Power in Numbers – Motivation Starts to Add Up for Wall Street

Motivation Strategies,

by Brendan Coffey

The numbers are in: Thanks to a series of recent studies confirming that happy employees boost the bottom line, motivation and people performance management are finally garnering positive attention in the boardroom. In fact, strong anecdotal evidence shows that senior executives are increasingly looking at motivational systems to lay the groundwork for long-term growth.

But even as converts inside companies become legion, convincing Wall Street has been a much harder proposition. In the past, executives who put employees first were often punished by stock analysts, says author and consultant Don Peppers.

"Even though employee churn is [lower], productivity is better and they're paying their employees better, [executives] didn't have any proof that being a good guy paid off," Peppers says. There are signs, however, that investors with a longer-term view are starting to recognize the benefits and reward companies that keep their workforce engaged in the business.

Earlier this year, investment strategies firm Russell Investment Group, best known for creating the Russell Index of stocks, released a study proving companies that motivate employees perform better in the stock market. The study examined the stocks of publicly traded companies on Fortune magazine's annual "100 Best Companies to Work For" list, which is produced by San Francisco–based Great Place to Work Institute.

Great Place to Invest

The institute examines companies that create trust among employees through fairness, credibility, pride, camaraderie and respect—all features found among a motivated workforce. The Russell study found that since the inception of the list in 1998, stocks on the list returned five times as much to investors as the broad market.

"There used to be people who didn't believe it," crows Amy Lyman, president of the GPTW Institute, "but it has proven itself out."

The Russell study examined a theoretical portfolio of the stock of each public company on the list, rebalanced each year by selling those that fell off the list and buying those that were added. The cumulative return of the list stocks was 176 percent through 2004, compared with 42 percent for the broad Russell 3000 Index and 39 percent for the benchmark S&P 500 Index.

The results are all the more significant because the time frame covers the dot-com boom, bust and slight rebound that have followed. The Russell study also found that buying and holding the stocks of the 1998 list (which includes 24 companies that have been on every list) beat the market by a wide margin, returning 103 percent. The study also showed that the current 2005 list outperformed the broad market by more than double in 2004.

Cynics have argued that it is companies' excellent performance that creates high employee morale, not vice versa. Lyman says that is disproved by the institute's proprietary polling data.

There are fewer naysayers now, in any case. The recognition of the financial performance of firms on the Fortune list has led to a huge interest in companies to participate, says Lyman. "Executives used to tell us, 'It sounds nice, but we have a business to run.' Now, we have a lot more high-level executives who realize that creating a high-trust environment gets you the things that are really important in terms of creating a successful organization."

Wall Street Divided

Investors are beginning to make bets that well-run, pro-employee businesses will continue to outperform their peers. San Francisco mutual fund house Parnassus Investments, which has $1.3 billion of assets under management, has introduced a 'Workplace Fund,' the philosophy of which is to invest in companies where employees love going to work, such as those on the Fortune list. "Companies which treat their employees well can be expected to provide superior products and services to their customers," says Jerome Dodson, who founded Parnassus in 1984 and serves as portfolio manager of the new fund. "They should, therefore, outperform competitors over time." Dodson's fund has started modestly, accumulating $1 million in investments and earning a 0.5 percent return since it began trading at the end of April, slightly behind the S&P 500.

More generally, individual investors are directing more of their savings into funds that invest in companies that treat their employees well, and also have other "socially responsible" characteristics, like favorable environmental policies and a commitment to diversity. Since 2001, assets in such socially responsible mutual funds grew 11 percent, to $151 billion, according to the Social Investment Forum.

Costco Battles Bias

Despite the strides made, there is still a bias among some of the white shoe crowd that pro-employee techniques are hurting profit lines. Nowhere is that clearer than with Costco Wholesale Corp., the Issaquah, Wash.–based warehouse chain.

