

“The Enigma of Good Management”

One of the great challenges of investing is the enigma of ‘good management’. Too often we praise a company’s management team merely because the company’s stock price has appreciated. How can we identify good management that enhances long-term shareholder value without getting caught up in the short-term performance of the company’s stock price? Can a brilliant entrepreneur evolve into a great manager of a large enterprise?

I am inspired to write this essay on management, having just finished a recently published book, *Bill & Dave, How Hewlett and Packard Built the World's Greatest Company* by Michael S. Malone. This is the inspiring story of two young Stanford engineering graduates, who started their company in 1939, in a now legendary garage located in Palo Alto, California. This garage is considered to be the origin of today’s Silicon Valley. While both Hewlett and Packard were terrific electrical engineers, their ability to start, grow and maintain one of the largest enterprises in the world, demonstrates their magnificent general management skills. There are thousands of books on effective management but very few actual books profiling great management. These two men are the epitome of what every current manager should aspire to become.

In 1956, Hewlett and Packard were worried about the growth of their company. They were becoming so successful that they “were afraid we’d lose the personal touch we felt was so important.”¹ So, they invented the off-site retreat that is now a common practice for corporations. In early 1957, at an inn in Sonoma, California, they convened a group of twenty of their senior managers to discuss the future objectives of their company. Today, “Management by Objective” has become so commonplace that it seems trite to write about it, but, in 1957, before the explosion of management theory, Hewlett and Packard wanted to establish some general objectives to guide their growing company. They wanted to create some overriding principals without constraining their managers, who, Hewlett and Packard believed, would make the best operating decisions. In short, they wanted to trust their people after giving them a few central guidelines.

1. Profit: To recognize that profit is the best single measure of our contributions to society and the ultimate source of our corporate strength. We should attempt to achieve the maximum possible profit consistent with our other objectives.²

¹ Malone, Michael S. *Bill and Dave: How Hewlett and Packard Built the World's Greatest Company*. New York: Portfolio, 2007. P. 143

² Ibid. p. 147



Amazing! The primary goal is to earn a profit. I have read a lot of corporate mission statements in the past twenty years, and I can't remember any one of them brazenly beginning with the goal of earning a profit. And, not just a profit, but the "maximum" profit! Before you think the worst of these men, these maximum profits have to be "consistent with our other objectives" that follow. I find it wonderfully refreshing to learn from Hewlett and Packard that it is normal to seek to earn a healthy profit when managing a private enterprise. Their very first objective is pure, unadulterated profit. Capitalism lives!

If you want to evaluate management all you have to do is read their financial reports and look at the profit line. (One needed update to HP's emphasis on profits is that the profits should be 'real', because reported earnings and accounting standards have become more 'imaginative' since 1966.)

2. Customers: To strive for continued improvement in the quality, usefulness, and value of the products and services we offer our customers.³

It is axiomatic that profits are realized by offering a product or service that is of value to a customer. What is interesting about this objective is the goal of "continued improvement". Companies and their management must not rest on their reputations. They always have to seek to do a better job for their customers. In spite of the book's subtitle, Hewlett and Packard informed their employees that they can never claim that they are "the world's greatest company", because they still have to improve in their customers' eyes. This is a tough objective because you have to improve, forever!

To judge management on continuous improvement, you have to look periodically at the company's product literature. Additionally, somehow, you have to understand their customers' motivations to purchase the company's newest products. Perhaps the best way to evaluate this objective is to ask the rhetorical question "Is this company leading its industry, while all of its peers are struggling to imitate them?"

3. Field of Interest: To concentrate our efforts, continually seeking new opportunities for growth but limiting our involvement to fields in which we have capability and can make a contribution.⁴

All of these objectives are interlinked. Profits come first. Continuous improvement comes second. At the same time, companies have to remember to be focused upon their core competencies. Put bluntly, this objective says, "Don't do anything stupid". Hopefully, the company can grow in an evolutionary manner, and expand on the basis of its current skills.

To evaluate managements on this objective take a look at their internal versus external growth. The best managements are able to grow through internally generated new products and services. At the same time, the worst examples of best management are

³ Ibid.

