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Scanlon Principles and Processes: Building Excellence at Watermark Credit Union

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Traditional salary systems were planned to ensure centralized control. The new banded models provide better control because the bands are planned around job-specific pay data.

The use of a merit matrix is a control mechanism that ensures all managers conform to a corporate policy. The matrix idea also constrains employee pay increases. In a broad, open band, the matrix idea is no longer viable. Both models described here are compatible with the use of a matrix, and thus restore greater control.

A key to the use of banding is the importance placed on career ladders. Companies with banded systems commonly emphasize career management, competencies and individual development. Banded systems provide a simple framework for managers and employees to plan for careers and for individual development. People earn increases and progress to higher career levels and higher salaries as they demonstrate their ability to perform at higher levels.

Banding simplifies salary management. It sends a message that de-emphasizes the job and job duties. It also de-emphasizes the internal pay comparisons that have been important and detrimental to salary management. The new models make it fully possible to manage salaries consistent with market levels. Pay will probably never fade into the background, but it is decidedly less contentious with banding.

Highly successful banded pay systems have been in place for a decade or more. The concept may not fit every organization. It should be compatible with the way people and their careers are managed. One of the companies surveyed is planning to move back to a traditional salary structure, but that is rare. The new models address the basic concerns that emerged from the initial banded systems. The philosophy is sound, and consistent with current human-capital thinking. [W]

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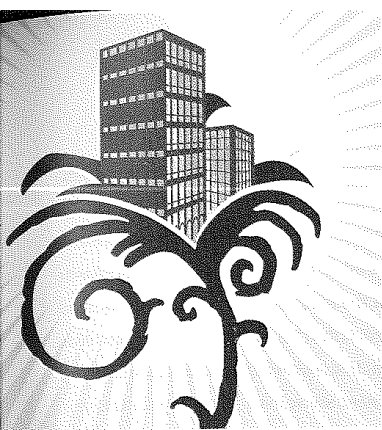
Scanlon Principles and Processes: Building Excellence at Watermark Credit Union

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This case study demonstrates that the use of Scanlon Plans (i.e., gainsharing) is not restricted to manufacturing companies, and that it can substantially contribute in the financial services industry. The fundamental principles of this participative management system are discussed as they are being applied at Watermark Credit Union.

In the late 1930s, Joe Scanlon developed a plan to save the struggling steel company for whom he worked and for the employees he represented as the president of his local steelworkers union. What was eventually called the "Scanlon Plan" was quickly recognized as an effective means for employers and employees to work together for the benefit of both. During World War II, Scanlon became acting head of the steelworker's research department, where he pioneered labor-management cooperation in a variety of industries. This collaborative approach caught the attention of Douglas McGregor, a professor at Massachusetts Institute of Technology (MIT) who was advocating participative management as a means to increase company innovation and productivity. McGregor brought Scanlon to MIT as a lecturer, where he taught and encouraged students and faculty to examine this extraordinary management idea. One of Joe Scanlon's students, Carl Frost, spent 30 years at Michigan State University (MSU) working with "Scanlon Companies" and

The Scanlon Leadership Network, an association of companies with Scanlon Plans, provides leadership in the development and implementation of these plans, and has been a repository of knowledge since the network was formed in 1964.

teaching students about the Scanlon Plan. Another student, Frederick Lesieur, who became a Scanlon Plan consultant, remained closely aligned with MIT.

Because of its strong academic roots at MIT and MSU, the Scanlon Plan is one of the most rigorously examined and improved upon set of leadership principles and business processes used today. The Scanlon Leadership Network, an association of companies with Scanlon Plans, provides leadership in the development and implementation of these plans, and has been a repository of knowledge since the network was formed in 1964. The Scanlon Leadership Network represents companies ranging from those with 50 employees to multinational corporations with thousands of employees. The Network has helped organizations in manufacturing, transportation, health care, retail, communications, warehousing and a variety of other industries implement Scanlon Plans. Although the Scanlon Principles (i.e., Identity, Participation, Equity and Competence) remain the same, the way these principles are implemented have become diverse and

incorporate state-of-the-art management systems, which may include lean systems, Hoshin's policy deployment, high-involvement teams, Deming's quality management and Six Sigma. The companies applying these principles represent some of the most profitable and best places to work in the United States. So why does the Scanlon Plan, according to *Training* magazine (Lee 1999), remain "Businesses' Best Kept Secret"?

