How We Went Digital Without a Strategy

by Ricardo Semler

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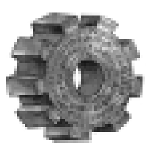


Over the last decade, Semco has successfully extended its business from manufacturing to services to the Internet. Here's what it has learned: transformation is easy – if you throw away your plans and let your people lead you.

by Ricardo Semler

I OWN A $160 MILLION South American company named Semco, and I have no idea what business it's in. I know what Semco does – we make things, we provide services, we host Internet communities – but I don't know what Semco is. Nor do I want to know. For the 20 years I've been with the company, I've steadfastly resisted any attempt to define its business. The reason is simple: once you say what business you're in, you put your employees into a mental straitjacket. You place boundaries around their thinking and, worst of all, you hand them a ready-made excuse for ignoring new opportunities: "We're not in that business." So rather than dictate Semco's identity from on high, I've let our employees shape it through their individual efforts, interests, and initiatives.

That rather unusual management philosophy has drawn a good deal of attention over the years. Nearly 2,000 executives from around the world have trekked to São Paulo to study our operations. Few, though, have tried to emulate us. The way we work – letting our employees choose what they do, where and when they do it, and even how they get paid – has seemed a little too radical for mainstream companies.

But recently a funny thing happened: the explosion in computing power and the rise of the Internet reshaped the business landscape, and the mainstream shifted. Today, companies are desperately looking for ways to increase their creativity and flexibility, spur their idea flow, and free their talent – to do, in other words, what Semco has been doing for 20 years.

I don't propose that Semco represents the model for the way businesses will operate in the future. Let's face it: we're a quirky company. But I do suggest that some of the principles that underlie the way we work will become increasingly common and even necessary in the new economy. In particular, I believe we have an organization that is able to transform itself continuously and organically – without formulating complicated mission statements and strategies, announcing a bunch of top-down directives, or bringing in an army of change-management consultants. As other companies seek to build adaptability into their organizations, they may be able to learn a thing or two from Semco's example.

How do you get a sizable organization to change without telling it to? It's easy – but only if you're willing to give up control.

Transformation Without End

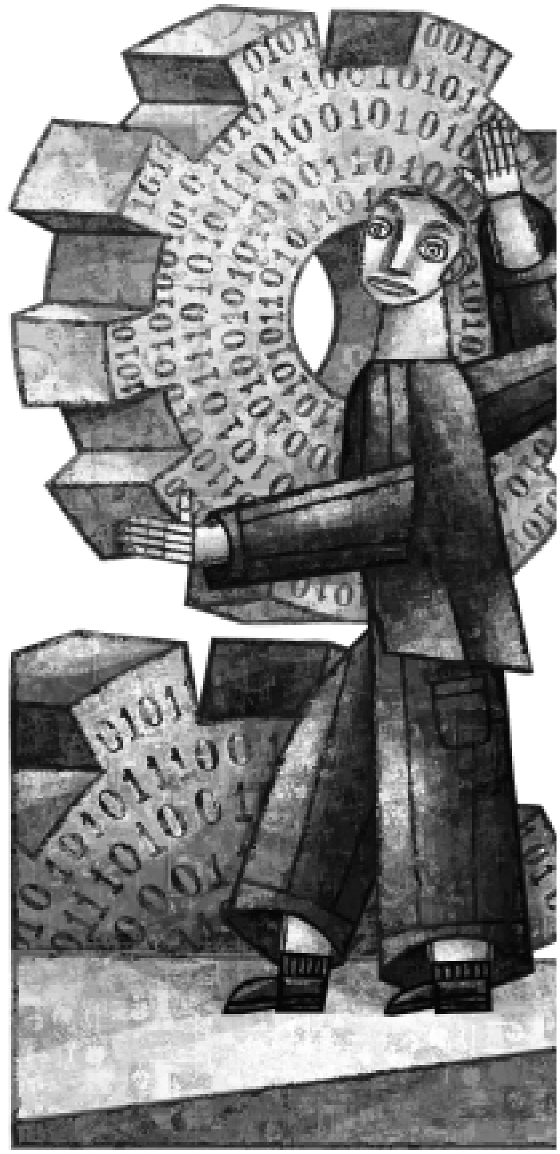
Over the last ten years, Semco has grown steadily, quadrupling its revenues and expanding from 450 to 1,300 employees. More important, we've extended our range dramatically. At the start of the '90s, Semco was a manufacturer, pure and simple. We made things like pumps, industrial mixers, and dishwashers. But over the course of the decade, we diversified successfully into higher-margin services. Last year, almost 75% of our business was in services. Now we're stretching out again – this time into e-business. We expect that more than a quarter of our revenues next year will come from Internet initiatives, up from nothing just one year ago. We never planned to go digital, but we're going digital nonetheless.

