

THE REALITIES OF OWNERSHIP

A HANDBOOK FOR OWNERS AND THE PEOPLE
THEY DEVELOP

THE PAID LAST SERIES
COMPANION

STEPHEN DEASON



Alder
Creek
EDITIONS

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Published by Alder Creek Editions, LLC, 8735 Dunwoody Place STE N, Atlanta, GA 30350, aldercreekeditions.com.

ISBN 979-8-952410-31-2 (hardcover). First edition.

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“If you’re going to eat shit, don’t nibble.”

Dave Conte, as quoted in Ben Horowitz,

The Hard Thing About Hard Things

PREFACE

What This Book Is, and What It Is Not

This book is written for business owners and for the people they are preparing to carry greater responsibility. It is not a general introduction to leadership. It is not a motivational book, and it does not attempt to make the reader feel better about the difficulty of running a company.

It is a handbook about what happens inside a business, particularly when the company pays for work, judgment, information, supervision, or execution that it does not receive.

That is the vantage point throughout. The company is a legal person. It owns assets, enters agreements, incurs obligations, and pays people to perform the work it cannot perform on its own. The people who occupy its positions are responsible for the work assigned to those positions. The

owner is responsible for building and maintaining the organization through which that work gets done. When the organization fails to deliver what the company purchased, the cost goes somewhere. This book follows that cost.

Some of its conclusions are uncomfortable. An employee may be performing badly because the company designed the job badly. The employee's failure remains a failure, and management's design failure remains a failure. Both have consequences. An employee may believe he is protecting the company when he withholds bad news. The company still loses the information it paid him to provide. A supervisor may believe he is being kind when he avoids correcting poor work. The company still loses the supervision it purchased.

This book does not soften those distinctions to make them more agreeable.

Nor does every failure require an inquiry into somebody's character or intentions. Much of what goes wrong in organizations can be established without deciding whether a person was selfish, frightened, dishonest, incompetent, or merely mistaken. The company assigned work. The work either happened or it did not. The circumstances matter when deciding what to do next, but they do not change what the company received.

The book is deliberately narrow in another respect. It is written primarily from the position of the residual claimant, the person whose claim is settled after the company's other claims. Employees, customers, creditors, and families also

bear consequences when businesses fail. The owner's position does not erase their losses. It explains why the owner must pay attention to costs that no one else in the organization has an immediate reason to find.

If an owner handed you this book, you are one of the people it was written for. Most entries describe what the company buys from your seat and what it loses when the seat does not deliver. Read them as the terms of the seat you hold now and of the seat you want next. The owner who handed you the book is held to the same terms, and Part Three shows what his seat costs him.

This book is also used between an owner and the people he is developing. The owner may hand someone the whole book, or open it to a particular Reality when the work calls for it. The entry names the operating condition, the duty, and the cost of getting it wrong. The owner supplies the context: how the principle applies to the company, what the person in that seat is expected to do, and where the principle reaches its limit. The book is a reference for that conversation.

The seventy-nine Realities in Part One begin with familiar sayings. Some are old. Some contradict each other. Many have been repeated so often that their practical meaning has been lost. Each entry identifies a loose reading, closes that reading with a more useful statement, and follows the

consequences of the underlying behavior. Particular attention goes to the costs that ordinary financial reports do not connect to the decisions that caused them.

These entries are not empirical laws. They are operating propositions drawn from the recurring problems of business ownership and management. Test them against your own company before you rely on them. A proposition may hold strongly in one circumstance and meet its boundary in another. Recognizing that boundary is part of the judgment the book is intended to develop. Part One ends with four collisions in which two sound operating propositions point in opposite directions.

The format is intentionally repetitive. The same idea may appear as a rule, as an explanation of the duty, and again as a consequence of failing to perform it. Those are different things for a manager to understand. The objective is to make the operating judgment usable.

Nor does this book attempt to teach every procedure required to apply its conclusions. It will tell a manager why inspecting work matters without supplying a universal inspection checklist. It will explain why an owner must understand the company's cash without attempting to replace a course in accounting. Those subjects deserve fuller treatment. This book is a companion to *Residual Claimants*, the first volume of The Paid Last Series, where many of these principles are developed through cases and sustained instruction.

