

# Should We Resort To Layoffs This Time?

*Reell's Difficult Choice*

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*"Whatever you emphasize you are in danger of overemphasizing."*

Bob Wahlstedt (Founder and Board member of Reell)

**“I**n 2001 the high tech bubble burst and we were particularly vulnerable in 2001 because of our laptop hinge business,” recalled Reell board member Bob Carlson, shaking his head. “I was co-CEO of Reell at the time, and our laptop business had been growing rapidly. We had just made a significant investment in an expansion of our manufacturing capacity to keep up with the growth in the business, so the crunch hit us especially hard.”

Signs of economic trouble for Reell began to first surface in the summer of 2000. “We couldn’t figure out what was going on at first,” Carlson explained. “Neither could our customers. At the same time, one part of Toshiba was calling us to say that they needed more hinges, while another part of Toshiba was calling us to cancel orders. We lost money in the 4<sup>th</sup> quarter of 2000 and then lost money again in the 1<sup>st</sup> quarter of 2001. In one year we lost 35% of the business – some seven million dollars in this strategic business line alone.”<sup>31</sup>

The company tried to improve sales, but the entire laptop market had dropped off. “Even if we had been able to develop new business,” Carlson clarified, “it wouldn’t have paid off for another year or two. Next we moved to cut everything else we could – education and training, temporary employees, building improvements, contributions to the ESOP [Employee Stock Ownership Plan] and 401ks, etc. – in ways that wouldn’t hurt our revenue producing ability.

“We had a tradition of regularly gathering the employees for something we called ‘pie day’ to update them on what was going on with the business and the company. When times were lean, the employees knew right away because instead of enjoying pie at our meeting we would gather instead for ‘cookie day.’ So when we gathered that day around cookies, the employees knew that things were serious. Even after all of the cuts we had been able to identify, we were still left with 80% of expense budget, with a large portion of that being payroll.”

This was not the first time in its history that Reell had faced a significant shortfall in projected revenues. As a privately-held and employee-owned company, Reell had a historical precedent of willingness to live with shrinking profitability even down to zero before putting the possibility of payroll reductions on the table.

By February of 2001, it was clear that the combination of the costs related to the recent investment in increased manufacturing capacity and the unanticipated revenue shortfall had brought the company to this zero profitability benchmark, jump-starting a dialogue at the senior leadership level of Reell. The options on the table for reducing payroll were relatively clear:

1. laying off co-workers to achieve the necessary reduction in costs
2. implementing a program of reducing wages to prevent layoffs for as long as possible

It wasn’t at all clear, however, which of these two options Reell ought to pursue. Further muddying the waters for leadership were several problems which until now had remained hidden beneath the waterline and now emerged as conspicuous.

“I RECALL OUR LEADERSHIP CONVERSATIONS being rigorous with disagreement about what we should do,” reflected Phil Billings, Reell’s Director of Technology Development. “My own perspective was that we should consider layoffs for several reasons. For one thing, the depth of the pay cuts necessary to make up the loss would affect the entire co-worker community both financially and morale-wise. Also, there were some in the company who contributed on a performance level much more than others, making it seem unfair to distribute the costs of a pay reduction evenly. The truth is that

this whole conversation brought to light problems at Reell that we hadn't sufficiently addressed. We hadn't been doing an adequate job managing the performance of our people, and we hadn't made an adequate commitment to a disciplined process of pursuing efficiency improvements."

"There was a concern," Bob Carlson agreed, "that if we elected to go with pay cuts instead of lay-offs, we would run the risk of losing our best people, those best able to leave for other work elsewhere. While none of us liked the idea of layoffs, there was significant concern about the problems associated with implementing a program of pay reductions."

"The conversations were good, active, intense and we couldn't reach agreement," recalled Kit Mundahl, VP of Corporate Service. "Along with everything else, there was real uncertainty about whether the lost business would return and, if so, how long it would be. We really didn't know if the future would sustain our current workforce."

"Following extensive conversation," Carlson recalled, "Steve Wikstrom and I indicated that as the co-CEOs we would make the call on which path to follow."

## Company Background: Its Practices and Business

THE STORY OF REELL PRECISION MANUFACTURING in St. Paul, Minnesota begins on October 13, 1970 with its three founders. Lee Johnson, Dale Merrick and Bob Wahlstedt, all engineers, had been employed at 3M Corporation. Although they respected 3M, it had become increasingly difficult for them to see their futures there.

The first reason for this was their observation that successful executives at 3M that they were associated with too often paid the price of family estrangement for career advancement. Lee, Dale and Bob saw that as one progressed up the company's ladder of success, relationships outside of work appeared to inevitably suffer. They witnessed fellow executives losing touch with their children and they had no interest in recreating that problem in their own lives.

Second, they experienced intense profit-related pressures "to get the job done yesterday" too often at the expense of the quality of their work. Racing to get product out the door frustrated their desire to feel proud about the quality of their work as engineers. They increasingly felt that they were not serving the needs of the customers and that they were becoming 'company employees.'

Having left 3M, they founded Reell as an engineering design manufacturing firm specializing in the development of precision applications of their proprietary wrapped-spring clutch technology. By the mid-1990s, Reell had grown to a company employing more than 120 co-workers and had opened operations in Europe. Today (2008) they employ approximately 230 employees, with \$40 million in revenue.

In the beginning, however, times were challenging and the three founders realized that given the pressures facing their new venture they were entirely susceptible to recreating in their own company the very same stresses they had stepped back from in leaving 3M. Wanting to avoid this, they asked a simple question: “What do we really want from our work in this new company?” They identified what they saw were four complementary aims:

- to earn a living
- to grow personally and professionally
- to be able to put family first
- to integrate their faith and work

Moreover, they realized that if these four aims were important to them, they could reasonably assume that their employees might also have these same aspirations for themselves. This helped them to define “success” in their new company – a business and workplace where they could with integrity achieve all four aims.

