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# Hidden Value



**How Great Companies Achieve Extraordinary  
Results with Ordinary People**

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## Chapter 6

# PSS World Medical: Opening the Books

PSS WORLD MEDICAL headquarters is located on the top two floors of an ordinary-looking building in an office park just off a busy freeway on the outskirts of Jacksonville, Florida. The lobby, although pleasant, decorated in dark wood paneling with comfortable furniture, is not showy. A small shelf contains a few of the medical supplies the company distributes to physicians, and an interior staircase leads to the fourth floor. Even the people, at first glance, seem like pleasant and friendly, albeit regular, people. Few have graduated from elite educational institutions—there are a lot more people from Florida State than Harvard—and the firm hasn't hired MBAs. Pat Kelly, the CEO, has commented, "We've tried to hire MBAs, but they've all failed. They're too structured, too hard core in their beliefs that they've got the answers."<sup>1</sup> Certainly no one would mistake this for a Wall Street investment firm, a prestigious consulting practice, or the bustling center of a high-tech start-up company. What is extraordinary about PSS, however, is its history of growth and financial performance, all built with ordinary people working in a highly competitive, low-margin industry—the distribution of medical supplies—who have performed in a most extraordinary way.

PSS World Medical offers several mysteries as we seek to understand how companies are able to accomplish extraordinary things with their people. First, the company operates in one of the most fiercely competitive industries in the economy—distribution. It is an industry undergoing constant change as both evolution and revolution in supply chain management continue. The company has been very successful, nonetheless. As of late 1999, its five-year growth rate in revenues was 52 percent and its five-year growth rate in earnings per share was 31 percent.<sup>2</sup> PSS World Medical's return on equity, return on assets, and profit margin were all more than twice the industry average.<sup>3</sup> But if you look at the company, nothing about it seems exceptional. How has it achieved such great results?

There is a second mystery. The evidence is overwhelming that most mergers and acquisitions are economic disasters, albeit not for the shareholders in the firms that are acquired, who receive a large financial premium. Mark Sirower found that about two-thirds of all acquisitions produce negative returns,<sup>4</sup> and a study by the Hay Group reported even worse results, with 80 percent of the acquisitions providing negative economic benefits.<sup>5</sup> However, PSS World Medical's growth has been achieved largely by acquisition. The company's founder and CEO, Pat Kelly, has stated:

If I had my way, we'd expand entirely by acquisition. An acquisition is just a whole lot easier than a startup. The facilities are in place. The reps have well-established relationships with physicians. . . . An acquired company, even one that's losing money, can be turned around and made profitable much more quickly than a startup.<sup>6</sup>

So, what does PSS World Medical do to manage its growth and acquisitions?

A third mystery also exists. It is well known that rapid growth strains companies, particularly companies that have strong cultures. Assimilating lots of new people and imparting the company's values and practices are difficult. Simply managing the logistics of growth, in terms of the demands on facilities, systems, and finances, is taxing. That is why managing hypergrowth is considered to be a substantial managerial challenge. PSS World Medical has grown extremely fast virtually since its inception—a rate of almost 60 percent per year compounded. For instance, it went from \$170 million in sales in 1993 to more than \$1.5 billion in 1999. How has PSS World Medical been able to successfully manage this rapid growth?

If we can understand what PSS does to grow rapidly and integrate acquisitions, and how it has been successful in such a competitive industry, we can learn a lot about building management practices that produce sustained success. So, let's solve the mystery of PSS.

### BACKGROUND

On February 8, 1983, Pat Kelly, then thirty-five years old, was vice president of sales and marketing at Intermedco, a \$41 million company headquartered in Houston and owned by British Tire and Rubber. He had worked in medical supply sales and distribution almost his entire career. Kelly, who was raised in an orphanage

and at the time was married with two small daughters, learned that day that the parent company had decided to freeze all officers' salaries for a year. When he told his boss he might have to look for another job, his boss took that statement as a resignation. When he told his boss he really didn't want to resign, his boss told Pat he was fired. Pat Kelly became a reluctant entrepreneur. He and some partners founded Physicians Sales and Service (PSS) on May 2, 1983.<sup>7</sup> PSS has enjoyed remarkable growth since its founding. Table 6-1 shows its recent financial performance.

### *Business*

"PSS World Medical is a specialty marketer and distributor of medical products to physicians, alternate-site imaging centers, long-term care providers and hospitals through more than 100 service centers to customers in all 50 states and five European countries. . . . Medical products distributed to physicians [through the PSS subsidiary] include various types and sizes of paper goods, needles and syringes, latex gloves, specimen containers . . . blood chemistry analyzers . . . exam tables and furniture . . . vaccines and numerous other items. The company serves more than 100,000 physicians' offices (about 50% of such offices). . . . Image offerings [through the company's Diagnostic Imaging subsidiary] include wet and dry laser cameras, automated film handling equipment, mammography systems . . . and magnetic imaging equipment. In addition, the company provides on-site maintenance, emergency service, and parts for a large number of its imaging products. The Gulf South Medical supply unit . . . distributes personal care items, wound care supplies, exam gloves, nutritional supplements, oxygen supplies, and related items [to nursing homes]."<sup>8</sup>

In late 1998, the company employed about 4,500 people and operated a fleet of about 1,000 vans and delivery vehicles. Approximately 50 percent of its sales were in the physician supply business, with about 25 percent in both the long-term care and imaging markets, and only 2 percent internationally. The markets in which PSS World Medical operates are extremely competitive. There are about 200 locally owned companies serving the physician supply market, 300 locally owned companies serving the imaging market, and 100 locally owned companies serving the long-term care market; a number of large national firms also compete in these markets. The industry has experienced rapid consolidation in recent years, reflecting government regulation and the cost containment pressures in health care. The CEO of a \$14 billion electronics distribution company described this business of consolidation and delivery as "a dirty little business" with low margins and fierce competition.<sup>9</sup>

### *Strategy*

The PSS strategy has two core elements: rapid growth, and differentiation based on outstanding customer service and a very broad product line with exclusive distribution agreements with a number of suppliers. Kelly sees growth as critical for future success and has, from the beginning of the business, established audacious goals for the company. In 1988, when PSS did \$20 million in business with 150 employees in seven branches, he set a goal of becoming the first national physician supply company.<sup>10</sup> In 1993, with sales of \$170 million, Kelly set a goal of doing \$1 billion in business by 2000. Now, PSS World Medical seeks to be a *world* distributor of medical products.

