues this company faced. Improvements in manpower efficiency would have a positive influence on virtually every one. Wages could rise. On-time delivery would improve. Costs would decline.

Moreover, manpower efficiency was a metric employees were already familiar with, albeit they had been focusing on gears produced rather than gears shipped. The difference was important, since the company had problems with on-time delivery. The employees could understand the metric, and they could easily see the connection between greater efficiency and better financial results.

Remember these three points about critical numbers:

1. There is no simple formula for determining a company's critical number, other than the process I just outlined. Every business is unique. Depending on the nature of your business and the issues you face, your critical number might be revenue per employee, room occupancy, or cost per unit. The trick is to find a number that's easy to understand and track, and that will have a beneficial effect on your company's results if it improves.

2. Most companies change their critical numbers every year as part of their planning process. Typically, they have made significant improvements in the original one. They have mastered it, so to speak, and they are ready to go on to something else. As employees become more financially literate, the critical number may become more financially sophisticated, like gross margin or return on assets.

3. Large companies typically have many different businesses within their company. So they typically break the company down into smaller business units or natural teams and determine critical numbers for each one. Once this is done, the same process I outlined works well. I have applied the process at big corporations such as Southwest Airlines, Capital One, and BHP Billiton.

You can see the importance of focusing on one critical number. It becomes the central concern of everyone in the company over the next six to twelve months, just as making the bank loan payment was in the early days of SRC. Creating a clear, common definition of winning for your employees has a powerful effect on engagement. Suddenly people are *players* in the game. And players like to win.

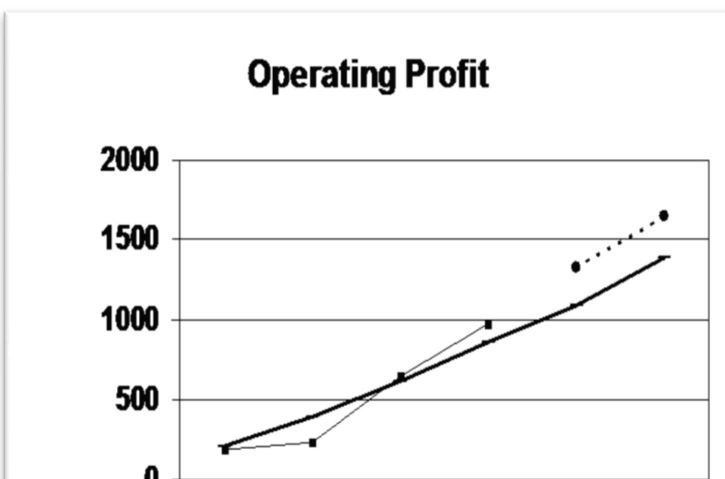
Step 2: Make results visible through a scoreboard

If employees have helped you define what it means to win, they are already more engaged in the business than they were before. Now it's time to take things to the next level: put up a scoreboard so everybody can track the results.

Draw a clear line of sight

Scoreboards can be big whiteboards mounted on the wall. They can be a site on the company's intranet. The only requirements are that they be visible to every employee and easy to understand. A scoreboard should create a clear *line of sight* for employees, so they can see the company's performance and begin to figure out how they influence overall results.

A good scoreboard reflects the company's organizational chart rather than a financial statement: it enables each department or group within the company to see the impact of its actions. Graphing overall results and showing actual performance relative to a baseline (such as the budget or last year's results) can clarify this line of sight.



	Jan	Feb	Mar	Apr	May	Jun
Budget	209	393	610	856	1,089	1,385
Actual	186	227	643	975		
Forecast					1,323	1,649

Here is a simple scoreboard from an engineering services company. This firm's critical number: operating profit. Everyone can see the company got off to a slow start, as results were below budget for the first two months. But March and April were strong and the company is now performing above plan.

At a glance, everyone can see that the company came from behind and is now *winning* against its budget. The forecast is to extend this winning streak into May and June. When May and June are complete, they can see how the forecasts compare to the actuals, which provides for further learning.