"The 20th century has been a hothouse of management fads... In the meantime one truly big idea has bubbled along since the 1940s, never receiving the accolades we regularly bestow on more modest insights. And it's surprising considering this one has all the elements of a blockbuster. Its watchwords read like an abstract of 50 years' worth of business hot buttons: employee participation, management-labor cooperation, collaborative problem-solving, teamwork, trust, gainsharing, open-book management and servant leadership."

The reasons for the lack of awareness include:
- The Scanlon Plan is purposely not trademarked, and so consulting firms and publishers have no economic motive to promote the Plan.
- It is challenging to implement and demands capable leaders.
- It is not branded consistently because companies who implement this Plan are encouraged to find a name for it reflecting their values, and others have a natural desire to rebrand it and promote it under their own name.

The authors believe a way to help managers learn about the Scanlon Plan is through case studies of organizations successfully using the Plan. Watermark Credit Union is a midsized financial institution that embraced Scanlon just two years ago. Following is its story.

Watermark Credit Union's Challenge

Watermark Credit Union, then Seattle Telco Federal Credit Union, was chartered in 1938 when the United States was still enmeshed in the Great Depression. Originally the credit union served King County telephone company

employees and their families. Today, Watermark's eight branches serve more than 70,000 members, and Watermark has assets in excess of $450 million. By all measures, this organization has enduring success and has been well managed. Watermark's senior management team and board are convinced that the company must become much larger and better-capitalized to remain competitive in the fast-changing financial services industry. In the last decade, more than 50 percent of banks and credit unions have either merged or closed. Many of these institutions lacked the resources to keep up with technology, provide competitive products and services or meet regulatory requirements. Watermark management believes the credit union must grow to at least $1 billion in assets with a capital ratio of at least 10 percent by 2012. This requires assets to double and an even-faster growth rate in capital. To achieve these goals, productivity must improve (i.e., the expense-to-asset ratio). Reducing this ratio from 4 percent to 3.5 percent, for example, would save more than $2 million annually.

Faced with this challenge, Watermark determined that the Scanlon Principles and Processes would be the best vehicle to accomplish these goals. Executives recognized that a collaborative effort with all employees involved would be required. Because the credit union implemented a Deming philosophy in the prior five years, management believed the organization was well prepared to successfully introduce a Scanlon Plan. Deming's emphasis on teamwork, open communication, process improvement and creating an excellent work culture fit perfectly with the Scanlon Principles.

Watermark's Application of the Scanlon Principles and Process

The Scanlon Principle of Equity requires a company to balance the needs of its key stakeholders. For most Scanlon organizations, key stakeholders include investors, customers and employees. Some Scanlon organizations also include suppliers and their community as key

stakeholders. Scanlon philosophy believes change is "a given," and it is a fundamental duty of leadership to help the organization change. Scanlon Principles and Processes can be seen in the philosophy of Watermark, in the process Watermark used to develop its plan and in the final plan it created.

The investor provides the capital for operating the organization and is one of the three key stakeholders. They want to receive a fair return on their investment and assurance that their investment is secure. Unlike many private organizations, Watermark does not have stockholders (i.e., investors), but capital is required, and that capital is held by the organization. Watermark's board and senior managers make judgments as to how best to invest that capital.

The second important group of stakeholders is Watermark customers (i.e., credit union members). Even though members have an ownership stake in the success of the organization, their primary interest is having access to quality financial products and services at a competitive price. There are many other forms of financial institutions that want their business.

The third group of stakeholders is employees who want to be paid fairly for their competencies and for the contribution that they make to Watermark. Employees also want a work environment where their contribution is respected, their jobs are secure and opportunities exist to improve their skills and position in the organization.

For an organization to survive in the long run the needs of these stakeholders must be balanced, but to flourish, these needs must be integrated to support all stakeholders. GM and Ford are public examples where this balance was unachieved, resulting in a serious decline for these companies. Until recently, both were known for high wages not only for production workers, but for management. They also provided good returns for investors. Today, their debt is considered "junk" status. Both failed to serve their customer needs. Quality was

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not as good as in Japanese auto companies, especially those that practiced lean methods developed by Toyota. Cooperative labor relations (learned from Scanlon) and quality methods (learned from Deming) provided a foundation that allowed the Japanese companies to produce better cars at lower cost, using less space, and with better supplier relations. Ford and GM have made significant gains in their production processes, but their efforts may prove to be too little too late.

