

A Review of
**OVERNIGHT SUCCESS: FEDERAL EXPRESS
AND ITS RENEGADE CREATOR**

by
Vance Trimble

reviewed by
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INTRODUCTION

This article is divided in two parts. The first part discusses common traits of new business ventures. The second, and major part, is the story of Federal Express and its founder Fred Smith. The primary source of the discussion of Federal Express is Vance Trimble's Overnight Success.¹

A REVIEW OF SUCCESSFUL BUSINESS VENTURES

There seems to be a pattern exhibited by successful new companies which they seem to have in common:

Communication: The management style in new companies is very informal. Communication and work organization is easy going. Work responsibilities are not clearly defined and change; job rotation is practiced; and responsibilities are overlapping.

Open access to the person in charge seems to improve work motivation and lead to an esprit de corps. Thinking about this makes perfect sense. Complaining to your boss in a casual company is like a nice talk in a pub. It gives you the feeling your criticism, and you, are taken seriously, and by being able to go to the person in charge you feel it is the first step in turning around a bad situation.

Once companies become larger and open access to the person in charge is no longer possible, workers can no longer direct

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their complaints to top management. Immediate superiors, who should be the person to talk to about suggestions and criticism, are busy meeting their performance targets. They do not appreciate people complaining and view complainants as potential sources of trouble. Owners, or top management, are in a totally different position. They look at criticism and suggestions in a different way because they are responsible for the entire company.

If workers cannot 'blow off steam' or cannot access management with direct suggestions, they will discuss issues in fruitless rounds among themselves. In large companies workers will not be able to change anything for the good and even good ideas will leave them with a feeling of helplessness. Even highly creative people will very likely develop an attitude, if they can not share their complaints and suggestions to the right person. Looking at cases of start-up companies, success is greatest during times when open access to the person in charge is possible. It would be good for companies to establish a suggestion network which enables workers to place suggestions and criticism at the very top. Personal contact with high level managers seems to be important for the esprit de corps.

Goal centered: Management of new companies is dedicated to a goal which is not shareholder value or money. This is not really surprising. General Washington's men beat the British mercenaries because the militia men were fighting for a just and noble cause; the British soldiers were fighting for money. Visions and ideas, which are very strong within new companies, are more persuasive than performance targets. Most of the time top management in new companies doesn't only preach a goal or dream, they live it. They work hard, they sacrifice, and they take pay-cuts. They lead by example!

Red tape: New enterprises tend to beat red tape by ignorance or outright fraud. Maybe future laws will loosen requirements for new companies.

Venture Managers: At some point new start-ups HIRE experienced managers to help solve organizational problems.

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Consulting companies are not really an alternative for new companies because they are expensive and cause negative cash flow.

Neglected niches: Many start up companies serve a market niche which has been neglected. Major companies looked at the market before, but it did not seem to be profitable. Though unrecognized by major companies, changes in technology, or in regulations, suddenly made the market seem more profitable for start-up companies. The opportunity goes by unnoticed by old companies in this field and eventually gives start up companies a chance.

Marketing: For all start-up companies marketing becomes a crucial factor at some point in time.

Failure: Many entrepreneurs experience failure before they ultimately succeed. This seems to be possible only in America. One reason might be of a legal nature. In most European countries personal bankruptcy is not possible. People cannot declare bankruptcy. They end up being broke and not able to pay back their debts, but claims will remain valid. If you are broke there is no incentive to make new money.

However legal procedures are not the only difference. There has to be some difference in society. The American culture gives people a second chance. The other extreme is the Japanese society which does not forgive failure at all. If a society tends to divide people in groups and if it is hard to move from one group to a higher group, people will be more risk averse. People are scared to be regrouped in a lower group because it is hard to move up again. For example, in Germany college is free, so many young people go there to get a degree. Jobs are, to a great deal, awarded on the basis of internships. If your father is with a good company it is easier to get a good internship. If he has a menial job, you will never get a good internship. Without good internships chances for good employment are very small. Even if education is free there seems to be a major barrier between groups. The opportunity cost to give up a good job and join a

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new business venture is high. In any case, grouping increases barriers and barriers avoid risk taking. Without risk takers there is little innovation which brings products to markets and people.

THE FEDERAL EXPRESS STORY

'Absolutely positively overnight!' – Federal Express is the largest provider for overnight mail delivery in the United States. The company employs approximately 145,000 purple-blooded workers. With more than 600 aircraft, among them the most sophisticated models from Airbus and Boeing, Fed Ex transports more than 3 million packages every day. Under the unique hub and spoke system most of the packages are flown from various destinations to the International Airport in Memphis, where the company's main headquarters is located. A huge team of workers sort incoming packages every night with the help of an advanced conveyer belt system. During a four-hour window, (the time span until the planes have to leave again), the mail was sorted by destination. Every night at 2:50 A.M. the first airplane leaves Memphis again and, for more than an hour every minute another plane takes off.