By setting audacious goals, Kelly doesn't mean just financial targets. In his view, real goals have to do with accomplishing something meaningful, something that gets people's juices flowing. He notes that coaches of sports teams don't motivate players by setting goals for percentage of shots completed or time spent on offense. They convey the idea of winning. He acknowledges that although there may be differences of opinion about strategies and tactics to attain the goal, there must be absolute clarity and agreement about what the goal is. This focus is critical in a fast-changing marketplace. Without this, it's easy to veer off track. This focus also helps in decision making.

But PSS World Medical isn't pursuing growth just for its own sake. Kelly ticks off some rewards from being number 1. First, you shift the balance of power in the marketplace, with suppliers soliciting you. Second, competitors use you as reference point in setting prices. Third, customers take pride in doing business with you. It is also the case that in an industry experiencing consolidation, you either grow or get acquired. Moreover, growth provides greater opportunities for people in the company to assume more responsibility: Company growth helps foster personal growth. And, growth is exciting. For Kelly, growth is most easily achieved through acquisitions, and the company has made more than sixty of them since 1989. To make a successful acquisition, however, you have to add value. PSS does this by replacing the old business model with its own. Sometimes this may mean increasing the number of sales reps in a territory by four to five times the old number. The company also teaches the sales force how to sell at higher margins. This means bringing in a PSS leader to run the operation.<sup>11</sup>

PSS's differentiation strategy is founded in part on a broad product line that permits its customers to deal with only one distributor for virtually all of their supplies. The company stocks about 35,000 products in its physician supply business, more than 4,000 products in its imaging line, and more than 18,000 medical products in its long-term care division. Because of PSS's broad relationship with its customers, it can sometimes negotiate exclusive distribution agreements with its suppliers, for instance, Abbott Laboratories, Hologic, Critikon (a division of Johnson and Johnson), and SonoSite. When PSS is the only distributor for a product, it can earn higher margins on that portion of its business. Customers can't shop other distributors for price, and distributors need PSS to sell their product, so they will offer better margins. PSS also uses broad market coverage and its size to negotiate

discounts from manufacturers. What the vendors get in these agreements is the attention of the best sales force in the medical distribution business (and one of the best sales forces in any industry) and broad geographic coverage even while dealing with a single organization.<sup>12</sup>

PSS also differentiates itself on the basis of superior delivery and responsiveness to customers. Whereas most of its competitors distribute products through common carriers such as UPS, PSS provides same-day service to all of the customers it can reach through its branch network. One of the drivers in Jacksonville commented, "My job is mostly making sure the customers are happy. You call. We haul."<sup>13</sup> PSS also offers a no-hassles return policy under which delivery drivers can take back any merchandise a customer doesn't want for any reason. The company does not charge customers a restocking fee for returned merchandise. Also, unlike virtually all of its competitors, no minimum order sizes are imposed on customers. A physician can order one box of tongue depressors.

To deliver outstanding customer service, decisions are decentralized. Delivery drivers have business cards with their name and "CEO" on them, because Pat Kelly believes "when you're standing in front of the customer, you are the CEO."<sup>14</sup> PSS's customer service relies on a proprietary information system, the Instant Customer Order Network (ICON). This system permits salespeople to write up and transmit their orders immediately after visiting the customer, not just at the end of the day, thus improving delivery service. The system also provides salespeople the ability to manage their business by giving them the information to check a customer's buying history, see what the gross margins are, and so forth, all from their personal portable computers. Warehouse employees also understand the importance of inventory management and of meeting customer requirements (no out of stock items). Drivers are taught not simply to rush into the customer's office and dump the package, but to know where the supplies go and to help unpack and shelve the items. A driver commented, "When I walk in, I like to spend a few minutes with them, asking if everything is okay, because if there's something special, then we want to do that."<sup>15</sup>

In describing his approach to strategy, Kelly distinguishes between understanding the *business* you are in and understanding your *business model*. The former refers to your industry; the latter is *how* you do business. For Kelly, this means the kind of company you create and what kind of value you bring to the customer. He maintains that Diagnostic Imaging's business model is identical to the PSS model: setting a service standard higher than anyone else's, putting in place systems to guarantee those service commitments can be met, and managing in ways such that people have fun, learn and grow, and share in the wealth.<sup>16</sup> For Kelly, the secret to diversification without losing focus is to enter a new business without losing your business model. This means understanding how each business is different and not blindly copying every procedure. As an example, he points out that each of PSS's three divisions has the same top twenty rules and the same values, but each has different practices. He believes that the closer you stay to your business model as you diversify, the more successful you are likely to be.

## PHILOSOPHY AND VALUES

In talking about how PSS implements its strategy, Kelly begins by talking about the importance of the PSS people and the company's values. "Business people don't like to talk about values. But without these, all business is about is making money," and this isn't enough. Kelly sees business as "people working together to deliver value to a customer."<sup>17</sup> He argues that it matters a great deal how people work together. For him, no achievement of business goals is worth sacrificing your values.

