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Inc.com

What's Your Culture Worth?

At first glance, Utah-based Setpoint appeared to have nothing that an acquirer normally seeks. Nothing except an organizational culture so distinct and powerful that someone wanted to buy Setpoint just to get it.

From: [Inc. Magazine, September 2001](#) | **By:** Bo Burlingham

In creating Setpoint, the founders had a pretty good idea of the sort of company culture they wanted to build. It didn't occur to them that what they came up with would become one of the company's most valuable assets

Steve Peterson says he had no particular agenda when he dropped by Setpoint for a visit late in the summer of 2000. He certainly wasn't thinking about a merger.

The truth is, he had his hands full with his own company, Petersen Inc., which his father had started 40 years before in a garage behind his house. Since then the business had grown to more than \$35 million in sales, with some 300 employees making everything from tunnel-boring machines to aerospace components, and was poised to grow by another 60% in the coming year without any additional acquisitions. It was a prospect that both excited Petersen and gave him periodic bouts of anxiety, and he expected the growth spurt to consume most of his time and energy for the foreseeable future.

How Setpoint might fit into the picture, he had no idea. As far as he could tell, it was just another custom-manufacturing company, with 30 employees and a little more than \$6 million in sales. Thanks in part to a roller-coaster contract, it had landed on the Inc 500 list in 1999, but most of its revenues came from designing and building factory-automation equipment -- a highly competitive business that Petersen wasn't particularly interested in getting into.

Nevertheless, the Setpoint guys had invited him over, and he was curious to see what they were up to. He'd heard about some of the things they were doing with project management and open-book accounting. Maybe he could pick up a few pointers. With that in mind, he decided to bring along his chief financial officer, Ted Johnstun.

Setpoint's CEO, Joe Knight, met them in the lobby and took them on a tour of the facility. At some point they wound up in the shop, a spacious, well-lit room with whitewashed walls and bright metal halide lamps hanging from the ceiling. About 10 employees were working on half a dozen machines strewed across the shiny concrete floor. Petersen says he was standing there surveying the scene, when he

happened to notice a large whiteboard off to one side, on a wall next to a canteen area in a corner of the shop. Scribbled across the board were about 20 rows and 10 columns of numbers forming a table of some sort, with a few dollar signs sprinkled here and there.

"What's that?" he asked.

"That's our board," Knight said. "It's how we track our projects and figure out whether or not we're making money."

"How do you do that?" Petersen asked.

Knight took Petersen and Johnstun over to the board and began explaining what the numbers were and where they came from. The visitors listened intently, occasionally asking questions.

Then Knight stopped. "You know," he said, "you really shouldn't take my word for it. You should get these guys to tell you about it." He called out to one of the technicians, a stocky young man with a baby face and a baseball cap turned backward on his head. The young man stopped what he was doing and ambled over. Knight introduced him to the guests.

"Would you mind explaining this board to us?" Petersen asked.

"Sure," the young man said and proceeded to walk them through it. He talked about calculating the GP - gross profit -- that he and his colleagues had earned the previous week on each project. He pointed out the column showing each project's GP per hour and explained the importance of keeping that number in mind. He said he also watched the ratio of overall GP to OE -- operating expenses -- since that's how you knew if the company was making money. He added that he liked to see it running at about 2.0.

"I was just amazed," Petersen recalls. "He knew that board inside and out. He knew every number on it. He knew exactly where the company was and where they had to focus their attention. There was no hesitation. He had great confidence in what was up there."

"I could see that the board was a cherished possession, and I was so impressed, not that Joe Knight understood it, but that the people on the shop floor had it down like that. It was their scoreboard. It was the way they could tell if they were winning or losing. I talked to several of them, and I just couldn't get over the positive attitude they had and their understanding of business."

"I knew right then that Setpoint had what we needed, and somehow we had to get it."

Shortly thereafter, Petersen began negotiating with the owners of Setpoint to acquire their business, their services, their management system, and their culture.

Mergers are always tricky propositions, and the negotiations between Petersen Inc. and Setpoint have not yet produced one. A deal seemed imminent in April, but then Petersen brought in a new CEO, who felt he needed time to get his bearings before taking on an acquisition. Nevertheless, the principals on both sides say that some sort of merger is likely within the next year. Whether or not that comes to pass, however, it's significant that Petersen would even contemplate such an acquisition. Why? Because Setpoint has none of the attributes that acquirers normally look for.

Experienced businesspeople will tell you that companies are bought for a limited number of reasons -- five, to be exact. "In almost every acquisition the buyer is looking for market share, earnings, cash flow,

strategic advantage, or some kind of synergy, either alone or in combination," says Sam Kaplan, president of Central Chase Associates LLC in New York City, who has bought and sold upwards of 50 businesses in his career, either on his own or with partners.