Fed Ex with its giant hub in Memphis is a very sophisticated logistic provider. Its customers can rely on the promise that each package will be delivered by 10:30 A.M. the next morning. While the package is on its way customers can trace it almost every inch of its journey. Fred Smith, the founder of the company, demands that his workers "treat every package as if it were the last package Fed Ex will ever handle". Customers appreciate the service and reliability of the company and pay more compared to prices of competitors. With its People-Service-Profit strategy Fed Ex grew to be a Fortune 500 company with more than \$13 billion in revenues.

The man behind the Federal Express success story is Fred Smith. This article describes first his family background, his life, and eventually turns to the history of Fed Ex. The conclusion will emphasize certain special characteristics for which Fed Ex is known.

FRED SMITH'S FAMILY BACKGROUND

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Transportation seems to run in the blood of the Smith family. Fred Smith's grandfather was a steamboat captain on the Mississippi river. Through him Frederick Wallace Smith, Fred's father, first became affiliated with the transport business. Frederick Wallace worked occasionally on the steamboats. The steamboats around the turn of the century not only transported goods, but also transported people. For a rather low fair transportation was provided, without much service or luxury. Later in the century the steamboat business was no longer profitable. Railways and trucks took over the transportation of goods. Cheap transportation for passengers was a new market left abandoned. Smith recognized this demand and was ready to serve it. With the help of a rather shady Memphis businessman Smith obtained a truck and built a passenger bus on the body of the truck. He drove his bus through west Tennessee and the adjacent states. This was the beginning of the Dixie Greyhound bus lines. Smith later sold his bus line to Greyhound.

Smith was an entrepreneurial type of person. He was ready to face challenges, dedicated to hard work, and always looked for business opportunities. One business opportunity was a little restaurant on wheels. The restaurant served Greyhound's customers while waiting for transportation. Smith called the restaurant the Toddle House because of the funny looks of the little restaurant when it was on the road.

Smith not only had an eye on business, he also loved boats. He had a dream of winning a race on the Mississippi. He never gave up his dream and eventually found a builder of boats who was able to build a boat suited for Smith's purpose. Smith won the race. This showed quite a high degree of persistence, since he had to wait for several years until he could afford the luxury of competing in boat races.

While Frederick Wallace Smith had an eye for business opportunities and boats, he was also known for various romances. His

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word in business was worth millions of dollars; his word in front of the altar was worth less. Smith was married several times. The mother of his son Fred was Sally Wallace Smith. She married at the age of 23, Smith was 49 years old. He divorced from Fred's mother pretending he would have to protect their assets from a government investigation. When Fred's mother returned to Memphis in expectation of reunion, she was surprised to find out there was a new Mrs. Smith. Frederick Smith's lifestyle was probably one reason he never became a member of the Memphis high society. The elder Smith was at odds with the upper class. He despised anyone with money who did not put it to work. He classified people as those who had inherited their wealth and were afraid to lose it, and those who had made their money and were not afraid to put it to work. Frederick Wallace Smith died in 1948 at the age of 53. He left behind a letter to his son. The letter was supposed to be given to his son when Fred Smith turned 21. The letter concluded with the request to put his inheritance to work and to use the funds held in trust as a foundation for greater wealth. At his death Smith left behind a son, Fred Smith, two daughters, one wife, and several ex-wives.

SMITH HIMSELF

Fred Smith was born with a hip disorder. Due to the early death of his father, Smith's mother raised the boy. She took great care to ensure that her son grew up just like an ordinary boy rather than the inheritor of a fortune. She tried to keep the memory of his father alive. She told the young Smith stories of his late father. Socially she introduced Smith to famous men of Memphis society who probably served as role models.

In school the young Smith was an outstanding student with outstanding organizational skills. After grammar school he went to the very prestigious Memphis University school, a fine private school which prepared children of the better off for top universities. Fred Smith's disability cured as he grew up. Fred became involved in sports. At the end of his school time he was voted "best-all-around student" in his senior year.

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He learned to fly at fifteen. In his free time a lot of his attention was dedicated to reading. He particularly liked to read about military history. His mother took him to sites of great Civil War battles. At the age of 15 he also organized his first business. Together with two classmates he started the Ardent Record Company. The three equipped a garage with sound recording equipment and broke even on their first record. Smith left the business after one year. One of his friends stayed on and later introduced Smith to his second wife.

In 1962 Fred entered Yale and majored in economics and political science. Yale was a different playing field for Smith. In Memphis he was a top student; at Yale he had to compete with the best and brightest of his generation. Smith had a hard time standing out among them, and at the beginning, he did not stand out. He later confessed, that he was a poor student. However, even at a time when things did not look very promising the young Smith had goals and plans. He wanted to be a member of the famous 'Skulls and Bones' club. Each year a few students of the senior class were given the honor to join the club, which supposedly was in possession of the skull of Geronimo. The story goes that George Bush's father stole the skull for the club. George Bush himself was a member of the club.

