Embracing an Ownership Culture

Strong opportunity and accountability exist in an ownership culture and both public and private companies can embrace such a culture to drive better short and long-term results.

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In his book Sam Walton: Made in America, businessman and entrepreneur Sam Walton wrote, “There is only one boss. The customer. And he can fire everybody in the company from the chairman on down, simply by spending his money somewhere else.” Owners like Walton think differently than others because they simply have no other choice. Their success isn’t based on how well they can negotiate their objectives or whether they can explain away performance variations. If a business opportunity falls through, there is no one to blame other than the person in the mirror. And missed opportunities are quickly back-filled by new opportunities, since no one is going to get the business back on track other than that same person staring back in the mirror.

We often encourage our clients to embrace an ownership culture and they often ask what we mean. In our view, it means ownership of decisions, results, and consequences. When each manager and employee accepts their business responsibilities as if they owned them, the collective organization delivers more success.

In addition to their own sphere of influence, employees see colleagues as partners whose mutual success or failure depends on how efficiently and effectively they jointly serve the customer. There may be a managing partner (a.k.a. the CEO), who leads the group, but an ownership culture is where each employee acts as an owner by improving how well customers are served.

We often find the sense of responsibility and accountability is diluted below the executive level, especially as a company becomes big, complex and bureaucratic. In an ownership culture, employees take pride in their work, cherishing the accountability, responsibility, and opportunity to prove themselves without ambiguity.

An ownership culture doesn’t require risking one’s life savings as an actual entrepreneur, but it does require that results matter and that they determine rewards. We’ve identified the five most important and distinguishing owner-like traits, and each is within reach in every company.

1. Spend like the money is yours: People tend to buy better things than needed and spend more than necessary when they are using other people’s money. Whether it’s a dinner at a nicer restaurant, an upgraded airline seat or any other form of overspending, managers and employees often don’t treat the company’s money as they would their own. Owners aren’t shy about spending their money, and often are more eager to invest in growth, as well as happier employees and higher quality products. But most won’t waste money on anything that doesn’t deliver a tangible benefit.

Many companies lack the results-orientation and accountability required to reinforce an ownership culture. For example, negotiated performance targets can insulate rewards from whether or not performance has improved. Is the business underperforming? Is there a problem with excess spending? It often doesn’t matter since managers in most companies can still be paid well if they are able to negotiate a sandbagged target.

The solution is to always measure performance improvements versus the prior year, rather than a budget. This requires a comprehensive measure of performance that balances revenue growth, cost efficiency and capital productivity. One such measure is Residual Cash Earnings (RCE), which measures profits after cash operating costs, taxes and a required return on the assets used by the business. When RCE improvements determine compensation, managers are encouraged to treat the company's money as if it were their own. If they spend wastefully, RCE will decline and a portion of the value destruction will come out of their compensation without any ability to negotiate out of it. And if they generate wealth, they will get a definitive share of that too.

2. Extreme prioritization: One of the most common complaints of public company executives is that they have no available time. Indeed, we've all been told "sorry, but he [or she] has been bouncing from meeting to meeting all week." There is inadequate prioritization and attention with too many initiatives and projects.

Successful owner-managers often practice extreme prioritization to absolutely make sure all really good things happen, to the best of their organization's ability, while not being distracted by mediocre ideas. They recognize that 80 percent of the potential success typically comes from 20 percent of the activities, so they give these fruitful opportunities their full attention. Lesser ideas are screened out or delegated. The executive team's full attention and the organization's full assemblage of resources can then be focused on the most productive uses and users of those resources.

An intensive and comprehensive prioritization of opportunities should be based on a fact-based Strategic Resource Allocation process. Capital, marketing and R&D should be concentrated where desirable improvement and trends in Residual Cash Earnings appear sustainable and expandable. Of course, spend where it's important for the well-being of the organization and to meet regulations, but stop wasting resources on mediocre activities.

3. Willingness to fail: At least partially because of the quarterly earnings call ritual, company leaders are often more concerned about avoiding bad outcomes than ensuring that good outcomes happen. This "loss aversion" often prioritizes incremental improvements to what a company already does with less emphasis on new bold things the company could do. Efficiency and productivity metrics often improve, which benefits the quarter, but less innovation and growth restricts long-term growth and value creation.

In a fascinating behavioral paradox, the very same owner-managers that ruthlessly prioritize resource allocations, are often willing to experiment and fail, although when they fail, they make sure they fail fast and learn from it. The willingness to fund new good ideas helped make Silicon Valley successful, but the ability to swiftly un-fund bad ideas is as important. Owner-managers quickly accept responsibility for failure, to stop throwing good money after bad and reallocate resources to better opportunities.