Setpoint has little to offer Petersen in terms of those five criteria. Yes, it's possible to identify some potential areas of synergy, but none that would justify an acquisition. Indeed, from one perspective, you could question whether or not Setpoint has any market value at all. The roller-coaster arm of the business is essentially a start-up, meaning that its long-term viability is still in doubt. As for the factory-automation business, more than 70% of its sales come from one customer, Autoliv Inc., a \$4.1-billion multinational corporation based in Stockholm, Sweden, and the world's largest maker of automobile-safety products. Should Autoliv ever decide, say, to close down its Utah plants or to change its policies with regard to suppliers, Setpoint could be out of business overnight. Few acquirers would consider buying a company with that degree of vulnerability.

And yet Setpoint does have one asset that Steve Petersen, at least, would be willing to pay a substantial price for -- namely, a particular type of corporate culture.

"How many companies can find out they're losing money in the first week of November and turn it around like that? Not many."

--Joe Knight, CEO of Setpoint

We generally think of corporate culture as the cumulative result of a lot of things a company does that have little or nothing to do with running the business -- dress codes, policies concerning pets, company outings, Friday-afternoon beer blasts, and the like. At many companies, moreover, that's about all there is to it. Culture is an add-on. It has only a tangential relationship to the hard logic of profit and cash flow that ultimately determines whether a business lives or dies. When the company gets into trouble, moreover, it often jettisons the very practices it's been using to define its culture. Witness the dot-coms.

But a growing number of companies like Setpoint have figured out how to build a vibrant corporate culture with a rigorous attention to the financials. The camaraderie, the sense of all-for-one-and-one-for-all, actually grows out of the company's management system.

Not that these companies are lacking in the kinds of rituals and practices we usually associate with corporate culture. Setpoint has enough to put any Silicon Valley start-up to shame. For one thing, almost half of its workforce -- including its two founders -- are dirt-bike fanatics, and they regularly go riding together in the mountains around Ogden, Utah, where Setpoint is located. On the bulletin board in the shop are photographs of various employees flying through the air on their motorcycles. (Not under Setpoint's auspices, of course.)

At Setpoint, such extracurricular activities work in tandem with the management system to create a culture that gives the business a kind of inner strength, allowing it to weather crises that would sink most other small companies and quite a few larger ones as well. That sort of a culture, Steve Petersen believes, has real value.

Petersen has been in business long enough to know how easy it is for a company -- especially a project-based company like his -- to run out of cash when it's growing 50% or 60% a year. He also knows that the risk is compounded when a company attempts to achieve such a growth rate by taking on entirely

new types of projects, as he plans to do. Those projects will make his company as vulnerable as any start-up to the danger of losing control of its cash.

That's where Setpoint comes in. Somehow it has built a culture that has everyone involved in the process of controlling cash. The process begins with Setpoint's management system, which allows people throughout the company to track their progress on specific projects with an extraordinarily high degree of accuracy. Using that information, Knight can forecast cash flow and determine how much cash will be needed to cover the company's financial obligations. If cash-flow problems lie ahead, he can't wave his wand and make them disappear, but he can see them coming 3, 4, sometimes as many as 10 months in advance. So he is never caught by surprise. He has plenty of time to sound the alarm. When the alarm goes off, moreover, Setpoint's people know what to do -- and they do it.

"That openness -- we started with it, but we've grown an average of 20% a year for 23 years. You lose that feeling over time. We want to get back to it."

--Steve Petersen

By way of illustration, Joe Knight likes to tell a story about an episode that transpired in November 1998, back when he was still the company's CFO. Setpoint had been on a growth binge and was pushing the limits of its credit line, as Inc 500 companies so often do. Its bank at the time was Zions Bank, and the loan officer was "breathing down my neck," Knight recalls.

"We'd had three months of losses, and we were running the company on our credit line, but I'd told the bank we'd break even in November and get back to profitability by December. Then I got the numbers for the first week of November, and they were awful. We just had too many projects that were losing money.

"We didn't have the board back then, but we had the same system on a spreadsheet. I handed it out to everybody, and I talked to Steve Nuetzman, the lead engineer. I said, 'Look at this, Steve. We're losing money again. If we don't do something, we're going to max out our credit line, and then we're really going to be in trouble with the bank.' "

Nuetzman got the message. On the following Monday, when Knight looked at the spreadsheet for the previous week, he was stunned to see that the situation had been turned completely around. Virtually no work had been done on the money-losing projects. Instead people had focused almost all their attention on the projects with higher gross-profit margins, so the company had made money for the week.

