

“High Road” and “Low Road” Strategies and the Birth of High Performance Work Systems

Southwest Airlines is in many ways an anomaly in the U.S. airline industry. It has been the most profitable airline in the United States over the past thirty years. Yet:

- Southwest has been roundly and consistently criticized by Wall Street analysts for being too conservative in its growth strategy, too reliant on retained earnings for growth, and too good to its employees.
- Southwest is the most highly unionized air carrier in the country.
- Southwest has continued to do well after the retirement of its high profile charismatic CEO and founder, Herb Kelleher.
- Southwest Airlines has the highest productivity per employee, is consistently rated as one of the best places in America to work, and rates at or near the top of the industry in quality performance and customer satisfaction.
- Southwest Airlines seldom participates in airline industry conferences and learning consortia, and few of the legacy airlines view Southwest as a model from which they might learn and imitate.

This list breaks many stereotypes and combines features that would surprise many: the airline profitable but is not loved by Wall Street; it is highly unionized but is the most productive airline and the one with the most satisfied and committed work force; its high performance has been documented but the company is not a laboratory for learning in the eyes of its competitors.¹

Within almost all industries we can observe at least one and often a number of Southwest equivalents—firms that are driven by values other than the quest for short-term stock prices, have business strategies that stress great customer service and figure out how to deliver this efficiently, and have employees who identify with the company mission and work together to execute the business strategy consistently and effectively and offer ideas for improving performance on a continuous basis. Some of these are highly unionized, some are partially unionized, and some have no unions. Some are relatively early-stage startups with strong, charismatic founders, and some are mature organizations that have had multiple CEOs. Some have done well for a long time and then fallen from grace for one reason or another, and some have been resurrected from the bottom of their industry. Box 3-3 summarizes an op-ed I wrote about Market Basket, the example mentioned in Chapter 1 in which employees fought a successful battle to retain this business model and the CEO who fostered it.

¹ Jody Hoffer-Gittell, *The Southwest Airlines Way* (New York: McGraw Hill, 2003).

Box 4-3 The Market Basket Story

Imagine high level executives, store managers, clerks, and warehouse workers standing outside their stores side by side for a month demanding their CEO be reinstated and the business model that made the company thrive be maintained. And imagine their customer base cheering them while they had to shop elsewhere at considerable inconvenience and expense.

That is exactly what happened this summer at Market Basket, a highly successful New England family owned grocery chain with 71 stores and 25,000 employees. It is clearly the biggest labor story of the year and, if it emboldens others to speak out for similar workplace causes, it may turn out to be the most important workplace event to come along so far in this century.

This broad-based revolt (aka strike) defied all traditional doctrines in labor-management relations, labor law, and corporate governance. It was the outgrowth of a longstanding feud within the Demoulas family owners whose warring cousins (Arthur T. and Arthur S.) vied for control of the business.

For years, Arthur T. had led Market Basket to high profits with a business model that provided consumers with low prices and good quality service by building a highly productive, well paid, and loyal workforce. But when Arthur S. gained control in June, he fired Arthur T., replaced him with new co-CEOs of his choosing, and began pursuing options to increase the flow of cash to family owners.

Employees demanded Arthur T. be reinstated and the business model they built together be restored. They organized rallies that attracted as many as 10,000 workers customers, and community supporters. They used a "Save Market Basket" Facebook page to spread their message and maintain solidarity across the ranks. At one point 68 of the 71 store managers signed a statement saying they would not work for anyone but Arthur T. Customers offer countless testimonials to the low prices and good service they were missing and documented the increased costs they incurred in shopping elsewhere by pasting their sales receipts on the windows of their local stores.

Unlike so many recent labor battles, this one ended happily. After weeks of negotiations, with a strong push for agreement by Governor Deval Patrick of Massachusetts and Maggie Hassan of New Hampshire, the board of directors agreed to sell the company to Arthur T. and allow him to lead employees back to work and customers back to their beloved stores.

While these dynamics alone make for an interesting story, there are larger lessons to learn from this case that will be debated in boardrooms, business school classes, labor union halls, social media, and hopefully public policy circles as well.

The broad base of community support for these courageous employees suggests that many could relate to the causes they fought for—a boss who cares for and treats employees with

respect, a business model they can be proud of and use to build bonds with customers, and a fair distribution of the profits they help generate. The social media conversations the case sparked suggest many others are looking for their own ways to speak out and perhaps mobilize against unfairness, inequality, and greedy bosses or owners and to support leaders who buck these trends.

