Culture Eats Strategy: Nucor's Ken Iverson on Building a Different Kind of Company

The problem with most management, leadership, and business books is that many of them harp on the same self-evident points, overconfident in the usefulness of their prescriptions for would-be imitators. They tend to vastly underestimate the role of circumstance, luck, the nature of completion, and the effects of scale, among other things; falling prey to the many delusions described by **Phil Rosenzweig** in his *incredibly* important book, *The Halo Effect*.

The main problem Rosenzweig describes in the book is that attributes we tend to think *cause* great performance (culture, leadership, etc.) are often just things that are *attributed* to companies we already know are high-performing. There's a Halo around everything they do.

How many current high-fliers would ever be described as having a bad culture, or bad leadership? It would be nonsense to say it. Thus, we run into a recursiveness problem. High performing companies have a great culture, and great culture is defined as the attributes that cause high performance.

In other words, when you ask someone if Apple has a great corporate culture, they will tell you it does. (And it's an extremely successful company, so of course it does.)

But when we try to pinpoint *which aspects* of Apple's culture make it more successful than its peers, and which would be predictive of success at other companies, we run into a difficult problem.

The Halo Effect tells us that we will find a lot of false positives. The attributes we think are causal of *success* are the same ones we often deem causal of *failure* when company performance deteriorates. This is the strategy paradox.

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Plain Talk, by **Ken Iverson**, is a memoir of his time running the steel company Nucor. Despite the warning, above this book deserves your attention for a few reasons:

- Nucor was extremely successful, for a long period, in an industry that provided huge headwinds. There are no magic pills to being successful in steel. It's generally an awful business.
- The company did some very unusual things that we see in few other companies, even successful ones.
- The book was recommended by a very smart friend who runs a very successful business of his own, using similar principles.
- The author/CEO, Iverson, seems honest about the fact that many of his prescriptions are not new or different. The book is not presented as a panacea.
- It's generally good to study outlier success or failure.

A Peculiar Kind of Success

Under Iverson, Nucor was an unusual sort of steel company compared to the Carnegie-esque behemoths of the past.

Some of its attributes remind us of companies like Berkshire Hathaway, but Nucor did it very differently. There were a few acquisitions. The company was totally focused on steel. Iverson describes some of the peculiarities in the opening of the book (this was written in 1998):

- Our 7,000 employees are the best paid workers in the industry, yet Nucor has the lowest labor cost per ton of steel produced
- Nucor is a Fortune 500 company with sales in excess of 3.6 billion, yet we have a total of just 22 people working at our corporate headquarters, and just four layers of management from the CEO to the front-line workers.
- Nucor operates in a "rust belt" industry that lost one out of two jobs over a 25-year time span, yet Nucor has never laid off an employee or shut down a facility for lack of work, nor have we lost money in any business quarter for more than thirty consecutive years.

That is, of course, a very interesting outcome. Most steel companies were struggling mightily when Nucor came up. Bethlehem Steel almost went bankrupt in the late 70s. (They eventually did.) Foreign competition, rising input costs, rising labor costs, commoditization…steel is about as bad a business as you could invent. Yet in Iverson's 30+ year reign, Nucor compounded its per-share earnings at a rate of about 17% per annum. There must have been something going on here — he sounds like an outsider.

Let's focus on a few things that were particularly unusual.

Extreme Decentralization

Nucor believed (and to my knowledge, still believes) strongly in decentralization. The only parallel for 22 people at headquarters in a $4 billion business is probably Berkshire itself. Capital Cities, now part of ABC, might have been another parallel.

To achieve that leanness at the top, power must have been pushed down pretty far into the organization. And of course, it was:

Each division operates its one or two plants as an independent enterprise. They procure their own raw materials; craft their own marketing strategies, find their own customers; set their own production quotas; hire, train, and manage their own work force; create and administer their own safety programs…In short, all the important decisions are made right there at the division. And the general manager of the division is accountable for those divisions.