One explanation for Fred's change from an average student at the beginning to an outstanding performer at the end may be the sad death of one of his friends in Memphis during Fred's first summer break. Fred and his friends rode out to a lake for the weekend. Smith lost control of his car, the car flipped over and his friend in the passenger seat was killed. The circumstances of the death were never verified. Even if Smith was not be guilty in a legal sense, the incident changed him according to the accounts of his college buddies. It made an old man out of Smith.

As a college student in the 60s, Fred was not only influenced by this tragedy but also by the world around him. The protest movement had not yet reached campus but the space race was in full

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progress. America challenged the Russians; Kennedy challenged society with the Peace Corps and the space race. It was the time of the new frontier and of a new breed of pioneers.

During his time at Yale, Fred had a lasting impact; he revived the dormant Yale flying club. In his senior year he was chosen a member in Skulls and Bones. He graduated from Yale in May 1966.

After graduation another frontier waited for Smith. As an undergraduate he had enrolled in the USMC platoon leader program. Therefore, military service was waiting for Fred. He was commissioned second lieutenant. At the age of 23 he was about to face the toughest challenge of his life, the war in Vietnam. Smith first became platoon leader; he was later promoted company commander. His first tour lasted seven months and he usually was right where the action was. He was in the middle of one of the toughest wars and he had to fight for his life and the lives of those who trusted him, his soldiers. At that time Smith got to know the less fortunate of society. He came close to the ordinary folks, the people who were much like many of his future workers.

After the end of his first tour Smith decided to return to Vietnam for a second tour. This time a more pleasant staff position awaited him. He was also able to use his flying skills; he flew A4D Skyhawks and OV-10 Broncos on reconnaissance missions. After his second tour Smith left the Marine Corps. He was discharged in July 1969 at the rank of captain. During his time in Vietnam he was awarded several medals, among them one silver star, one bronze star, two purple hearts, the navy commendation medal, and the Vietnamese cross of gallantry. His military experience helped him later to understand his employees. A friend said about Smith's time in Vietnam, "it gave him toughness." A reporter later asked him if he went through all the pain with Federal Express to fight his memories of the war; Smith answered with "yes". It is very likely the war experience made some hardships of starting Fed Ex easier for Smith because he had faced more serious challenges. The experience probably had an impact on the way he later treated his employees. The

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military develops a strong sense of camaraderie within people. This sense seems to be present at Fed Ex. Fred's motivational skills were later described by Art Brass, one of Fed Ex's leading managers, as follows: "If Fred lined up all Fed Ex employees and told them to jump from a bridge, 99.9% would jump."

On his return from Vietnam Smith married his high school sweetheart in Hawaii. After his time in Vietnam, Fred was not really sure what he wanted to do next. In a sense the decision was made for him by his step-father. His step-father had invested in an aviation business in Little Rock, Arkansas. Fred had given him \$50,000 for a down-payment to buy a 49% share in the aviation business. The business's name was Arkansas Aviation Sales. The company sold and repaired aircraft. The business was a money losing operation. Fred's interest in the company was not limited to the \$50,000 down-payment. When Fred Smith turned 21 he wanted to reimburse his mother for what his father had done to her. The sudden divorce left her with almost no money. To make things easier for her, Fred had turned over dividends in excess of one million dollars to her. With the financial misfortune of his step-father the easy life for his mother was at stake again. Sooner or later his mother would support his step-father and throw good money after bad money. Fred Smith decided to protect his and his mother's interest and take care of his step-father's aviation business. As a decorated war hero he was well received in Little Rock. Eventually Smith managed to turn around the Little Rock aviation business. It even grew to be a money maker through the sale of airplanes. Fred started some other very successful businesses. One of them was a retail business for used airplane parts. But Fred did not like that business; there were too many shady characters in the market for airplanes.

Smith's inheritance at that time was still in the Frederick Smith Enterprise Company family trust. Fred owned 38.5% of the shares. His two sisters owned the remainder. The trust was passively managed. The trustees had invested conservatively and not really put the money to work. In 1971 Fred Smith became board president of

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the trust. His two sisters were eager to change investment policies of the trust. They were aware that there were better investment opportunities.

THE YALE TERM PAPER

As an undergraduate Fred had written a paper on an overnight mail service. He received a C for his paper. The professor turned it back with the remark that the idea would never work. With his aviation business in Little Rock, money in his bank account and not really anything else to do, the idea of proving the professor wrong became more and more tempting. Smith himself was a victim of unreliable air-freight service. To repair airplanes his company occasionally needed spare parts. Even for small parts the company had to wait a long time until they were shipped to Little Rock. Air transportation was unreliable and unfriendly. Most of the time the freight forwarders could not tell Smith where his shipment was. Between the pick up point and the point of delivery, air-mail was lost in a huge black hole. Fred had pointed out the substantial weaknesses of the air-freight transport industry in his Yale paper including the fact that air transportation was only thought of as an add-on to passenger service.

