

How to Lead and Organize a Brain Capital Enterprise: Reflections from a Personal Journey¹

Prof. Hermann Simon | **Simon-Kucher & Partners** | <http://www.simon-kucher.com/pl>

Dzien dobry,
dear Professor Kozminski,
Magnificence Rector Bielecki,
dear Ladies and Gentlemen, dear Friends,

I must admit that I am flattered to receive this honorary doctorate. I would like to thank the Senate of Kozminski University for their trust as well as for the entirely underserved praise in the laudatory speech by Professor Kozminski. My thanks go also to the reviewers, Professor Jerzy Dietl, Professor Philip Kotler and Professor Erwin Pesch. I can only say: “Lord, forgive Professor Kozminski and the reviewers for exaggerating so much, and Lord, forgive me for enjoying it!” I would also like to thank my family and especially my wife Cecilia who is with me for their continuing support.

I am particularly proud to receive a honorary doctorate from a Polish university. Poland and Germany have a special relation. The past is burdened with extreme atrocities the Germans did to the Polish people. But today our two nations are friends and I am very happy that we can be part of this friendship. I also would like to add that I am very optimistic about the future of Poland. I have got to know many young people here and they always impressed my with their entrepreneurial spirits. Maybe my speech will further encourage many of them and graduates of Kozminski University to pursue an entrepreneurial path.

For my speech I chose the following title: *How to Lead and Organize a Brain Capital Enterprise: Reflections from a Personal Journey*



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¹ Wykład wygłoszony na uroczystości wręczenia doktoratu honoris causa prof. Hermannowi Simonowi 14 lipca 2012 r. w Akademii Leona Koźmińskiego.

I will structure the speech into three sections:

- Ownership and incentives
- Organization
- Values and leadership

The inner makings of brain capital enterprises, especially consulting firms, are rarely revealed. I will reflect on my experiences with the consultancy Simon-Kucher & Partners. Simon-Kucher & Partners was founded in 1985 by Dr. Eckhard Kucher, Dr. Karl-Heinz Sebastian and myself. When I joined the firm as full-time CEO in 1995 we had 40 employees. Today we have 650 employees and 25 offices in Europe, the US and Asia. I retired as CEO in May 2009 and have been Chairman since then.

| **On Brain Capital Enterprises**

In 1968 Peter Drucker coined the term “knowledge worker”. A knowledge worker does primarily mental, not physical work using his mind and brain. Companies that mostly employ knowledge workers are called brain capital enterprises. Simon-Kucher & Partners is a typical example. 84% of our employees are professionals with academic degrees, many of them have Ph.D.s. We don't produce any tangible goods. Our project reports on paper and increasingly in digital form only carry information and knowledge.

With knowledge workers, the process of value creation cannot be controlled. When an employee gazes out the window, you don't know whether he or she is daydreaming or developing a brilliant solution to a problem. Someone who comes up with a great idea in an hour achieves more than somebody who broods over a question for three hours without finding an answer.

A second peculiarity of brain capital enterprises is that the critical assets leave the office every evening. You can only hope that they come back the next morning. The critical resource resides indeed in the heads of the employees. This is most true for the best qualified consultants and especially the partners. Therefore retaining them is a necessity and a great challenge.

Brain capital enterprises need little financial capital. They typically rent their office space. Working capital needs are also limited; for instance, they have no inventory. Thus, there are no serious financing problems. However, special and early action needs to be taken to keep the capital in the hands of the active partners. Most brain capital enterprises fail in this endeavor.

Brain capital enterprises play an increasingly important role in modern economies. Consultancies, law firms, R&D and inspection companies are examples. Of course, universities and business schools are also brain capital organizations. It would be interesting to apply some of the ideas which follow to them, but I will not do that today.

| The Partnership Model

It is often said that everything depends on the boss. This may apply to an industrial company with a hierarchical structure. It is less true for a brain capital enterprise. After such a firm reaches a certain size, success depends rather on the partners than on the chief. The partners lead groups which act like small enterprises. Therefore the partners must be true entrepreneurs. Stanford Professor Charles O'Reilly postulates that brain capital enterprises should be owned by the active partners, not by external financial investors. His rationale is that the scarce factor is brain capital, not financial capital.