This is scary for most companies. They are not willing to allow local general mangers that kind of control and responsibility. The allure of synergy and the allure of top-down controls are too strong. And once it's in place, headquarters culture has a way of taking on a life of its own. Take a look at PepsiCo, or General Electric, or any number of corporate beasts in the United States. There is huge, expensive bureaucracy at the top. It is always thus. (Of course, that keeps firms like 3G Capital in business.)

But Iverson was willing to take the tradeoffs:

“We are honest-to-god autonomous,” says Hamilton Lott, general manager of our Vulcraft Division in Florence, South Carolina. “That means we duplicate efforts made in other parts of Nucor. The company might develop the same computer program six times. But, the advantages of local autonomy are so great, we think it’s worth it.”

Any of you who have worked in a modern corporation know how unusual this mentality is. Who would allow the same company to develop the same software six times? Why not increase knowledge sharing and synergies?

Part of the problem is that the tremendous *benefits* of local autonomy are less immediately tangible than the *costs*. Berkshire has dealt with this for years. Every time one of Buffett’s subordinates acts up, and it happens pretty darn infrequently by our count, people pipe up and ask why he isn’t imposing more rigid oversight on them. It’s very simple: the long-term benefits of trust-giving have *far* outweighed the occasional cost of non-compliance.

Call this an unrecognized simplicity. Nucor’s corporate overhead expense was so small they didn’t even bother allocating corporate expenses to the divisions. *That* is rare.

The other under-appreciated value of decentralized control is that great ideas tend to *rise from the bottom* rather than being dictated by the executives. Iverson claims that many or even most of Nucor’s great innovations came from down in the divisions. The company merely had to be smart enough to harness them.

This has happened elsewhere in Corporate America. Look at McDonald’s. Do you think Ray Kroc invented the Chicken McNugget, the Big Mac, and the Filet ‘o Fish? Do you think he figured out how to keep millions of pounds of potatoes fresh and get them to customers tasting exactly the same every time? No. But franchisees and suppliers did. He just had to be smart enough to help the ideas spread.

Simple and Precise Strategy

In the book *Good Strategy, Bad Strategy* by Richard Rumelt (highly recommended, and we’ve written about it before), the author is clear that what makes a good strategy is that it’s *clear* and that it’s *precise,* a real call to a specific action:

The kernel of a strategy contains three elements: a diagnosis, a guiding policy, and coherent action. The guiding policy specifies the approach to dealing with the obstacles called out in the diagnosis. It is like a signpost, marking the direction forward but not defining the details of the trip. Coherent actions are feasible coordinated policies, resource commitments, and actions designed to carry out the guiding policy.

This is precisely what Iverson did at Nucor:

We don’t clutter the picture with lofty vision statements, ask employees to pursue vague, intermediate objectives like “excellence,” or burden them with complex business strategies. Our competitive strategy is to build manufacturing facilities economically, and to operate them efficiently. Period.

Simple but not easy.

Was the technology that went into developing and implementing this strategy simple? I'm not an expert in metallurgy, but I doubt it. The modern steel company is quite efficient and quite advanced. Nucor made major strides like the mini-mill and thin-slab casting of flat-rolled steel. Whether that kind of technology would have been given a chance to succeed in a different culture is hard to say. We can't re-run history, but Nucor's purposeful drive seems to have fostered the right environment.

Remove Unnecessary Hierarchy

Ultimately, it's hard to build a great, supportive, seamless web of deserved trust if the executives are consistently treated as "above the fray" – subject to a different level of treatment than the rank and file. This is the way it is in most organizations.

The results tend to be predictable. Envy, plus a violation of basic Kantian fairness tendency, will create a lot of hatred. You can't put the managers and the executives in first-class and stick the associates in coach and expect anything but resentment. It's basic human nature, driven by biology. Nucor was smart enough to avoid this folly:

Our executives get the same group insurance, same holidays, and same vacations as everybody else. They eat lunch in the same cafeterias. They fly economy class on regular commercial flights (although we do allow the use of frequent flyer upgrades). We have no executive suites and no executive cars. At headquarters, our "corporate dining room" is the deli across the street.

