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Corporate Culture and Stock Options in Emerging Companies

A recent article chronicling Google's spectacular success highlights the company's 'over the top culture, including bathroom stalls with Japanese high-tech commodes and heated seats. Each stall features a geek quiz that changes regularly and asks technical questions about testing programming code for bugs. The toilets reflect the company's general philosophy of work: generous quirky perks keep employees happy, working hard and thinking in unconventional ways'.

In another news item last year, the world's largest independent video game maker, Electronic Arts, was accused of using similar perks such as health clubs, daycare, free gourmet cafeterias and concierge services to avoid paying overtime to its technical staff. According to one of the disgruntled employees, the company's culture 'reeks of white collar slavery founded on relentless and abusive demands of effort and time, much of it unpaid and all sugar coated with meaningless benefits'. Responding to the simmering discontent, including unprecedented attempts at unionization, the company's Vice-President of Human Resources announced that the firm would agree to pay overtime to its programmers, though he lamented that the gesture 'moves the company out of a culture that emphasizes entrepreneurialism and ownership and into a clock-watching mentality.'

Welcome to the world of corporate culture where one firm's secret recipe for success is another firm's dirty little secret. A key organizational enabler to some, a manipulative tool to others and simply immaterial to others, corporate culture is what fires the belly of the organizational beast.

What is Corporate Culture?

On any given day, references to corporate culture can be found sprinkled throughout the business press. From the HP 'Way' to Toyota's 'Culture of Excellence' to Enron's 'Culture of Greed', the term is commonly used to explain why some firms perform better, or worse, than the rest of the pack. It is also almost always pointed to as a key variable in successful mergers, acquisitions and in organizational change. Take the recent departure of Bob Nardelli from Home Depot as an example. In one of the scores of articles dissecting his dismissal, the writer notes, "A graduate of GE's data-driven culture, Nardelli was dismissive - indeed openly contemptuous – of the folksy corporate culture nurtured by predecessors Bernard Marcus and Arthur Blank. Moreover, he was committed to changing it as a means of achieving his growth goals for the organization".

Corporate culture is the tangled web of values, beliefs, written and unwritten rules and actions that shape the personality and behaviors of an organization. It is 'how things really work' in a company, what gets rewarded, punished and even ignored. It is what a firm's leadership pays attention to, measures, controls as well as the assumptions which underlie them. It is the metrics of success, how people are treated, how decisions are made, how scarce resources are allocated, who gets promoted, and how a firm deals with adversity. Culture defines the proper way to think, act and behave in a given organization if one wants to fit in.

In companies where employees have an emotional attachment to the company's goals, have internalized what the company believes in, and have a certain intrinsic satisfaction from the work itself, there are few places that they would rather be. They don't need a lot of external controls because they will act in a way consistent with how the company wants them to work. Strong cultures therefore, guide people to behave in ways that the company finds beneficial. At the same time however, corporate cultures which are too strong, too uniform, and without adequate variability, become susceptible to 'groupthink' which can seriously hinder a firm's ability to adapt to a changing world. At the other end of the spectrum, too little corporate culture compels management to apply an assortment of carrots and sticks in order to herd their employee charges.

Finally, there is no single idealized corporate culture which can be prescribed for all companies in all situations. Instead, certain cultural attributes are a better fit to specific businesses, strategies, contexts and leaders at various times. Corporate culture is always a work in progress and fit is always the key.

How corporate culture takes shape in emerging firms

Tech firms are usually born of innovation, a vision, or a perceived gap in a market. Emotion is the kindling of early corporate culture with founding teams rallying around powerful sentiments like 'making a difference', 'changing the world' or in the case of Google, 'avoiding evil'. Some firms are fueled by rebellious, anti-establishment, or David and Goliath emotions. Steven Jobs, for example, had a famous yell of 'It is better to be a pirate than join the navy". For yet others, the mobilizing energy can be something as powerful, yet basic as revenge. Terry Garnett has founded a series of companies all of which share one characteristic: they are aimed squarely at inflicting harm on Larry Ellison who unceremoniously fired him from Oracle. His latest firm, Ingres, is populated largely with former Oracle employees similarly bound together by a lust for retribution. As Mr. Garnett stated in a recent article, "the simplest way to create a culture is to pick an enemy".