The Scanlon philosophy recognizes that productivity improvement and innovation are not the exclusive purview of management, engineering or R&D, but must come from all employees within the organization. However, to tap this potential, employers must provide employees with an opportunity to participate or contribute their ideas. In addition, employees must have the information and competence to participate intelligently, and they must have a compelling reason to participate. Research and more than 60 years of experience indicate that innovation and productivity improvement are direct results of engaging employees, and capturing and implementing their ideas.

Finally, the Scanlon Principles and Processes seize the inevitability of change and transform this inevitability into a competitive advantage. Recognizing that every person is in the process of becoming either more competent or less competent, developing the necessary tools to improve competency is a central mechanism for coping with the changing customer needs, technologies and mandates from society.

Scanlon Plan Fundamental Principles Implemented at Watermark: The EPIC Plan

The Scanlon Plan has four fundamental principles that provide a foundation for living the Scanlon philosophy and creating extraordinary performance outcomes. As is evident from the Watermark case, these principles are specifically adapted to meet organizational needs. The Scanlon Principles are interdependent, and thus, require implementation as a whole rather than step by step or in a specific sequence.

Identity

The "Identity" principle asserts that each organization must have clarity of purpose and offer a unique set of services and products to survive. Each person in the organization must understand the business and how he/she contributes to its success. As a result, management must not only educate employees in the technical requirements of their job, but also help employees understand the wants and needs of customers, the strengths and weaknesses of competitors, and the contribution that investors make to the organization's success. Without this basic organizational knowledge, employees will be unable to make meaningful contributions to the success of the business.

Creating an identity is an educational process beginning with an organization's history, mission and goals, and external mandates under which the business must operate. The identity section of Watermark's plan was developed to explain the credit union's vision and why there was a compelling need to change to reach

that vision. This became a tool for helping employees understand the Scanlon Principles and Processes. The plan's Identity section describes:

- The history of the credit union movement and Watermark
- Watermark's business strategy, board of directors and organization structure
- How capital affects the credit union, customers (i.e., members) and employees
- Why Watermark needs to change to survive.

In conjunction with developing the Identity section of the Scanlon Plan, management is committed to creating a transparent business model where financial and operational information is available and is explained to employees.

Participation

Watermark follows a traditional Scanlon Process for obtaining employee input. The system is designed to solicit input and solve problems at the lowest possible level, while sharing and integrating ideas for improving productivity companywide. Two committee types work in tandem to solicit suggestions and facilitate implementation of suggestions. Every department elects a two- to five-member "review committee" responsible for evaluating, responding to and processing suggestions received from its area. Appointed department managers or supervisors lead the review committees. Every Watermark employee is represented by a Review Committee and is given the opportunity to provide input and influence decisions.

The second type of committee is the "screening committee," which reviews all suggestions forwarded by the review committees. The committee prioritizes, approves and oversees implementation of suggestions that fall outside of the review committees' authority. The screening committee is comprised of a mix of appointed and elected members. Senior management appoints members based on the potential member's

expertise; review committees elect members to represent different constituencies throughout Watermark. Both review processes give careful consideration to employees' leadership and technical competence. At no time does the number of appointed members exceed the number of elected members, ensuring employees and management have equitable representation.

The review committee and the screening committee are empowered to form improvement teams that conduct research or implement an approved suggestion. Improvement teams are chartered for a fixed period with a beginning and ending date. Improvement teams practice the, "Plan, Do, Check, Act" cycle, introduced by Deming. The committee that charters the team monitors the team's work.

Suggestions focused on business innovation and improvements are routed through an evaluation process to obtain approval for implementation and to monitor suggestion implementation. Consistent with Deming's management philosophy, Watermark has eliminated all individual incentives. Employees, therefore, do not receive any individual payment for making suggestions. The financial reward, (as will be described), results from actual productivity improvement or innovations that provide a financial return for Watermark. Because all employees share in the financial return from suggestions, it is in every employee's best interest to help develop and implement a suggestion regardless of who initially made it.

To facilitate employee involvement, a full-time coordinator position has been added to hold all participants accountable for EPIC Plan responsibilities, to serve as liaison between management and staff, and to facilitate committees and employees in accomplishing EPIC goals.

Equity

Equity is defined as *a fair and just return among key stakeholders, i.e., the organization, its members, and*

employees, for the investments they make in the organization. Balancing the interests of these stakeholders is critical to the long-term success of a Scanlon Plan. Equity does not mean "equal" in a Scanlon organization. It would be impossible to create equal returns for each stakeholder because each has a different need and makes a different contribution.