The air carrier market was heavily regulated. In 1960 airlines had entered the air freight market. They wanted to utilize the unused space in the bellies of aircraft to transport goods. However the oil crisis in the early 70s changed the airline business. Boeing built larger planes. These large planes did not fly on small margins. They could make money just by carrying passengers. During the oil crisis the government also tightened the supply of fuel and airlines had to cut back on night flights and on routes. "Passengers were day animals and mail was a night animal", so the two markets suddenly did not fit anymore. All airlines eventually abandoned the air freight market and most never achieved any profit in it.

Prior to Smith's entry there were only a few attempts to run an air mail service in the USA. In 1925 the Ford Motor Corporation flew mail between its plants and considered for some time starting an

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airmail service, but decided against it. The US Postal Service, Pan Am, and Railway Express Agency had also unsuccessfully tried to run an airmail service. Basically, Smith's idea of an overnight air mail service had never before been tried on a large scale and everybody who got close to it got burned and lost a lot of money. But someone who just survived Vietnam and who had a family history in transportation is not just 'everybody'. There was a real need for the service Fred Smith intended to offer and therefore he decided to give it a try.

FEDERAL EXPRESS

Fed Ex became incorporated on June 18, 1971 in Delaware. The name of the company was Federal Express Corporation. The big challenge Fed Ex had to face was it had to happen all at once. A slow buildup of a delivery network city by city was not possible. To attract customers a large network had to be in place from day one. With the task of building a national network of mail delivery Fed Ex faced two problems. First, organization: how could a system delivering mail all over the United States work from the very beginning? Fed Ex solved this problem by hiring managers from UPS and basically copying the UPS organizational system. The backbone of the Fed Ex system became the hub and spoke concept. Besides the organizational problem, there was the problem of financing. Demand for the new service was there, but it had never been tried before and the idea required huge starting investments. Smith had to make investment bankers understand the problems and requirements of the new high tech industry. He had to persuade them that computer parts are sometimes small, but very valuable and a must have. He had to explain his idea to serve the market niche for "time-sensitive" parts. He had to make them believe that his idea offered a solution for a real business problem, and that businesses were willing to pay for that solution.

There was also the question of trust. The air freight industry did not have a good reputation at the time. Fred Smith had to make people trust him and his company. If you entrust someone with valuable computer parts or important medicine, you want to be sure

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your package will not be lost. So Fred Smith and Fed Ex faced the challenge of starting a nationwide air-mail system which would meet high customer expectations.

The first big customer Fred targeted was the Federal Reserve System. He offered to transport checks and money letters for them. Until then it took a long time to clear checks because they were in the mail for a long time. Fred Smith offered to solve this problem with overnight air delivery. However, due to regional rivalries, the Board of Governors did not approve the plan. Federal Express had derived part of its name from the idea of flying for the Federal Reserve System and even before the company fully operated, its biggest customer was gone. But Fred did not allow himself to be discouraged. He pushed on and created the purple truck line.

THE TRUCK LINE WITH WINGS

Fred Smith once described Fed Ex as “a freight service with 550-mile per hour delivery trucks”. Fred Smith had the first feasibility study for this kind of service done in Dec 1972. He asked two separate companies to do a market research study for an overnight air mail service. Neither company knew of the other. The two companies were AT Kearney, a consulting company for the air market, and Aerospace Advance Planning Group (AAPG), a small company in the consulting market. Both companies received \$75,000 for their study. The studies predicted a great chance for a service as Smith intended it. They were later used to sell the Fed Ex idea to investment bankers. The people in charge of the study at AT Kearney and at AAPG consulting group both ended up working for Fred Smith.

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Y'ALL COME DOWN TO MEMPHIS

The truck line with 550-mile delivery trucks needed trucks. Smith looked at several airplanes and decided to use a French model, the Falcon 20, produced by Dassault aircraft. Pan Am's business jet division had the market rights for the USA. The plane had been sold as a small corporate jet, but the market for corporate jets was down. During the recession and the oil crises almost no company could afford a jet. Pan Am's business jet division had several Falcons and was eager to sell them. When Smith approached Pan Am they made an incredible offer to sell 23 Falcons to him, but there were several problems with the Falcon. First, the plane had to be remodeled to transport air-freight. Second, the plane was too heavy. Fred Smith wanted to operate Fed Ex under the provision for air taxi service; this way he would not have to worry about getting certification in the heavily regulated airline industry. However, the provisions for air taxis had a weight limit and the Falcon exceeded the limit. The Civil Aeronautics Board had to change regulations regarding the weight limit. Smith went to Washington and pushed for a change. He eventually succeeded in July 1972, but it was a tough fight and he came under heavy attack from providers for corporate air services.

The deal with Pan Am provided for delivery of the planes until 1974, one each month. The deal had to be renegotiated several times because Fed Ex had trouble providing financing. In addition to the option for 23 Falcons from Pan Am, Fed Ex had bought two Falcons prior to the Pan Am deal and after the deal the company bought an additional 8 planes. Before the company had even started to operate it had bought or signed contracts to buy 33 planes at a total cost of \$56.1 million. Smith clearly emphasized growth. Think big and make it big!

