PROFIT AT THE BOTTOM OF THE LADDER

A Summary Report on the Experiences of Companies that Improve Conditions at the Base

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The full report, along with case studies and strategies for implementation, is available as a book, *Profit at the Bottom of the Ladder: Creating Value by Investing in Your Workforce*, published by Harvard Business Press, May 2010.

Overview

While companies have long been accustomed to using high wages and good working conditions to attract and retain quality professionals, they often pay relatively little attention to the benefits, wages, and incentives provided to their lower level employees. The assumption is often that employees at the bottom of the ladder are more readily replaceable or are not as valuable to the company's performance and therefore investing in them is not seen as profitable.

This study focused on understanding the experience of companies that have invested in employees at the bottom of the corporate ladder. During the course of the six year study, we conducted case studies of companies in nine countries, ranging in size from 27 to 126,000 employees and including companies working within the automobile, personal goods, technology hardware and equipment, pharmaceutical, food production, construction and materials, and industrial metals industries, as well as other general industries and retailers, and the banking sector. We interviewed employees at all levels, from the lowest-paid workers to those in top management positions including CEOs, CFOs, and COOs. We also compiled information on companies through publicly available data, financial reports from publicly traded companies, and academic, professional, and media reports on the companies' financial and social performances.

The findings demonstrate that investments in employees at the bottom can be an advantage both in times of economic growth and recession.

Questions that matter

When conducting our study on private sector initiatives, we sought to answer fundamental questions. First and foremost, we looked at the question C-level executives and other senior managers are asking themselves: Are there additional ways to increase my company's success? At the same time, we sought to answer the question raised by all levels of employees: Is there a way for the company and its employees to succeed together?

Addressing these questions

- Result of six year study on private sector initiatives.
- Global in scope, including companies in North America, Europe, Latin America, Asia, and Africa.
- Interviews with employees at all levels, from CEOs to line workers.
- Companies ranged in size from 27 to 126,000 employees.
- Sectors represented included automobiles, general industries, personal goods, technology hardware and equipment, general retailers, pharmaceutical, food producers, construction and materials, industrial metals and banking.

For six years we studied initiatives related to working conditions in the private sector. The companies featured in the in-depth case studies were chosen to represent diversity in geography, size, and sector, and to include both publicly traded and privately owned companies. We sought companies that had chosen to improve working conditions for employees at all levels in a range of ways including increased wages, profit-sharing, leave and flexibility, health care, and training and advancement opportunities. Our interviews and site visits were then designed to examine whether improved conditions occurred and what relationship these conditions bore to the firms' productivity, financial costs, and returns. To ensure that workers at the bottom of the ladder felt comfortable in accurately describing their experiences, we guaranteed confidentiality. In the majority of cases interviews were conducted in the primary language spoken by the employee. When a translator was needed, a translator independent of the firm was employed.

Findings

When we started this study, our initial assumption was that we would find companies that had managed to provide good working conditions while succeeding economically, but as was commonly believed, we also assumed that there would be no causal relationship between the two. Over the course of our study, we went from believing that it was possible for companies to improve their working conditions while being profitable to realizing that the companies we studied had increased their profitability by investing in their employees at the bottom of the ladder. The companies in our study found ways to profit together with employees at the bottom of the ladder by implementing a series of clear steps:

1. Supporting the health of the lowest-level employees

Investing in workers' health led to reductions in absenteeism and turnover rates, and to greater productivity. Examples include Autoliv Australia's leave and flexibility policies which had a strong impact on its employee retention. After implementing these policies, turnover decreased from 15–20 percent to 3 percent. As a result, the policies saved more money than they cost to implement.

- Healthy workers are essential to greater productivity and lower absenteeism and turnover rates.
- On-site clinics at American Apparel, SA Metal and ACC India reduced the time taken by employees for external appointments.
- After implementing leave and flexibility policies, turnover at Autoliv Australia decreased from 15–20 percent to approximately 3 percent, saving the company money.
- Novo Nordisk had ergonomic machines and exercise breaks that reduced injuries from repetitive strain.
- SA Metal in South Africa provided free access to HIV/AIDS treatment for its employees. HIV/AIDS treatment cost less than 25 rand a day (approximately US$3.50), whereas it cost the company 750 to 1,000 rand a day (approximately US$105–$140) when a truck driver and a truck were out of commission for health-related reasons.

At American Apparel, in addition to providing affordable health insurance to all employees, workers' health was promoted through on-site exercise classes and massage therapy as well as more nutritious menu offerings at the company cafeteria. Illness and injury rates were reduced, as were their accompanying costs. The company also set up an on-site clinic where employees could receive health care without having to leave work and reduced unnecessary absenteeism as a result.