"I added it all up, looked at the number, and thought, 'Wow,' " Knight recalls. "I went right over to Nuetzman and congratulated him. I was pretty excited because it meant I'd be able to go to the bank and say, 'See, I said we could turn it around, and we did.' How many companies can find out they're losing money in the first week of November and turn it around like that? Not many."

"It really wasn't a big deal," says Nuetzman. "We just looked at the projects we had and realized we could shuffle resources around. We got the delivery dates on the less profitable projects extended and turned them over to contract labor. Then we put our high-powered internal resources on the most profitable stuff.

"I didn't think too much about it, but Joe Knight keeps bringing it up. I guess it's because the other two

Joes were away at the time, and so we did it on our own."

The other two Joes are Joe Cornwell and Joe VanDenBerghe, who cofounded Setpoint in 1992 and subsequently, with Joe Knight, developed its management system. Around the company they're referred to individually as Joe C., Joe V., and Joe K., and they function very much as a team. Other companies have senior managers. Setpoint has "the Joes."

Reinventing the accounting process: "If you don't like something, you set it up as an engineering problem, and then you solve it," says Joe VanDenBerghe.

The three met at Arrow Dynamics Inc., a company based in Clearfield, Utah, that designs and manufactures amusement-park rides. There the Joes were more or less typical entrepreneurial malcontents. Cornwell and VanDenBerghe used to sit around dissecting the projects they'd worked on, trying to figure out why so many went bad. "As engineers we began by complaining and then turned our complaints into engineering," says VanDenBerghe. "That's how engineers think. If you don't like something, you set it up as an engineering problem, and then you solve the problem."

They brought the same type of thinking to Setpoint, where the "engineering problem" they set out to solve was how to manage projects. Cornwell and VanDenBerghe had never seen a project-management system that worked, and one of their primary goals was to invent one. To do so, they realized, they'd have to delve into the accounting process, which plays a major role in the way projects are tracked. Neither of the founders knew accounting, however, so they set up a research project.

That research project turned out to be the crucial first step in the creation of Setpoint's management system and culture. In the course of figuring out how they wanted to do their accounting, the Joes wound up developing the tools they needed to get the entire workforce involved in controlling the numbers.

Cornwell took the lead. Although an engineer by training, he'd become very interested in the numbers of business. ("Joe Cornwell is an engineer who decided business was cooler than engineering," says Knight.) He began by purchasing copies of QuickBooks, the small-business accounting program from Intuit Inc., and a basic textbook on accounting, which he used to familiarize himself with accounting language and concepts. He also started meeting every Wednesday evening with his friend Joe Knight, who was still at Arrow. Knight had a strong financial background, including an M.B.A. from the University of California, Berkeley, but he was also a bit of an iconoclast, and he was open to Cornwell's unconventional ideas.

"I didn't agree with the textbook about the way you should do things," says Cornwell. "For example, they said you should treat labor as a variable cost. Well, you can treat labor as variable if that's the deal - if you're hiring temps, for example, or contract labor. But it's stupid to treat your regular employees as a variable cost, because the cost doesn't vary in reality. You can't hire and fire people as the work comes in and goes out. Even if you were a hard, cruel bastard, you couldn't do it. Nobody would come to work for you if you did."

Cornwell believed that a company's values were embedded in its accounting system and that a lot of its problems came from that system as well. Together he and Knight began rethinking the entire way that a project-based company handles its numbers internally, challenging accounting conventions at every turn. Out of that process emerged Setpoint's unique approach to managing projects, built around the

Joes' particular way of thinking about -- and defining -- gross profit and operating expenses. That approach is the cornerstone of Setpoint's management system. (For a fuller explanation of the accounting involved and the thought process behind it, see "Online Resources," below.)

To be sure, the Joes weren't the first businesspeople to put aside accounting conventions in order to develop their own critical numbers. Many -- perhaps most -- successful entrepreneurs go through a similar process. But Setpoint stands out in another respect, namely, the extent to which its employees use those critical numbers to decide how they can best direct their efforts as they go about their jobs.

The Joes were, in fact, committed to promoting a high degree of employee involvement from the beginning. Inspired by Jack Stack and his colleagues at Springfield Remanufacturing Corp. (SRC), in Springfield, Mo., they'd decided early on that Setpoint would be an open-book company and that they'd put great emphasis on financial training and sharing information. But it wasn't until the fall of 1998 that someone finally hit on the particular mechanism around which Setpoint's entire management system could coalesce. The credit for that goes to a Reid, not a Joe.