Highly respected for its business model, the way its stores are run and its employee relations, Costco has grown at a hot pace, with sales of $52 billion in its latest year, up 60 percent over the past five years. Yet when the company posted a 25 percent profit gain and raised its forecasts for future sales, Wall Street sold Costco stock down 4 percent because employee pay is significantly higher than arch rival Wal-Mart.

"At Costco, it's better to be an employee or a customer than a shareholder," said Deutsche Bank analyst Bill Dreher at the time. Dreher, and others, felt that by not slashing employee pay and benefits to a level closer to Wal-Mart, it would be leaving easy money on the table.

One year later, after Costco again posted excellent numbers and even raised the health-care premium employees must pay, from 4 percent to 8 percent of total cost, analysts still attacked the company. Sanford C. Bernstein analyst Emme Kozloff was quoted in the New York Times criticizing the fact that 8 percent is still well below the 25 percent of total cost average in retail. Referring to Costco CEO James Sinegal, Kozloff commented at the time: "He's right: A happy employee is a productive employee, but he could force employees to pick up more of the slack."

While that makes great headlines, it's unclear how widespread such feeling is. Dreher's comments might be influenced by the fact that Deutsche Bank does investment banking business with Wal-Mart. But for her part, Kozloff says she was misquoted by the Times and that she was in fact relaying her belief of what others on Wall Street felt. And there are even those among the club of equity analysts who tend to be very short-term minded who dissent.

"It is apparent that treating employees with respect and paying them fairly goes a long way to establishing an efficient and creative organization," says Steven Kent, a retail stock analyst at Goldman Sachs. He points to Starbucks and Four Seasons, both known for their excellent use of employee motivation tools, as prime examples. Starbucks stock is up 3,200 percent since its 1992 IPO, and Four Seasons, one of the 24 companies to appear on all the Fortune best companies lists, is valued in the stock market at more than double its nearest peer.

As for Costco, it has been rewarded nonetheless by investors: Its stock has risen 40 percent since late 2003. It goes to show that investors reward growth; how that is achieved matters a lot less.

The problem Costco has had, and that other companies face, is a failure to explain to Wall Street how methods of increasing employee productivity improve its growth prospects. Says consultant Peppers, "You're going to have to educate the moneyed interest."

Don E. Schultz, professor emeritus at Northwestern University and founder of the school's Forum for People Performance Management and Measurement, says everyone is beginning to examine how some companies are succeeding in otherwise reeling industries. For instance, in the airline industry, Southwest Airlines continues to be profitable while competitors enter bankruptcy; in computers, Dell chugs along while competitors like IBM abandon the hardware business altogether, and Starbucks manages to sell people a commodity—coffee—at a hefty profit.

"Senior management looks at these companies and wonders what is unique about them, and they suddenly realize that it is how they treat their customers and how their employees relate to their customers," Schultz explains. Great strides made through the Forum and elsewhere in measuring return on investment have helped the cause immensely, he adds.

And it's being able to measure results that turns executives—and investors—into believers. For sales-based incentives, results are relatively easy to determine through benchmarking. At Diebold, for instance, the company calculates that its incentives program for salespeople boosted revenues by 8 percent last year. Beyond sales departments, it's becoming easier to demonstrate the return-on-investment tie-in with having happy, motivated employees.

Shorter Vacancies, Less Churn, More Profits

According to its "Human Capital Index" study, Watson Wyatt, a consultancy based in Washington, D.C., found companies that are able to fill vacant positions faster (about two weeks on average) gave investors a total return of 59 percent over the past three years, versus 11 percent for slower companies (which took seven weeks on average to fill vacancies). The study also found that companies that pay top performers substantially more than under-performing employees return 50 percent more to shareholders than those who offer fewer financial rewards. Low turnover, effective internal communication and a balanced method of internal promotion also made significant impacts on financial returns, Watson Wyatt found.

As Arthur Friedson, head of incentive programs at computer products retailer CDW, told Motivation Strategies, "We're not doing this to go to Heaven. The bottom line is results."