These aims were translated into four moral and spiritual principles, which have remained constant in their direction statement over the years (see Appendix 1 for their current direction statement):

- **Do what is right:** We are committed to do what is right even when it does not seem to be profitable, expedient, or conventional.
- **Do our best:** In our understanding of excellence we embrace a commitment to continuous improvement in everything we do. It is our commitment to encourage, teach, equip, and free each other to do and become all that we were intended to be.
- **Treat others as we would like to be treated**
- **Seek inspirational wisdom:** By looking outside ourselves, especially with respect to decisions having far-reaching and unpredictable consequences, but we will act only when the action is confirmed unanimously by others concerned.

These principles have a deep connection to the Christian faith of the founders as well as many other Reell employees. For those who do not share this religious tradition, the

principles rang true often because of their strong resonance with more universal humanistic values and principles.

As the company evolved, managers and employees sought to embody these principles in particular practices and policies that they believe would create a community of work that would enable co-workers to grow and develop. Like any organizational practices designed to reflect and deliver on cherished ideals, these were at times implemented imperfectly - at times even poorly. There was, however, a strong commitment in the company to walk the talk and this relationship between principle and practice created a distinctive culture, which helped them to see more clearly the moral and spiritual realities in the practical problems facing the organization. Some of the practices advanced by the company were:

**Spiritual Support Group:** As the company began, Dale Merrick recognized a spiritual dimension to their work and asked whether there were ways to more explicitly share this experience with other employees. They started a weekly Bible study which went on for 10 years. They were eventually discontinued because the meetings became less unifying and more divisive over conflicting interpretations of the Bible. More recently, the new CEO of the company, Eric Donaldson has begun a prayer group on Monday mornings at 7:00 am. Open to all in the company, it serves as a time to “seek inspiration,” share concerns with each other that deal with personal, familial, and professional life and to strengthen a community of work by relating to each other in a different way.

**Seven Minutes of Silence:** When the three founders first started Reell, they would meet weekly and pray together over larger decisions. As the company became more diverse, the leadership of Reell revised this practice, and began their meetings with 7 minutes of silence as a discipline to practically “seek inspirational wisdom.”

**Outside Counsel:** When the company first began, the founders of Reell sought counsel from their church pastors. Today, the company participates in a roundtable sponsored by Seeing Things Whole. This roundtable brings Reell’s leadership together with leaders from other organizations to explore together how their companies might best integrate the wisdom of faith, values and organizational life. Leaders participate in these roundtables not as individuals, but together as teams representing their company, so that the conversations which take place at these roundtables and STW’s multiple-bottom line way

of understanding organizations might be brought back into the company and shape internal conversations within Reell.

**Target Wage:** Reell hires new individuals at a competitive market wage. For production workers, however, the market wage often does not reflect a living wage. The company has committed itself to raising their pay to a “target wage” within a relatively short period of time, by providing skills and training that increases their value to the company. The challenge for the company is to structure the work and to teach the individual the skills required to bring the work’s “instrumental value” into line with the target or living wage.

**Teach-Equip-Trust (TET) style management:** Seeking to design better and more effective jobs through training and skill development, Reell redesigned their assembly-line from a Command-Direct-Control style management (CDC) where management and engineers made all the decisions concerning the conception of the assembly area, to a Teach-Equip-Trust (TET) style management where employees were taught inspection procedures, equipped with quality instruments and trusted to do things right on their own assembly-line. Employees decreased set-up times for new products, reduced the need for quality inspection, increased overall quality and required less supervision. By reducing these costs, the company not only was able to pay a living wage, but also created more humane work.

**Pie (or cookie) Day (Monthly All-Employee Meetings):** This practice began as a monthly celebration of employee birthdays, and was later expanded to offer employees regular updates on what is happening with the business. It is one of the venues in which management delivers on Reell’s commitment to open book management, sharing all financials with the employees. Building upon the Employee Stock Ownership Plan (ESOP), the meetings are used to foster a deeper sense of ownership within the company.

**The Forum:** The Forum’s primary role is to monitor the expression of Reell’s Declaration of Belief and Direction Statement in the day-to-day activities of the company. Members discuss improvements to existing policies/benefits or proposals for new ones. It is a group comprised of 7 coworkers whose selection is based on geographic location within the company; as well as, the head of Coworker Services. Pre-requisites for Forum membership are 3 years employment at Reell and a demonstrated interest in the daily expression of the Declaration of Belief and Direction Statement within the company.

**Volunteer Time:** Reell encourages its employees to give not only their treasure, but also their talent to the community. The company matches volunteer time with vacation pay.

**Tithing:** Inspired by the biblical command to give the first fruits of one's earnings to the poor, Reell has instituted a tithing program where its contributions to charity are at 10% of pretax earnings.

**Equity Pay Ratio Indicator:** While there is no hard and fast ratio between the highest and lowest paid employees within the company, management is conscious of the fact that internal equity is an important reflection of its mission and principles.

**Last Alternative Layoff Practice:** In economic downturns, layoffs are a last alternative, resorted to only after seeking cost reductions in other areas.

Over time, the distinctive character of such policies and practices has attracted and helped to retain employees at Reell. Historically, employee turnover rates have ranged from 5-8%. At the same time, the spiritual and religious underpinnings of some of these practices was a source of dis-ease and a sense of exclusion for a few of Reell's employees.<sup>1</sup> There was also the problem of some of the practices falling into disrepair. For example, concerns were expressed that the training and development activities and budget did not keep up with the aspirations of the TET philosophy.