⁴ Ibid.



usually found at those companies that make ill-considered external acquisitions in a different sector.

4. Growth: To emphasize growth as a measure of strength and a requirement for survival.⁵

While all of HP's objectives are interlinked, it is telling that growth is well down the list at number four. Growth is important, but not as important as profits, continued improvement and staying within areas of expertise. However, it is still vital to grow in order to survive. Put differently, as Satchel Paige once said, "Don't look back, something may be gaining on you"⁶. All businesses need to grow to insure that their competitive advantages, their strengths, remain intact. Growth is not an end in itself, but rather it is an insurance policy.

I think the best way to measure 'strong growth' managers is by monitoring profit margins. If a company is growing prudently, it is maintaining its profitability and growing simultaneously. Far too often, poorly managed companies over-emphasize growth to the detriment of their current and future profitability.

5. Employees: To provide employment opportunities for HP people that include the opportunity to share in the company's success, which they help make possible. To provide for them job security based on performance, and to provide the opportunity for personal satisfaction that comes from a sense of accomplishment in their work.⁷

Of all of HP's written objectives, this one about employees is the longest. The words that stand out for me are: opportunity, share, job security, and a sense of accomplishment. All companies depend on their employees to represent them each day in the best possible way. Exemplary employees are those, who take pride in their work, because they are secure in their position and are proud of their efforts. Today, too many corporations seem to devalue their employees by removing their security through layoffs, benefit reductions, and demeaning their work by hiring from outside the company rather than promoting internally.

I believe you can measure a senior management team's commitment to its employees by reading the company's proxy statement. How long have the top managers been working for the company? Are the annual option grants to employees shared widely at all levels? Are the top managers' salaries reasonable? The best companies do, indeed, allow all employees to "share in the company's success".

6. Organization: To maintain an organizational environment that fosters individual motivation, initiative and creativity, and a wide

⁵ Ibid.

⁶ http://en.wikipedia.org/wiki/Satchel_Paige

⁷ Malone, Michael S. Bill and Dave: How Hewlett and Packard Built the World's Greatest Company. New York: Portfolio, 2007. P. 147



latitude of freedom in working toward established objectives and goals.⁸

Freedom is the key word here. Hewlett and Packard wanted to insure that their organization would be free from too much top-down supervision. Instead, they hoped to foster profitable and continuous growth at HP by allowing their employees to work in a creative environment. I was surprised to learn that HP was the originator of casual Fridays. This was Hewlett and Packard's subtle way of communicating to their employees that Friday was a day to think and act creatively, all in the hopes of improving the company and its products.

This is a tough objective to measure without talking to the company's rank and file employees. Perhaps the best evidences of a good creative organization are the stories and myths that exemplify the corporation's self image. In HP's case there are numerous stories of the founders going out of their way to serve their employees – including serving the beer at the Friday afternoon 'beer blasts'.

7. Citizenship: To meet the obligations of good citizenship by making contributions to the community and to the institutions in our society which generate the environment in which we operate.⁹

I find citizenship to be a wonderfully old-fashioned term. Hewlett and Packard want their employees to serve their own communities and also the institutions that surround their company. The key word here is obligation. It is every employee's obligation to serve as an engaged citizens of the world outside of HP. You cannot assume that the public servants of the community will do what is right. In the eyes of HP, every employee has an obligation to be a public servant.

Again, this is an objective that is difficult to measure without knowing a company and its employees on a personal basis. Perhaps we can evaluate a management's citizenship by searching on the internet to see what if any charitable organizations they support, and on whose boards they might serve. I was amazed to learn that Bill Hewlett actually took the time to serve on the Palo Alto School Board. That is a great example of grass-roots citizenship.

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'Good management' is very difficult term to define and even harder to find. It is a valid exercise to try to measure a corporation's management, because the work will reveal important information. In the end though, good management is really in the eyes of the beholder. In the meantime, Bill Hewlett and Dave Packard are wonderful role models for all of us who aspire to be good managers and good citizens.

⁸ Ibid.

⁹ Ibid. p. 148