However, it is not easy to transfer the ownership into the hands of younger partners. By definition the founders own the firm from the beginning. And founders have a natural tendency to keep as many shares for as long as possible. All too soon they find themselves in their fifties, and if the firm has been successful, it will be too expensive for the younger partners. At this point the firm is typically sold and loses its identity. Only a few brain capital enterprises make it into the second generation. In this situation, the only alternative to selling is to give away the shares to the younger partners for free or at a very low nominal price. This is exactly what happened at McKinsey and the Boston Consulting Group. It is the only reason why these consulting firms retained their independence. The consequence, however, is a model that is not truly entrepreneurial: the partners who received the shares as a gift from the founders can hardly sell them at market prices to the next generation. They are rather trustees than owners. The shareholder value is never realized.

At Simon-Kucher we had a different model from the beginning. Starting in 1988, only three years after the foundation, the founders continuously passed shares on to the younger partners. In the first years the prices were determined by earnings multiples and the number of shares to be sold was negotiated, which invariably led to a lot of bargaining. The most important decision we ever made was in 1998 to introduce a true market model for the transfer of shares. Since then, prices and numbers of shares sold are determined by supply and demand. The internal stock exchange runs for one week every year in November on the Internet. The result are – in a perfect theoretical way – supply and demand curves whose intersection determines the market clearing price. This model caused an increase both in prices and the number of shares that were transferred. The problem of passing shares to the younger partner generation is solved today. The shares are widely distributed among the 65 partners. No partner owns more than five percent of the firm. This shared ownership combined with the value appreciation is a highly effective instrument for retaining partners and committing them to a common cause.

This ownership structure is an idiosyncratic organizational and leadership feature of our firm. I haven't seen anything similar to it in the consulting industry. Why did it work?

1. From the beginning there was a common understanding among the partners that the firm should remain independent. Despite numerous offers we never seriously considered selling.

2. We started handing over shares early on. This was partially due to the insights from Professor O'Reilly's theory. I attended a speech by him in the mid nineties. This is also a nice example of the practical value of academic research.
3. We found a market model to determine prices and volume.

| On Partner Incentives

In a brain capital enterprise the importance of incentives can hardly be overemphasized. For those aspiring to become partners the opportunity for ownership and entrepreneurship is the strongest motive. Also important are direct monetary incentives, which are comprised of three components:

1. A fixed salary,
2. A dividend based on the number of shares, and
3. A division bonus depending on the profit margin of a division.

Each division has several partners. At the beginning of the year these partners agree on how the division bonus will be distributed among them. So, during the year there is no dispute about this bonus. Our remuneration is very entrepreneurial. The fixed salary accounts for less than half of the compensation. The division bonus can vary considerably from year to year. We have retained these three components over the years and only made small adjustments. In our entrepreneurial culture it has been very important that the dividend and the division bonus are based on indisputable economic results and not on subjective evaluations.

However, we were never fully satisfied with these three components. We made repeated attempts with a fourth component. We tried to offer incentives, based on subjective evaluation, to those who contributed to external communication or internal education. This did not work in our entrepreneurial, performance-oriented culture. In a second trial we introduced a growth bonus which equalized the slope of the incentive curve in the relevant interval for all partners. All equally benefited from the firm's growth, including those who had not contributed to growth in a given year. This again turned out to be incompatible with our culture and the growth bonus was abolished. Then we introduced a so-called outperformance bonus which strongly rewarded above-average performance, especially that of younger partners who owned few shares. The intention was to help the outperformers to buy more shares. A partner who was only slightly above average received a high bonus, while another partner with an outcome only slightly less good received nothing. Theoretically this outperformance bonus looked very smart. But it did not survive, the differentiation was too strong.

What did we learn from these experiences?

1. A brain capital enterprise needs strong performance-oriented incentives for the partners.
2. There is a clear conflict between sufficient differentiation and complexity of the incentive system. When in doubt, simplicity should dominate.
3. Whether subjective evaluation systems are accepted on the partner level is a matter of the corporate culture. In our case they did not meet with acceptance so far.

| **On Employee Incentives**

The assumption of responsibility and quick promotions are the strongest motivators for employees of a brain capital enterprise. In contrast to an industrial company, it is difficult to measure an employee's performance in a brain capital business. Remuneration systems based on purely quantitative output are not applicable. Nevertheless, incentivization for employees is less complex than for partners. But you should be wary of sunny-weather systems. In our first years we paid a growth bonus, differentiated according to ranks. This worked well as long as we had high growth rates. But when in one year we grew only by 6%, there was great dissatisfaction among the employees. In contrast to entrepreneurs, employees are not willing to accept a greatly reduced bonus in weak years.

