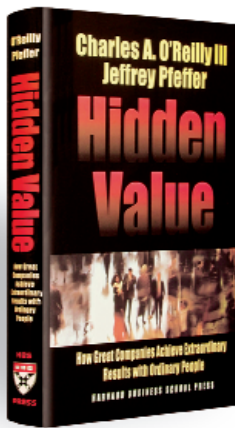


SOUNDVIEW Executive Book Summaries®

FILE: PERSONNEL/
HUMAN RELATIONS

By Charles A. O'Reilly III and
Jeffrey Pfeffer

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How Great Companies Achieve Extraordinary Results with Ordinary People

HIDDEN VALUE

THE SUMMARY IN BRIEF

In its famous study, “The War for Talent,” consulting giant McKinsey & Company asked 200 executives from a number of companies why they joined, stayed with or left an organization. McKinsey found that 58 percent of its respondents cited values and culture as being absolutely essential.

While McKinsey used its study to build a case for finding superior talent as a prime source of competitive advantage, Charles A. O'Reilly III and Jeffrey Pfeffer see things a bit differently. Certainly, companies that want to succeed need great people — making recruitment and retention important. But even more important, and often more difficult to obtain, is the establishment of cultures and systems in which these great people can actually use their talents, as well as management practices that make it possible for ordinary people to perform as if they were in the top 10 percent of their field.

According to the authors, companies must find new ways to engage the knowledge, experience, talents and energy of employees — to find the *hidden value* in organizations and leverage that value to achieve strategic goals. As they studied a number of companies that successfully leveraged their hidden value, the authors found six essential practices that all have in common:

✓ **They place values and culture first**, creating a set of principles or standards that define the company, then communicating those principles and their importance to employees.

✓ **They make those values real**, through consistent expression of those values and alignment with the practices that put those values into action.

✓ **They hire for fit**, bringing on board people who will appreciate and espouse their values, and weeding out those who won't fit in.

✓ **They invest in people**, providing the training and tools necessary for continuous learning and improvement.

✓ **They share information widely**, giving employees all the data they need to successfully achieve company goals.

✓ **They reward and recognize adherence to values**, from the everyday environmental perks to benefits and compensation that reinforce their organizational commitment to its culture.

Are you doing the things that unlock the hidden value in your organization? Turn the page to find out ...



HIDDEN VALUE

by Charles A. O'Reilly III and Jeffrey Pfeffer

— THE COMPLETE SUMMARY

What People-Centered Companies Do

People-centered companies find long-term success in highly competitive industries without having any of the usual overt sources of sustainable competitive advantage (such as barriers to entry or sources of market power). They do so not by winning “the war for talent,” but by fully unleashing the talent and unlocking the motivation of the people they already have (thus the term “people-centered”). Underlying the oft-used cliché, “people are our most important asset,” is a deeper truth — to the extent that any organization that can truly unleash the hidden value of its people will increase its chances for success.

This is particularly true in today’s corporate environments and global market, where intellectual capital and knowledge have become increasingly valuable to companies as revenue-builders and sources of competitive advantage. Most organizations cannot capture this value; the companies listed in this book have, and have done so consistently.

Three Themes

What explains the success of people-centered organizations? These companies’ competitors find it increasingly frustrating to try to keep up with them, because their secret cannot be imitated without extensive changes being made to the competitor’s organizational structure and overarching corporate culture and philosophy.

That said, there is not any one correct answer or any single mystery to solve in developing such extraordinary success. While each successful people-centered organization is intrinsically different in the ways it develops and taps the potential of its people, there are three common themes:

- **Each has a well-articulated set of values that are widely shared and act as the foundation for its management practices, outlined below.** These practices build the core capabilities that, in turn, provide a basis for the company’s competitive success.
- **Each has a remarkable degree of alignment and consistency in the people-centered practices that express its core values.**
- **Each has senior management (not just founders or executives) whose primary roles are to ensure**

that the values are maintained and constantly made real to all the people who work in the organization.