PSS World Medical is built on a culture of trust and mutual respect. The company has a set of core values and a philosophy for managing that provide the foundation for everything the company does. Some of those values are as simple as teamwork, respect for people, and having fun. The company's management practices, such as calling people at all levels by their first names, all derive from four central ideas. The first is to run an open company. The company not only practices open book management by sharing lots of financial information, but also has an open door policy and encourages people to ask questions. When Pat Kelly or the other officers attend meetings in the branches (called "stores"), they carry \$2 bills with them and give them out to anyone who asks a question. Any question is legitimate and must be answered. For instance, Eric Miller, the controller in the PSS division, said that if someone asked him his salary, he would, under the norms, have to answer. "The right to communicate with anyone, anywhere, without fear of retribution is one of the core values."<sup>18</sup>

The second idea is to give people authority and accountability. Kelly believes it is easier to ask forgiveness than permission, and he encourages people at all levels of the firm to take initiative, to make decisions, and to be responsible for their own performance and behavior and that of their unit. Michael Weise, the operations leader in Jacksonville, said, "At PSS, you get an opportunity to shine."<sup>19</sup> The company gives out "Don't Grow on Trees" awards to people who take initiative to provide outstanding customer service. People aren't afraid for making honest mistakes, because mistakes are to be expected if people are taking responsibility and making decisions. And the only way to learn is to try new things.

The third idea is to share the wealth. PSS World Medical has an employee stock option plan and numerous bonus and incentive programs. The idea behind these programs is that the people who help create the financial performance should share, generously, in what they have created.

Finally, the fourth idea is to have lots of leaders, not managers. You won't hear the word "manager" at PSS

World Medical. There are no sales managers or operations managers—there are sales leaders and operations leaders. Kelly believes in the concept of servant leadership, something we find also at The Men's Wearhouse and at ServiceMaster, a \$6 billion industrial cleaning company that has also learned how to unleash the potential in its largely unskilled workforce. Described by Mahatma Gandhi, the idea is that a leader is the servant of the people he or she leads. The leader works for those who are led, in the sense of having the responsibility to provide coaching, teaching and development, and feedback and guidance so that those people can reach their true potential.

PSS World Medical also has a set of twenty core values, shown in Figure 6-1, which it posts in every office. Many of these values have to do with the importance of people and the need to treat each other with trust, respect, and dignity. Many companies have similar values; what is different about PSS, though, is how it lives these values. The integration of Taylor Medical, in Dallas, Texas, illustrates the PSS philosophy about people in action. Pat Kelly described the initial situation and the company's response:

When I went to Dallas about three years ago, the warehouse was chaotic. We had bought Taylor Medical. The culture was bad. They had cameras throughout the warehouse, and the manager sat in his office watching all the employees. And we knew we were going to make a change there. The day after we closed the deal, I called Gary Corliss in Minneapolis and said, "I want you to go to Dallas and I'll introduce you to the employees there."

So I went and put Gary in charge. And Gary said to the people, "Folks, can you plan on sticking around tomorrow night? I'm going to have dinner brought in and let's just talk about PSS, what it's going to do, what's going to happen."

I was out of town that evening. I get a voice mail from Gary about midnight the next night. He said, "Pat, I know we just spent all this money for Taylor Medical. But you need to know first hand from me that I just managed to destroy \$10,000 worth of cameras and video in the building tonight. So, if you would, just please write that down, and if you have to, take a payroll deduction against me." Gary had walked into the meeting with a baseball bat, and he asked the employees, "Tell me everything you hate." And he knew what was going to be the first thing they mentioned. They pointed at the cameras. And Gary took a swing with the baseball bat. Knocked the camera off the wall. . . . Then he says, "Does anyone else want a bat?" And they threw blankets over the cameras and destroyed all of them. And that started the whole conversation about cultural change. Now, they haven't had any turnover in a truck driver in six months.<sup>20</sup>

## ORGANIZATION AND MANAGEMENT PRACTICES AT PSS

### *Organizational Structure*

PSS World Medical has a flat organization consisting of three divisions (PSS Medical, Diagnostic Imaging, and Gulf South) with a small corporate headquarters. There is no written organizational chart. The company's structure is similar to many geographically structured U.S. distribution firms. Each division consists of a small number of regional units (typically three or four) that oversee the separate branches or service centers. Each branch is equivalent to a small business, with its own P&L, responsibility for gross margin, and complete discretion to set prices and determine its operations. For instance, each branch is responsible for its own janitorial and maintenance activities. At virtually all the branches, cleaning and routine maintenance are performed by the employees themselves. The typical branch is headed by a sales leader (never referred to as a manager) responsible for sales and an operations leader responsible for the warehouse, distribution, and back office (accounting, billing, and collection functions). Smaller branches may have only a single head, but most use a dual leadership approach. The typical sales leader is charged with supporting an average of ten sales representatives who call on thirty customers daily, versus an average of twenty visits to customers for other medical supply firms. The typical operations leader has a warehouse staff, administrative staff, and an average of ten truck drivers, who are responsible for the same-day delivery of products to the customer.

All this is pretty standard stuff. But it is what is not on paper that makes the organization of PSS different. In describing how PSS is organized, Kelly begins by saying, "I've always been bothered by structure. I'm bothered by how structure will become an excuse for why people can't perform. I became a devout believer that we are not going to have a lot of things in writing."<sup>21</sup> He sees his job as eliminating the "corporate arthritis" that sets in when bureaucracy takes over.

This translates into several unique features within PSS. First, there are no policy manuals. The company emphasizes personal communication rather than putting things in writing. The company's policy guidelines are written on a large, colorful foldout brochure called "Rules of the Game." The sheet describes guidelines in seven areas: equal opportunity; sexual harassment; rules of conduct; alcohol, drugs, and firearms; absence of unions; guidelines for leave and holidays; and complaint resolution procedures. Second, there are no memos. Kelly's rule is that everybody is required to read the first memo they get each month, and none thereafter. This means that if you need to send a memo and want to ensure that it's read, you stay up until midnight on the last day of the month and send your memo.

PSS has a relatively lean corporate staff: seven people in the corporate human resources department, a three-person business development group looking for acquisitions, corporatewide financial reporting (although each division has a controller and financial staff), and a corporate development department that includes PSS University. Kelly believes that staff should have line experience and should serve, not direct, the frontline people.