2. Training and career advancement for employees at every level of the company

- Training and career opportunities serve to make employees more efficient as well as reduce turnover.
- Xerox Europe used training and career tracks to attract and retain employees in a high-turnover industry. Over the course of a year, 20% of entry-level employees received promotions and an additional 20% were transferred to other departments to which they had applied.
- Novo Nordisk's turnover rate for operators was 5 percent. This was much lower than the average turnover for the pharmaceutical industry at the time, which was 24.1 percent in China and 15.5 percent in Tianjin.
- Costco promoted from within its own workforce 98 percent of the time; sixty-eight percent of Costco's warehouse managers started out working with the company as hourly employees. After the first year of employment turnover was less than 6 percent.

The companies in our study found that offering **training and career tracks to line workers led to lower turnover and easier recruitment, and served to make employees more efficient while they were with the company**. Managers established training opportunities that were not available to low-level service and manufacturing workers in competing firms. Dancing Deer, a smaller company with only one production facility in Boston, offered free ESL classes to its production workers. The company found that these classes improved communication between employees who had immigrated from a wide range of countries and who frequently spoke no common language upon their arrival. Their increased ability to communicate effectively with one another in turn increased the efficiency of their work.

Career tracks also served as a powerful motivating tool for employees who took advantage of advancement opportunities that were not as readily available elsewhere. Xerox Europe emphasized career opportunities to decrease the high turnover rates that were characteristic of the call center industry. Many employees specified that the training and advancement opportunities at Xerox were a major factor in their decision to remain with the company.

Costco similarly went against the norm by providing career opportunities for employees at all levels. In fact, senior managers estimated that the company promoted from within its own workforce 98 percent of the time. Costco's policy of developing the skills and talent of its employees helped with the recruitment, motivation, and retention of warehouse workers and improved the quality of management in the long term. Experience working in lower-level positions within the company provided an in-depth understanding of the company's day-to-day operations. Sixty-eight percent of Costco's warehouse managers had started out working with the company as hourly employees. Costco's commitment to providing career opportunities also led to a low turnover rate. After the first year of employment, turnover was less than 6 percent.

3. Providing incentives at the bottom of the ladder

The companies we studied devoted significant time and attention to finding the best ways to motivate their employees. The experiences of Costco and American Apparel provide two illustrative examples. After implementing a teamwork system in which sewers were paid based on the number of garments produced by their team, productivity at American Apparel increased dramatically; output tripled from thirty thousand to ninety thousand pieces a day, with only a 12 percent increase in the number of workers. In the United States, average wages at Costco were approximately 42 percent higher than those at their closest competitor, Sam's Club, the wholesale branch of Wal-Mart. Though Costco had higher labor costs than its competitors, it also had higher productivity and lower turnover rates. While the high productivity wasn't solely due to employee incentives in either case, financial rewards clearly fueled employee productivity in both cases.

- Companies used various mechanisms including profit-sharing, stock options, and productivity incentives to provide incentives to all workers, resulting in increased productivity and decreased turnover.
- After American Apparel implemented a teamwork system where sewers were paid based on productivity, output tripled from 30,000 to 90,000 pieces a day.
- Dancing Deer put in place a stock-option program in which all employees participated. In one year, sales increased by 74 percent and stock options increased in value by 40 percent.

In addition, **some companies set up asset-building programs such as profit sharing and stock options, which increased employees' sense of ownership and investment in the company's performance.** In addition to providing incentives for every aspect of production, Jenkins Brick set up a profit-sharing program in which employees became vested after six years. Turnover decreased while productivity and product quality improved as a result.

4. Engaging line workers and acting on their best recommendations

Companies in our study established ways to **learn from their lowest-level employees, who had the most expertise on the ways in which much of the work at the company was done and could be improved.** Great Little Box had several different programs to encourage employee suggestions. The company offered small rewards for spotting errors in work orders. These rewards encouraged employees to pay more attention to detail and to the quality of their work. In addition, the Idea Recognition Program was designed to encourage employees to come up with ways in which the company could save larger amounts of money. The firm offered financial rewards of up to CAN$2,500 for ideas that were implemented. Savings from employee suggestions could be substantial, with managers reporting cost savings of up to CAN$25,000.

- Recommendations from line workers provided effective cost-saving and efficiency-increasing ideas.

- Novo Nordisk implemented the c-LEAN process, where employees provided feedback and suggested solutions for problems that arose. c-LEAN resulted in an estimated 50 percent increase in efficiency rates.

- Isola restructured production into a teamwork system where six or seven workers functioned as a group, with one team leader who reported directly to the plant manager. Employees' greater sense of responsibility and mutual pressure by team members led to reductions in absenteeism rates of 28 percent for the summer and 39 percent for the winter.

- Great Little Box's Idea Recognition Program was designed to encourage employees to come up with ways in which the company could save money. The firm offered financial rewards for ideas that were implemented, with payouts as high as CAN$2,500. Managers reporting cost savings of up to CAN$25,000 from employee suggestions.