Our executives wouldn't have it any other way. They see our egalitarian culture serving their interests as much as the interests of our employees. For one thing, our mangers don't have to waste time fretting over their chances to get the fancy corner office or arguing over who gets to use the company plane. We don't have those perks, and we imagine they would cause a lot more stress than fulfillment. What a bunch of nonsense! Chasing meaningless status symbols and tokens of power…

Nucor had essentially four promotions available: Supervisor, Department Manager, General Manager, and Chairman (Iverson himself). That's it. I can imagine that over all those years of growth, more than one consultant tried to get Iverson to create a whole lot of bureaucracy, but he wisely resisted. The costs (such as the mathematically unavoidable large spans of control due to fewer managers in the system) were once again greatly outweighed by the benefits. Another unrecognized simplicity.

And when it came time for pay cuts, *everyone shared in the pain*. What a simple, yet generally unused concept:

Why, then, would workers who had endured deep cuts in pay and who had every reason to fear for their futures reach out to share a laugh with a *manager* passing through a mill? Simple. No employee was being asked to carry more than his or her part of the burden.

You see, their department heads had taken pay cuts of up to 40 percent, and the general managers and other officers of the company were earning 50-60 percent less than we had made in preceding years. My own pay dropped that year to about $110,000, from about $450,000 the year before. We not only *shared* the pain, but doled out the lion's share to the people at the top.

Think about what an inversion that is of most organizations, where the CEO takes a minor cut in pay (or worse, no cut) and hundreds of low-level employees simply lose their jobs. Wouldn't most places work better with Nucor's ethos? The fact that they did this in the highly cyclical steel business gives some tailwind to the idea. It wasn't a story like Google, where constant success has allowed them to pamper employees financially and otherwise. Nucor managed to avoid layoffs and share in the pain in a business that, by necessity, is constantly offering pain to share.

A Postscript on the Post-Iverson Era; Implications for Investors

In the final analysis, Nucor probably didn't have any core attributes that were unavailable to its competitors. It simply made better choices and was more fanatical about sticking to them. The resulting success was deserved. This is why culture eats strategy.

But the postscript to the Iverson era has been interesting, at least from the perspective of the passive investor. Nucor was a brilliant investment in Iverson's time as manager, but if you'd bought the stock in the early 90s when Iverson left the CEO post, your results would have been pretty mediocre. Can we see why? Let's deduce a few reasons.

- Partially, the stock was fairly rich at that time – trading for something like 40x price/earnings. That's high even for a *good* industrial company. It's not so high now. But their fundamental performance has not been nearly as impressive either, in the time since Iverson left, especially in the last five or six years.
- Partially, the effects of compound interest have served to slow down an increasingly large corporation. Nucor is now a giant in the steel business. They started off as a tadpole. If the company's net earnings had continued to grow at 17% per annum, they would currently be earning $4 billion a year, versus a little over $120 million in 1993. There's only so much profit available in steel.
- Is there a tinge of Halo Effect here, as described at the beginning of the piece? Perhaps. Iverson would be the first to say his prescriptions were not that ground-breaking. I tend to think some of the attributes above **did** contribute greatly to its unusual success, but more of the success may have been situational and strategy-driven than Iverson recognized.
- Even more important might be to recognize that the steel business *always* was a fundamentally hard one, and even the best ships might struggle on a stormy enough ocean. Iverson and his team rowed very hard and successfully for many years, and that has continued to this day. Bethlehem Steel went bankrupt in 2001 and Nucor made money that year. U.S. Steel has been bleeding red ink for years and Nucor, although less profitable than it once was, has still made money. But the ocean current is what it is.

So even if Nucor has been better than most of its competitors in the last ten or twenty years, and I suspect it has, an investor would have had to ask him or herself: Do I want to be in the steel business at all? As Buffett used to say, something not worth doing well is often not worth doing at all.

Regardless, the lessons from *Plain Talk* show that the roads less traveled can be worth exploring. They’re not that complicated. But they work.