Business executives should take note that American workers, indeed the American public, are fed up with owners and shareholders who try to maximize their short term gains at the expense of employees and customers. Executives are now on notice that in today's transparent world questions of business strategies and governance are no longer off limits to employees.

Labor union leaders can take heart in the solidarity observed across this broad coalition and ask how they might build and support similar employee-manager-consumer coalitions seeking a fair share of profits and economic growth.

Policy makers should use this case to review our outmoded labor law that provided no established avenues for these employees to channel their concerns and left the supervisory and managerial employees completely vulnerable to being fired for standing up for what they believed. It is time to recognize that the old manager-labor divide no longer makes sense and the ossified doctrines of a labor law passed in 1935 need a comprehensive update.

Business schools better revise their curriculums to catch up with the workforce. These employees did more to teach everyone about how to run a business that works for owners, employees, customers, and community than any b-school case yet written. It is time to build this knowledge into economics, finance, strategy, operations, and human resource courses so that these skills become part of the standard toolkit of the next generation of business leaders.

So, thank you Market Basket for providing the best labor lesson of this century to date. Let's hope others will provide more of the same.

Source: Thomas A. Kochan,.....

The point is that there are alternatives to being a slave to a company's stock price that seem to work well for multiple stakeholders, including long-term investors. Let's see what we have learned about what these firms seem to have in common. It turns out that answering this question has been a favorite research topic of many of us at MIT and among human resource and labor relations researchers around the country for the past three decades. We think we've learned some things that might well inform how to shape the future.

High-Performance Organizational Models

The search for an understanding of what these firms have in common started in the 1980s, when researchers noticed that firms seemed to be going in divergent directions in terms of business strategies and employee relations and were getting reasonably predictably different results. The language that was used to differentiate these two approaches quickly evolved to a comparison of “high-road” and “low-road” business strategies and “high-performance work systems,” which viewed labor as an asset, versus “command and control” systems, which viewed labor as a cost like any other factor of production.

A comparison of the business strategies of two household names, Walmart and Costco, illustrates the differences between low-road and high-road business strategies. Walmart has been extremely successful (when judged solely on the grounds of finances and shareholder value) by pursuing a business strategy best captured by its marketing tag line: “Every day low prices.” To achieve this strategy, it places top priority on minimizing and tightly controlling labor costs, discouraging long-term tenure of its “associates,” investing little in training and development, and avoiding unions at all costs. Costco’s business strategy places a higher value on product quality and customer service, and to achieve these objectives it pays higher wages, invests more in training its work force to understand and serve customer needs, and has longer tenure patterns (and thus lower turnover costs). As a result, Costco’s employees are more productive, stay with the firm longer, and have more discretion to use their time and knowledge to solve customer problems.² Both Costco and Walmart are successful on financial grounds. The big difference between the two lies in worker experience and outcomes—Costco workers are better paid, better trained, stay longer with the company, and some have chosen to unionize and some have not.

What then seems to determine the choice of different business strategies? Here is where values and assumptions—mental models, to use a modern term—matter. Way back in 1960, MIT Sloan School professor Douglas McGregor published perhaps the most famous management book of that era, *The Human Side of the Enterprise*. McGregor differentiated between two different mental models management might bring to thinking about its work force. A Theory X view is that workers are self-interested, uniformed, and uninterested in the enterprise’s goals and need to be told how to do their jobs, closely monitored, and controlled to make sure they do what needs to be done. An alternative Theory Y mental model is that workers are motivated to do a good job and want to contribute to an enterprise they can be proud to work for and have 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

² Wayne Cascio, “Decency Means More than ‘Always Low Prices’: A Comparison of Costco to Wal-Mart’s Sam’s Club,” *Academy of Management Perspectives* (August 2006): 25–28. For more on Costco, Walmart, and the practices of other retail firms, see Zenep Ton, *The Good Jobs Strategy: How the Smartest Companies Invest in Their Employees to Lower Costs and Boost Profits* (New York: Houghton Mifflin, 2014).

trust and correlated behaviors. What is often overlooked in McGregor's work is that he extended this thinking to relations with unions or other forms of employee voice, essentially saying that management gets the type of employee organization it deserves, given its views and behaviors. So values, assumptions, or mental models are a starting point for understanding what makes a high-road and high-performance organization tick.