We then introduced a system that is independent of the company's development but is based on subjective evaluations. The bonus varies according to rank. The evaluation does not lead to great variations in the bonus amount. The first version of this system has been working very well for the last nine years. This year we slightly adjusted the system without changing its fundamental structure.

To acknowledge special performance, partners can grant an extra bonus that is not determined by any formula. Corporate management sets a budget for the sum of extra bonuses.

The following conclusions can be drawn regarding employee incentives in a brain capital enterprise:

1. Besides their basic salaries, employees want a bonus that reflects their performance in a transparent manner.
2. The amount of the bonus is less important than a comprehensible evaluation of an employee's performance. The bonus should not be too high.
3. "Sunny-weather systems" that lead to high bonuses in good times but much lower bonuses in weak years should be avoided, because the internal valuation by the employees is strongly asymmetric.
4. It is impossible for a system or a formula to account for all aspects. Therefore an extra bonus for exceptional cases based on a purely subjective evaluation is recommended.

| On Organizational Structure

This is a very complex topic I can only touch upon. At Simon-Kucher we have a one-dimensional structure. Our units, the so-called divisions, are primarily industry-oriented. A typical industry division is “life sciences”. This division works for the pharmaceutical industry worldwide and has people in all of our offices. But we also have divisions defined by the country they are working in. A division with a country focus is France. Apart from the life science sector, the Paris office works for all industries in France.

We were never fond of a matrix organization. The double reporting clashes with our entrepreneurial culture. We are aware that our strictly one-dimensional divisional organization does not always lead to optimal results. People sometimes do not cooperate simply because they belong to different divisions. The word “division” comes from “to divide”, which says it all. If partners want to cooperate, division boundaries are irrelevant. If they don’t want to cooperate, it’s very difficult to overcome the resistance with organizational measures or incentive systems.

In the recent past and with increasing size (as I said we have now 650 employees in 25 offices and 19 countries) we observe a certain tendency towards regionalization. I wouldn’t be surprised if in five to ten years there will probably be a shift back to industry divisions. According to Murphy, a real problem is defined by the absence of a solution. The organizational structure of a brain capital enterprise belongs to the category of real problems à la Murphy.

Therefore, I am short of definitive advice when it comes to the organizational structure of a brain capital firm. My personal view is that the organizational structure is not really relevant in brain capital enterprises. This may sound strange, but partners do anyway what they want. This is a fundamental difference to a manufacturing company or a bank where such conduct would result in chaos. And if you try to direct the partners too rigorously entrepreneurship and initiative suffer. This inevitably leads to the question “How do you lead a brain capital firm if not through organization?” My personal answer and conviction is “through values”. Of course, you always need a certain minimum of organization. And this minimum tends to increase with increasing size of the organization.

| On Values

Values are a pillar of leadership in brain capital enterprises. Only in 1996, eleven years after the foundation, did we explicitly formulate our values, visions and strategies in a so-called “vision and values” statement. Our four core values are honesty, quality, creativity and speed. The most frequently violated principle, by the way, is speed.

How important is the explicit written formulation of values? Written value statements tend to sound rather banal and general. Most good companies have similar values and it is hardly possi-

ble to express those in an idiosyncratic way. What counts is not whether the values are put on paper but whether they have penetrated into the hearts and minds of the employees, whether they are actually “lived”.

For practical leadership, values are crucial. Honesty is an illustrative example. We expect honesty from all employees. Honesty is a *conditio sine qua non* for our extremely lean administration, controlling etc. In our culture dishonesty is socially sanctioned. Neither the partners nor the employees tolerate dishonesty. The quickest way to become a *persona non grata* is to be dishonest. We have fared well with this principle. How long it can be maintained in a growing company remains to be seen. Alluding to Albert Einstein’s phrase: “There is nothing more practical than a good theory.” Let me say: “For the leadership of a brain capital enterprise, there is nothing more practical than lived values.”

| The Hardest Challenge

The hardest challenge during my 14 years as CEO of Simon-Kucher was the opening of foreign offices, or, more precisely, finding the right individuals to run a new office. We made many mistakes. Both in France and Japan we needed three trials to become successful. The managing director of a new office faces great challenges. Nobody knows us when we enter a new country. The new office does not have an experienced team.