At the time Reid Leland was a 29-year-old project engineer; he has since become the operations manager of Setpoint. The idea for the mechanism came to him, he says, as he was returning from an open-book-management conference that fall. There he'd heard about other companies' weekly "huddles." He thought Setpoint should have them as well. But how would you present the numbers to people? You needed something visual. Joe Knight was already doing a weekly update for managers on a spreadsheet. Why not put the same information up where everybody could see it?

Thus the board was born.

Life at Setpoint has changed, everyone agrees, since the introduction of the board and the weekly huddle. "Before that, we had monthly meetings to go over the numbers, but it was too little, too late," says Ken Waudby, the shop manager.

Now there's a huddle every Monday at 11 a.m. "[But] we don't just look at the budget and the hours on Monday," says Brad Stryker, a project engineer. "We monitor them throughout the week, and we make decisions based on them. Should we buy component x or y, considering the price difference? Should we put an extra 15 hours into this project to do such-and-such? It's a constant, daily process."

Nor is it simply a matter of figuring out how to cut costs. "A lot of people think it's all about saving money," says Cornwell, "but it's not. It's about leveraging resources. Sometimes you have to spend money to make money."

When it comes to leveraging resources, moreover, the technicians on the shop floor are as focused as the engineers. "I watch GP per hour," says Johnny Lane, a technician. "Like that one," he says, pointing to a line on the board. "Twelve dollars an hour is not acceptable. What is acceptable? We average \$60 to \$80 an hour. If we could make \$100 an hour, it would be great, but a lot of jobs aren't bid for that." But do people actually talk about their GP per hour while they're working? "Oh, yeah, sure," says Lane. "We discuss it all the time."

That's true, says Waudby. "Like someone will say, 'I worked my butt off, and we only made \$50 an hour.' People are always talking about the hours."

That's the most interesting part: the process itself serves as a motivator. "It keeps you involved and lets you understand your impact," says Lyman Houston, a project engineer. "I like to know what condition

jobs are in, and why, and what I can do about it. That totally interests and motivates me."

Not that Setpoint shuns the use of incentives. Back in 1998, while the rest of the business world was going crazy with stock options, Joe K. came up with the idea of giving all employees a denim jacket if they generated enough gross profit in the fourth quarter to turn around an otherwise lackluster fiscal year. (They did.) In addition, Setpoint has an annual bonus plan.

What's striking, however, is how small a role such incentives actually play at the company. That became clear last year when a brouhaha arose over the Joes' decision to split Setpoint into two separate companies with two separate bonus programs. Based on their company's financial performance, the people who worked on the roller coasters weren't eligible for a bonus. They didn't complain, but the people in factory automation, who did earn a bonus, were upset. Their leader, Waudby, argued that the bonus money should be divided equally among the employees in both companies. "I just didn't want the bonus to mess up what we have here," he says. "I like the way things are."

Asked to elaborate, Waudby tells a story about an experience he had a couple of years ago. It was during the summer, a busy time for the automation business, and as he was leaving one day, he noticed that a couple of the roller-coaster guys were working in the parking lot. When he asked them what they were doing, they said they were setting up a braking station for a test the next morning. A crane was arriving at 6:30 a.m., and all the sensors had to be mounted, wired, and checked that night. It was a big job, and the coaster guys obviously needed help. Waudby put his lunch box in his car and came back to lend a hand.

From the plant floor: "I watch gross profit per hour," says Johnny Lane, a technician. "We discuss it all the time."

Meanwhile, other people from automation were emerging from the building on the way to their cars. One by one, they walked over to see what was going on, then put their lunch boxes away and returned to help. At one point the coaster guys looked up and saw five people from automation working on the sensors. Not until 11:30 p.m. did people knock off work for the night. By then, everybody was getting "a little rummy," says Waudby, so he and Johnny Lane came back at 4:30 a.m. to finish the wiring.

"No one planned it," he says. "No one asked us to do it. No one said, 'Hey, guys, let's go help.' We all just did it on our own. That's what I like about this company. You don't need to ask for help. It's just there. Which goes back to the deal about the bonus. I don't want things like that to mess it up by causing friction between the people who get the bonus and the people who don't."

It's an interesting story, for sure, but you have to wonder, Where did the sense of urgency come from? Why did seven Setpoint employees feel it was so important to get the braking station ready that they worked late into the night to finish it? Why not just finish it the next morning?

When asked about it, Waudby seems perplexed. "If it wasn't ready, we'd be paying \$300 an hour for the crane to be there, doing nothing," he says.

Right. Of course.