Corporate culture takes shape as the founding vision or dream interacts with the personality of the founder along with his or her assumptions about how a successful enterprise is built. The importance of the founder cannot be overstated as a young company's corporate culture reflects, to a large degree, the personality of the founder/leader. The dour, untrusting analytic founder can be expected to cultivate a work environment somewhat different from the fun-loving bon vivant. The founder models and reinforces the behaviors valued by him or her. Employees watch and learn to the benefit or detriment of the firm. A firm's corporate culture evolves, or fails to evolve as leaders get to know themselves, what works for them and most importantly, how their actions affect their organizations.

In addition to their individual personalities, founders/leaders also bring personal sets of assumptions about how to run a successful technology company. For some it is an obsession with technical accomplishment versus market innovation, a view of business as a short-term sprint versus long distance marathon, a strong sense of ownership, a community feeling. These assumptions guide the trade-offs which the organization will make in pursuit of its goals - speed, service, quality, efficiency, innovation. They will also drive the eventual social characteristics of the firm such as whether decisions are consensus based, top down, bottom-up, whether the firm is formal or informal, has structure or no structure, is risk-taking, high initiative, proactive, or reactive.

Together then, emotion propels the start-up organization forward while corporate culture regulates its speed, guides, focuses and ultimately nourishes it. All questions pertaining to corporate culture ultimately centre on the nature, design, application and value of these regulating controls.

For many leaders in the technology sector, the recipe for building successful tech companies has only a few key ingredients. It starts with smart, driven employees who share a sense of urgency. In a recent survey of the 2006 Technology Fast 50, 'high quality employees' ranked as the factor contributing most to the growth of the survey respondents' companies. Furthermore, attracting, motivating and retaining such employees however does not require an inordinate investment in corporate culture. Instead, these can all be managed with the help of one simple, elegant instrument stock options (ranked by far as the number one tool used by the Fast 50 in attracting and retaining talent). Stock options allow start-ups to preserve precious cash while tying employees to the goal of building shareholder value. When generously applied, stock options have a powerful effect on attraction and motivation. Vesting over a period of time, they also have a superb effect on retention. Stock options set up a simple quid pro quo in which the start-up organization holds out the promise of future riches in return for the employees' commitment of body and soul. Manage the dream as well as the stock options pot of gold and the leader manages the behaviors of the employees. Stock options thus serve a powerful carrot in focusing an organization's employee population on a journey that will require prodigious collective output. A stock options-anchored corporate culture remains the most commonly used operating model for today's start-up company.

While few would argue against the usefulness of stock options for emerging companies, many would caution that they should not be the only arrow in management's quiver of practices. There are other equally important elements of corporate culture and these have little to do with the often reported toys such as latté machines, sushi bars and foosball tables. Instead they start and revolve around developing consistent practices that address employees' basic needs for respect, trust, fairness, consistency, feedback, recognition, appreciation and honesty.

SAS Software is the world's largest privately owned software company. It has never offered stock options to its employees and boasts one of the lowest employee turnover rates in the sector. For its owners, corporate culture matters a great deal, not because it is designed to optimize shareholder value, but because it is the DNA for the interaction of the firm's biggest assets, its people. SAS was founded by two university professors with the following simple premise, "make sure revenues are greater than expenses. Keep your customers happy and above all, value your employees, as they are the intellectual capital of your company". The firm has never wavered from these founding principles.

While focusing on employee-centered management practices may sound overly simplistic, it is not. For a variety of reasons, tech companies are often built for speed rather than distance, and leaders often assume that they must stay focused on the business tasks at hand. Some organizations pay a large price for such assumptions. For example, a recent book chronicles the story of Nobel Prize winner William Shockley who invented the transistor and subsequently established one of the first start-ups in Silicon Valley to commercialize his ideas. Due to his sizable reputation as well as his compelling vision of a future electronic age, his start-up Shockley Semiconductor attracted a world class team and unlimited funding. However, Mr. Shockley's dismissive approach to leading people (elements of which included taking all of the credit, as well as an autocratic, divide and conquer management style tinged with paranoia), lead directly to the demise of the firm in less than 18 months. As a measure of the size of opportunity which was squandered, two of Mr. Shockley's disillusioned team members started their own firm, which they named Intel.

For business leaders, crafting consistent, constructive workplace practices is challenging, in part, because it requires an ongoing awareness of how employee behavior is shaped by the leaders' behaviors, values and actions. This requires self-awareness and a commitment to ongoing self-improvement from the leaders as well as the encouragement of the boards to which they report. And, as with everything else in life, the devil is in the details.