A willingness to experiment and accept failure is necessary to create the fresh and differentiated products and services that fuel long-term value creation. However, leaders must set expectations upfront so their managers and employees have a clear sense of what success or failure looks like, and how to react when failure arrives.

4. More doing and less talking: Making decisions can be uncomfortable. "What if it goes wrong? What if I am blamed? What if there is information I should have had when making this decision? It could be bad for my career, so let's study it more to be sure before we make a decision." But we never know everything and must make judgments under uncertainty by accepting that we cannot eliminate all risks.

Obviously, owners don't want to be wrong. But they know that investing $10 million in something worth $12 million creates $2 million of wealth, but spending $3 million studying it before investing destroys value. That's why owners are decisive. They do carefully evaluate decisions but there is no analysis paralysis because they care about results, not covering all bases.

A results oriented manager spends more time doing things and less time talking about them. They consider the pros and cons of a situation and are decisive. Before they present an idea to others, they convince themselves they believe it will work. And if they are presented an idea, they have more confidence in what is presented when they know the presenter is absolutely accountable for the result.

5. It's about the long and short-term: It is very unfortunate that many public company executives act as if next quarter's results are the goal. A study in 2004 by John Graham of Duke University and others showed that three-quarters of businesses would knowingly sacrifice shareholder value in order to report earnings that rise smoothly year to year. It's absolutely nauseating, and it's gotten worse since then.

On the other end of the spectrum, some executives only advocate a long-term strategic viewpoint. They can be commended for avoiding the typical short-termism, but often they act as if the short-term doesn't matter. This often leads to hockey stick forecasts that decline in the short run, but, if you believe them, the future is so bright we have to wear shades. With a lack of any focus on shorter term results, the anticipated bright future gives way to clouds every time.

The strategic priority of owner-managers is always long-term value. They pursue all investments that drive long-term growth and return higher, and they want to drive current year performance too. They wouldn't cut investments in advertising or R&D to meet short-term EPS objectives, but they still motivate the sales team to sell, the manufacturing team to be productive and for everyone else to be as efficient as possible. They seek profitable growth in the near term to pay for the long-term investments.

Owner-managers are absolutely driven by maximizing long-term value while at the very same time motivating current performance as strongly as possible. It's not about the short-term or the long-term, it always involves both - the short-term and the long-term.

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Business processes need to align with and support the ownership culture. In our Fortuna Management System, we recommend Residual Cash Earnings (RCE) as the primary focus for planning, decision-making and performance measurement. Unlike traditional return on capital, economic profit and EVA measures, RCE spreads the benefits of investments more evenly over time, which encourages more willingness to invest in the future while being accountable for earning returns on investments over time. In other words, it encourages managers to meet short-term demands while planning for long-term results.

Managers with an RCE line-of-sight can determine which investments to make, how to price products and services, and when to incur operating cost to improve the business. When companies hold managers accountable for improvements in RCE, they ensure they believe their own forecast, which internalizes the ownership culture. If RCE declines, they make less money, and if RCE rises, they make more money. Period. It is a true simulation of ownership.

To embrace such a culture requires extensive communication and training about how these principles should translate into behaviors and actions. It is most effective to use case-based training where employees can see how decisions, actions and results translate into success or failure for the company and themselves.

Executive buy-in is critical. If they talk-the-talk without walking-the-walk, the culture will fail. Managers and employees must witness the senior executives treating the company's capital as if it were their own, prioritizing initiatives, experimenting with innovative ideas, emphasizing results and balancing the long and short-term. And senior executives must be seen to take concepts like "competitive advantage" and "strategy", which are often platitudes, and make them points of real emphasis every day. After all, competitive advantage is the most significant driver of RCE improvements.

Properly designed compensation provides upside opportunity and downside accountability, and can reinforce an environment where doing what's best for the company and shareholders is also best for the individual manager. The financial alignment over both the short and long-term is critical. Why make managers choose between what's good for the company and what's good for themselves and their family?

Companies that embrace an ownership culture develop better strategies, improve execution and deliver more profit and cash flow, culminating in higher total shareholder return, more secure jobs, and higher compensation. Like most things worth doing, embracing an ownership culture requires considerable effort. But it's those things that are challenging to do that provide defensible competitive advantages that are difficult to replicate. Creating an ownership culture is one of those challenging things worth doing.

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