Management Practices

There are six management practices that are essential to finding and leveraging the hidden value in an organization. Truly people-centered companies:

- **Place values and culture first.**
- **Make those values real through alignment and consistency.**
- **Hire for fit.**
- **Invest in people.**
- **Share information.**
- **Reward and recognize adherence to values.**

Each of these practices is examined in the remaining pages of this summary. ■

Place Values and Culture First

The most visible characteristics that differentiate extraordinary companies from ordinary ones are their values — and the fact that those values come first, even before stock price. Most organizations purport to have values, usually expressed in a mission or vision statement and handed out on 3-by-5-inch laminated cards, to be taken everywhere. However, these are often mere slogans, offering no real advantage and inviting cynicism from a skeptical work force.

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Place Values and Culture First

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True company values are typically defined as a set of beliefs about what is worthwhile to a corporation: the principles or standards that it feels are important and that define, in essence, what employees should pay attention to. For a person to succeed in an organization, they discover what's important to that firm by: looking carefully at the activities or behaviors that are rewarded; observing how people get ahead and who gets promoted; and watching and listening to what senior managers do and how they spend their time.

True Values Revealed

Unfortunately, employees often find discrepancies in what senior managers say and what they do, revealing the true underlying values of a company (usually things like, “follow orders,” “please your boss,” “don't take risks” and “results count; people don't”). These things can only be hidden for so long, if indeed they are hidden at all; regardless of what the mission statement or senior management says, employees will eventually come to understand what the company's real values are.

As a result, employees behave in accordance with these values:

- **Employees are not likely to exert much effort beyond for what they are explicitly rewarded; the “show me the money” mood prevails.**
- **Employees are constantly on the lookout for new and better job opportunities in other organizations; loyalty is for fools.**
- **Unless cooperation is explicitly monitored and rewarded, teamwork is viewed as optional.**

The cycle is never-ending. In order to resolve problems brought on by employee behavior (performed in reaction to the “true” corporate culture), management creates and employs ever more sophisticated control and incentive systems to ensure that necessary teamwork occurs and that loss of intellectual capital (as a result of employee defections) is minimized.

The Humanistic Value System of AES

Contrast the norm described above with the way in which values and the cultures they imply are handled at AES Corporation, a power generation company operating more than 110 plants in 19 countries. With 10,000 people in its employ, all speaking different languages and without common history or tradition, AES has been extraordinarily successful at implementing a humanistic value system and a management scheme based on trust.

It is the company's value system that has made it successful. In its 1998 annual report, AES defined its four

core corporate values: **integrity, fairness, social responsibility and fun.** It is the last value — fun — that has gotten the greatest amount of attention. AES management defines fun as “establishing an environment in which people can use their gifts and skills to make a difference in society without fear of being squelched.”

AES backs its words with a commitment to its employees; people are given interesting things to do, decisions to make, challenges to meet and many opportunities to learn and try different things. AES readily trades the gains from specialization — having people do the same repetitive tasks, ad infinitum — for the interest and enthusiasm generated when people get to take on new, challenging assignments.

AES' four corporate values are so strongly held that some outside the walls of the corporation see them as a liability. The Securities and Exchange Commission requires the company to

list its adherence to values as a possible risk factor when it offers stock to the public. The following statement must accompany each public offering:

“An important element of AES is its commitment to four major ‘shared’ values. ... [If] the Company perceives a conflict between these values and profits, the Company will try to adhere to its values — even though doing so might result in diminished profits or forgone opportunities. Moreover, the Company seeks to adhere to these values not as a means to achieve economic success, but because adherence is a worthwhile goal in and of itself.”

Most employees and managers at AES find it amusing, if not incredible, that adherence to company values would be listed as a risk factor. They wear that “risk” as a badge of honor. ■

“My own choice for the reason corporations do and should exist — their ultimate purpose — is to steward resources to meet the needs of the world. Don't get me wrong — profits are an important aspect of a successful business. They provide compensation to shareholders for their equity capital, as well as provide an objective measurement of a company's ability to steward its resources. This is an integral part of any successful business, but it is not the primary reason a business exists.”