Watermark recognizes the interests of these stakeholders:

▶ "The organization (i.e., investor as represented by the elected board) wants growth and financial soundness, which is represented by capital, to ensure the continued existence of the organization."

▶ Members (i.e., customers) want competitive prices, quality service and a long-term relationship with the financial institution.

▶ Employees want job security, competitive wages and benefits, involvement and the opportunity to share in the Credit Union's profitability (Watermark's EPIC Plan 2005).

Although Scanlon companies use performance measures including labor cost saving, EVA, profit, earnings and waste reduction, Watermark chose a traditional gainsharing formula which tracks its productivity and rewards employees for improvements. The gainsharing formula is a productivity ratio of operating expenses that employees can affect (e.g., compensation and benefits, supplies, telephone expenses and software/hardware maintenance) divided by gross income (e.g., loan, investment and fee income). Improvement in the gainsharing formula is based on a rolling quarterly average of the three most recent years. All full-time, part-time and temp-to-hire employees are eligible for earned gainsharing bonuses. The gainsharing bonus pool generated by productivity improvement is divided evenly (50 percent for each) between the organization (i.e., the credit union) and employees. Eighty percent of the employees' share is paid out each quarter, with 20 percent held in a reserve account. The payout to individual employees is based on a percentage of their earnings during that

quarter. No exempt employee receives more than the highest amount paid to a nonexempt employee.

The reserve account's purpose is to offset any year-end deficit (i.e., productivity is less than the three-year rolling average) and to focus employees on annual performance goals. If at the end of year, a surplus is in the reserve account (company performance improved during the year), the balance is divided among employees, as per the gainsharing formula. If, however, a deficit occurs (overall performance improvement has declined), the loss is deducted from the reserve and the organization writes off any amount not covered. The reserve fund is set to zero for the upcoming year. Everyone at Watermark, including the CEO, is eligible to receive a bonus from Watermark's Scanlon Plan.

The design team invested considerable time developing a performance measure that was reliable and valid, and would provide timely feedback to program participants. Watermark is committed to making financial data available to all employees in an understandable form.

Competency

This principle is based on the belief that continuous improvement requires continuous learning. The Scanlon Principles recognize that operating in a more flexible and proactive work environment requires employees to have broadbased job skills, stronger interpersonal competencies and fundamental understanding of how the business operates (i.e., business literacy). For employees to contribute ideas that have the potential of increasing productivity, they must be more knowledgeable than employees in traditional organizations. Watermark provides numerous development opportunities including tuition assistance, access to an online university, internal training on Scanlon Principles and the EPIC Plan, on-the-job training, software skills training, supervisor and management training, Deming training and leadership development.

Implementation

The Scanlon implementation process has proven to be one of the most engaging and effective change processes in business. This process is designed to:

▶ Adapt the Scanlon Principles and Process to meet specific needs of the company.

▶ Help employees understand the specific features of the plan.

▶ Build employee and management commitment to the Scanlon Principles and Processes.

▶ Build internal competency.

▶ Develop a written plan documenting how the Scanlon Principles and Processes will be practiced.

The implementation process starts at the top and cascades through the organization. It relies on employee involvement in the development of the plan and multiple secret ballot votes to assess commitment during the design and trial period. As is described in this paper, Watermark followed the implementation process that has been refined and tested in numerous organizations during the last 60 years.

Leadership Exploration and Commitment

The senior leaders at Watermark first learned about the Scanlon Principles and Processes and the Scanlon Leadership Network through their CEO, Chuck Cockburn, who studied Scanlon at previous organizations. After adopting Deming's Total Quality Management philosophy, instituting the Scanlon Process seemed an obvious next step for supporting the Watermark management team's aggressive growth goals. The leadership team studied Scanlon-related articles and attended a meeting where they met with the president of the Scanlon Leadership Network and a local Scanlon consultant to learn more. In that meeting, the need to pursue a Scanlon Plan became obvious to all (as was made clear through a secret ballot vote). The vote had two questions: (1) is there a compelling need to change and (2) should Watermark try to develop a Scanlon Plan? The

senior team unanimously affirmed both questions. After receiving support from top management, Watermark's CEO drafted Watermark's "mandate for change" to document for management and staff why change is inevitable and should be embraced rather than avoided.