How can we find the right person to successfully lead a new office? To this day I don’t have a general answer to this question. One method is to deploy an experienced consultant from headquarters. However, there may be no one who knows the new country, speaks the language or has a network of contacts. An alternative is to hire a seasoned consultant from the country in question. But he or she won’t be familiar with our culture, our methods, our employees. It has always been amazing how hard it is for experienced consultants from other firms to adjust to our methods and culture. Therefore we have grown increasingly wary of hiring high-level outsiders. In most cases it didn’t work. So every new country is a new adventure. We have no standard procedure. Success always depends on one or a few persons.

| On Personal Leadership

With regard to leading individuals in brain capital enterprises, freedom is the key aspect for me. As I pointed out before, one cannot control the process of value creation with knowledge workers. The best way is to give them the highest possible degree of freedom to achieve their goals. However, the knowledge worker must reciprocate this freedom with commitment and the willingness to perform. Tom Peters spoke of the inseparable combination of “delegation and accountability”. At Simon-Kucher we practice this leadership style, characterized by the polarity of freedom and performance. Our entrepreneurial incentive system supports this polarity. Beyond this syste-

mic aspect, leadership always has a strong personal component. In the end what matters is the authenticity of the leaders – as opposed to role play.

Summary

1. In terms of value creation, key resources and capital requirements, brain capital enterprises are very different from industrial businesses.
2. Brain capital enterprises should be owned by the active partners. To achieve this, the handing over of shares has to start early on. An internal market model is the most effective method to determine prices and volumes of shares transferred.
3. Apart from a fixed salary, partners' variable compensation should reflect both their individual and the company's performance. Instead of striving for perfect differentiation, simplicity should rule.
4. Employee incentives should be moderate and avoid great volatility.
5. The organizational structure of brain capital enterprises belongs to the category of real problems in the sense of Murphy, i.e. there is no generally optimal solution. On the brighter side, the organizational structure of a brain capital enterprise is not really important.
6. Values are a key aspect of the leadership of a brain capital enterprise. What counts is that the values are communicated effectively and lived out on all levels, not that they are written down.
7. The greatest challenge for brain capital enterprises is successfully penetrating new foreign markets. The most essential and, at the same time, hardest part is to find the right person to head a new foreign office.
8. The leaders of brain capital enterprises should give their employees a high degree of freedom. On the employee side, this must be matched with a strong commitment to top performance.

I thank you very much for your attention.

Dzięki.

26 kwietnia 2012 r. Senat Akademii Leona Koźmińskiego jednogłośnie zdecydował o przyznaniu tytułu doktora honoris causa Profesorowi Hermannowi Simonowi. Uroczysta ceremonia z udziałem nowego doktora honoris causa odbyła się na zakończenie V Światowego Kongresu Etyki Biznesu, zorganizowanego w ALK w dniach 11–14 lipca 2012 r.

W laudacji Profesor Andrzej K. Koźmiński, prezydent ALK i promotor honorowego doktoratu, stwierdził, że reputacja Profesora Hermanna Simona jako wybitnego uczonego, autora ponad 30 książek i 1000 artykułów, założyciela czołowej firmy konsultingowej, i światowego autorytetu w takich dziedzinach jak zarządzanie cenami i trwałe utrzymywanie czołowej pozycji na rynkach niszowych, mówi sama za siebie i stanowi potwierdzenie imponującego dorobku.

Profesor Simon jest szanowany i dobrze znany w Polsce, którą od lat regularnie odwiedza. Prowadzi u nas projekty badawcze wraz ze współpracownikami z warszawskiego biura swojej firmy, ukazują się tu jego książki i artykuły. Wykłada także gościnnie w ALK i uczestniczy w pracach Międzynarodowej Rady Konsultacyjnej Biznesu ALK. Wniosek o doktorat honoris causa dla Profesora Simona poparł Profesor Jerzy Dietl z Uniwersytetu Łódzkiego, Profesor Philip Kotler z Kellogg School of Management w Northwestern University i Professor Erwin Pesch z Siegen University.