In May 1972 Smith also started hiring people for his new company. He looked for entrepreneurial type people. "He appealed to the entrepreneurial spirit of most of those he hired". Sometimes he promised stock options, but nothing was put in writing. Smith gave

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people a dream; he even told them they would be part of a Fortune 500 company. Again he used the growth target, and he must have been very persuasive. Some of his employees loved to fly, others were longing for the excitement. Frock, the man who had done the feasibility study at AT Kearney, was such a person. Smith lured him down to Little Rock with stock options and the prospect of excitement. Frock brought organizational knowledge to the company; he was a good technical planner. He joined Fed Ex because he was in his late 30's and wanted to get out of the consulting routine. Overall Smith did an incredibly good job in hiring people. He picked people who were very experienced in their field, ready for an adventure, ready to take a pay cut, ready to work hard, and ready to make some sacrifices. Most experts he hired had no corporate experience. They were not spoiled! Smith has to be given credit in mixing these experts with rough groundwork truck people and making them a team. His marine experience probably helped him a great deal.

Fed Ex was an exciting place that was everything but plain business. The team used to have knock-down drag-out meetings. One source described the atmosphere down at headquarters as "macho". Communication was rather informal. Maybe people are more productive when they don't have to watch every word. They are certainly more creative. Sometimes even the company's boss appreciated the informal style; Smith is described as "real tense" occasionally. "Once in a while he'd throw something against the wall, so we would try to get him drunk at some bar, hoping it would relax him and, perhaps, keep him away from the office the next day. But he'd come bouncing back early the next morning ready to take on the world again, and get back in the thick of everything going on."

Nineteen seventy-two was not only the year of the start of operations, it was also the year Fed Ex signed its first big customer. Fed Ex bid for a US Postal Service contract. The company undercut all competitors' bids because Fred wanted the routes. The contract generated cash flow and helped to persuade investors.

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Fed Ex also tried to win other customers. Ford decided to ship one order with Fed Ex. Fed Ex flew the materials, but since the changes in air regulation provisions regarding weight limits were not lifted until July 1972, Fed Ex was legally not allowed to charge Ford. Therefore, Fed Ex flew for free.

Fed Ex had a hard time winning large customers which, in 1972, were the prime focus group for Fed Ex. Smith used his former aircraft salespeople as sales staff. The air freight business was new to them. They had to learn not to accrue high bills.

To train its pilots Fed Ex opened its own pilot school. The company even tried to do training for other companies. Later, when the company could no longer offer jobs to flight school graduates, this part of Fed Ex operations was closed.

THE FINANCIAL PICTURE AT THE END OF 1972

In 1972, the three profit centers, air mail, charter cargo, and pilot training, yielded revenue of \$2.8 million, while expenses run at \$3.7 million. The operating loss was \$0.93 million, and debts totaled \$21.7 million. In addition, the company had severe organizational problems. The accounting department was a mess and the company was fighting deadlines and always on the edge of bankruptcy. Financing was still not secured.

In 1973 Fed Ex made its first acquisition. Smith bought Little Rock Airmotive (LRA) of Little Rock. Smith paid \$2.5 M for the company with a net worth of just \$1.3 million. Nevertheless, the acquisition was a good one. LRA was the main contractor for remodeling the Falcons and, with control over the company, he could make sure the work was carried out in time. Fed Ex also owed LRA a lot of money from remodeling the first jets. With possession of LRA, Fed Ex did not have to pay these bills. Another big change in early 1973 was when the company moved operations to Memphis. The International Airport in Memphis was larger, the weather was better,

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and the airport was hardly ever closed down. It may not have hurt that Fred knew people with the airport authority and got a very good deal on a hangar. The company was able to rent a hangar at a very low price. In March 1973, a sorting system for 10,000 packages per hour was completed in the new hangar. March also brought the first night of full operation. The day looked very promising. Sales people had called in reporting things were looking good. At night employees and friends had come down to Memphis and waited at the airport for the planes to arrive and unload. When the planes opened their loading doors, the package count was a sobering six. At that point management realized they still had a lot of work to do. Marketing still had to be improved. The network of 11 cities Fed Ex served was still not large enough.

On April 17, 1973 Fed Ex started again with a larger network of 25 cities. The plan was to add four cities every week. The night of the second attempt Fed Ex was much more successful. That night the company transported 186 packages. The first run in March was declared to be a test run and April became the official birthday of Fed Ex. May was an even better month for Fed Ex. The average nightly package count was close to 500; in July it was above 1,000 and in October it was at 2,517.

THE JACKALS OF WALL STREET

Financing was a huge problem for Fed Ex in the early years. In the beginning, sources of capital were Fred's father's trust fund, and loans from banks in Memphis and Little Rock. The company had a hard time finding equity. Investors liked the idea of an overnight air mail service, but they were not willing to put money in it.