“Staff to me means a mentor. Staff is an advisor . . . to help people solve problems. . . . I think the best staff leaders are people who have been in a line role, and vice versa. If you look at the three chief financial officers in our divisions, they all came in as accountants, and they all went out and operated companies.”<sup>22</sup>

### *Recruiting and Selection*

Finding the right people with the right attitude and values is important at PSS. PSS does recruit some experienced salespeople and experienced operations people, including truck drivers, from other companies. But its preferred recruiting pool is right from school. Because PSS is headquartered in northern Florida, many of its sales representatives come from Florida schools, such as Florida State. The company for the most part has not recruited from elite institutions or sought out people with graduate degrees. In fact, credentials aren't very important in the company. Gene Dell, the president of the PSS division, does not have a college degree. The downplaying of formal credentials is partly because the nature of the business—sales—probably won't appeal to people with elite or advanced degrees. Nor would the company's practice of starting almost everyone in operations. Moreover, PSS leaders believe that much of what the company needs to do to be successful is best learned on the job or at PSS. Because the company tries to get people early in their careers and has grown rapidly, it is a relatively young organization. The average age of PSS people is thirty-five.

Recruiting is based in large measure on personal referrals. Michael Weise, operations leader at Jacksonville, commented:

I don't use newspapers. Our recruiting is word-of-mouth. What I try to do is promote my company so much that people actually enjoy being here . . . make it fun so they tell other people. And so when I'm looking for somebody, I normally go right to the drivers and say, “I'm looking for a position. Does anybody know anybody? If you do, just let them call me.” And boom, we fill the position.<sup>23</sup>

Jane, a driver in Jacksonville, was recruited by someone who worked at PSS, and she took a pay cut to join the company. Many of the sales representatives come to the company through personal networks. Salespeople calling on hospitals or physicians' offices naturally meet others working for the competition. They learn who is good and who would fit the PSS culture; this informal network is an important recruiting method. The company also recruits on college campuses, occasionally uses agencies, and obtains people when it acquires companies. Nepotism is not discouraged, and people will get not only their friends but also their relatives to apply for jobs. Charlie Alvarez, vice president of corporate development, says that “We hire people like ourselves. I like to be associated with people who are ambitious, driven, competitive, athletic. . . . I don't care how good a sales rep is, how much money he drives into the branch, if he's negative and brings the branch down, that person is going to get a talking to.”<sup>24</sup> Recruiting for attitude or fit is important. As Pat Kelly put it, “If you want to build a company of CEOs, you have to hire people who are capable of becoming CEOs. . . . You can teach people *how* to accomplish great things. It's much harder to teach them to *want* to accomplish great things.”<sup>25</sup>

No one is hired at the company until that person is interviewed by an officer. The hiring process takes six to eight weeks. One of PSS's methods is not to call people back for interviews. After the first recruiting contact, candidates are given a phone number to call for a follow-up interview. If they don't initiate the contact, the process ends. Next, the applicant will go to a local branch for interviews. Even if this interaction is positive, people from PSS will not call back. Rather, at the end of the interview, the candidate is invited to contact the manager of another branch. This requires more initiative and provides the opportunity to further evaluate the candidate. And so the process continues through several more rounds. The company wants to see if people are interested enough, entrepreneurial enough, and aggressive enough to pursue the job opportunity on their own initiative. Often interviews will be done on Saturday, to see if the people will come in, and if they do, if they are hung over from Friday night.

Early in its history, PSS hired with less care and relied on washing out the new hires who didn't fit or weren't working out. But people realized that this wasn't cost effective, and so the company developed a behavioral interview guide. The guide consists of a series of about thirty questions each interviewer can use for screening applicants, along with suggestions to the interviewer about what to listen for in the answer. The interview begins with some questions to break the ice and then moves to more revealing questions, such as what type of relationship the person wants with coworkers (PSS is looking for people who want more than just a business relationship). Interviewers also ask what a candidate finds attractive about sales (they look for independence and a desire for unlimited earning potential and are wary of answers that emphasize “talking to people”).

### *Training and Career Development*

Pat Kelly believes that if a firm's whole competitive edge is built on doing things differently, it follows that training in how to do things is a critical first step. In 1991, the company brought all its training activities together under the rubric of PSS University. Prior to that, training had been done in the branches. Putting its money where its values are, PSS spends about 5 percent of its payroll budget each year on training, an amount that is now about \$5.4 million. Kelly says that in a sales company, training is the firm's research and development. In 1999, about 1,000 people went through PSS University.

The company has an orientation program for new hires. People are also expected to attend various other training classes as a way of becoming acculturated and of meeting others in the company, building enduring social relationships in the process.

Training at PSS World Medical has several unique aspects. First, its sales training is different from what most medical supply companies do. New sales recruits attend PSS University upon joining the company (previously, trainees spent time in the field before attending the university). After an orientation week, “there’s 12 weeks of field training during which they shadow veteran reps and, Kelly says, ‘do all the manual work we can push on them’—from cleaning bathrooms to driving trucks to stocking warehouse shelves—to learn how the company works from the bottom up. Then it’s back to PSSU for two weeks of sales development training.”<sup>26</sup>

Most companies train their people in product information. PSS expects training at the branch to provide the necessary product information. Instead, sales training at PSS University uses role playing to emphasize selling skills. Greg Griffin, director of PSS University, described it this way:

Usually about the end of the week we say, “Okay, let’s just talk about some of the objections you get and how we would overcome them.” My philosophy is we’re not here so much to teach as they are here to learn. And when you have 20 people with a lot of knowledge, you’re going to learn more from the people around you than you do from Charlie and I and Susan getting up and talking.<sup>27</sup>

In addition to sales training, there is Creativity Week—about 150 people went through that program in 1999—and leadership training. The training experience not only imparts knowledge (people are exposed to various books, such as Covey’s *Seven Habits of Highly Effective People*) and skills, but also creates bonding among the participants. People stay at one of four corporate apartments instead of at hotels, or they will stay at the homes of people who staff PSS University and even at the homes of officers. Even if they don’t stay there overnight, they will have dinner with each other and with corporate officers. Charlie Alvarez commented on the importance of this for building rapport: “One of the guys said, ‘I was at J & J [Johnson and Johnson] for 15 years. I didn’t even know my division president’s wife’s name. And here I am rummaging through Pat’s cigar humidor, picking out my favorite cigar.’”<sup>28</sup>

Another unique aspect of the training is the emphasis on peer learning, discussion, and teaching as a way of learning. The instructors don’t do a lot of talking, but instead, ask a lot of questions. PSS distinguishes “teaching” from “learning,” and emphasizes acquiring skills and knowledge by confronting hypothetical situations and by sharing knowledge with others. For instance, in Creativity Week, the company will run more than one section during the week. A student from the day before becomes the teacher for the material the next day.