Dennis Bakke,
CEO, AES

Make Values Real

A strong set of corporate values is crucial to the success of extraordinary organizations. In and of themselves, however, they are virtually worthless; to make values real, the following must happen:

● **Senior management must believe in those values and act consistently in accordance with them.** If man-

“I learned a long time ago that in team sports or in business, a group working together can always defeat a team of individuals. Even if the individuals by themselves are each better than your team.

If you’re going to empower people and you don’t have teamwork, you’re dead.”

John Chambers,
CEO, Cisco Systems

agement says one thing and does another, employees will become quickly skeptical and reluctant to act upon those corporate values — regardless of how attractive they might seem.

● **There must be consistency between the organization’s values and the practices that express these values.**

While the extraordinary organizations referenced throughout this summary are all quite different, each relies on the same six essential practices to reinforce its values. When aligned with each other and properly used, these six practices communicate the importance of values and are consistent with each other. When misaligned, they undermine

those values, as well as the credibility of the people espousing the values.

Social Control Systems

Values also feed into powerful social control systems, acting as the basis for shared expectations about appropriate attitudes and behaviors. A people-centered company demonstrates a clear and consistent alignment of its values, the norms that express those values (the culture of the company) and the specific attitudes and behaviors that create the company’s core capabilities. At AES, for example, the core value of “fun” helps establish an environment in which employees can use their gifts and skills to make a difference without the fear of being put down or reprimanded.

Truly people-centered firms have strong cultures that provide explicit norms; people understand exactly what attitudes and behaviors are expected, as well as what attitudes and behaviors will not be tolerated. ■

Cisco: Winning with Culture

Cisco Systems is not your average Silicon Valley company. Aside from its extraordinary financial success (it reached a market capitalization of \$100 billion in 12 years — faster than Microsoft), the company manages its 26,000 employees with remarkable deftness. Its secret: a culture that eschews technology as “religion” and places people — both employees and customers — in the center of its strategies.

- ✓ **Customer satisfaction drives the entire organization.** CEO John Chambers personally reviews as many as 15 critical accounts every day, often calling customers himself to handle complaints and straighten out problems. He leads by example; because someone at his level — the very pinnacle of the company hierarchy — pays attention to detailed customer issues, employees at every level are expected to do the same. This is one essential reason that Cisco maintains an 85 percent customer satisfaction rating.
- ✓ **Employees are encouraged to think and respond to problems and negative circumstances in ways that are consistent with the company’s values — taking risks and finding new ways to achieve strategic objectives.** Such innovation is a requirement for success, even if it often results in failure. Cisco strongly encourages its employees to learn from failures brought about by their outside-the-box thinking. As Chambers says, “It’s more important to do and make mistakes than to sit back and wait to get permission.”
- ✓ **Openness is also the rule, with employees encouraged to challenge the status quo.** One example of this is the monthly “birthday breakfast” meetings Chambers holds for anyone with a recent birthday. At this meeting he answers every question put to him, regardless of how tough the question. To ensure the exchange will be open and honest, vice presidents and directors are strongly encouraged not to attend.
- ✓ **Cisco is also known for its frugality, in “doing more with less.”** No one flies first class. There is no executive dining room. Executives brag openly about how much less their buildings cost to operate than others in Silicon Valley.

Hire for Fit

Once a company's values and culture are clear, it then designs processes that help it identify the people who will best fit into the organization, and to screen out those who do not share their values. This often means vetting candidates with a list of needs that is balanced between skills and chemistry. These companies recognize that employees must feel comfortable in an organization in order to contribute to the achievement of its long-term goals.

Thus, organizations are likely to seek candidates who are willing to learn and try new things, who are versed in teamwork, who are willing to accept responsibility — abilities that help people grow, change and develop in order to meet new business challenges.

Make Expectations Clear

To hire for cultural fit, companies must begin with an explicit set of values, then screen people against those values. They must take sufficient time to show candidates exactly what would be expected of them and give them opportunity to bow out if they do not feel it is a good fit with their needs and ambitions.

The best people-centered organizations also allow employees to drive the recruiting process, since it is they who know the job best and can accurately convey to candidates exactly what expectations are required to succeed.