Smith bought planes and relied on investment bankers from White, Weld & Company who promised to help him raise capital, but they failed to live up to their promise. Fed Ex was in desperate need for money because Pan Am could not deliver the Falcons unless financing was guaranteed. Pan Am threatened to sell them to other customers if Fed Ex would not exercise its option. Smith was in very

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deep trouble. His investment bankers had promised him they would raise \$20 million in bonds and equity if he would throw in additional money. So, with money being so tight in February 1973, Smith forged papers to get loans from the banks in Memphis and Little Rock. The papers stated that his family trust secured the loans.

One weekend, after giving a presentation to investors, Smith decided not to fly home, but to go to Vegas instead. He won \$27,000 on that trip. This small amount was not crucial but in Smith's eyes it was a sign, an act of faith. Eventually someone came up with short-term capital to save Fed Ex. An entrepreneur by the name of Colonel Crown, who had made his money in construction, saved Fed Ex in early 1973. His company, General Dynamics, secured a \$23.7 million loan on May 4. The option with Pan Am was to expire on May 15! In exchange General Dynamics had the option of buying 80.1% of Fed Ex stock at the total price of \$16 million. The amazing thing about the deal is Smith's persistence. Crown's financial officer was hospitalized, and Crown told Smith he would like to make the investment but he would not do so without approval of his financial adviser. Smith pushed so hard he went to the hospital and settled the deal there. Regulations prohibited General Dynamics as a maker of aircraft from possessing air carriers. Fred was almost certain the option would not be exercised. In 1973 General Dynamics did not take over Fed Ex, but they helped out with loan guarantees. After the first loan, they did an extensive study on Fed Ex (about 3,000 man hours) to make sure their money would not be lost. The study later helped Fed Ex persuade other investors that Fed Ex's prospects were promising. Crown and General Dynamics did not help Fed Ex for financial reasons; they liked Smith and wanted to give him a chance. They were convinced by Fred Smith's enthusiasm for his business model.

In October 1973 the company was in trouble again. General Dynamics had only agreed to secure the \$23.7 million loan until October. When time expired, Fed Ex managed to obtain two \$10 million loans each from two banks. The banks only agreed to throw in some additional money if Smith came up with another \$4 million

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himself. Like many times before, his father's trust secured the loan, but this time tensions were high. The board of trustees was about to uncover Fred's swindle with the forged papers.

The year 1973 was the toughest ever for Fred Smith. Investors did not trust Fred's youth and replaced him as CEO. He was ousted and a former air force general became CEO; Fred stayed as president. In early 1974 Fed Ex needed a third round of financing. This time the company needed an additional \$9 million. Art Brass flew to France to persuade the Rothschilds to come up with the needed funds. The family had already invested a substantial amount of money through their American investment company New Court. Eventually, the Rothschilds agreed to kick in the necessary funds, but it was a tough sell.

In 1974 however, Fred Smith finally got caught in the financial turmoil. The trust finally found out Fred had used forged documents to pledge the same shares held by the trust to secure two different loans. Fred's sisters sued him for his deeds and Fred had to stand trial. He thought about leaving the company altogether, because the pressure was just too much. Investors had asked Fred Smith to resign, while the charges were pending. Fred informed his senior managers he would resign, but they refused to stay if he resigned. Investors were faced with the choice of firing Fred and seeing all senior managers walk away from the company or to keeping Fred. At the end of a very turbulent board meeting it was announced that Fred would stay as chairman, the air force general would leave, and Art Brass would become president. Fred not only won his company back, but eventually was also acquitted.

From then on the road to success, even financial success for Fed Ex, was much smoother. In 1976 the company realized \$3.5 million net income. In 1977 this figure improved to \$8.1 million, and in 1983, the company made its first billion in revenues with a net profit of \$88.933 million. In November 1988, Fed Ex even managed to take over one of its biggest competitors, Tiger International. Fed Ex paid \$880 million for Tiger. It acquired worldwide landing rights. Fed

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Ex became a global player with this acquisition. Many analysts viewed the move very skeptically. The international venture turned out to be a money losing business for Fed Ex, But the landing rights and the international oversees network should pay off with wider use of the web. Fed Ex had to cut back on ground operations abroad, but the landing rights are still with the company.

FED EX AND ITS EMPLOYEES

Federal Express employs roughly 145,000 people. The turnover rate is a minuscule 3 percent. It is said that Fed Ex employees have purple blood and are very dedicated to their company. This dedication may come from several programs and features within Fed Ex which are unique. Fred Smith once said in an interview: "I don't think a damn thing Federal Express does in terms of its people is particularly revolutionary and unknown," - while pointing at a bookshelf in his office - "we just do what's in all those books." But in the same interview he emphasized the high priority which personnel issues are given within Fed Ex, saying, "I firmly believe employee dedication mirrors the extent to which an organization demonstrates its commitment to its people." Fred Smith spends 25% of his time on personnel issues. This shows. Fed Ex has many programs which other companies don't have. A lot of attention is paid to details. The company, for example, has 25 national recruiting centers. Fed Ex also has a peer recruiter program. Above all, the company has a declared no-layoff policy. Together with superb pay this sounds too good to be true.