You may wonder how that's possible. How do you get a sizable organization to change without telling it – or even asking it – to change? It's actually easy – but only if you're willing to give up control. People, I've found, will act in their best interests, and by extension in their organizations' best interests, if they're given complete freedom. It's only when you rein them in, when you tell them what to do and how to think, that they become inflexible, bureaucratic, and stagnant. Forcing change is the surest way to frustrate change.

Enough lecturing. Let me give you a concrete example of how our transformation has played out. Ten years ago, one of the things we did was manufacture cooling towers for large commercial buildings. In talking with the property owners who bought these products, some of our salespeople began to hear a common refrain. The customers kept complaining about the high cost of maintaining the towers. So our salespeople came back to Semco and proposed starting a little business in managing cooling-tower maintenance. They said, "We'll charge our customers 20% of whatever savings we generate for them, and we'll give Semco 80% of those revenues and take the remaining 20% as our commission." We said, "Fine, give it a shot."

Well, the little business was successful. We reduced customers' costs and eliminated some of their hassles, and they were happy. In fact, they were so happy that they came back and asked if we'd look after their air-conditioning compressors as well. Even though we didn't manufacture the compressors, our people didn't hesitate. They said yes. And when the customers saw we were pretty good at maintaining compressors, they said, "You know, there are a lot of other annoying functions that we'd just as soon offload, like cleaning, security, and general maintenance. Can you do any of those?"

At that point, our people saw that their little business might grow into quite a big business. They began looking for a partner who could help bolster and



extend our capabilities. They ended up calling the Rockefeller Group's Cushman & Wakefield division, one of the largest real-estate and property-management companies in the United States, and proposing that we launch a 50–50 joint venture in Brazil. Cushman wasn't very keen on the idea at first. People there said, "Property management by itself isn't a very lucrative business. Why don't we talk about doing something that involves real estate? That's where the money is."

We spent some time thinking about going into the real-estate business. We didn't have any particular expertise there, but we were willing to give it a try. When we started asking around, though, we found that no one in the company had much interest in real estate. It just didn't get anyone excited. So we went

***Ricardo Semler** is the majority owner of Semco in São Paulo, Brazil. He is the author of two previous HBR articles, "Managing Without Managers" (September–October 1989) and "Why My Former Employees Still Work for Me" (January–February 1994), and the book* Maverick *(Warner Books, 1993).*