Then one has to ask the tough question: Assume I have this Theory Y mentality. Can I make it economically viable in my industry? What do I have to do? This is where one often has to push a rock up a hill. The standard economics answer is to do what other firms are doing because those that are surviving and performing well must be managing in the one best, rational way. And the more important labor costs are as a proportion of total costs of goods or services, the more pressure there is on management to control them with whatever it takes. If there are key strategic or "core" competencies or "stars" that are critical to achieving high performance, build your organization around attracting and retaining these people and outsource as much other labor as possible to avoid having to pay a premium for that less essential work.

Overcoming these tough challenges to a Theory Y value set requires a *system* of mutually reinforcing employment practices. There is no single silver bullet like a magical incentive compensation plan that will get the needed results. Instead, research has shown there is a bundle of generic practices that need to be fitted to the specific industry and occupational setting.

While the specific practices vary across industries, the generic features include the following:

- careful selection for employees with strong technical, problem-solving, and collaborative skills
- significant investment in training and development
- commitment to building trust and to drawing on employees' knowledge to solve problems, coordinate operations, and drive innovations
- compensation systems that align employee and firm interests
- labor-management partnerships in settings where employees are represented by a union and/or professional association

Two decades of research on high-road companies that employ these practices has 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.³ More recent case

³ Eileen Appelbaum, Jody Hoffer Gittel, and Carrie Leana, "High Performance Work Practices and Sustainable Economic Growth," March 2011, <http://www.isn.ethz.ch/Digital-Library/Publications/Detail/?ots591=0c54e3b3-1e9c-be1e-2c24-a6a8c7060233&lng=en&id=128703>.

studies are now documenting the same patterns of success in smaller firms across manufacturing, retail, and health care establishments.⁴

The review above suggests that organizations that function well for both employees and owners, that generate good financial and customer service results, and that provide good jobs and good career opportunities can come in a variety of organizational forms and governance arrangements. What they share in common appears to be a systemic combination of features: a mission that incorporates the values and strategies of top executives, a commitment to distributing leadership across levels and functions, nurturance of a shared culture across the organization that is aligned with the values of management and employees, cultivation of teamwork, and a desire to empower well-trained and talented front-line workers. My colleague Zenep Ton brings this point home clearly and concisely in the introduction to her study of high-performance companies in the retail industry:

There are different ways to make money, I tell my students on the first day of the class I teach on operations for service industries. You can certainly succeed at the expense of your employees by offering bad jobs—jobs that pay low wages, provide scant benefits and erratic work schedules, and are designed in a way that makes it hard for employees to perform well or find meaning and dignity in their work. You can even succeed at the expense of your customers; for example by offering shoddy service. . . . Many people in the business world assume that bad jobs are necessary to keep costs down and prices low. But I give this approach a name—the bad jobs strategy—to emphasize that it is not a necessity, it is a choice. There are companies in business today that have made a different choice, which I call the good jobs strategy. . . . These companies—despite spending much more on labor than their competitors do in order to have a well-paid, well-trained, well-motivated work force—enjoy great success.

The lesson: Companies that are implementing these high-road business strategies and high-performance work systems are essential for achieving a new social contract. They are critical if we are to once again see workers' incomes, employment conditions, and living standards advance in tandem with the productivity and profits they help generate.

The problem is these practices and systems are not being diffused widely across American industries, and in fact their prevalence may have declined somewhat in the past decade. We don't have a clear understanding of why. Explanations (really hypotheses) are varied: lack of information about how to implement these practices; the high startup costs and delayed benefits they experience (sometimes called "worse before better" traps); failure to reform and modernize labor law to support these strategies; and the pressures from financial market agents to maximize short-term returns.

⁴ The Hitachi Foundation tracks and supports a number of these cases. See their Web site: <https://web.archive.org/web/20131203015536/http://www.hitachifoundation.org/our-work/business-and-work-grants-program>.

There may also be a market failure at work here. As employee tenure decreases and more parts of a firm's value chain are outsourced, the incentive for an individual firm to invest broadly and deeply in the work force also decreases. Indeed, the most recent fad in the human resource management literature is to emphasize "talent management" of key executives instead of investing in the firm's overall work force. This may be rational behavior for an individual firm, but it is not optimal for building human capital across the value chain or across American industry.

Very likely all of these factors play a role. The net effect is a two-equilibria economy: some firms compete on high-road, knowledge-driven strategies, while others compete on the low road by minimizing labor costs. To date, more have chosen the latter than the former. This puts high-road firms on the defensive and discourages others from following their lead. The key challenge is to tip the balance in favor of the former so that the low-road firms are forced to upgrade their practices and employment standards to remain competitive. This will require overcoming the barriers and market failure noted above, and it will require coordinated actions among employers in the same industry and/or region.

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Thomas A. Kochan

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