Updating is critical!
Keeping the scoreboard up to date is a vital part of open-book management. Create a regular forum for posting and reviewing results. Help people learn to celebrate victories, identify variances, and pinpoint issues. Most companies schedule a short weekly meeting, 30 minutes or so, for these purposes. This is not a problem-solving gathering. Its purpose is to track performance, learn from what happened the past week, and identify needed adjustments. It provides the context for later brainstorming and problem-solving sessions.

Step 3: Align employee incentives through a bonus plan

Once you have defined winning and begun to track results, and once employees begin to understand how they can affect those results, you can develop a powerful incentive plan tied to improvement in the critical number. The incentive should be self-funded from the incremental dollars generated by improvements in performance.

For smaller companies, I usually recommend that employees participate in a companywide incentive plan. That reinforces the importance of the team. For larger companies, the relevant unit may be a business unit or a particular geographic office. Reinforce the linkage between the company winning and the employees winning. *The incentive should be completely transparent and easy to understand*. By tracking the scoreboard, employees are essentially tracking their bonus. You may want to add bonus numbers to the scoreboard to make the connection even clearer.

Some people believe that incentive payments should go mainly to the individuals who are most responsible for generating improvements. In the long run, this will probably be the case, because the most competent and innovative individuals will earn a disproportionate share of promotions and pay raises. But the purpose of a bonus plan should be to reinforce team accomplishments. After all, business is a team sport. Any salesperson going after a new account with many great references knows that most of his or her success is due to the fact that the company has delighted its customers.

The mechanics of a bonus plan can get complex. Depending on your business, for example, you may decide to pay part of the bonus quarterly and part when the yearly results are in. Some companies divide the bonus pool equally among all employees; others pay shares that are proportional to each individual's compensation. Whatever your decisions about the mechanics, however, make sure that you meet the two fundamental requirements for an open-book bonus program: it must be transparent, and it must be self-funding. If people don't understand the program, it won't have any effect as an incentive. And if results do not improve, you do not want to be paying anybody a bonus.

Step 4: Forecast and drive results

With the critical number, the scoreboard, and the incentive plan all in place, you're ready to start running your company along open-book lines. People understand what the company's top priority is. They can see how they're doing on the scoreboard, and they have a stake in winning. They'll begin to ask how they can contribute. They'll begin to think like owners. This is where teamwork comes into play. It's up to you and your managers to foster cooperation and innovation. It's up to everyone to come up with ideas for resolving problems and increasing efficiency. The critical number is invaluable in this context—it keeps people focused on what's important right now.

Get together weekly

The weekly meeting plays an essential role. As part of the meeting, you can get people *thinking ahead* about what they can do to affect results.

Have them forecast expected monthly results in their areas of responsibility. Record the forecast on the scoreboard. For example, here is how a landscape company tracked its forecast of gross margin dollars, its critical number:

Owner	*Bill*	*Mary*	*George*	*John*	*Frank*	
Revenue:	Landscape	Nursery	Com. Maint.	Residential	Tree Shrub	Total
Budget	$154,500	$37,000	$225,000	$52,000	$4,000	$568,082
Forecast	*$147,250*	*$34,000*	*$280,000*	*$50,000*	*$11,300*	*$607,550*
Expenses:	Landscape	Nursery	Com. Maint.	Residential	Tree Shrub	Total
Labor Budget	24,200	6,600	73,713	16,500	594	136,326
Labor Forecast	*22,500*	*6,800*	*85,000*	*15,500*	*1,356*	*141,356*
Materials Budget	36,000	800	1,500	1,407	2,775	49,137
Materials Forecast	*33,000*	*1,500*	*3,500*	*1,525*	*1,530*	*49,160*
Gross Margin:	Landscape	Nursery	Com. Maint.	Residential	Tree Shrub	Total
Budget	$94,300	$29,600	$149,787	$34,093	$631	$382,619
Forecast	*$91,750*	*$25,700*	*$191,500*	*$32,975*	*$8,414*	*$417,034*
Actual						

Notice how this company is divided into various teams. Each team can see how it affects overall performance. Identifying each component of performance—labor and materials—provides a higher level of *ownership* of results.