**Business/Market Backdrop:** Reell sought to produce a product that they could be proud of and that would serve their customer needs. The founders were all engineers who delighted in creating and serving customers. Their experience of working for 3M and a rep business enabled them to understand the market and find potential improvement of existing products. All three were keen on customer relations:<sup>2</sup>

- Be Close to the Customer: The start of this business was the result of knowing the market place.

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<sup>1</sup> For a fuller discussion on tensions over the spiritual character of Reell see Kenneth E. Goodpaster, Laura L. Nash & Henri-Claude de Bettignies eds., *Business Ethics: Policies and Persons* 4th ed. 2005) (1985)

<sup>2</sup> We are grateful to Stan Nyquist, current chair of the board, who provided this information.

- Design Excellence: The first product was the result of good engineering and offering a better, superior product. They were fortunate that some of their products had long product lives, which did not require rapid redesigns.
- Quality and On Time Delivery: They would manufacture a product with superior quality, deliver the product on time.
- Strong Long-term Relationships with Suppliers: One aspect of that relationship was to pay suppliers within 30 days, even if that placed hardship on the company.

This mission of Reell demanded a premium price strategy to support a strong research and development budget. One of the more difficult pressures Reell faced and continually faces is how to respond to customers price reduction pressures on its products. In the late 1980s, Xerox (approximately 70% of revenue) was demanding a major price cut on one of Reell's clutches, which would have hampered future R&D and employee benefits. The buyer threatened that "If you don't reduce the price, there'll be no more business." Bob Wahlstedt's response was "Well, all I can tell you is that our last shipment will be on time." Fortunately, for Wahlstedt and Reell, the buyer was bluffing, and Reell was able to retain the business.

For Wahlstedt, he was not playing a game, but rather he saw the buyer's request as unfair. He believed that it was right for Reell to make a fair profit. In return, Reell would not price gouge their customers and they would provide a high quality product. A fair price included recovering costs and having reasonable profit that allowed for R&D to improve and develop new products. Reell left money on the table by not pricing what the market would bear. They also walked away from money by not coming down on prices with what the market wouldn't bear.<sup>3</sup>

Ten years later in the late 1990s, these downward price pressures continued with even greater intensity.<sup>4</sup> Dan Stem, VP of Sales, felt that Reell could no longer resist price reduction requests without losing major customers. As a small company, Reell has always been dependent upon a couple of very large firms such as 3M, Xerox, Kodak,

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<sup>3</sup> Wahlstedt later reflected that always going in with their best price and not moving off this price did not always serve the company well since it did not create room to negotiate. In light of the current norm on price negotiations, he would have probably padded the price offer and allow for reductions.

<sup>4</sup> In the 1990s, Reell's growth area went from rotary motion devices found in copiers to hinges in laptop computers. This brought significant growth, but also turmoil in terms of significant price reductions in computers, shortening life span of computers placing greater demands on new product development, erratic increases and decreases in demand and the movement of production of computers to China.

Apple, Toshiba, Dell, etc. One customer at any one time could make up between 20-70% of the company's revenue.

At the end of 2000, Toshiba was one of Reell's largest customers with approximately 20% of Reell's revenue. Stem negotiated a price with Toshiba, which reduced Reell's profit margins. Stem and others at Reell felt that failing to negotiate price reductions with Toshiba would lead to losing an important customer for its future. The laptop hinge business was growing rapidly and there were clear signs that laptops in the computer market had significant growth potential.

Stem along with some in senior leadership believed that such profit pressures could actually be good for Reell to improve its own purchasing practices and improve its manufacturing processes around the management of inventory, supply chains, quality, rework, scrap, etc. So while there may be a decrease in margins initially, in the long term, increased volume followed by improved operational efficiencies would make Reell a larger and more profitable company.

The price reduction strategy with Toshiba increased Reell's volume significantly. In order to handle the increased volume, Reell expanded its manufacturing facility from 40,000 to 80,000 square feet and purchased new expensive automated equipment. The expansion and purchasing was financed by taking on \$4.2 million of debt. Yet, as the paint was drying on their capital investment, Toshiba's orders began to fall fast resulting in the need to reduce cost, including those related to labor. Reell's precarious situation, along with the economy slipping into recession was reflected in its share price which dropped 20% between 2000 and 2001 from \$100 to \$80 a share.

## A Time to Decide

AS REELL FACED THE DIFFICULT DECISION about how to reduce payroll, their own historical precedent was pulling them toward the option of utilizing pay cuts, an option Reell had utilized on four earlier occasions (see Appendix 4). Their decision this time was complicated by their uncertainty about whether this downturn in the market was different. There was a great deal of confidence at Reell in its technology and the capability of its people, but no clarity about whether or when the market would regain strength, and to what extent. If the market was not regained, for the foreseeable future Reell simply had too many people for the work that needed to be done.

Facing an uncertain future, management drew upon both principle and precedent in making its decision. The stories of the utilizing pay cuts in the past as a way of avoiding layoffs contributed to the strong culture at Reell. There was a sense that choosing layoffs would negatively impact this culture – that to choose layoffs would be to break solidarity not only with one another but with Reell’s legacy.

When the founders faced their first downturn in the 1970s, they drew upon both their experience and their spiritual principles in shaping their response. Their experience at 3M made them determined not to create a company like the one they left. Their principle “treat others as we would like to be treated” posed the question “how would we want to be treated in such economic downturns.” The founders’ response was to reduce their wages in order to avoid layoffs. This did not come from a perspective of enlightened self-interest, but rather emerged as an expression of their commitment to allow these principles to become more than nice-sounding ideas. In truth, they regarded this principle very much as a principle rooted in the gospel that had a claim on their behavior as leaders within their company.

