The Leaders’ Choice

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BY THOMAS A. KOCHAN

BUSINESS LEADERS HAVE A CHOICE in how they compete. The popular way this choice has been framed is between a “high-road” and “low-road” option. High-road companies seek to compete through high productivity, innovation, and quality customer service that both require and support high wages and good job and career opportunities for employees. The low-road strategy seeks profits and shareholder returns by minimizing costs and controlling labor in ways that keep wages low for most employees and/or independent contractors.

Two decades of research on high-road companies have documented their ability to achieve world-class productivity and service quality in industries as diverse as steel, autos, airlines, telecommunications, apparel, health care, computers, and semiconductors. More recent case studies are documenting similar patterns of success in smaller businesses in manufacturing, retail, and health care.
Southwest Airlines Co., headquartered in Dallas, Texas, is often viewed as the prototype high-road company. Over the past 30 years, it has been the most profitable airline in the United States. From the time the company started flying in 1971, founder and former CEO Herb Kelleher decided he would compete differently than other legacy airlines. Rather than fight to avoid unions or treat them as adversaries, Kelleher accepted them but insisted they work in partnership with him by avoiding rigid work rules and fostering teamwork throughout the organization. The business strategy required that everyone in the organization work together to reduce the time from landing to the next takeoff. This effort generated the productivity that allowed Southwest to keep prices low while also providing good jobs and great customer service. It is not surprising that Southwest has often been rated as one of the best places in America to work.4

In almost every industry, there are some companies that are managed for long-term (not just quick) returns, have business strategies that stress great customer service, and figure out how to operate efficiently. Such companies draw on the talents of employees who identify with the organization’s mission. In retail, compare Costco Wholesale Corp. and Walmart.

Walmart has grown to become the largest U.S. retailer and employer by pursuing a business strategy best captured by its marketing tag line: “Everyday low prices.” To achieve this strategy, it has placed top priority on minimizing and tightly controlling labor costs, investing comparatively little in training and development for the bulk of its workforce, and avoiding unions at all costs. Costco, for its part, places a higher value on product quality and customer service, and to achieve these objectives, it pays higher wages, invests more in training its workforce to understand and serve customer needs, and has longer employee tenure patterns (and thus incurs lower turnover costs). As a result, its employees are more productive and have more discretion to use their time and knowledge to solve customer problems. Not surprisingly, Costco consistently ranks higher on customer service and employee satisfaction than Walmart.5 Moreover, while both companies are successful financially, between 2010 and 2015 Costco’s stock price increased at a much higher rate.6

In the summer of 2014, residents of New England witnessed one of the most vivid examples of the power of a high-road leadership and business strategy with Market Basket, a family-owned grocery store chain with 71 stores, headquartered in Tewksbury, Massachusetts. The company had 25,000 employees and was known for providing low prices, great customer service, and high-quality jobs and careers. However, its legacy was threatened by a family feud that was played out among members of its board of directors. One faction fired the popular family member who had been serving as CEO because it wanted to either sell the business or extract more immediate profits for the owners. In response, executives, store managers, clerks, warehouse workers, and truck drivers mounted a protest to reinstate the fired CEO and also to protect the business model that had served employees, customers, and their communities for many years. After a six-week “strike” by nonunion employees and managers that had broad community and media support (it caused an astounding 92% reduction in the company’s revenues), the board agreed to sell the business to the ousted CEO.7

High-road organizations are an international phenomenon. In her book The Good Jobs Strategy, Zeynep Ton describes how the Spanish retailer Mercadona achieves similar results with high-road business strategies and operations and workforce practices.8 German companies such as Siemens and Volkswagen have extended their investments in training and development for manufacturing workers and technicians at all levels. In this way, they follow Toyota’s approach to achieving high productivity, quality, and good employee relations that the company pioneered when it started assembling autos in the United States in the 1980s. The evidence is that high-road strategies can work in a variety of industries and cultures, with both entry-level workers in manufacturing and services and high-level professionals in health care and high tech.

High-Performance Organizational Models

Efforts to understand what high-road companies have in common have a long history at MIT. Back in 1960, MIT Sloan School professor Douglas McGregor published one of the most famous management
McGregor described two different mental models managers might use for thinking about their workforce. Theory X held that workers were self-interested, uninformed, and uninterested in the enterprise’s goals. Therefore, they need to be told how to do their jobs, closely monitored, and controlled to make sure they do what needs to be done. Theory Y held that workers were motivated to do a good job and wanted to contribute to an enterprise they could be proud to work for. Moreover, they had the knowledge, skills, and motivation to perform well without tight monitoring and controls.

McGregor’s key insight was that these mental models become self-fulfilling: Acting on Theory X assumptions breeds resistance and the need for tight controls; acting on Theory Y assumptions builds trust and correlated behaviors. So values, assumptions, or mental models are an important starting point for understanding what makes a high-road and high-performance organization tick.

Of course, this raises a tough question for managers. Assuming that you are sympathetic to Theory Y, how do you know if it can be applied successfully in your industry? How do you make it work? The standard economics answer is to do what other successful businesses are doing, keeping in mind that the more important labor costs are as a proportion of total costs of goods or services, the more pressure management will feel to control these costs. If there are key strategic or “core” competencies or “star” employees that are critical to achieving high performance, a common approach would be to build the organization around attracting and retaining these people and then outsource as many other functions as possible to avoid having to pay a premium for that less-essential work.