New United Motor Manufacturing, Inc. (or NUMMI) is one of the most efficient automotive assemblers in the United States, a designation it holds as a result not of technological advancements, but of solid corporate values and culture, and a commitment to unleashing the

Making Friends at Cisco

Cisco's John Chambers justifies his company's commitment to recruitment this way: "If you are selecting a partner for life, your ability to select the partner after one date isn't very good." Job-seeking candidates go through a minimum of five interviews up and down the organizational structure before the company makes the decision to hire.

Where Cisco stands apart from other organizations is in its "Friends Program." Visitors to the Cisco recruitment Web site (which receives a half-million hits per month) can click the "Make Friends @ Cisco" button. Within 24 hours, a Cisco volunteer will contact the job-seeker to talk about life at Cisco, answer any questions, and (if the job-seeker is still interested) to help arrange a visit to Cisco. According to Chambers, 60 percent of the people who join Cisco join because they have a "friend" there.

power of the work force. The company is able to hire great workers in part because it is able to successfully weed out those who would not fit into that culture.

Before being hired, each hourly applicant goes through a three-day assessment that includes production simulations, individual and group discussions and written tests and interviews. Evaluations (conducted by team leaders) concentrate on the applicant's ability to follow instructions quickly and safely, and to act in a team environment. ■

Invest in People

Having performed the appropriate screening for employees who fit the culture and values of the organization, people-centered companies then signal clearly to their employees the importance that is placed on each and every one of them.

NUMMI, for example, has a no-layoff policy, one initiated by Toyota (which runs NUMMI as a joint venture with General Motors), as a first step in establishing a culture of fairness, trust and mutual respect. The policy stipulates that no one will be laid off unless the long-term viability of the company is threatened. The company will drop outside contract work and give its top 65 executives pay cuts before even one line worker is laid off.

Rather than laying people off during slow periods, the company will lower line speed and retrain workers in the basics of production, teamwork, problem solving and statistical quality control techniques. This train-rather-than-lay-off strategy is appreciated by NUMMI workers; one survey showed that more than 80 percent of NUMMI employees feel that job security is the most important aspect of

"I believe an organization that is authentically built on servant leadership, where people are not just trying to acquire for themselves, and where they see cooperative effort that is all around them, ends up affecting things in very metaphysical ways. When people feel connected to something with a purpose greater than themselves, it inspires people to reach for levels they might not otherwise attain. Our business is based on human potential.

George Zimmer,
CEO,
The Men's Wearhouse

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Going to School at The Men's Wearhouse

One of the reasons The Men's Wearhouse has become the nation's leading retailer of off-price tailored men's clothing (with sales over \$1 billion) is the investment the organization makes in keeping its culture vital and its people energized. Throughout the year, the company organizes events for training and culture maintenance across multiple levels of leadership, all the way down to its associates (or wardrobe consultants):

- ✓ **In February, the company has a three-day meeting of managers, buyers and senior executives in The Men's Wearhouse "spiritual home" of Pajaro Dunes (a resort in northern California).** CEO Charlie Bresler describes it as "a three-day combination of training, spiritual renewal, parties, lots of sports ... a wild three days with a lot of training thrown in."
- ✓ **In March or April, the company's "Suits University" training calendar starts up, and wardrobe consultants from all over the country are brought to Fremont, Calif., to engage in sales training and socialization into the corporate culture.**
- ✓ **Out in The Men's Wearhouse's markets, "Suits High" (a sales introduction and preparation for "Suits University") and "Sales Associate University" (a training session for cashiers) are also held throughout the year.**
- ✓ **Throughout the summer, the company conducts manager meetings in up to five locations in its markets.** Managers, assistant managers and wardrobe consultants are flown to the nearest location for additional training.
- ✓ **In September, another multi-unit manager meeting is held in Pajaro Dunes for all district and regional managers and store operations executives.** The same group meets again for additional training in preparation for the fourth quarter.

The most amazing thing about this wealth of training opportunities is that The Men's Wearhouse operates without a training budget — it spends whatever company leaders think is necessary. In addition to imparting selling skills as well as product and market knowledge, these meetings and training sessions do one other important thing: They signal to people that the company takes them seriously and is interested in their development.

Invest in People

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working at the company.