Managers at Novo Nordisk actively encouraged greater employee involvement because they felt that the workers manufacturing the products would have the best ideas about how to improve the efficiency of production. Workers would also be more motivated if they felt that their input was sought and appreciated. In Novo Nordisk's method of production, the c-LEAN process, employees provided feedback and suggested solutions for problems that arose. c-LEAN has led to an estimated 50 percent increase in efficiency rates since the program's implementation.

Isola restructured production into a teamwork system to provide workers with greater decision-making power. Instead of reporting to a foreman and underforeman, six or seven workers functioned as a group, with one team leader who reported directly to the plant manager. All employees could apply to become team leaders and take the team leader training course. Absenteeism was greatly reduced as a result of employees' greater sense of responsibility and mutual pressure by team members. Absenteeism rates declined by 28 percent for the summer and 39 percent for the winter.

5. *Taking strategic steps that ensure companies and communities profit together*

With increasing globalization, companies may no longer be located in a single nation; however, **they always have a profound impact on, and are deeply affected by, the communities in which they operate.** As demonstrated by ACC's long history, investing in the community's good can be financially beneficial. Since limestone is the main ingredient in cement production and is costly to transport, firms benefit economically from building their factories in the rural communities where the limestone is located. ACC needed communities to be willing to sell their land for limestone extraction and cement production. These rural locations were poor and not yet developed, and the company built the physical infrastructure they needed, providing roads, water, and electricity. ACC went beyond providing these basic necessities and also invested in facilities for the communities, such as schools and clinics. As a result, the company was much more likely to be welcomed into new communities. By investing in health and education infrastructure, ACC had sought to entice workers to remain in their communities and work in their factories instead of migrating to the cities in search of economic opportunities. According to ACC managers, investments in community development and good working conditions had the added benefit of diminishing labor unrest during periods marked by high numbers of strikes at other companies. Furthermore, the firm's investments in health and education had long-term gains, since the next generations of workers were healthier and better educated.

Operating in a very different context, Costco didn't need to set up the physical infrastructure when it opened stores in the United States. Instead, the company was valued by the surrounding communities because it provided economic opportunities—jobs with decent wages, benefits, and advancement opportunities that were sorely needed but increasingly unavailable to workers with only a high school education. Starting wages at Costco were significantly higher than the minimum wage. At the time of the site visit, their cashiers started at twice the minimum wage and truck drivers at three times the minimum wage. Employees also had the opportunity to advance and receive salary increases in their first few years with the company. After working as a cashier for only four years, employees with a high school education could earn $43,000 a year, which was more than double the $18,380 national mean annual wage for cashiers in the United States. As a result of its reputation for providing good jobs and investing in the community, Costco faced less community opposition than its competitors, such as Wal-Mart, when looking for new sites for its warehouses.

While ACC and Costco had very different approaches, they both saw the benefits of having good relationships with local communities. They both opted to provide what the local communities needed, whether this was roads and schools or good jobs. As a result, they benefited from not facing the kind of opposition to expansion that has often surrounded companies in extractive industries and big-box retail.

Lessons to be drawn

The experiences of the companies we studied around the world suggest a blueprint for effective change, with **five ways in which corporate leaders need to adapt their strategic approaches if all levels of a company are to profit together**:

1. **Understand who performs the majority of the essential work at their firms:** At professional services firms, this may be lawyers or paralegals; in surgical clinics, this could include surgeons, nurses, technicians, paramedics, and individuals preparing the operating room; and in manufacturing, it is clear that those working on the factory floor carry out most of the essential work. Likewise, in call centers, the employees answering the phones are central to the firm's productivity; for wholesalers or retailers, the sales staff perform a central role.

2. Realize that their **firms' success depends on the quality of the work of those who carry out the majority of the labor.** Remarkably few firms currently structure their work environments to optimize the efforts of employees at the bottom of the corporate ladder—even when these employees are central to creating the firms' added value.

3. Recognize that **the quality and productivity of employees at the bottom of the ladder, like all parts of their workforce, depend on whether these employees are healthy, adequately rested, well prepared to carry out the tasks they are asked to perform, and motivated in their work.**

4. Realize that the **line workers are often the ones who know best how to increase the efficiency of operations**, either by increasing the quality or the pace of production.

5. Recognize that the same factors will influence the quality of their production around the globe as companies increasingly operate in distant locations**. The health, skills, training, motivation,**

input, and commitment of line workers influence the quality of production, whether the factories are in California and Quebec or in China and Bangladesh.

Implications for Wall Street reform

The companies in our study showed that investing in their employees at all levels made economic sense, going against the common market wisdom that considers these investments an unnecessary expense. When it comes to evaluating firms, Wall Street had gotten in the habit of rewarding companies that cut wages, jobs, and benefits to employees and punishing those that make such long term investments. The financial crisis has revealed numerous weaknesses in the systems by which Wall Street firms estimated the long term value of investments. As practices on Wall Street and in firms are being rethought, along with the role of the public sector in rendering the investment process more transparent, **one of the areas needing a new approach is the evaluation of and reporting on long term investments in employees**.

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