Logical thinking is behind this policy, not generosity. Fred Smith believes in the People-Service- Profit (P-S-P) philosophy. According to Fred Smith, "The P-S-P philosophy is like an unbroken circle or chain. There are no clearly definable points of entry or exit. The People link is supported by Profit, which is supported by Service, which is supported by People. Each link upholds the others and is, in turn, supported by them." The PSP philosophy is implemented by

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answering several basic questions. New employees typically ask the following questions during extensive orientation programs.

The first question new employees ask is: "What is expected of me, and what do you want me to do?" One of the challenges for Fed Ex is to gain trust with its customers. Service is therefore important. The way a delivery man behaves could be described as a little business card handed out when a Fed Ex employee makes contact with a customer. Employees have to understand they are not just delivery people, but they are part of a problem solution which Fed Ex offers – a solution for a transport problem.

The second question is: "What is in it for me?" It is just natural to ask this question. There has to be some incentive to live up to the challenge of the first question. It is like rewarding children with candy. There are a lot of rewards at Fed Ex. First, the company puts high emphasis on in-house promotions; there is an extensive in-house posting system for job openings. To qualify for promotions employees have many training opportunities. Among them are interactive video instructions. Even better is the leadership evaluation and awareness program, which qualifies non-management employees for management positions. Even with a low level job, at Fed Ex employees have the prospect of getting out and up, and making it to the top! Managers can improve their skills in management through applied personnel skill programs. The company also has a tuition refund program.

Besides the training opportunities there are many award programs. For efforts beyond one's job description, employees are given a "Bravo Zulu". A "Bravo Zulu" is a formal recognition program and can include both management appreciation and gift certificates or theater tickets. Another award program is the suggestion award program. This program encourages employees to submit ideas. Employees can earn between \$100 and \$25,000 for ideas. Golden Falcon Awards are for full-time employees, who have demonstrated customer service which goes beyond and above the call of duty. The highest award is the Five Star Award. It awards performance which helps the company to enhance service, profitability, and teamwork.

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The third question in the PSP circle is: "Where do I go to resolve a problem?" Fed Ex has a very sophisticated and rigid complaint management system. Strict time limits assure complaints are processed within a short period of time. As part of the open door policy every employee can express concerns to the management. There is no time limit for the employee with this program. The company CEO, Fred Smith, gets a list of filed complaints which management must respond to within 14 days. Another program is the Guaranteed Fair Treatment policy. In an appeals process of grievances an employee can take the case all the way to the supreme court level of Federal Express. The Fed Ex supreme court is staffed by senior executives, and often the chairman, Fred Smith himself.

The first step in the Guaranteed Fair Treatment policy is a management review of the complaint. A complaint must be filed within 7 days of the incident leading to the complaint. Management must reach a decision within 10 days. During the decision process, management must hear the complainant either personally or in a telephone interview.

If the complainant is not satisfied with the result of the management review the decision can be appealed within the next seven day period. The second step is an officer review done by either a vice president or a senior vice president of the division. The complaint must be investigated with a decision being reached as soon as possible or within another 10 days. Again an appeal is possible.

The third step is an executive review. The executive review is the Fed Ex supreme court which can overrule any decision made at lower levels.

Federal Express also has a survey-feedback-action program to evaluate employee attitudes. If a manager's feedback scores are low, he or she is expected to develop and implement corrective action.

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Fed Ex believes employees need a sense of purpose and reward for a job well done. They must have the power to influence what is done and how it is done. Most recently, and despite all the awards and complaints programs, the company had increased trouble with unions. Unions had failed several times before to organize Fed Ex's pilots. After the merger with Tiger, Federal Express hired many unionized pilots. So far, the Fed Ex pilots have always stood by Fred Smith, but trouble in the 1990s became more serious.

UNSUCCESSFUL VENTURES

The story of Federal Express and of Fred Smith is not one of unqualified success. There were also some failures. Two of the biggest flawed strategic decisions were the Zip-Mail venture and the expansion to Europe.

Zip mail was the idea to cut out part of the delivery process and fax documents. This way same day delivery would have been possible. However, the market for fax machines changed. Fax machines became so incredibly cheap every office could afford one. There was no real market for the Zip mail product. Fed Ex lost \$300 million in the venture. Fred Smith held on far too long to his idea, and much more money was lost than really necessary.