Yet, as strong and robust as the principles and legacy were at Reell, it was clear that while principles were the criteria for success they were not guarantees for survival. Reell faced significant issues:

- Uncertainty about whether business would return and to what extent and whether the workforce they had was too much.
- The need to actively seek out new customers and products for its technology application.
- A better pricing strategy that would buffer market downturns.
- The need to creatively improve operational efficiencies.
- The need to more effectively address performance issues among employees.

Although Reell sought to respond to the economic downturn as a highly principle-based company, these issues, if not properly addressed, could undermine their decision not to implement layoffs.

“During the time when Steve Wikstrom and I (Reell’s co-CEOs) wrestled with the decision about whether to reduce the cost of Reell’s payroll through layoffs or salary reductions,” Bob Carlson recalled, “I kept thinking about another company named Tennant that I had worked for. It had been growing nicely, breaking into the Fortune 2000. Up until 1979, when faced with financial difficulties Tennant had not resorted to layoffs, but had instead implemented pay cuts. In the 1980s, though, Tennant laid off employees and the company fundamentally changed. The sense of ‘we’re all in it together,’ the sense of humor and good spirit was diminished. It wasn’t that it became a bad company, but there was a real loss to the culture, and we wondered what it would take to get it back. It was like a really big wound that wouldn’t fully heal.” Other Reell employees had similar experiences to Carlson.

As an aid to their discernment about whether to resort to layoffs or pay reductions, Bob and Steve invited another member of Reell’s leadership cabinet, Jim Grubs (VP of Co-worker Services), to draft a statement examining the current dilemma in light of Reell’s Declaration of Belief (see Appendix 3). Jim was regarded by Reell’s leadership as something of a theologian in residence. One of the explicit responsibilities assigned to his role was the care and nurturing of Reell’s unique values-based culture. “When Jim returned with his statement several days later,” Carlson recalled, “Steve and I were really pleased. Jim’s piece really captured well what many of us had struggled to articulate – our commitment to the people we worked with and our conviction that we must do everything possible before taking the measure of laying someone off.”

“At that point, we were pretty sure which direction we were going. Before announcing the decision, we polled the cabinet twice – once about the decision itself, and again about their readiness to support the decision once it was announced. When it was clear we had their support to implement a program of pay cuts in order to avoid layoffs, we then wrestled with the question about how best to distribute the pain.

“Some advocated that we should all take the same percentage pay cut as a symbol of our all being in this together. In the end, we opted for a differentiated pay cut in which upper level management absorbed a 12-16% salary reduction, with a lower percentage of 7% for our salaried production workers, and management implementing their own pay cuts 30 days earlier. Those at or below the target wage were exempt from the pay cut” (see Appendix 5).



## Discussion Questions:

The options on the table for reducing costs immediately in light of the significant drop in revenue and its expansion costs were relatively clear for Reell's leadership, but very complex:

- laying off co-workers to achieve the necessary reduction in costs
- implementing a program of reducing wages to prevent layoffs for as long as possible.

1. How would you evaluate Reell's decision? Do you think they were mistaken in implementing a wage cut? Where did they get it right? What are some possible unintended consequences of their decision? What issues did they not think about?

2. How did Reell get into this situation? Could they have done things differently to avoid it?

3. What would you have done if you were in charge? Lay out a decision strategy to address your shortfall between revenue and cost, and what would you do to possibly avoid this situation in the future?

## Theological Reflection: Seeing Things Whole

THROUGHOUT THIS TIME OF WRESTLING with the question of how best to reduce payroll, Reell's leadership drew increasingly upon a three-fold understanding of their organization introduced through their Seeing Things Whole roundtable. The three-fold model articulates the connection between faith and organizational performance by describing organizations as dynamic systems comprised of three interdependent dimensions: Identity, Purpose (or mission), and Stewardship.<sup>5</sup>

- In the dimension of *Identity*, the primary focus is internal and concerned largely with the experience of those who work in the organization. It is how the organization arranges the character, culture, and quality of its life, including a host of issues such as job design, compensation, hiring, firing, evaluation, promotion, training/development, and how these issues both model commitment to its principles and deal with the gaps between principle and policy.
- The dimension of *Purpose* is externally focused on how the organization engages the world around it, especially, but not exclusively, its customers or clients, revealed by how it offers a “good” or service needed by others. Core to this dimension is a deep and active commitment to genuinely understand the needs of the world, and a commitment to move responsively to this understanding.
- The dimension of *Stewardship* focuses on how the organization secures and utilizes its resources (human, financial, and material) so that it becomes stronger and healthier and better able to serve the common good. Essential elements to stewardship are sustainable profitability, continuous performance and productivity improvements, increased marketability for products, etc.

Each of these dimensions and the concerns they represent are necessary to an organization's health and well-being. This is a multiple-bottom line model of evaluating organizational success. Yet, while each of these three dimensions is essential to an organization's health, these dimensions and the needs they represent are in an ongoing dynamic *tension* with one another.

When organizations address the tensions by overvaluing one or two of the dimensions at the expense of the other dimensions they find themselves in a disordered state that makes it difficult for them to harness their full potential. Ken Goodpaster calls this disorder *teleopathy*. *Teleopathy* is a disordering (pathy—*pathos*) of ends (teleo—*telos*), which is an

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<sup>5</sup> See David L. Specht & Richard R. Broholm, *Toward a Theology of Institutions*, in *Practicing Servant Leadership: Succeeding Through Trust, Bravery and Forgiveness*, Larry C. Spears and Michele Lawrence eds (Jossey-Bass 2004) pp. 167 and David Specht & Dick Broholm, *Threefold Model of Organizational Life: Testimonies and Queries for Seeing Things Whole*, at <http://www.seeingthingswhole.org/images/3foldModel.pdf>. . Whereas the Specht and Broholm use the term “purpose,” Reell management tended to use the word mission.

occupational hazard of organizations and their leaders that cause them to forget the purpose of what they are about. The principal symptoms of *teleopathy* are fixation, rationalization, and detachment.<sup>6</sup> It was this insight about the nature of this normative and necessary tension among the three dimensions and the disorders that result when these dimensions fall out of reasonable balance that was so helpful to Reell's leadership as they worked to better understand the situation they were in. We will highlight three possible aspects of this tension and disorder in light of the 3-fold model and Reell's situation.