A company says that it values performance but fails to reward high performers or release low performers. A firm espouses teamwork yet implements reward systems that are highly competitive and focus on the individual. A CEO values quick decision-making but insists that he must approve them all. Corporate culture is hard because walking the talk is hard. And it is not just small companies which struggle with aligning words with actions. Consider the recent challenges of the new President of Ford Motor Company's North American operation. Appointed with much fanfare, he has the unenviable task of aligning the company's unions and employees behind yet another series of painful belt-tightening initiatives. Imagine the unions' receptivity after it was revealed that the company is spending upwards of a $1mm to cover the new president's annual commuting costs, by private jet no less, between his office in Detroit and his home in Florida.

Stock Options Cultures

While stock options have become the management tool of choice for many tech firms, it is important to caution that when used exclusively, they render a firm vulnerable. First, stock options dominated cultures are highly dependent on employee trust and faith that their efforts, their sacrifices and pain will have a payoff. Employees must see evidence of incremental progress, of valuations rising, competitors going public, revenues increasing, milestones being met. The 'pot of gold' must never be too far over the options horizon.

If employees come to sense that the dream is unattainable or will be unreasonably (to them) extended or withheld, then commitment begins to fray and the other elements of corporate culture, or lack thereof, are laid bare. Anxious employees begin to question the stock options quid pro quo and those conditioned to rely on stock options carrots leave for bigger, better and potentially more accessible carrots. A start-up client who once proudly described himself as a 'benign dictator' lost 50% of his executive team when a glitch in a new product delayed its release for 6 months, thus extending the firm's likely time to liquidity. With the luster of their stock options program fading, firms are forced into either reevaluating their overall employment practices or resorting to manipulation of the options program (as evidenced by the options backdating brouhaha now facing so many organizations).

When the stock options culture cracks at the sector level, as in the industry meltdown of several years ago, employees stand back and reflect on the broader employer/employee relationship model. In one of the many books published by disillusioned employees after the tech sector meltdown, the writers of NetSlaves vented their frustration in the prologue, 'people are nuts, no matter what profession they are in, but people forced to work like dogs with the carrot of stock options and untold wealth dangling under their noses are especially nuts'. In the years since the technology sector meltdown, battle-hardened employees at all levels have been far less willing to trade-off cash compensation for options. They will still readily take the stock options but, they now also want the cash.

The Electronic Arts unionization drive illustrates the tipping point when employees conditioned to 'go the extra distance' and 'pay the price' begin to feel exploited. The games sector is a brutally competitive sector, with short product life cycles, and regular release timetables around the holiday gift-giving season. When employees are driven to work inordinately long hours, year after year, for a company whose stock options plan ceases to offer the promise of pina coladas and warm beaches, there comes a day of reckoning when enough is enough. Suddenly, the concierge service which the company so generously introduced to make employees' life 'easier' starts to feel like another ploy to shackle them to their desks.

Conclusion

There is an old Chinese curse, "May you live in interesting times". These are indeed interesting times in the start-up sector. Hot new technologies are percolating, companies are being funded, and many are growing, going public and even being sold. And while many people are enthusiastically jumping back onto the tech sector bandwagon it is important to caution against reflexively applying yesterday's techniques to today's pursuits.

The 1990s vision of a company going from VC funding to public offering or sale in two years is increasingly rare. Instead, today's tech sector landscape is littered with a wide assortment of companies in varying proximity to their investor 'due dates', many of which remaining 'works-in-progress'. New business models are appearing, with different funding requirements and as yet undetermined exit horizons.

While it may be convenient to continue conceptualizing the start-up as a 100 meter sprint, for many in the start-up sector the finish line increasingly lacks visibility. By extension, it cannot be assumed by today's start-up that it need only design employee systems with that finish line in mind, nor can be it assumed that the single blunt instrument called stock options will continue to suffice as the fuel of choice. Yet, we still see boards and executive teams compensated and evaluated in exactly the same manner as in the past. The metrics of 'traction' and the cultural levers being deployed remain unchanged.

It is perhaps time to reevaluate the cost/benefits of investing in and supporting stronger corporate cultures. It is perhaps time for investors to recognize that strong corporate culture helps mitigate risk not enhance it. And it is perhaps time to measure leaders on the corporate cultures they nurture or fail to nurture.

To the naysayers, may you live in interesting times…

About The Author

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