At PSS World Medical, there is an emphasis on promotion from within and moving people around to different divisions and different roles. For example, Michael Weise, an operations leader who has been with the company nine years, began by training in Dallas and driving a van and working in the warehouse. Then he moved into sales in Dallas and subsequently sold in Phoenix. He then moved to operations. People move from headquarters to the field and back. There is increasing movement across the divisions. This provides people more opportunity for learning and advancement. The idea is to learn the various aspects of the company and its operations by doing them all. Almost everyone who starts at the company, particularly those hired right out of school, begins by driving trucks, selling, and becoming intimately familiar with the work of PSS.

Moving into leadership is very much a voluntary decision and one that requires sacrifice, particularly in the sales track. As one leader commented when asked why people wouldn’t want to move up to leadership roles: “It means giving up freedom. The sales rep has a lot of independence. The sales rep has ultimate control of his or her financial gains versus a sales leader who has to depend on other people.” Moreover, leadership in PSS World Medical means something different than in many other companies. “In other companies, moving up to a leadership role, you become more powerful, your income increases. In our company, going into leadership means you’re giving up income. You’re actually losing some job security because you tend to get moved around a lot more. And what we get is people going to leadership for the right reasons, and not going into it for a pay increase. They do it for the challenge, and they do it for the internal drive, and their interest in helping other people be successful.”<sup>29</sup>

The leadership selection and development process begins when a successful branch employee who wants to become a leader volunteers for a one-week course conducted at PSSU. After an intense week during which they discuss fifty real-life leadership problems (see figure 6-2 for an example) and receive plenty of feedback on their strengths and weaknesses, the individual must decide whether he or she really wants a leadership position. At this point, about 40 percent of candidates recognize that being a leader isn’t for them and return to sales positions. The others make the decision to become a leader for the “right” reason; that is, they choose to become leaders for the responsibility and challenge it provides, not because they were selected or see it as a way to make more money. After this decision, all future PSS leaders then attend a second one-week training session, called Creativity Week, which entails spending three days with PSS senior leaders in intense discussions about fifty real-life problems faced by PSS leaders.

### Rewards

PSS has a clear compensation philosophy: The wealth should be shared, but shared in such a way that people earn what they make and then get to keep what they earn. There is never a cap placed on sales representative commissions. When a salesperson joins the company, at first he or she gets paid mostly on a base salary. Each month, as the person learns more about the business and selling, the base salary goes down and the commission goes up. After about a year, salespeople are paid strictly on commission. There are also some more collective

incentives. For instance, branches are eligible for bonuses if they meet certain financial targets. However, if salespeople don't make their forecasts, they are not eligible for a share of that bonus.

In many companies, people don't really know what they have to do to get a raise or bonus, or how the amount of the bonus is determined. If they know, they may have limited ability to affect it. At PSS, everyone knows the numbers and how they fit in. The bonus plan is expressed in terms of a game that everyone can play and everyone can win. Known as the "Field of Dreams" (based on an analogy with baseball), the rules are as follows:

- The bonus is paid semiannually.
- You have to have been an employee for six months to be eligible.
- Sales reps are not eligible for a share of the branch bonus unless they achieve their gross profit forecast.

Operations people must attend ten of the twelve Challenge meetings (monthly meetings) during the year to be eligible.

- The bonus pool is shared among employees, not the leaders in the branch.
- The bonus pool for each branch is the amount by which the branch's net income exceeds 6 percent of sales. The branch can receive up to 20 percent of this bonus pool.

- The branch gets 5 percent for hitting the forecast, in terms of percentage returns.
- The branch gets another 5 percent (of the total pool) for hitting or exceeding its dollar objectives.
- The branch gets another 5 percent if it keeps its asset days (inventory and receivables) below a target level.
- The branch gets the final 5 percent and hits a home run if it exceeds its forecast by an additional 2 percent of net income as a percentage of sales. So, if the branch was forecasted to do 7 percent (net income as a percent of sales) and it achieves 9 percent, it has hit a home run.

Eric Miller, the PSS controller, checked his records and indicated that in the first six months of 1998, six branches of the forty-six in PSS Medical had hit "home runs" and more than thirty-five branches were awarded some bonus. The largest individual bonus for the six-month period was \$4,145, not bad if you were a truck driver making about \$16,000 a year.

In addition to sales commissions for the representatives and the branch bonuses, PSS World Medical encourages all of its employees to own stock in the company. In the Jacksonville branch, for instance, about 70 percent of the truck drivers own stock. After three years with the company, all employees receive stock options.

#### *Open Book Management*

Open book management originated at PSS World Medical partly from Pat Kelly's philosophy and values and partly because, early in the company's history, it was financially strapped and sold stock to the employees. As Kelly explains, "When my neighbor pulled his financial support and the bank kicked us out, we had to raise money. The employees bought stock in the company. All of a sudden, we became an employee-owned company and I had to share information. From that point on, we became an open book company."<sup>30</sup>

Kelly recognizes that if you want a really effective organization, everyone has to be involved, not just the managers or salespeople. To get people to act like CEOs and rise to the occasion, he believes that you have to run an open company. This means people have to see and understand all the information so that they can see where they fit and how their efforts contribute. He sees typical companies as dens of secrecy with departments not knowing (or caring) what other groups are doing. Only the people at the top see the overall numbers or can truly understand how they contribute to the larger effort.