Part Two, *Harsh Truths*, states consequences of ownership more briefly. Part Three, *The Owner's Life*, considers what carrying the residual claim can do to an owner's time, relationships, household, and judgment. Those costs belong in the account as much as the financial ones do. Some cannot be recovered, regardless of what the company eventually earns.

There is no promise here that following these principles will make a company successful. Markets can turn, customers can leave, good decisions can produce bad outcomes, and owners can do nearly everything correctly and still lose.

What the book can offer is a way to see the company more clearly: what it owns, what it owes, what it buys from the people working in it, what it receives, and what it loses when the work is not done.

INTRODUCTION

This book collects the Realities that open the lessons of *Residual Claimants: How to Think Like and Become a Business Owner*, the first volume of The Paid Last Series. They are printed here on their own so an owner can keep them on the desk and hand them to the people he is developing.

Where an entry names a lesson, part, or appendix of *Residual Claimants*, that place works the reality through with a case. The entries stand without it.

TERRAIN TO BE NAVIGATED

What follows is a working list rather than a theory. Each entry is a reality that holds whether or not anybody likes it. They are terrain to be navigated, not morals to be fought over or problems to be solved. The operator who treats one as a problem spends money proving it is terrain.

Several of these entries contradict each other. The contradiction is not sloppiness in the list. Two of these realities can both hold and still point in opposite directions. The space between them is where judgment lives. Where these collide, the last chapter of Part One, works through four of the sharpest collisions.

THE COMPANY COMES FIRST

Every entry in this book begins with the company: what it owns, what it owes, what it bought from each seat, and what happened when the company did not receive what it bought. A company is a legal person. It holds the assets, carries the obligations, and cannot act on its own. It therefore buys performance, judgment, information, supervision, execution, and stewardship from the seats it creates and fills.

ELEVEN QUESTIONS

When something goes wrong, the questions run in this order.

1. What did the company buy or entrust to this seat?
2. What duty followed from that assignment?
3. Was the duty performed?
4. If it was not, name the failure plainly, in the words that describe what did not happen.
5. Why did it fail? Incentives, fear, capability, design, competing priorities, or several at once.

6. Can you answer the first four questions without reading anybody's mind? Usually you can. Where you can, answer them that way.
7. Was information filtered, softened, withheld, or never learned by a seat that owed the company an accurate account of it?
8. What did the company lose, or have to buy a second time?
9. What did it lose that nothing in its records will ever show?
10. Where does that cost come to rest?
11. Where does the rule stop holding?

Question five explains. It does not excuse. Human incentives are why duties get breached. A system that repeatedly asks people to choose against their own interest is fragile and badly designed. Neither fact converts a breach into performance. Both can be true at once. The owner who accepts the explanation has purchased a diagnosis, not a result.

Question seven carries a definition of lying broader than the ordinary one. The definition has to be broader, because the ordinary definition is useless to an owner. A seat owes the company two things: to know what the seat is responsible for, and to give an accurate account of that. Filtering, softening, selective omission, failing to learn what the seat was obliged to know, and letting a cleaner picture travel upward are all failures of that duty. Nobody has to sit down and decide to deceive. Intent may change what the owner

should do about the failure. Intent does not change whether the company got the truth it was owed.

Questions eight and nine are Bastiat's distinction put to work. The seen cost is the consequence that the ordinary account of an event sees, measures, or readily connects to that event: the severance, the rework, the vacancy, the legal fee, the lost account. The unseen cost is what the same account fails to connect to the decision that caused it: the output never produced, the capacity never built, the client who quietly reduced the order, the decision made a year later on information that was wrong. The list exists to make the unseen cost visible.

Question ten runs down the claims. A fixed claim does not become residual because somebody performed badly. Fixed claims are settled on their own terms. Some costs travel outside the company altogether, to a customer, a supplier, an insurer, or a creditor. Whatever loss is left with the enterprise once those claims are settled reduces the residual. That is why each entry follows the loss until it stops moving.