## 1. Identity Fixation: Performance Problems and Efficiency Requirements

REELL'S FOUNDERS AND LEADERSHIP had taken great care over time to develop a robust organizational identity that, at its heart, sought to compensate for the familiar excess of a single bottom line model of organizational success (see Appendices 1 and 2). This single bottom line approach leans heavily on measurements of financial profitability as the primary indicator of the company's health. Their commitment to see layoffs as a last alternative was one practice that contributed powerfully to this strong identity. It contributed to employees' sense of safety, giving them confidence that their jobs were secure. This way of doing business had several benefits for Reell that were initially unforeseen:

- increased creativity leading to innovative product development such as the invention of the electronic clutch and the development of efficient production processes such as *Just In Time* and *Lean* manufacturing.
- following market downturns when demand did return, Reell, having maintained its capacity, was ready to ramp up at a much faster rate than their competitors who had laid off needed employees.
- high employee retention rate – Reell has historically been very successful in retaining their employees, even though their salaries are not equal to some larger competitors. There has historically been a sense that Reell is one of those companies that rewards loyalty with loyalty.

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<sup>6</sup> See Goodpaster, "Ethics or Excellence? Conscience as a Check on the Unbalanced Pursuit of Organizational Goals," *Ivey Business Journal* (March-April 2004): pp. ??.

While Reell's culture of loyalty to its employees has had many positive benefits, it also cast a *shadow*.<sup>7</sup> As Bob Wahlstedt observed, "I've come to believe that the opposite of fear isn't only security. At least at Reell, the opposite of fear has been sometimes a creeping sense of entitlement on the part of some of our employees."

Because there had been no history of layoffs in response to previous economic downturns, some employees regarded the responsibility of responding to the challenge of such downturns to be solely the province of management. As one manager observed, "Everyone knew that things were becoming difficult. However, only *some* people responded by putting in extra time, working to discover new efficiencies, come up with new ideas. Others continued to work as usual. It was if they thought the difficulty we faced was somebody else's problem. This was especially a problem once the wage reductions had been in place for awhile. To be working like crazy to turn things around while others around you who were paid the same amount weren't, began to feel unfair."

While wage reductions brought a strong sense of solidarity to Reell, their longevity was wearing thin the good will of certain co-workers, especially those who were putting in long hours. Pay cuts can strengthen a company culture, but their longevity stretches and strains the culture, which can eventually become debilitating.

This awareness that some employees were working much harder than others, contributing much more than others, led some to wonder whether the need for payroll reduction might offer an opportunity to "get rid of some of the dead wood." In talking about this possibility, there was general consensus among leadership that layoffs were not a good way to deal with previously unaddressed performance issues. It was a wake-up call to everyone, however, that Reell needed to strengthen the stewardship dimension of its life in order both to more effectively manage performance, build in accountability and to simply remain viable. There is what some people call "the Lake Wobegon effect," where everyone is considered above average. This effect is a real and pervasive human tendency to overestimate one's work and talents and lose sight of one's lack of performance and the need for continual improvement in one's work.<sup>8</sup>

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<sup>7</sup> STW's threefold model of organizational life posits the potential of a *shadow* expression of each of the organization's three dimensions. The shadow refers to the unhealthy or destructive possibilities associated with each of these dimensions, including those which can result from any of the dimensions becoming inflated at the expense of the other dimensions. This is consistent with an early church definition of *heresy* as the error of mistaking a partial truth as the whole truth.

<sup>8</sup> The Lake Wobegon Effect comes from Garrison Keillor's radio show about a fictional Minnesota town where "all the women are strong, all the men are good looking, and all the children are above average."

## 2. Purpose Detachment and Customer Price Pressures

WHILE REELL SOUGHT TO CREATE a strong and stable community of work in St. Paul, Minnesota, its product market was rapidly changing because of the global economy. Both its suppliers and customers were increasingly moving to China. This created increased shipping costs, more complicated inventory management, greater price pressure reductions from customers, etc. Globalization created significant competition for Reell, which provided Toshiba and other customers more sources of supplies. This placed even greater importance for Reell to diversify its product mix and customer base in order to avoid the perils of overdependence on a few large customers. Whether Reell could have resisted the price down pressures in the late 1990s as they did in the 1980s is a hypothetical question, which cannot be answered. The benefit of hindsight, however, suggests that the failure to create enough customer diversification in a globalized economy compromised their ability to walk away from a customer's unreasonable demands.

Customers are the core mission of a company, but if they become king, if they possess too much power in a company's life, they tend to disorder the company's identity and stewardship. Bob Wahlstedt was able to resist the price pressures from Xerox in the 1980s. Dan Stem felt that such resistance was not feasible in the late 1990s. This difference of opinion on pricing strategy between Wahlstedt and Stem was reflected in a heated exchange when Stem asked Wahlstedt rhetorically "Why are you afraid of success?" Wahlstedt was critical of Stem's price strategy to expand the company based on lower profit margins. Reell's customers were increasingly viewing the laptop hinge market as a commodity, and consequentially, its relationship with Reell became increasing a price relationship. Wahlstedt and others always saw its competitive strategy based on price and quality. With one of the best quality hinges in the market as well as innovative engineering ability to solve customer problems, he did not want to compete on price alone and fall into a commodity business. Its strength was in specialty not commodity products. For Stem and others, the situation dictated a new strategy, which was the best chance for future success.