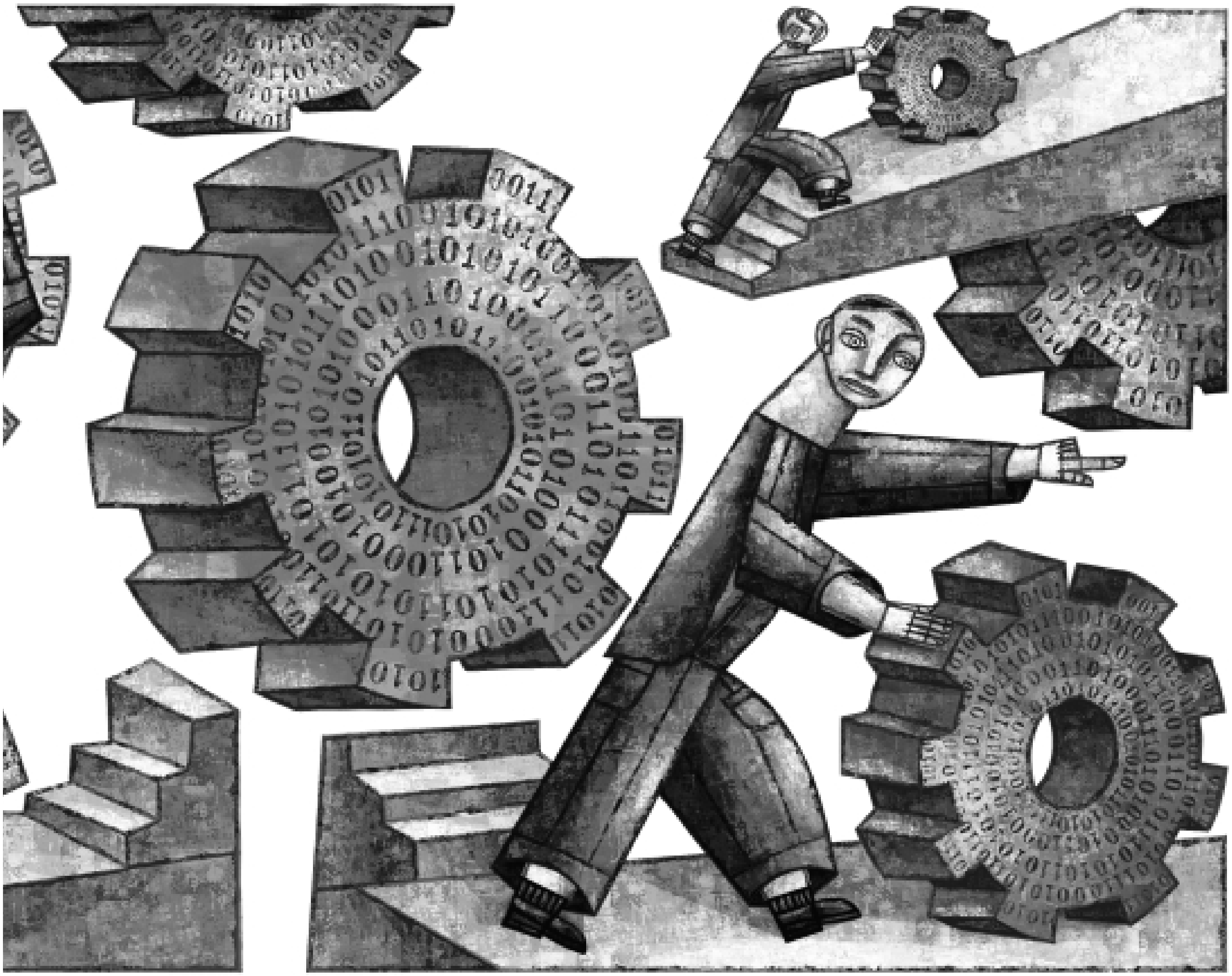


ILLUSTRATION BY RICHARD DOWNS

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back to the Cushman folks and said, "Real estate sounds like a great business, but it's not something we care about right now. Why don't we just start with property management and see what happens?" They agreed, though not with a lot of enthusiasm.

We ponied up an initial investment of $2,000 each, just enough to pay the lawyers to set up a charter. Then we set our people loose. In no time, we had our first contract, with a bank, and then more and more business came through the door. Today, about five years later, the joint venture is a $30 million business.

It's also the most profitable property-management business within Cushman & Wakefield. The reason it has been so successful is that our people came into it fresh, with no preconceived strategies, and they were willing to experiment wildly. Instead of charging customers in the traditional way – a flat fee based on a building's square footage – they tried a partnership model. We'd take on all of a property owner's noncore functions, run them like businesses, and split the resulting savings.

One customer, for example, had been using 126 subcontractors for all sorts of maintenance and security tasks. It was a nightmare to manage, it resulted in poor or haphazard service, and it was ridiculously inefficient. We took over all 126 tasks, from changing lightbulbs to managing the car fleet to maintaining elevators, and we treated each as a separate business. We tore every task apart to see how it could be done better, and we made a series of improvement proposals to the client, ranging from relatively simple operating changes (reducing security personnel by installing video cameras) to highly technical systems installations (revamping the ATM architecture to dramatically reduce downtime). We outlined the investment and the expected gain and shared the cost reduction. The client reaped big savings and service improvements and got a single point of contact for doing everything necessary to run the building. And Semco made a heck of a lot more money than it would have by charging a flat fee.

Most manufacturers would probably consider a shift from making cooling towers to managing buildings pretty radical. Before making such a leap, they'd do a lot of soul-searching about their core businesses and capabilities. They'd run a lot of numbers, hold a lot of meetings, do a lot of planning. We didn't bother with any of that. We just let our people follow their instincts and apply their common sense, and it worked out fine.

Going to the Net

Our recent move into the digital space has proceeded in much the same way, with our people again taking the lead. In fact, some of the eight Internet ventures we've launched grew directly out of our earlier service initiatives. As our facility-management business expanded, for example, we extended it, through a joint venture with Johnson Controls, to managing retail facilities. As our people began to work closely with store managers, they began to notice the huge costs retailers incur from lost inventory. One employee came forward and asked for a paid leave to study opportunities in that area. We gave him a green light, and within a year he had helped us set up a joint venture with RGIS, the largest inventory-tracking company in the world. Less than two years later, the venture had become the biggest inventory-management business in South America. Now it is branching out into Web-enabled inventory control, helping on-line companies coordinate the fulfillment of electronic orders.