The exploration of the Scanlon Plan was expanded to other management team members. At this stage, the top leadership team, not outside consultants or trainers, explained the Scanlon Principles and the reason that senior management believed that this plan was essential to Watermark's future success. All levels of management had an opportunity to vote to implement a Scanlon Plan. Watermark managers unanimously offered their support and voted to proceed.

Employee Exploration and Commitment

After the management team voted to proceed, the mandate and the Scanlon Principles and Processes were explained to all Watermark employees in small group meetings. Once this information was presented, employees were asked if the implementation process should continue by chartering a design team to draft a Scanlon Plan customized for Watermark. More than 80 percent of all Watermark employees voted to proceed with the implementation process with the understanding that once the plan was designed they would have an opportunity and responsibility to approve the plan.

Proposal Development and Approval

The design team consisted of 14 members: six members appointed by the CEO based on specific expertise needed to develop the plan and eight elected employees who represented a cross section of Watermark employees. For five months, the design team developed its plan, which became known as the "EPIC Plan." This name was chosen in recognition of the four Scanlon Principles and because it symbolized the journey to excellence upon which the company embarked. To keep employees informed of its progress, the design team shared the minutes from each

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of its meetings. When the plan was completed, it was presented to all employees one week prior to the employee vote. Employees were asked to submit any questions to the design team in the week before the off-site, all-employee conference meeting where voting took place. At the meeting they were provided the opportunity for additional discussion prior to the vote.

On Oct. 10, 2005, employee commitment to the EPIC Plan was demonstrated when more than 85 percent of the employees voted in favor of implementing the plan. The board of directors unanimously approved the plan on Nov. 18, 2005.

Plan Implementation and Review

Upon the EPIC Plan's approval, Watermark began the implementation process, with a set start date of Jan. 1, 2006. As part of implementation, Watermark developed courses to educate employees about the principles and process of the EPIC Plan. This approach ensured that each person was skilled and knowledgeable about the plan. All staff received training on:

▶ Scanlon history and EPIC Principles
▶ The suggestion system
▶ An introduction to business literacy.

In addition, all team and committee members received training in the following:

▶ Active team participation
▶ Leading and working in teams
▶ Reviewing and screening committee roles and responsibilities.

For many companies with a Scanlon Plan, a trial period of one to two years is often an integral part of the implementation process. This period allows for the plan to be tested and fine-tuned before a final approval vote. In any change effort, skeptics often have good reason to be skeptical. In the Scanlon implementation process, skeptics are given a chance to see the plan in action before they vote. In most Scanlon organizations, this is the final vote where others continue to vote to renew their plans either when major changes are required, or after a scheduled renewal date.

Rather than implement its EPIC Plan for a trial period, Watermark built a review process into its plan. For the first two years, the EPIC Plan is reviewed every six months, and annually thereafter. It is now in the beginning stages of the first review. The suggestion system is processing an average of 29 suggestions per month. A bonus was paid in one of the two quarters that have passed since plan implementation. Training programs have begun to help employees understand the EPIC Plan and become more competent at their jobs. The "fairness committee" (a nonunion grievance procedure) recently was developed and is in the implementation stage.

Challenges and Opportunities

The Scanlon Plan's success is contingent upon the development of a collaborative relationship among three critical stakeholders, i.e., employees, owners and members. Leadership must become more universally shared throughout the organization, with the understanding that

leaders serve the organization and the employees who report to them. With this type of stable, caring leadership, Scanlon Plans can produce extraordinary performance and commitment. Watermark is committed to perpetuate this "servant leadership" style of management.

Maintaining employee interest and commitment to the EPIC Plan presents a challenge. Currently, Watermark is working out how to prioritize the vast number of suggestions submitted through its EPIC Plan. To help identify the suggestions with the greatest impact, the screening committee developed a prioritization matrix. Queued suggestions are scored in the matrix, and the suggestions with the highest score will have the greatest impact. The matrix is made public so employees are kept informed about why certain suggestions are being worked on rather than others. Senior management realizes that employees need to be kept in the communication loop to maintain a high level of involvement. Additionally, senior leadership remains committed to integrating the Scanlon values and methods into the everyday operations of the business.

In summary, management believes that implementing a Scanlon Plan will enable Watermark to use the untapped knowledge, creativity and resourcefulness of its employees. Employees will participate in making decisions and suggestions. They will learn that they can make a difference, and they will share in the gains realized. Employees will be able to align their goals with the company's goals and view themselves as stakeholders. The productivity increase will result in the lower expense-to-asset-ratio needed for Watermark to achieve its long-term plans for growth and profitability. **W**

Authors

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