Profesor Simon stwierdził po otrzymaniu wyróżnienia: „Czuję się uhonorowany i wdzięczny za przyznanie tego tytułu. Kiedy porównuję pierwsze cztery dekady swojego życia ze współczesnością, widzę wyraźnie, jak duży postęp dokonał się w ostatnim czasie. Akademia Leona Koźmińskiego stała się wzorcem, jak można z powodzeniem wykorzystać zachodzące zmiany. Dziś to czołowa szkoła biznesu w Europie Środkowej i Wschodniej, co stanowi naprawdę niezwykle osiągnięcie. Jestem dumny, że mogłem choć w niewielkim stopniu przyczynić się do sukcesu tej doskonałej uczelni i do dalszego rozwoju Polski”.

W krajach niemieckojęzycznych Profesor Simon jest uznawany za najbardziej wpływowego – po nieżyjącym już Peterze Druckerze – autora z obszaru zarządzania, według stale aktualizowanego rankingu Managementdenker.com.

Profesor Hermann Simon urodził się w 1947 r. w regionie Eifel, w najbardziej wysuniętej na zachód części Niemiec, z którym jest blisko związany do dzisiaj. Ukończył szkołę oficerską w Monachium i w latach 1967–1969 służył w dywizjonie myśliwskim niemieckiego lotnictwa. Od 1969 r. studiował biznes i ekonomię na uniwersytetach w Kolonii i w Bonn, w 1973 r. ukończył studia w Bonn. Dysertację doktorską o strategiach cenowych dla nowych produktów i rozprawę habilitacyjną o marketingu produktów przedstawił także na Uniwersytecie w Bonn.

Karierę nauczyciela akademickiego rozpoczął w 1979 r. na Uniwersytecie w Bielefeld, gdzie później został mianowany profesorem zarządzania i marketingu. W latach 1985–1988 był dyrektorem Universitätsseminar der Wirtschaft (USW) w Kolonii, największej instytucji zajmującej się badaniami zarządzania w Niemczech. Poznał wówczas osobiście szefów większości czołowych firm niemieckich.

W latach 1989–1995 był profesorem na Uniwersytecie Johanna Gutenberga w Mainz. Prowadził badania i wykładał za granicą: w Massachusetts Institute of Technology, w INSEAD, był profesorem wizytującym w Keyo University w Tokio i w Stanford University. Przez rok pracował w Harvard Business School, a przez kilkanaście lat prowadził zajęcia w London Business School.

Jego zainteresowania badawcze obejmują zarządzanie cenami, z uwzględnieniem ich dynamicznych modeli i związku z innymi zmiennymi rynkowymi. Prace Profesora Simona są podręcznikami do zarządzania cenami w krajach niemieckojęzycznych, zostały też przetłumaczone na 15 języków.

Innym obszarem badań Profesora Simona są tzw. tajemniczy mistrzowie (*hidden champions*) – firmy doskonale radzące sobie we własnych niszach i utrzymujące czołowe pozycje przez długie lata. Profesor Simon jest twórcą tego terminu, a jego prace i osobę spopularyzowały pisma biznesowe, np. „BusinessWeek” i inne znane periodyki. Profesor Simon jest pierwszym autorem z Niemiec, który tak często publikuje w cenionych amerykańskich pismach naukowych z dziedziny zarządzania.

W 1995 r. Profesor Simon odszedł z pracy akademickiej, by objąć posadę prezesa Simon-Kucher & Partners, wówczas 40-osobowej firmy konsultingowej. Powołał ją z dwoma swoimi studentami, którymi są Dr Eckhard Kucher i Dr Karl-Heinz Sebastian. Pod kierunkiem Profesora Simona firma podjęła międzynarodową ekspansję: obecnie zatrudnia 650 osób w 25 biurach w 19 krajach. Firma Simon-Kucher & Partners jest uważana za światowego lidera w konsultingu cenowym. W 2009 r. Profesor Simon zamienił fotel prezesa na przewodniczącego rady nadzorczej.

Profesor Simon zasiada w radach nadzorczych i komitetach doradczych firm, uniwersytetów, w tym Akademii Leona Koźmińskiego. Dobrze zna Polskę, a warszawskie biuro jego firmy odgrywa istotną rolę w projektach badawczych o „tajemniczych mistrzach”. W Polsce ukazało się 5 książek Hermanna Simona, liczne artykuły, w tym w „Master of Business Administration” (4/2010).

Opracowała: Ewa Barlik