Our work in property management also brought us face to face with the disorganization and inefficiency of the construction business. Here, too, our people saw a big business opportunity, one that would build on the unique capabilities of the Internet. A number of the members of our joint ventures with Cushman & Wakefield and Johnson Controls banded together, with Semco's support, to set up an on-line exchange to facilitate the management of commercial construction projects. All the participants in a building project – architects, banks, construction companies, contractors, and project managers – can now use our exchange to send messages, hold real-time chats, issue proposals and send bids, and share documents and drawings. They can collaborate even if they're using different software, because the Web platform automatically does all the translation. The exchange is revolutionizing the construction process here in Brazil.

That business, which we're operating as a 50–50 joint venture with the U.S. Internet software company Bidcom, has itself become a springboard for further new initiatives. One of the most exciting is the creation of a South American Web portal for the entire building industry. The portal, called Edify, provides a single point of access for all the people, goods, and services required for a construction project. It's a place where contractors can hire tradesmen, hardware stores can sell lumber and fixtures, homeowners can buy insurance and cable television service, and real-estate agents and interior decorators can promote their offerings. We make money by charging transaction fees on all the business that takes place through the portal.

We're also partnering with a company called eTradeshow to host virtual construction fairs within the portal. As our people began to work closely with construction companies, they realized that many sectors of the South American building trade – flooring and masonry, for example – aren't large enough to pay the costs of physical trade shows. As a result, new ideas and products have been slow to enter the markets. We saw that on-line shows would be highly attractive to these sectors, providing them access not only to new products but to potential new partners all around the world. We'll be holding 60 different fairs on the site. In addition, we'll be hosting virtual versions of major international trade shows in such industries as automobiles, computers, and medical equipment. Visitors will be able to walk through a 3-D representation of the trade-fair space, collect business cards and brochures, watch presentations, and chat with sales representatives. These shows will generate fees for us while driving more traffic to the portal.

Management Without Control

Semco's ongoing transformation is a product of a very simple business philosophy: give people the freedom to do what they want, and over the long haul their successes will far outnumber their failures. Operationalizing that philosophy has involved a lot of trial and error, of taking a few steps forward and a couple back. The company remains a work in progress – and I hope it stays that way forever.

As I reflect on our experience, though, I see that we've learned some important lessons about creating an adaptive, creative organization. I'll share six of those lessons with you. I won't be so presumptuous as to say they'll apply to your company, but at least they'll stir up your thinking.

Forget about the top line. The biggest myth in the corporate world is that every business needs to keep growing to be successful. That's baloney. The ultimate measure of a business's success, I believe, is not how big it gets, but how long it survives. Yes, some businesses are meant to be huge, but others are meant to be medium-sized and still others are meant to be small. At Semco, we never set revenue targets for our businesses. We let each one find its natural size – the size at which it can maintain profitability and keep customers happy. It's fine if a business's top line stays the same or even shrinks as long its bottom line stays healthy. Rather than force our people to expand an existing business beyond its natural limits, we encourage them to start new businesses, to branch out instead of building up.

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Never stop being a start-up. Every six months, we shut down Semco and start it up all over again. Through a rigorous budgeting and planning process, we force every one of our businesses to justify its continued existence. If this business didn't exist today, we ask, would we launch it? If we closed it down, would we alienate important customers? If the answers are no, then we move our money, resources, and talent elsewhere. We also take a fresh look at our entire organization, requiring that every employee – leaders included – resign (in theory) and ask to be rehired. All managers are evaluated anonymously by all workers who report to them, and the ratings are posted publicly. It has always struck me as odd that companies force new business ideas and new hires to go through rigorous evaluations but never do the same for existing businesses or employees.

Don't be a nanny. Most companies suffer from what I call boarding-school syndrome. They treat their employees like children. They tell them where they have to be at what time, what they need to be doing, how they need to dress, whom they should talk to, and so on. But if you treat people like immature wards of the state, that's exactly how they'll behave. They'll never think for themselves or try new things or take chances. They'll just do what they're told, and they probably won't do it with much spirit.