Companies also demonstrate the value they place on employees by making continued investments in employee development and career growth. Take these examples:

- **New orientation at Southwest Airlines begins with a celebration to welcome new employees as members of the team.** The company hires people not for a single job, but with a sequence of jobs in mind, investing in continued development through 80 hours of mandatory training each employee must have annually.
- **New associates at The Men's Wearhouse are treated to a trip to northern California for skills training and socialization [see sidebar].**
- **New employees at Cisco barely have time to sit down, as they are immediately given training in the Cisco way, followed by continued offers to update their skills.**

As we see above, the investment companies make in training does not have to be in skills training; often, people-centered companies orient the training explicitly toward socialization to their culture. By doing so, they convey the message to all levels of employees that each one of them matters, not just as a number, but as a person — and that the company is committed to them over the long haul. ■

Share Information

In many companies, operational and financial data are not shared with employees — this is viewed as somehow risking the security of the firm or compromising important competitive information.

People-centered companies, on the other hand, see this information as vital to the work of their employees. They assume that if employees' intellectual capital is really to be used, they must understand in detail how the firm is doing and what it is trying to do. This open attitude leads to extensive sharing of information across all levels of an organization.

Open Books at Southwest and PSS

At Southwest Airlines, for example, all employees have access to critical information, including figures on turnaround times, on-time performance, lost bags and other customer service concerns. It is easy to see that Southwest's management considers its people to be trustworthy and smart — people with the ability and desire to use company information to the benefit of their

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Share Information

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customers and organization.

PSS World Medical is another example of how open books can mean more efficient business. The \$2 billion medical supply distributor has maintained an “open-book” policy since a financial crisis in the company’s early days led it to sell stock to employees. Since the employees own the company, its books are open and all manner of information is shared with them.

Patrick Kelly, CEO at PSS, knows that to get people to act like CEOs and rise to the occasion, they must see and understand all company-specific information. They can then see where they fit in and how their efforts con-

Firing the Bosses at PSS

One interesting outgrowth of PSS World Medical’s people-centered culture is the empowerment employees are given and the way that empowerment manifests itself. In fact, the idea of empowerment is taken so seriously, people can actually fire bosses who don’t perform up to expected standards.

The process begins when someone calls one of the company’s officers and informs that executive that the work group is unhappy with its leader.

At that point, one of the organization’s senior executives will go to the facility in question and meet with the entire team, without the leader present. After some open discussion, the leader is brought in and the matter is discussed openly, with the senior executive facilitating discussion and, in most cases, achieving some semblance of understanding that allows the work process to move forward again.

According to CEO Patrick Kelly, 80 percent of the time, bosses will not get fired by their people — the process simply opens further communication and lets work proceed. The company has, however, “fired” some bosses, usually by repositioning them in a lower capacity, somewhere in the company — a soft landing that allows them to re-energize and improve their performance. In fact, most of the people in senior officer positions at PSS have been repositioned back, but have improved and moved ahead to very successful careers as officers.

Regardless of the outcome, no sanctions are ever imposed against the people who raise the issue. Those people are actually praised publicly by the company’s senior leadership for getting problems and concerns out in the open.

tribute to the greater whole. This knowledge empowers employees — an empowerment that manifests itself in interesting and creative ways (see box below).

A Question of Trust

Regardless of whether they intend to do so, most companies with need-to-know information policies send a negative message to their employees that they aren’t smart enough or reliable enough to be trusted with that information. Whether they fear disclosure or simply have a general distrust of their employees, companies with these kinds of policies hinder employees from contributing to the full extent of their capabilities.

Contrast this with truly people-centered companies, whose open-book policies arm their people with the information they need to make real, sustained contributions over the long term. ■

“Businesspeople don’t like to talk about values, but without these, all business is about is making money. To me, achieving business goals is great. But no business goal is worth sacrificing your values. If you have to treat people poorly, or cut corners in your dealings with customers, forget it.”

**Patrick Kelly, CEO,
PSS World Medical**

Reward and Recognize Adherence to Values

People-centered organizations must carefully align their reward systems to their values. This doesn’t always mean emphasizing money to motivate employees. In fact, money is often a minimal factor in the reward systems of these companies; recognizing that money is a powerful driver of behavior, they are careful in how they use it in their incentive systems.