Another ill-fated decision was to enter the European market. Fed Ex established a main hub in Frankfurt, Germany. Ground delivery operations in several countries were started, however, there was no real market for Fed Ex's service in Europe. Mail within major states, like France, England, and Germany, usually arrives the next day anyway. Mail to other countries is still not as common as in the United States. Fed Ex also had to face legal problems. Frankfurt has Europe's largest passenger airport. To improve safety and public relations, the airport has a night flight ban. Fed Ex thought the ban would be lifted but airport authorities refused to do so. The main hub had to be moved to Brussels, Belgium. Eventually, Fed Ex abandoned Europe. Ground operations were sold, but Fed Ex kept the landing rights and still serves many European cities with transatlantic mail

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delivery. Fed Ex's journey to Europe, however, had an impact on German politics. The company decided to move its hub from Germany to Belgium at a time when a new law to attract foreign investment in Germany was discussed in parliament. The fact that another international company left Germany helped push the law through.

Both unsuccessful ventures showed high persistence by Smith who kept on trying against all odds. In these two instances this turned out to be a bad character trait. In others it was a plus. For example, his admiration for technology, and his persistence, helped build Fed Ex. Such was the case when he read about the bar code system used in stores and wondered if this could help to identify packages - and it sure did. Today Fed Ex uses bar codes to track packages.

FEDERAL EXPRESS POLITICAL INVOLVEMENT

Fed Ex had to rely on politicians during its growth. The company was occasionally in conflict with the law over deregulation of the air industry. However the overall political climate for deregulation was improving, so Fred Smith basically rode a wave. Back in Memphis he used his influence to support politicians. Later, he turned out to be a strong supporter of minorities. He got involved to protect his employees against racist remarks by police officers. On its 25th birthday, Fed Ex issued a statement committing to make Memphis a better place to live and raise a family. In the statement made by the Vice President of Fed Ex, crime was identified as a major problem.

Fred Smith also tried to help his hometown get a NFL extension team. He withdrew from the effort when the public viewed his role with suspicion.

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BUSINESS ETHICS

Fred Smith and business ethics is an interesting issue. On the one hand there are the many admirable traits discussed earlier. On the other side is the fact that he was tried for a criminal offense. He forged signatures and used false documents to obtain a loan. If John Doe would do that to finance his new house or car, he would go to prison. So, does the purpose justify the crime? Fred Smith did not falsify anybody's signature, he forged documents of the company he represented, and almost owned. He did wrong, but probably could see no other choice. Any other decision would have left Fed Ex bankrupt, and most of the trust money would have been lost anyway. The risk exposure was too great already. He had to go forward and make the best of whatever was left. This move may have protected the rest of a large investment.

Very questionable also is his behavior in the killing of a man in a car accident. Authorities in Memphis never investigated the incident, which appeared as a cover-up of a nasty story. Fred Smith may have no guilt in the accident, but he still should have to face an investigation. The issue of the car collision is truly a weak spot in Smith's history. Other than that, he comes across from readings as an honest fellow who works hard, takes chances, and cares about his employees.

CONCLUSION

Art Brass, Fed Ex president between 1975 and 1980 said about Fed Ex's early years: "A miracle! The company should have died 3 to 5 times in the early years. Fred refused to let it go." He did not give up. He put his personal wealth on line, sacrificed part of his life, especially his private life, and he built a great company which serves its customers well. Employees benefit from a company who cares for them. Stockholders benefit from growth and economic success of the company. A job really well done!

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In 1997 Fred Smith received the Peter F. Drucker Award from the Strategic Leadership Forum for his outstanding performance, "because he had a vision of how to combine existing technologies and develop new processes to realize new possibilities."

What made Fred Smith a successful leader? Consider the following three characteristics.

Successful leaders break down barriers.

- Fred Smith certainly broke down barriers. He broke down legal barriers and overcame resistance to invest in his company. Breaking down barriers is certainly an ability Fred Smith possesses.
- They create and manage a compelling vision. Warren Bennis says that great leaders and followers create a compelling vision and then manage the dream by communicating, recruiting, rewarding, retraining and reorganizing.
- Many of his early management staff joined Fed Ex because they wanted to be part of a challenge. Smith wanted entrepreneurial type of workers and he gave them the goal to make Fed Ex a Fortune 500 company. Fred Smith worked a lot with persuasion.

Successful leaders champion the vision.

- Fred Smith was certain he would create a Fortune 500 company. To him, failure was not an option
- They feel they are a legitimate part of what is going on. Stanford professor Steven Brandt says, "The magic, the zest that produces ideas and then converts them into quality products and services, comes from being a legitimate part of what is going on."

Successful leaders try to bust the bureaucracy.

- The certainty with which Fred Smith campaigned to get changes in the air traffic regulation is amazing.

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The story of Fred Smith is an American post war success story. He was born wealthy, but that did not stop him from serving his country when asked to do so. He had to bear a lot of risk during his life; he created great wealth, but others made the big money. Today, Fred Smith is worth close to \$1 billion. Those who 'generously' helped him finance his business probably made more. There are some dark spots on Fred Smith's record which makes him even more human. He never gave up and he never gave in! Readers can learn from the Fed Ex and Fred Smith story about persistence and toughness.

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