HOW TO READ AN ENTRY

The numbered entries here name conditions of the work and, where one follows, the operating rule that comes with the condition. Each entry is laid out in six parts. Loose reading is what the saying in the entry's title is usually taken to mean. Wording that closes it is the saying restated so

the loose reading has nowhere to stand. False Belief is what operators commonly assume. Reality is what holds instead and why. Where an operating rule follows directly, Reality states that rule too. Seen Cost is what the ordinary account sees. Unseen Cost is what it does not, followed to where the cost lands. Where a lesson in *Residual Claimants* works through the reality, the lesson is named at the end of the entry. Part Two, Harsh Truths, and Part Three, The Owner's Life, use a shorter form. Each line is stated once and followed by a short explanation.

TWO WORDS USED THROUGHOUT

Duty. A company is a legal person. It holds property, signs contracts, owes obligations, and carries a reputation, and it cannot walk into a room, look at its own work, or defend itself. Everything it does, it does through people authorized to act for it. When a company fills a seat, it is buying a set of acts from whoever sits there. In this book a duty is the work the company assigned to a seat, and a failure of duty is that work not done, whatever the reason.

Residual claimant. There are two kinds of claim on a company. A fixed claim is fixed by agreement, not by amount: a wage, a salary, an invoice, rent, the interest on a note, a commission at four percent of collections. A rule agreed in advance decides it. A residual claim is whatever is left after every fixed claim has been satisfied and the rules have run out of people to pay. It can be large. It can be zero. It can

be negative. The residual claimant holds that remainder. He is paid last, and every cost nobody else absorbs comes to rest with him. That is why each entry follows its cost until it reaches him.

PART ONE

THE REALITIES

HUMAN NATURE AND INCENTIVES

Well, I think I've been in the top 5% of my age cohort all my life in understanding the power of incentives, and all my life I've underestimated it.

Charlie Munger, "The Psychology of Human Misjudgment,"

Harvard Law School, 1995

1 Nothing in the company belongs to the people using it.

LOOSE READING A rule about equipment. Do not steal, and do not treat the company laptop as personal property.

WORDING THAT CLOSES IT The tools, the accounts, the paid hours, and the work itself are the company's. A supervisor or manager who asks to see any of them is the company looking at what it paid for.

FALSE BELIEF The tools, the hours, and the accounts a person works with every day are in some loose sense his, because he is the one using them.

REALITY The company owns the assets and pays for the work. An employee who uses those assets every day does not come to own them. The supervisor responsible for that employee answers to the company for the employee's work and use of company assets. The company has purchased supervision from the supervisor. A supervisor who asks to see the work is the company looking at what it paid for, getting exactly what it bought. The company may choose to credit an employee by name in a presentation of the work. That credit is a labeling choice. It gives the employee no lien on the work.

SEEN COST The repair bill for a company vehicle an employee returned damaged. The paid hours an employee spent on work he preferred, in place of the work he was assigned. The monthly charge for a subscription an employee bought on a company account and nobody cancelled.

UNSEEN COST An employee who believes the tools, the hours, and the accounts are his treats a supervisor's request to see them as an intrusion. He slows the work the company is paying him to do. The company bought those hours and is not receiving the work, which makes the slowdown time theft. The supervisor who asked, and other supervisors who witnessed the exchange, decide that inspecting

the work is not worth the argument. They stop asking. The company bought supervision from each of them and is no longer receiving it, though it is still paying their salaries. That is time theft too. Once no supervisor checks, unchecked work becomes the department's standard. Under that standard, an employee who treats company assets as his own uses them on his own judgment. He spends the company's money on what he wants. He puts the company's tools and paid hours toward the work he prefers. He never asks whether the company would have bought what he bought. No line in the company's records shows the slowed work, the supervision paid for and not delivered, or the purchases the company would have refused. What the company paid for, it did not receive. Each of these costs is borne by the residual claimant, the owner.

2 Titles are verbs.

LOOSE READING A manager should be busy and visibly active.