Not only was Reell under downward price pressures, but they were also expanding at the same time to capitalize on the opportunity represented by the growing laptop market. This created a significant dilemma for Reell. In expanding to keep up with the growth in their customer's business, Reell fell hostage to devoting an ever increasing portion of their own resources to keeping this business and so began to be driven by their customer's demands, even when these expectations started to significantly erode Reell's own profitability and culture. Healthy profit margins were critical to their research and

development plans, as well as to treating their employees well. While the expansion and growth of any business is a good sign for the future, it is also an extremely vulnerable time in a company's life. Growth in revenues and market share do not always create more financial success for businesses. Top line growth does not always result into bottom line results. Actually, more businesses fail due to their inability to successfully manage the growth of their company than for most any other reason. The strain on working capital created by increasing inventories and growing accounts receivable, resource needs such as new staff, more equipment and bigger space, the failure to create systems that can manage the increased production of the company effectively, and the failure to delegate can all contribute to failure in a growing business.

On top of these internal pressures of the business, there are also the unpredictable swings of the economy. As a business grows, debt financing is easier to secure. But in the frenzy of growth, the company can take on a level of debt that cannot be sustained during the inevitable downturns that all businesses face. Many of the post 9/11 business failures were the result of funding their growth through high levels of debt financing. When the economy stalled after 9/11, debt-laden businesses could not meet their financial obligations.

All these factors highlight the unpredictability of the future. Whether Reell should have doubled its manufacturing space, increased its debt load, reduce its prices is difficult to say without the benefit of hindsight available to us after the dust has settled. Very few people predicted the 2001 recession and no one forecasted the looming 9/11 disaster and its rippling effects on the economy. What does seem clear, however, is the critical importance of Reell knowing its customer and its market in order to not eliminate risk, but to better manage it. The entitlement problem at Reell discussed above could have contributed to a lack of attention to customers and the overall market. This inattentiveness probably contributed to Reell's misreading of Toshiba's customer orders. There was little product development occurring with their torque technology. Expansion on customer orders was done passively and not proactively, where customers came to Reell, rather than Reell proactively seeking problem solutions to customers. Executives were also not traveling to customers. Again, this is not to say that uncertainty can be overcome, but if you are close to your customer you can better predict these things. While some of the decisions faced by Reell's leadership team in this case are shaped by assumptions about whether the business would come back, there is also the larger question of whether Reell was structured in such a way to meet the needs of this rapidly changing marketplace. Did they have the right people in the right jobs to serve the right customers? Were the processes, capabilities, and staffing levels structured in such a way

to meet the current and future business needs of its customers? Were positions re-scoped to better align specific coworkers with the needs of the company? All of these questions demand great attention and understanding of Reell's customer and market.

Yet, with all this said, it is extremely difficult to have authentic relationships with customers when their only value is price. As the laptop hinge market began to change from a specialty to commodity market, customers like Toshiba and others began to *detach* themselves from Reell except in terms of price, which made it difficult, although certainly not impossible for Reell, to be connected to their customers.

### 3. Stewardship Neglect and Identity Rationalization

IN HINDSIGHT, MANY OF REELL'S LEADERS, the founders among them, reflect that the company's strong and clear emphasis on the quality of workplace experience for Reell's employees (*identity* dimension) came at the expense of an equally strong and clear emphasis on disciplines and practices concerning efficiency and profitability (*stewardship* dimension). While no one in the company would deny the importance of stewardship, there was a sense that when identity and stewardship came into conflict, identity trumped stewardship most of the time.

The company was regarded as "faithful, ethical and values-based" when it behaved in ways that appear to prioritize the wellbeing of employees over the concern for financial success. However, the company was considered "compromising or forsaking its values" when it placed high performance demands on its employees in response to financial pressures.

This bias against stewardship is not unfounded. The founders of Reell left 3M because they experienced a fixation on stewardship at the expense of identity. Other employees who came to the company expressed a similar experience. Reell has known from day one that the maximization of shareholder wealth was not its mantra. The company was very conscious that it was different than most other companies. In their direction statement they state "We are committed to do what is right even when it does not seem to be profitable, expedient, or conventional."

But, as Bob Wahlstedt put it "Whatever you emphasize you are in danger of overemphasizing." This uniqueness of who they were created among some in the organization a subtle disregard for the independent importance of stewardship. There was the implication that the stewardship dimension of the company would *result* from a strong identity. It was somewhat like Adam Smith's invisible hand argument but

reversed. Whereas Smith stated that if individuals pursue their financial self-interest, the common good would result. Some co-workers at Reell were saying if employees are treated right, profits will result. This “result logic” disregarded a very important insight of the 3 fold-model of Seeing Things Whole, that each of the organization’s three dimensions must be independently and intentionally attended to and that while they are interrelated, health in any of the dimensions does not automatically result from strength in another dimension.

This brings us to one of the most enduring challenges of organizations in relation to one of the most significant principles of the Christian social tradition—the common good. One dimension of the common good is to see it in terms of foundational and excellent goods. Foundational goods fall principally within the realm of stewardship—profits, efficiencies, productiveness, waste reduction, etc. They are the goods that enable a company to survive. Excellent goods are connected to the nature of relationships and human development, particularly the growth of coworkers (identity) and the contributions a company makes to society (purpose). In a welcoming statement that the founders of Reell use to give all employees, the relationship between foundational and excellent goods were metaphorically articulated.

We do not define profits as the purpose of the company, but we do recognize that reasonable profitability is necessary to continue in business and to reach our full potential. We see profits in much the same way that you could view food in your personal life. You probably do not define food or eating as the purpose of your life, but recognize that it is essential to maintain your health and strength so you can realize your real purpose.