Eric Miller, controller for the Physician Sales and Service division, described the open book management process at PSS and its advantages. By the tenth of each month, he and his staff send to the operations leader in each branch a preliminary profit and loss statement that is a detailed presentation of the revenues and expenses for the branch. All of the financial information is posted at the branch, including sales by individual representatives, compared with last year and to the budget. "It's posted in such a format that they look at each expense item that exists in that branch and how they're matching up to their forecast. . . . [T]hey know if they're going to get a bonus, they've got to be able to hit their bottom line and so they look at each expense item."<sup>31</sup> People in the branch have the ability to bring up the details behind these numbers on the firm's intranet, download them into an Excel spreadsheet, and look at the specific transactions that make up a particular expense category. They can question specific items that they think are inaccurate. Miller commented:

This is a good control for us because it gives them the ability to go through and make sure we haven't double paid an invoice. . . . So in my mind, aside from them understanding their own business, it also gives us an extra pair of eyes that knows their particular branch better than we do to make sure that if an employee has been terminated and perhaps our HR department didn't get the paperwork in on time, that the person doesn't get overpaid. . . . And so they submit their questions. We go through them. We respond to them. We make any corrections . . . and then we go back and issue the final P&Ls, and those are the ones that would get posted at their branch.<sup>32</sup>

At least once a year, at one of the monthly Challenge meetings, where the entire branch gets together to talk about business issues and have some fun together, there will be a review of elements of the profit and loss statements. People will explain what makes up the various expense categories. They will explain what depreciation is, what interest expense is, and so forth. Because earning a bonus depends on hitting the numbers, people are interested in learning about operations and the branch's financials. Obviously, people vary in both their interest and sophistication, but the level of understanding generally is quite good. Eric Miller commented,

“they’ll understand it if it means money in their pocket.”

One problem with financial objectives and measures, as Kelly sees it, is that in most companies the goals seem to be plucked out of thin air—at least it often seems this way to the majority of people who are charged with meeting these numbers. At PSS, open book management works because from the very beginning of the forecasting process for the next year’s budget, people are heavily involved in setting the goals. The process is one of bottom-up forecasting. It begins in January, three months before the end of the fiscal year. At that time, corporate headquarters creates a financial model for each branch based on the previous year’s sales history, expenses, and growth. This is sent to each of the branches. The branch fills out the forecast based on its own assessment of its capabilities, what is going on in the market, and what the people in the branch will commit to achieve. This includes a line-by-line forecast of expenses and a specific forecast for each sales representative in the branch. For example, this forecast will include all estimates of employee raises, whether there needs to be another delivery truck, and so forth. The key number that everyone looks at is the percentage of sales owing to the bottom line. During the next three months the CEO and senior managers visit every branch for a four- to six-hour review meeting to go over the forecast on a line-by-line basis. Once the forecasted budget is agreed upon, it is signed by the branch leaders, the regional vice president, the division president, and Pat Kelly.

### *Integrating Acquisitions*

When PSS buys a company, regardless of its size, it is not operated autonomously but rather is expected to become part of the PSS culture. PSS leaders talk about the difficulty of getting the new people to adopt the PSS way, but nonetheless are determined to do it. Jean Collins, the vice president of human resources, described the process:

We just keep talking. We bring them to the University. We have their leaders come in, and we just try to keep pumping it into their heads. Then Pat, one of the division presidents, or one of the regional guys goes to those locations, and we just keep trying to tell them, this is the culture of PSS. . . . Sometimes it takes about a year, in some people. Some of them are very excited right away, especially in the sales and the leadership. They feel there’s such an opportunity, especially if they were in a small company.<sup>33</sup>

Susan Parker, a corporate trainer in PSS University, described what happened when the company acquired Gulf South:

The acquisition closed I think March 26th. And the first weekend in April, we invited every single one of their sales reps here to be part of the work we call the field support. They came down. They met with these new people and learned who they were. We had a large barbecue for them. In just four days, they learned some really unique things about this company. We’re all on a first name basis. We all socialize together. All their leaders were part of it. With the Gulf South acquisition being so big and all at once, we said we’re not going to be able to piecemeal it. So, they were all brought here, 125 people for four days.

During the four days, they also met with their regions individually about how this was going to affect them. They met with who was now the new leadership. I think they were absolutely amazed at how open everything was. Every question they asked we would answer. If we didn’t have the answer already, someone would get out their laptop and get the information and share it. . . . We were more honest with them than we had ever been with an acquisition. We said we’ve seen the cycle. The first three months, we’re going to drive you crazy. The next three months, you’re going to drive your customers crazy, because it’s going to take them about that long to figure out that it’s not going to be the same. And the last three months, it’s going to be an accounts receivable nightmare. But just having come here and being introduced to the feeling of welcome and excitement, made them go back into the field accepting it more easily.<sup>34</sup>

### **THE PSS CULTURE AND HOW IT IS MAINTAINED**

PSS is a values-driven company with a strong culture. Jean Collins described the culture as energetic, outgoing, and workaholic. Charlie Alvarez is the vice president of corporate development, but informally his title is “CEO of Culture.” He talks with passion about the importance of culture for PSS and its success. The culture is built and maintained through PSS University, through the selection process for new employees, through the meetings and social events, including the monthly Challenge meetings, and through practices that build accountability into the organization. The culture and values have been unchanged over the years—despite growth, expansions of the focus of the business, and the various challenges the company has faced.

Every organization has its unique cultural rituals, stories, and practices that make its values and beliefs real. At PSS World Medical, these unique cultural practices help to exemplify the basic belief in people and their importance. They include the ability to “are the boss,” efforts to drive fear and distrust out of the workplace, an emphasis on having fun, and practices that ensure accountability and consistency in how this rapidly growing, geographically dispersed company operates.