Forecasting is amazingly powerful

It encourages employees to think about cause and effect. It helps them see how they can influence the numbers rather than just passively looking at results to date. Learning to forecast requires discipline and practice. But once people learn it, it is amazingly powerful. For example, each week you can get an update from employees on expected results. Often the forecast is simply "no change from last week," so it doesn't take much time. However, when forecasts do change, there is something to be learned. Encourage people to provide a brief explanation of why they changed their forecast, so that everyone can absorb the lesson. When actual results are available at the end of the month, compare forecasts to actuals and discuss variances. This process encourages additional learning. It also gives you a clear idea of who is on top of his or her part of the business and who needs help.

If you're like a lot of company owners, you may believe that forecasting is impossible in your business. So were a lot of company presidents who are now reaping the benefits of weekly forecasts. Believe me: it works.

Tip: Forecast the bonus
A great way to make the bonus visible and demonstrate that it is being funded by the teams' efforts is to forecast the critical number and show the resulting bonus for that period. As forecasts on the critical number move up or down, so does the forecasted bonus. This reinforces teamwork throughout the company and helps everyone understand that they directly influence their bonus.

Maybe operations forecasts an increase in efficiency, thereby improving the critical number forecast, and everyone's bonus goes up. Or perhaps the sales team can increase the price on a key product, improving the critical number, and everyone's bonus is increased. Contrariwise, say that the company loses a major customer; now everyone's bonus goes down. The everyday wins and losses of business are right up there for everybody to see.

Going forward, engage employees in making refinements to the critical number, scoreboards, and incentive plans for the next year, as part of the planning and budgeting process.

Ready to start reaping the rewards of having more engaged employees?
I hope you are. Don't be afraid of making mistakes. You will—and so will your employees. But you will learn from those mistakes and make progress along the way. If you run into too many obstacles, or if you aren't sure what to do first, please call me for help. The only real mistake is not moving forward.

You can lead your industry in reaping the benefits of engaged employees or you can follow. You can be the Southwest Airlines of your industry or the TWA. Being Southwest is more fun—and more profitable. Good luck!

ABOUT BILL FOTSCH

Bill, the founder and Head Coach at Open-Book Coaching, has built collaborative improvement efforts in nearly 400 companies over a 20-year period, with a global client list that includes Southwest Airlines, BHP-Billiton, Harley Davidson, Roadway Express, Scottish Hydro Electric, and Capital One.

Before becoming a coach, Bill had 20 years of experience as a results-oriented manager, with a successful record of improving company sales and profits in a broad array of industries.

Bill graduated from Marquette University and earned an MBA from Harvard Business School, where he graduated as a Baker Scholar.

If you would like to build an open-book company, Bill would love to hear from you.

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Scan for more info on Open-Book Coaching.

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What Bill's clients say…

I was part of an executive team that hired Bill to help build a culture where our 225 employees were focused and vested in the profitability/success of our company. Bill was very experienced, knowledgeable, and easy to work with. Most importantly he delivered results that meet and exceeded our goals.

Joe Candido
Sales, marketing, research, and general business consulting

Bill coached our Pilot group to think outside the box. We had a diverse group of uniquely different thinkers, from "me people" to "group thinkers" to skeptics. Bill helped us produce a program that exceeded our wildest expectations. When finished our development sessions we had a focused TEAM that had goals and motivation.

Bill turned us into True Believers in open-book management and helped us rekindle the successful concept that frontline employees have the answers required to continue on our road to a profitable, rewarding and FUN future.

Kent Roper
Pilot at Southwest Airlines

Bill's knowledge, expertise, and help have been invaluable to us. From getting us started in the Great Game of Business to working with us now with high-involvement planning, he has brought us farther and much faster than we ever could have done on our own.

He delivers on his promises, both the content and the timing. He provided us with simple solutions to complex problems. We would not have received a lot of the recognition we have without his influence on our business.

Mark VanDeWege
General Manager at Anthony Wilder Design/Build, Inc.

Head Coach is an honest description of Bill Fotsch, not just a clever title on a business card. He has an understanding of both "the game" in manufacturing companies, having played it himself for many years, and the process of coaching, which is getting others to play the game better.

The Great Game of Business was one of the two most exciting management practices we began at Green Mountain Coffee. Our adoption of it is due, in no small part, to Bill's ability to work effectively with C-level executives and front line workers. The results, when we followed his lead, spoke for themselves.

James Jennings
CEO at @1