Instead of focusing on money, great people-centered companies emphasize the intrinsic rewards of fun, challenge, teamwork and growth. They provide opportunities for employees to feel good about their accomplishments, and find interesting and motivating ways to express the company’s appreciation for employee accomplishments and efforts.

The Perks at SAS

You can’t show much more appreciation for employees than The SAS Institute. The \$1 billion, privately held software company has been described as “the

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Reward and Recognize Adherence to Values

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world's sanest company" for the way it treats its employees, both in its working environment and its methods of compensation.

In a business noted for long hours, little company loyalty, high turnover and outrageous pay practices, SAS stands out by offering these and other value-driven environmental perks:

- **Reduced work hours.** Everyone at SAS, from code writers to executives, works a 35-hour workweek: 9 a.m. to 5 p.m., Monday through Friday, with an hour off each day for lunch and/or exercise. The company's management feels that people perform more effectively when they are alert (in the office) and have a life (outside the office). David Russo, longtime head of human resources at SAS, once noted that if you shot off a shotgun in the parking lot at 7 a.m., you wouldn't hit anything — a far cry from other software makers, where 18-hour work-days are the norm.
- **An on-site medical facility, staffed by six nurse practitioners, two family practice physicians, a physical therapist, a massage therapist and a mental health nurse.** SAS recognizes that time spent obtaining medical care can't be used on work — thus there is never more than a five-minute wait if you have an appointment. The facility is free to employees and their families, but there is a small co-payment for the massage therapist.
- **The company offers a full indemnity health plan, with a \$100 deductible per person, \$350 per family, and full cost coverage for many things.** The plan includes vision care, dental plan, free physicals, free mammography and other benefits. Even with all these offerings, the company's health care costs are \$1,000 per employee below the average health care costs for plans that aren't as rich as theirs.
- **SAS provides on-site Montessori day care, with a staff-to-child ratio of one-to-three.**
- **The company has a fitness center that includes aerobics, basketball courts, yoga rooms and workout areas segregated by gender.**
- **SAS also provides snack facilities (eating areas and small refrigerators) throughout its headquarters.** The company is noted for its consumption of M&Ms — it uses 22.5 tons of the candy every year.

SAS's compensation practices also venture far from the industry norm. It provides none of its employees

with stock options or other similar share-based compensation. It does contribute the maximum allowed by Internal Revenue Service regulations (15 percent) to employees' 401(k) retirement programs. This is not a matching contribution — employees do not have to contribute anything. Base salaries are competitive with the industry and are adjusted annually, although some employees have taken pay cuts to work at SAS because they value the environment so highly. ■

Take Organizational Action

It's one thing to read about how other companies have turned people-centered values and practices into successes. It's another thing altogether to put that understanding to work for you, to turn comprehension into strategies that help sustain and build your culture, transforming your own insights into action.

Here are some suggestions:

Recognize that this is a process, not the final answer. Throughout this summary, you can see how even the most successful people-centered companies have stressed continuous improvement through trial and error learning, out-of-the-box thinking and employee empowerment. AES, for example, has refused to have a book written about it because the company believes it is on a journey that is not yet complete, and all the answers aren't in yet. Learning by doing and continually learning and trying new things are important components of any implementation effort in any company.

Involve as many people as possible in the process. This doesn't mean embroiling your people in endless committee meetings and planning sessions, or drowning them in red tape or endless memoranda. It does mean that if you intend on tapping their intellectual capital and leveraging their talents toward the fulfillment of your organization's goals, you must tell your people what you are going to do and why.

Involvement doesn't stop with planning discussions. It means giving people real responsibility to do things that grow outward from the management practices that are essential to finding and leveraging the hidden value in your organization.

Emphasize real events. Don't let talk substitute for action — what your organization does is much more important than what it says. Whether you hold open question-and-answer sessions with employees, conduct values surveys, provide your people with special benefits or offer any number of other opportunities or amenities, you must provide tangible reminders of what your company is about, how it operates and what it stands for. ■