WORDING THAT CLOSES IT Supervisor, manager, director, vice president, and president each name an act the company pays for every pay period. A manager who leaves a capable team alone is managing only after he has inspected the work and judged that leaving the team alone is the better course for the company.

FALSE BELIEF A manager who leaves a capable team alone is extending trust, and no complaints means the work is being done.

REALITY Supervising, managing, directing, and owning are continuous acts performed on assets belonging to the company. The company placed each person in his seat to perform the act the title names. The company pays the supervisor, the manager, the director, the vice president, and the president for that act every pay period whether or not it happens. The owner is paid last, from whatever remains. A manager who inspects the work and then leaves a capable team alone is managing. A manager who never looks at the work and calls the absence of complaints trust is not performing the duty he is paid for.

SEEN COST Work the team produced below standard for a quarter before any manager looked at it. The rework the company paid for once a manager looked at the work.

UNSEEN COST The company paid the manager's salary every pay period to buy management of the team's work. The manager never inspected the work. No line item showed that the company was not receiving what it paid for. Decisions that belonged to the manager's seat were made by employees with no authority to make them, or were never made. A decision that is never made leaves no trace in the records. Employees carry work methods no manager checked into the next department they join. An employee whose output would have earned a promotion

went unnoticed, because no manager examined the output. The employee left. The company lost both the employee and the work he would have done in the higher seat. A manager who does nothing generates no incident. The owner learns of the failure only when the bad output reaches him. By then the company is paying for the correction on top of the salary it paid for management it never received.

3 People work for their own grand vision.

LOOSE READING People put their own interest first, so when they fail, the system is to blame and they are excused.

WORDING THAT CLOSES IT Do not build a system that requires people to lose so the company can win. When such a system breaks, an employee who did not perform has still breached the duty of the seat.

FALSE BELIEF Enough commitment to the mission will carry people through a system that asks them to act against their own interest.

REALITY People will carry the company's goal a long way. Do not build a system that requires them to lose so the company can win. A system built that way will eventually break. When it does, an employee who did not perform has still breached the duty of the seat. Both things can be true. The employee failed, and management built a system that made faithful performance unnecessarily hard.

SEEN COST An initiative that stalled under a system that required employees to lose so the company could win. An employee disciplined for the stall.

UNSEEN COST The company's records file the stall as a personnel matter, so management never redesigns the system that broke. The next system management builds rests on the same premise and fails the same way. The residual claimant buys the same design error three and four times, and the records file each instance as a personnel matter. Employees who watched a colleague disciplined for the stall stop reporting the conflict between the system and their own interest, so the next conflict surfaces later. The owner pays in installments for a design he could have changed once. Nothing in the company's records shows that the installments are the same purchase.

4 Perverse incentives are guaranteed.

LOOSE READING Measurement corrupts, so measure as little as possible.

WORDING THAT CLOSES IT Wherever a performance number is easier to move than the result it measures, somebody measured by that number will move it. Build the measure so that moving it requires producing the result.

FALSE BELIEF A carefully written metric measures the thing it names.

REALITY The moment you put a number on performance, people learn how the number moves. If moving the number

is easier than producing the result it measures, somebody being measured will eventually move the number instead.

SEEN COST An employee's gamed performance number, and the results that failed to follow it.

UNSEEN COST Every decision the residual claimant made on the gamed number while believing it described the business. Hiring, pricing, and capacity move on measured things. A metric that came loose from reality propagates into decisions nobody later connects to it. An employee who performs honestly and is outranked by an employee gaming the measure copies the gaming or leaves. The roster shifts toward employees who manage the measure. The company paid those employees for results and received movement in the number. The owner holds an operation optimized against his own instrument. He paid for the optimization.

WORKED THROUGH IN RESIDUAL CLAIMANTS *Lesson One.*

5 Gratitude expires instantly.

LOOSE READING People are ungrateful, so do not expect thanks.

WORDING THAT CLOSES IT Prior performance does not discharge present duty. The person in a seat earns the seat again every week. Standing cannot be drawn on as a company asset.

FALSE BELIEF Past results bank standing that can be drawn on later.