### *Firing the Boss*

At PSS World Medical, the idea of empowerment is taken so seriously that people can actually are their boss. Although this idea may seem radical at first, Kelly believes that it isn’t radical at all. If the job of a leader is to make a branch or other unit work, and that person is failing at his or her task, then “if leaders can’t deliver, the customers will are them.”<sup>35</sup> PSS would rather solve the problem sooner with fewer consequences for performance. Also, as Kelly commented, “ultimately, your people will are you anyway. They are you two ways. One, they don’t perform. Two, they quit. So, what we try to do is to provide an environment for our employees and for our leaders to understand that, if your employees can are you, maybe you need to be listening to your employees and

taking care of your people.”<sup>36</sup>

The process begins by someone calling Pat or another officer saying that the group is upset with their leader. Then Pat or another very senior executive will go to the facility and meet with the entire team, without the leader present. Very often the complaint is from just one person or a very small group of people, and other people think the leader is doing a great job. After some open discussion, the leader will be brought in. As Pat Kelly puts it, “we just create an environment where they can start talking.” Regardless of the outcome, there are no sanctions against the people who raise the issue. In fact, senior leaders publicly praise them for getting problems and concerns out in the open. Kelly summarized PSS’s experience with “aring the boss” as follows: 80% of the time, the people don’t get a red by their people. It’s just more opening up communications. Sometimes, they do get a red. We offer soft landings to those, to go back to the level of what they can do. And many of them come back. I had been saying for a long time that about 30%–40% of our officers have had a soft landing in their career. I got reminded more recently at an officer retreat that it’s more like 60% of our officers have screwed up somewhere along the line, had to be repositioned back, and they subsequently got moved ahead and were very successful as officers.<sup>37</sup>

#### *Driving Out Fear*

One of the company’s core values is never punishing people for making an honest mistake. Everyone at PSS is promised a “soft landing.” Clearly, the practice of rapid promotion means taking risks regarding people. It also means an increased chance that people will fail. In most companies, failure in a job means failure in a career. This creates tension that often makes people cautious and organizations risk averse. At PSS, this isn’t the case because of the “soft landing” policy. If a person does well in a \$5 million branch but not in a \$20 million one, the company needs to end the experiment quickly. For this reason, PSS keeps a careful eye on the numbers and listens to the opinions of people in the branch as well as to customer feedback. If a leader is in trouble, it is the job of the regional vice president to help as much as possible. However, if the poor performance continues, the company moves quickly to a replacement. But if the company wants to keep people and truly develop them, the answer is not to shunt the poorly performing person into a dead-end job or to encourage him or her to leave—the policy followed by many organizations. At PSS, the soft landing policy means that the company will help the person find another job at which they can succeed. The company is filled with examples of successful people who failed multiple times before succeeding.

The company also practices open communication, something that extends beyond an open door policy. The idea is that there are no secrets and that chains of command, in terms of information sharing, aren’t very important. People should feel free to talk to others about their ideas for making the company better. When there is a board of directors meeting, Kelly will invite employees to attend receptions and dinners and talk to the directors. He and other corporate officers spend time in the field visiting branches and, while there, talk to as many different people as possible. There is no standing on ceremony.

#### *Accountability*

PSS World Medical has a culture that emphasizes accountability and accepting responsibility. It also wants to be a company that operates with consistent values and beliefs across its divisions and across its many dispersed locations. One of the ways that this cultural consistency is built and maintained is through “Blue Ribbon” inspections.

The Blue Ribbon Tour is a cornerstone of the culture. Twice each year one of PSS’s senior leaders shows up unannounced at every single branch for an inspection. Everyone in the company has a booklet entitled “The Blue Ribbon Scorebook—A Foundation for PSS Culture.” This lists 100 items detailing the way every branch should look and operate. The senior manager evaluates the branch on all 100 items. These assessments operationally define the culture and include things such as the following: Are the trucks clean? Are there refreshments available for guests? Is there a map showing all PSS locations? Are truck maintenance logs maintained? Is there a Wall of Fame celebrating employee accomplishments? Is the phone answered on three rings or less? Are all visitors asked if they would like coffee? Every question has a yes or no answer, resulting in a possible total of 100 points. The inspection usually takes between three and four hours and involves meetings with employees, who are asked questions about customer service, product knowledge, inventory, and goals. Rather than being a solemn event, the inspection often becomes a raucous social occasion with employees shouting out answers and prodding their colleagues with hints. Two-dollar bills are handed out for all questions asked, and \$20 bills are given to those who pass on-the-spot quizzes. This is not seen as a visit from Big Brother but rather as something done in a spirit of fun and celebration. Branches compete vigorously to be among the top ten highest scoring branches—both for bragging rights and for the \$2,000 per employee awarded to the top branch (\$1,500 for second place, \$1,000 for third, \$750 for fourth, \$500 for fifth place, and \$250 per employee in the branches that finish sixth to tenth).

Commenting on the culture of accountability, Michael Weise, an operations leader, stated:

When it all comes down to it, you’ve got a group of people that are responsible for everything. And we all want to hit blue ribbon numbers. We all want to get bonuses. We all want to save money. We are all bound to each other. So when you see something out of the ordinary, out of whack, you’re going to say, “Hey, don’t do that, because that’s wasting us money.” So, we’re all a little company ourselves.<sup>38</sup>

#### *Fun*

Kelly believes that you need to take business responsibilities seriously, but you also need to have fun. People

spend too much time at work not to. This means you have to have fun all the time, not just on special occasions. Leaders throughout the company thus set regular times for people to get together and enjoy themselves. The annual sales meetings, held in resorts, are filled with celebration, humor, and fun. Once a month, everyone in the branch gets together after work for a Challenge meeting. If a person attends ten out of twelve meetings, the individual receives 100 shares of PSS stock. Challenge meetings are usually held at a theme park or amusement center and always begin with a twenty- to twenty-five minute session playing the Challenge Game, modeled on the TV show *Family Feud*. Participants are formed into two teams and compete to answer questions about the company (“What is amortization?”). Points are awarded for correct answers and are redeemable for PSS merchandise contained in a catalog. After the game, everyone eats and enjoys himself or herself. These activities emphasize the importance of practical learning and having fun. Eileen Delaney, the operations leader of the Diagnostic Imaging branch in Jacksonville, believes that these meetings are a good way to educate people and ensure that leaders communicate with their people.