The founders of Reell recognized that if the pursuit of profits and other foundational goods is not taken seriously, an organization will weaken and soon collapse. Revenue, profit, efficient use of resources are necessary goals—and real goods—because they are the necessary means to organizational survival. In other words, foundational goods are always goods for something else. Nevertheless, if an organization is dedicated solely to profitability, then even if it happens to pay good wages and to produce socially useful products, something about the organization is deficient. In particular, what is deficient are excellent goods. Excellent goods of the organization are principally found in the development of people through the relationships they have with each other. When employees, for example, join together to serve in an authentic way customer needs, their shared vision and values bind each along with the customer in relationships.

This relationship between foundational and excellent goods brings us to an interesting dilemma for the leadership at Reell which can be captured in a rather simplistic decision moment: pulling the trigger of layoffs too soon and pulling the trigger to late.

- Laying off people too soon without seeking other alternatives to preserve people's jobs weakens the bonds of communion within the company since employees will experience little commitment from leadership. This was Bob Carlson's experience at Tennant.
- Laying off people too late weakens the economic health of the company to compete in the future, which deteriorates its ability to compete in the future.

In other words, every road has two ditches. Reell can err either in terms of defect by not laying off and seriously harming the economic health of the company. It can also act excessively by laying off people too quickly and too extensively and seriously harming the culture of the company.

## Conclusion

REFLECTING ON REELL'S EXPERIENCE of wrestling with the challenge of how best to respond to the financial pressures it faced to reduce payroll leaves us a little off balance. It begins by inviting us to celebrate Reell's intentional and substantial culture of high commitment to the men and women who are employed there and what, in many ways, must be understood as a heroic response to the dilemma posed by the financial pressure they faced. We are then, however, haunted by the possibility that the glow of the very same organizational framework of beliefs, guiding principles and management practices that helped make possible such a compassionate commitment to Reell's employees may also unintentionally have cast a shadow. While contributing to a great sense of well-being and solidarity among employees, Reell's practices may have also unintentionally undervalued other disciplines equally essential to the long-term health and well-being of the company.

Perhaps our calculus of "organizational faithfulness" needs to be more complex to include variables that have been relegated to the category of "necessary evils" – variables such as financial discipline and success, efficiency and productivity. Might beliefs and practices which contribute to health and performance in these areas also be understood as a necessary part of the equation, not only for a successful organization, but for faithful organization as well?



## Appendix 1

### Our Reell Direction

Reell is a team united in the operation of a business based on the practical application of spiritual values to promote the growth of individuals and advance the common good for the benefit of co-workers and their families, customers, shareholders, suppliers, and community. Rooted in Judeo-Christian values, we welcome and draw on the richness of our spiritually diverse community. We are committed to provide an environment where there is harmony between work and our moral/ethical values and family responsibilities and where everyone is treated justly.

The tradition of excellence at Reell was founded on a commitment to excellence rooted in the character of our Creator. Instead of driving each other toward excellence, we strive to free each other to grow and express the excellence that is within all of us. By adhering to the following four common spiritual principles, we are challenged to work and make decisions consistent with God's purpose for creation according to our individual understanding.

**DO WHAT IS RIGHT** We are committed to do what is right even when it does not seem to be profitable, expedient, or conventional.

**DO OUR BEST** In our understanding of excellence we embrace a commitment to continuous improvement in everything we do. It is our commitment to encourage, teach, equip, and free each other to do and become all that we were intended to be.

**TREAT OTHERS AS WE WOULD LIKE TO BE TREATED**

**SEEK INSPIRATIONAL WISDOM** by looking outside ourselves, especially with respect to decisions having far-reaching and unpredictable consequences, but we will act only when the action is confirmed unanimously by others concerned.

We currently design and manufacture innovative products for a global market. Our goal is to continually improve our ability to meet customer needs. How we accomplish our mission is important to us. The following groups are fundamental to our success:

**CO-WORKERS** People are the heart of Reell. We are committed to provide a secure opportunity to earn a livelihood and pursue personal growth.

**CUSTOMERS** Customers are the lifeblood of Reell. Our products and services must be the best in meeting and exceeding customer expectations.

**SHAREHOLDERS** We recognize that profitability is necessary to continue in business, reach our full potential, and fulfill our responsibilities to shareholders. We expect profits, but our commitments to co-workers and customers come before short-term profits.

**SUPPLIERS** We will treat our suppliers as valuable partners in all our activities.

**COMMUNITY** We will use a share of our energy and resources to meet the needs of our local and global community.

We find that in following these principles we can experience enjoyment, happiness and peace of mind in our work and in our individual lives.

## Appendix 2

### **Declaration of Belief**

We believe the dignity of every individual to be sacred...

We believe life's highest purpose for each individual is to become all that she or he is created to be, and...

We believe the highest purpose for the Corporation is to make worthy contributions to the common good, therefore...

All activities, objectives and policies are to be ordered toward individual development and the common good.

Because economic success is essential for an environment that fosters human development and provides for the common good, we must maintain an orderly, efficient and profitable organization and respect the dignity of every individual.

Because many spiritual traditions speak powerfully regarding the conditions necessary to provide for the common good, foster individual development and respect human dignity, we will encourage each other to draw wisdom from these traditions and from individual expressions of spirituality.

## Appendix 3

March 15, 2001

### **Factors around the Issue of Wage Reduction Vs. Layoffs**

From casual conversations throughout this week I know that many, if not all of you, have been wrestling with this issue of reducing wages verses the laying-off of some of our co-workers. I would like to briefly give you my perspective on this.