REALITY Prior performance does not discharge present duty. What you did for somebody last year has no purchase in this week's crisis. Your seat is re-earned continuously. Standing is not a company asset and cannot be drawn on as one.

SEEN COST Results not produced in the weeks a manager spent trading on last year's work.

UNSEEN COST Corrections the manager postponed because he believed he had credit. Risk the manager took on the assumption that his record would cover a miss. Standing the manager then bought back with concessions on schedule, scope, or pay. The residual claimant has to honor those concessions. Concessions become precedent. The company's record shows a manager with a strong history and a bad quarter. The concessions outlive the manager. The company paid the manager for present performance and did not receive it.

6 Loyalty is conditional.

LOOSE READING People are disloyal, so trust nobody.

WORDING THAT CLOSES IT People hold their positions because the structure serves their security and ambition. Every arrangement that rests on personal loyalty is an exposure. The owner prices each such arrangement as one.

FALSE BELIEF People who say they are loyal to you personally will be there when the company's structure changes.

REALITY Positions are held by people whose security and ambition the company's structure serves. Expecting personal loyalty from an organizational structure is a category error.

SEEN COST A trusted person who left for a competitor, or who took the side that served him in a dispute.

UNSEEN COST Arrangements never written down. Succession that rested on affection. A second supplier never developed because the first one felt like family. Each is an unpriced exposure the residual claimant carries. He discovers what each arrangement was worth on the day the arrangement fails. A seat holder who withholds information to protect his position while professing loyalty has failed the duty to inform the company. The company paid the seat holder for that information. The owner pays the cost of the withheld information without learning that it was withheld.

7 Demagoguery is a profitable career.

LOOSE READING Agitators are a fringe problem that treating people well will prevent.

WORDING THAT CLOSES IT Somebody is always paid, in standing, following, or cash, for telling your people they are victims. Treating your people well does not withdraw that payment. An owner who dilutes what he says to avoid being quoted pays for the dilution from the residual.

FALSE BELIEF A workforce that is treated well will not find a flatterer persuasive.

REALITY Flattering people, telling them they are victims, and blaming outside forces pay whoever does them, in standing, in following, and sometimes in cash. Somebody is always willing. Treating the workforce well does not retire that payoff.

SEEN COST A grievance campaign, the paid hours spent answering it, the output lost while it ran.

UNSEEN COST What the residual claimant stops saying after a grievance campaign, once he has learned how his plain statements get repeated. A standard he did not raise that year. A correction he delivered softly enough to be missed. An honest account of a bad quarter he replaced with something safer. From then on the operation runs on a diluted version of what he actually thinks. No document records the dilution. He remains the residual claimant of an operation steered by whatever he can say that will not be turned against him. He pays for the dilution from the residual.

8 You cannot care more than the person responsible.

LOOSE READING Stop caring about other people's results. Their results are their problem.

WORDING THAT CLOSES IT No manager can permanently supply the motive a seat needs when nobody is supervising it. That motive is screened for at the entrance. The manager

still supervises the seat and answers to the company for its results.

FALSE BELIEF A manager who cares enough can supply what the employee is missing.

REALITY Coaching, incentive, and pressure change behavior. They work on whatever the employee values, which need not be the quality of the output. No manager can permanently supply the motive a seat requires when nobody is supervising it. That limit is why the company filters for that motive at the entrance.

SEEN COST The months of coaching, the documented plan, the separation that happens anyway.

UNSEEN COST Supervisory attention spent indefinitely manufacturing performance in one seat was unavailable for higher-return supervisory work elsewhere. A strong performer elsewhere who would have repaid that attention developed a year later than he could have. Where the owner is the one doing the supervising, the hours spent are hours the company cannot buy more of. The bill is the work that did not happen. The residual claimant pays it, whether the hours belonged to the owner or to a supervisor the owner was already paying.

WORKED THROUGH IN RESIDUAL CLAIMANTS *Lesson One.*

This preview ends with the first chapter of Part One.

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Hardcover ISBN 979-8-952410-31-2

Alder Creek Editions

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