However, the research on high-performance work systems cited above challenges this view. Implementing a Theory Y value set depends on a system of mutually reinforcing operations and employment practices. Rather than there being a single silver bullet (for example, a magical incentive compensation plan that will get the needed results), the research indicates the importance of a bundle of generic practices that need to be tailored to the specific industry and working environment. Among the important features are:

- Careful selection and screening processes to attract and choose employees with strong technical, problem-solving, and collaborative skills. Southwest, for example, screens applicants both for their technical skills and their willingness to work in teams.
- Significant investment in training and development for the full workforce, not just high-level executives or professionals. Our auto industry research showed the highest-performing companies invested three times as much in training as low performers.
- Commitment to building trust and to drawing on employees’ knowledge to solve problems, coordinate operations, and drive innovations. Based on her airline and health care research, Jody Hoffer Gittell has built an international network of professionals helping organizations build “relational coordination” capacity to drive performance improvements.
- Compensation systems that align employee and company interests by use of profit sharing, group incentives, and/or payment for attaining higher levels of skills. For example, Market Basket paid employees a year-end profit-sharing bonus even in the year it experienced the six-week shutdown.

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The View from the Workforce

In spring 2015, I taught a massive open online course (MOOC) to engage members of the next-generation workforce in a conversation about what needs to be done to create and sustain more high-road organizations and career opportunities. At the same time, I taught a parallel course on campus to MIT Sloan MBA students so that they could interact with young workers from around the world. Students taking the MOOC commented online about the high-road/low-road distinction based on their personal work experiences. (See “The View From Students.”)

Students indicated they were ready to vote with their feet by accepting jobs with organizations that foster high-road strategies and work practices and rejecting jobs with those that do not. We saw this in a class exercise aimed at developing a “Good Jobs” smartphone app in which students interviewed employees of 170 different organizations they were interested in. Students posed a range of questions to employees about the companies’ business strategies and employment practices, and they generated a wide distribution of answers to the questions. In analyzing the data, we found that the employers that used high-road strategies and practices (that is, practices that research links to both good business performance and good working conditions and employee satisfaction) had a much better chance of attracting the potential employees. Using these indicators, we could predict with 80% accuracy whether or not these potential employees would accept a job offer.

Nevertheless, we have a lot more work to do with this survey instrument before we will be confident of its validity and generalizability. But we hope that this app and others from organizations such as Glassdoor or Indeed enable employees to rate their employers and assist job seekers who are considering whether or not to take a job with a given employer. Ultimately, this should encourage more organizations to move in the high-road direction.

Making High-Road Strategies the Norm

Unfortunately, high-road practices and systems are not spread across organizations and, in fact, they seem to have declined somewhat in the past decade. We don’t have a clear understanding of why. Among the hypotheses: lack of information about how to implement some of the practices; the high startup costs and delayed benefits they provide (sometimes called “worse before better” traps); failure to reform and modernize labor law to support the strategies; and investor interest in maximizing short-term returns.

Market failure may be a factor as well: As the average time an employee stays with a given employer decreases and more parts of a company’s value chain are outsourced, the incentive for an individual organization to invest broadly and deeply in its workforce also decreases. Indeed, a recent trend in human resource management stresses “talent management” of key executives, as opposed to investing in the overall workforce. This may be rational for individual businesses, but it isn’t an optimal way to build human capital in their full workforce, much less across the supply chain or the economy as a whole.

It’s likely that all of these factors play a role. The
net effect is a two-equilibria economy. Some companies will compete with high-road, knowledge-driven strategies, while others will compete on the low road, by minimizing labor costs. To date, more have chosen the latter, which puts leaders who want to build high-road organizations on the defensive and discourages others from following their lead. The goal is to tip the balance so that the low-road businesses are forced to upgrade their practices and employment standards to remain competitive.

Overcoming market failure requires coordinated, distributed leadership within and across organizations and institutions. Business leaders need to work together to support high-quality education and training programs in their communities; build positive, partnership relationships with unions and other worker advocacy groups that are emerging; and educate investors and investment analysts about how companies with high-road strategies will generate long-term payoffs for owners and other stakeholders.

The Choices Ahead

If all managers understood and accepted the value of the high-road model and worked together to promote it, the pace of economic progress would accelerate, fueled by the incomes of a growing middle class. But this hasn’t been happening. For years, many middle-level managers have been rewarded for maintaining control and adhering to Theory X management styles. Today, few MBAs learn about high-road strategies in their economics, finance, and operations courses; they don’t learn that, as business leaders, they will have distinct choices to make about how to compete. The MBAs who participated in the on-campus version of the online course I taught commented on this omission and saw the need for MIT Sloan and business schools in general to integrate this lesson into the core curriculum.

Academics, business and labor leaders, and employees themselves all have a role to play in educating current and next-generation business leaders about the choices before them. Working together, these different groups can encourage future leaders to build successful organizations that are dedicated to creating a more innovative and dynamic economy — one that shares the prosperity widely in their organizations, communities, and societies.

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5. See customer ratings from the American Customer Service index and employee ratings from Glassdoor for Walmart, Costco, and other retailers at www.goodjobscore.com.
14. For a quick overview of the course videos, materials, and lessons learned from the students in the MOOC, see “The Next Generation’s American Dream and How to Achieve It: Lessons From Our MITX Course,” www.speakupforwork.com.

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