Initially let me say that while there is valid reason for either option, I am firmly of the conviction that we should continue with salary reductions. My point of reference is primarily our Direction Statement and Declaration of Belief.

As we all know, we have a history of wage reduction and I believe we've chosen this because it expresses some of the basic Judeo-Christian values (most of which are present in other faith traditions). The value of freedom to choose is paramount to the dignity of the individual – it is an underlying principle of the Human Rights Charter of the United Nations drawn up in Helsinki, Finland. When you tell an individual they must leave then you tear at the very fabric of their dignity – it is no longer a choice for her/him. They tend to view themselves as being judged of lesser significance/value. Practically speaking, we can no longer say 'We're all in it together'. Volunteering to leave is a great deal different from being told to leave. In fact, it prevents the co-worker from doing the very thing we've asked them to do and that is to "stay at the table" - stick with it/us and work this thing through.

Another primary value is that the basis for community is the sharing of assets. This particular value is a key ingredient for realizing our commitment to developing an environment of harmony between work and the rest of our lives. The policies and mechanisms within RPM are literally riddled with evidences of this value. We work together in groups – constantly sharing time, energy, ideas, skills, tools, wisdom, monies, etc. This idea of sharing assets was a hallmark of the Judeo-Christian community. We have shared well in times of plenty, and likewise, need to do so in these times.

The value of 'emptying' one's self for the sake of the other is a premise for the highest form of love or better said compassion (to suffer with). It is the 'sizzle' of caring for one

another – a very clear evidence that you do care for me – answering one of the three important questions everyone asks, “Do you really care about me?” In other words, when people see the self-emptying behavior they really get motivated to do likewise.

At the same time I am very mindful of the *Declaration of Belief*'s commitment toward the common good and the clear need we have to have a corporation. For if we have no corporation then we lose our ability to make “worthy contributions to the common good”. In many respects this is a good time for layoffs because the job market continues to be strong; we have strong resources to help with placement efforts; and we can better remain, compensation-wise, competitive with the market. Added to that, one might say, by laying-off we get to choose who stays and who goes thus better ensuring ourselves that we have the resources we need. We should never lose sight of this and continue to keep as an item for consideration. However, I believe that we have continually demonstrated to one another an ability to creatively resolve situations, such as the one in which we now find ourselves, in a manner that is fair to everyone.

Overall, we must think this idea through very carefully because it represents a major paradigm shift in our corporate culture. It is a shift that moves us significantly, in my view, toward an environment of judgment rather than discernment; of fear rather than trust; of selfishness rather than community. It is a decision, which “above the waterline” may appear to make good economic and even leadership sense, but “below the waterline” creates a strong current of frustration, anger and loss-of-hope. It is a decision, which invokes a loss of freedom, loss of trust and loss of compassion.

Finally, when we ask the three questions of: Can I trust you?; Are you committed? and Do you care about me?, it is my belief we currently need to continue with the wage reduction strategy.

Thanks for “listening.”

Jim Grubs  
VP for Co-worker Services



## Appendix 4

### Reell Payroll Reductions History

#### Seventies

- In 1974 there was a period of about six months where the Founders took a 50% salary cut and the rest of the co-workers took an initial 10% cut that grew to 20% before it was over.

#### Eighties

- In 1982 only the shop worked reduced hours (with corresponding reduced pay) for two or three months of the summer due to reduced production volume.

#### Nineties

- Across the Board pay and hiring freeze was in effect from February of 1994 through August of 1994.
- A 10% payroll reduction from May 13, 1996 through September 13, 1996.
  1. No reduction in hours during the time of the reduction in pay.
  2. Voluntary time off without pay was available only in the shop due to reduced production volume. People requested this via Policy Exception form.
  3. We went through a September 1 corporate wage change cycle. Regular (uncut) wages were adjusted according to the usual factors and the new wage effective September 1 was again reduced by 10%. This kept the us current with market when the reductions were lifted a few weeks later.
  4. 80% of the 10% cut was paid back 12-6-96. We did a little better than break-even for the year and our intent was to be at break-even, so we paid everyone back with the extra.

#### 2001 into 2002

- A 12% to 16% pay reduction for the Reell Cabinet members effective January 29, 2001. A 7% pay reduction effective March 12, 2001 for most other coworkers. Phased in for newer hires, effective June 4, 2001. In all cases, those below “target wage” (currently \$11.46/hr.) are not reduced. In other words, no one is reduced below \$11.46/hr. This lasted until April 1, 2002.
  1. No reduction in hours during the time of the reduction in pay.
  2. Eliminated our third shift as of April 13, 2001.

3. Eliminated the Reell 401k (up to 2.5% of salary) match as of April 23, 2001.
4. No hiring beyond the open co-VP/GM of RM/CA position w/o Cabinet approval.
5. Voluntary time off without pay available. People requested this through their supervisors and/or via RPM Policy Exception forms.
6. In October of 2001 we decided to restore pay of the month of October 2001 and to start looking at each months results going forward and restore pay whenever we had sufficient operating income to prudently do so. This was framed as an experiment.
7. We restored pay for November, December, January 2002, February and March. Pay was never restored for any other months (Feb. 01 for Cabinet and March through September 2001 for all coworkers affected by cuts. We also paid those at or below the target wage an additional 3% of salary for those same months.
8. Pay cuts lifted April 1, 2002 and 401k match restored.

## Appendix 5

### **Last Alternative Layoff Practice**

1. Get as many employees involved to take ownership in reducing costs, eliminating waste, enhancing margins and generating revenue.
2. Hiring freeze
3. Reduce expenses such as education and training, temporary employees, building improvements, contributions to the ESOP and 401ks, etc.
4. Institute pay cuts indexed to salary.
5. Provide lots of communication
6. Institute layoffs when the above is not enough to starve off loss of profitability.