At Semco, we have no set work hours, no assigned offices or desks, no dress codes. We have no employee manuals, no human resource rules and regulations. We don't even have an HR department. People go to work when they want and go home when they want. They decide when to take holidays and how much vacation they need. They even choose how they'll be compensated. (See the sidebar "Eleven Ways to Pay.") In other words, we treat our employees like adults. And we expect them to behave like adults. If they screw up, they take the blame. And since they have to be rehired every six months, they know their jobs are always at risk. Ultimately, all we care about is performance. An employee who spends two days a week at the beach but still produces real value for customers and coworkers is a better employee than one who works ten-hour days but creates little value.

Let talent find its place. Companies tend to hire people for specific jobs and then keep them stuck in one career track. They also tend to choose which businesses people work in. The most talented people, for instance, may be assigned automatically to the business unit with the biggest growth prospects. The companies don't take into account what the individual really wants. The resulting disconnect between corporate needs and individual desires shows up in the high rates of talent churn that afflict most companies today.

We take a very different approach. We let people choose where they'll work and what they'll do (and even decide, as a team, who their leaders will be). All entry-level new hires participate in a program called Lost in Space. They spend six months to a year floating around the company, checking out businesses, meeting people, and trying out jobs. When a new hire finds a place that fits with his personality and goals, he stays there. Since our turnover rate in the past six years has been less than 1% – even though we've been targeted heavily by headhunters – we must be doing something right.

Make decisions quickly and openly. The best way for an organization to kill individual initiative is to force people to go through a complicated, bureaucratic review and approval process. We strive to make it as easy as possible for Semco employees to propose new business ideas, and we make sure they get fast and clear decisions. All proposals go through an executive board that includes representatives from our major business units. The board meetings are completely open. All employees are welcome to attend – in fact, we always reserve two seats on the board for the first two employees who arrive at a meeting. Proposals have to meet two simple criteria that govern all the businesses we launch. First, the business has to be a premium provider of its product or service. Second, the product or service has to be complex, requiring engineering skills and presenting high entry barriers. Well-considered proposals that meet those standards get launched within Semco. Even if a proposed business fails to meet both criteria, we'll often back it as a minority investor if its prospects look good.

Partner promiscuously. To explore and launch new businesses quickly and efficiently, you need help; it's pure arrogance to assume you can do everything on your own. I'm proud to say that we partner promiscuously at Semco. Indeed, I can't think of a single new business we've started without entering into some kind of alliance, whether to gain access to software, draw on a depth of experience, bring in new capabilities, or just share risk. Partnerships have provided the foundation for our experiments and our expansion over the years. Our partners are as much a part of our company as our employees.

Staying Free

I travel a lot in my job, and recently I've been spending time in Silicon Valley. I've been visiting Internet companies, talking with technology visionaries, and participating in panel discussions on the future of business. The new companies and their founders excite me. I see in them the same spirit we've nurtured at Semco – a respect for individuals and their ideas, a distrust of bureaucracy and hierarchy, a love for openness and experimentation.

But I'm beginning to see troubling signs that the traditional ways of doing business are reasserting their hegemony. Investors, I fear, are starting to force young start-ups into the molds of the past – molds that some thought had been broken forever. CEOs from old-line companies are being brought in to establish "discipline" and "focus." Entrepreneurs are settling into corner offices with secretaries and receptionists. HR departments are being formed to issue

Eleven Ways to Pay

At Semco, we let employees choose the way they are paid. There are 11 compensation options.

1. *Fixed salary*
2. *Bonuses*
3. *Profit sharing*
4. *Commission*
5. *Royalties on sales*
6. *Royalties on profits*
7. *Commission on gross margin*
8. *Stock or stock options*
9. *IPO/sale warrants that an executive cashes in when a business unit goes public or is sold*
10. *Self-set annual review/compensation in which an executive is paid for meeting self-set goals*
11. *Commission on difference between actual and three-year-value of company*

And because the options can be combined in different ways, there is a vast number of possible permutations. We've found that by being flexible about rewards, we encourage our employees to innovate and take risks. In the end, people understand it's in their best interest to choose compensation packages that maximize both their own pay and the company's returns.

policies and to plot careers. Strategies are being written. The truly creative types are being caged up in service units and kept further and further from the decision makers.

It's sad and, I suppose, predictable. But it isn't necessary. If my 20 years at Semco have taught me anything, it's that successful businesses do not have to fit into one tight little mold. You can build a great company without fixed plans. You can have an efficient organization without rules and controls. You can be unbuttoned and creative without sacrificing profit. You can lead without wielding power. All it takes is faith in people.

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