Considering the way people feel about Setpoint, and about change in general, it's not surprising that a

wave of anxiety swept through the company when the Joes first began talking about a merger with Petersen Inc. They went to great lengths to explain the logic behind the deal, but people were still nervous, and so Setpoint started holding "merger meetings" at which employees could air their concerns and the Joes could try to address them.

Steve Petersen came to some of the meetings. "I thought I was open-book, but I hadn't seen anything," he recalls. "They went into a lot of detail about banking relationships, about sales volumes. And they asked me some very personal questions. One woman asked me what kind of vehicle I drove. I was very happy I could say Chevy pickup rather than Lamborghini.

"That openness -- we started with it, but we've grown an average of 20% a year for 23 years. You lose that feeling over time. We want to get back to it. We want to have that feeling again here at Petersen. It's something to strive for."

For now, at least, Petersen and Setpoint will be striving for it as separate corporate entities, although the links between them will be strong. There's already a major joint venture in the works. In addition, Petersen hopes to position his company as the primary fabricator of Setpoint's roller coasters, which are suddenly hotter than ever.

Meanwhile, he's moving forward on the establishment of an employee stock ownership plan at Petersen Inc. After it's in place, he says, he may ask Joe Knight to come in and do business-literacy training for his employees.

But those are just the first steps -- "going steady," Petersen says, "before getting married." Eventually, he'd still like to merge the two companies, and his people echo the sentiment. "Setpoint has already had an impact on us," says Rob Despain, vice-president of business development. "It's opened our eyes to things we could do better."

"Setpoint has what we need to get where we want to go," says Ted Johnstun, Petersen's CFO. "Better planning. Better forecasting. Better day-to-day control of the numbers."

Petersen himself puts it a little differently. He tells a story from a book he once read -- about a man who accidentally locks himself in the freezer car of a train. It's the end of the day, and he realizes he could die from the cold before anyone comes to open the door. He sits there shivering, obsessing about his desperate situation, until he finally passes out. The next morning his body is found. An autopsy determines that he froze to death, which confounds everybody. The car's refrigeration system wasn't turned on. The temperature never fell below 61 degrees.

"That's very similar to what happens with upper management," Petersen says. "When I don't have the tools and the data, I can create a huge fear inside myself, even though the company might be healthy and strong. We as managers have a tendency to worry more than we need to, and the same thing can happen with employees on the floor.

"So I relate that story to the merger. I think [the merger would] help to alleviate those kinds of problems in our company."

And that, he believes, is something worth paying for.

[Bo Burlingham](#) is Inc's editor-at-large. He is also the coauthor, with Jack Stack, of *The Great Game of Business* (Doubleday/Currency, 1992) and the forthcoming *A Stake in the Outcome*

(Doubleday/Currency, February 2002).

Online Resources

The genius of Setpoint's management system lies in the numbers its people use to track their progress on the various projects they're working on. For a discussion of the logic behind those numbers, go to "[By the Numbers: How Setpoint Stays in Control](#)." There you will also find an explanation of the system Setpoint has developed for tracking long-term projects (those that take more than three months to complete), which is slightly different from the one it uses for short-term projects. See also "[Tracking Progress and Profits on Projects](#)," a downloadable worksheet Setpoint cofounder Joe Knight developed so others could follow his company's example.

Setpoint is just one of thousands of companies that use some form of open-book management. By that we mean the practice of sharing financial information with people throughout a company for the purpose of getting everybody to focus on helping the business make money. Not that sharing information is all there is to it. Like Setpoint, the most successful practitioners do considerably more. You can find numerous examples of open-book management by searching the *Inc* archives at Inc.com.

Inc has actually been writing about open-book management since the mid 1980s, when we ran the first major article on Springfield Remanufacturing Corp. (SRC), a pioneer of the concept. That article, titled "[The Turnaround](#)," and many others about open-book management are available at www.inc.com/magazine/columns/numbers.html, where we've collected various pieces by and about Jack Stack, SRC's cofounder and CEO and an *Inc* contributor. There's also a link to "[The Open-Book Revolution](#)" there, our June 1995 cover story by former senior editor John Case, who not only coined the phrase open-book management but has written two books on the topic.

Other articles worth checking out:

- "[Being the Boss](#)," October 1989, an interview with Jack Stack, by Bo Burlingham
- "The Great Game of Business," by Jack Stack, with Bo Burlingham, June 1992 (not currently available on-line)
- "[A Company of Businesspeople](#)," by John Case, April 1993
- "[Games Companies Play](#)," by John Case, October 1994
- "[Keeping Score](#)," by John Case, June 1998

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