People are also encouraged to get together on their own time. For instance, at corporate headquarters, people get together once every three months and go somewhere. This is a surprise and is announced the night before; for example, everyone goes surfing or attends a party at which prizes such as a free trip to Hawaii are given out. The annual picnic is held over a weekend near a theme park. Families are invited and a competitive volleyball tournament is held. The idea is that your colleagues will become your friends and you will enjoy going to work to be with them. They’re part of the family.

### LESSONS FROM PSS WORLD MEDICAL

As we consider what PSS World Medical does that leverages their employees’ talents, several things become clear. First, the answers to the three mysteries posed at the start of the chapter are quite interrelated. What the company does to successfully integrate acquisitions also permits it to manage rapid growth and enables it to achieve outstanding financial results in a competitive environment. That’s because solving each of these issues entails the same thing: building a system, a set of management tools and practices, that helps people do their best and permits the rapid integration of new people (whether from internal growth or acquisition) into the organization.

Second, most of what PSS does is not rocket science. Recruiting people who will fit the culture, sharing information so that people know what is expected and how they are doing, providing people incentives to do well both individually and collectively, making it safe to try new things and take on new responsibilities, being consistent in behaviors and connecting behaviors to the company’s core values, and measuring what matters—the key elements of culture and behavior—seem like obvious things to do. In some sense, they are. However, a number of considerations make these things difficult to implement. And it is in actually implementing management practices that PSS World Medical excels.

What makes this all harder to do than it appears? One element is the need for consistency and alignment among the various management practices if they are going to achieve all they can. What management does, beginning at the top and cascading down through the organization, sends a set of messages about what is important and how to think about the business. If these messages are inconsistent, people get confused. Achieving consistency and alignment is hard work. It requires attention to all the myriad details of day-to-day management. PSS is similar to the other companies we have seen in this book in that it has achieved a tremendous congruence and consistency across its various management practices. If you are going to give people responsibility and accountability, then they need training, and PSS provides both the opportunities and the training necessary to capitalize on them. If you are going to hold people accountable, then they expect to be rewarded for their accomplishments, and PSS does this also. If you are going to build a company of motivated, ambitious people, then you need to recruit the right people in the first place, people who are interested in the challenge. PSS’s hiring for fit, its rigorous selection process, and PSS University all help to build consistency in core values and beliefs. If you are going to be flexible and cope with rapid growth and change, you can’t be bureaucratic. PSS’s flexible, decentralized structure and absence of rules help build adaptability.

Doing what PSS has done also requires enormous attention to detail, not only to achieve consistency across activities but to structure each management practice with enough forethought that it produces the attitudes, values, and behaviors crucial to the firm’s success. Think of the Blue Ribbon inspections and the need to consider all of the things that are important to success—answering the phone promptly, being polite to visitors, knowing certain facts about the business, meeting certain delivery targets, having branches look a certain way to provide visual cues that guide behavior, and so forth. This level of detail is easily ignored by those who attend only to the “big picture” or the grand strategy and ignore the myriad details of day-to-day implementation.

Managing this way requires immense patience and persistence, qualities that are often in short supply. It takes time to train people in the financial concepts that enable them to understand the business, and it takes time to recruit selectively. And achieving consistency and performance once is not enough: The need to engage in management practices that build the core capabilities of the company and are consistent with its values is ongoing and ever present. As Pat Kelly remarked, “[T]he key to our success is the people you’ve got to motivate and fire up every day to want to get out there and do something a little bit better.”<sup>39</sup> Note that Kelly talks about “every day,” not “occasionally.” Every day PSS sales representatives and drivers are in the field building and

maintaining customer relationships that are crucial to the company's success. And so, every day, the company must be sure that it has motivated and trained people to perform the thousands of interactions with its customers and suppliers that determine its financial performance.

We see that PSS has built a set of capabilities that have permitted the company to change the competitive dynamics in its marketplace. PSS competes on service: no-hassle return policies, no restocking charges, same-day delivery, no minimum order sizes, helping the customers shelve the products. But these activities all take time, time is money, and the medical supply distribution business is fiercely competitive and subject to stringent cost pressures from purchasers of medical services.

PSS World Medical's success is very similar to that of Southwest Airlines, The Men's Wearhouse, and AES (described in the next chapter). Each of these organizations is managed in a way that leads to immense productivity from their employees. Southwest does this through their fifteen-minute turnarounds, which gives them higher levels of productivity than their competitors can achieve. The Men's Wearhouse invests in people, who then sell more merchandise than their competitors. AES, a company that runs power plants, reaps a similar reward by running their plants with greater efficiency than the competition. PSS has sales reps who call on 33 percent more accounts on average and are better at meeting the customer's needs. Each of these firms does this not by pressuring or "pushing" people but by giving them information, opportunity, training, coaching, and a fun place to work. The secret of these companies is no secret at all—it simply requires more attention to detail than many managers are willing to devote. Success is in the small operational details, not the grand strategic decisions that entrance many senior managers.

But PSS is not perfect. Although they have successfully met one of the great leadership challenges—unleashing the potential in their workforce—their success is not guaranteed. Recently, after a large acquisition, accounting irregularities were uncovered that caused Wall Street to punish their stock. They have also learned that their business model may not work as well in the long-term health-care sector as it does in the medical supply business. So, for the moment, PSS is in a period of retrenchment. But their same-store sales continue to grow and their people remain committed. What remains true, in spite of their current difficulties, is that PSS has built a set of management practices that has helped them tap the energy and enthusiasm of all their people.

This is a challenge that many of the companies we have seen in this book have met. To do this requires a different mind-set about where business success comes from and how to produce it, and a different set of values about people and how to manage them than can be found in most companies. Regardless of their current difficulties, PSS has done this.