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The Result: An $8 Billion Business Success

Those who contribute to the company should own it, and ownership should be commensurate with a person's contribution and performance as much as feasible.[1]

—J. Robert Beyster

Perhaps you've already been introduced to Science Applications International Corporation, or SAIC. Maybe you're one of the tens of thousands of people who have worked for the company since I founded it in 1969, or perhaps you're working on one of the company's 9,000+ current contracts. Or you might be one of SAIC's current or former customers in the public or private sector, a list that includes a veritable Who's Who of federal government leaders and agencies (like the Department of Defense, the Federal Aviation Administration, the Department of Energy, NASA, the Department of Homeland Security, and many more); a variety of state and local governments; commercial firms such as Southern California Edison, Entergy, Pfizer, and other Fortune 100 companies; and international customers such as British Petroleum, the Saudi Royal Naval Forces, and Scottish Power.

Or you might even be one of SAIC's new shareholders. This company—employee owned since the very beginning—recently completed an initial public offering in October 2006, raising $1.13 billion.

But even if you're not familiar with SAIC and its remarkable story, you've surely felt its impact on your own life. If you've ever wondered how elusive terrorists are tracked down and captured by sifting through mountains of electronic data gathered by the nation's intelligence services, you may have encountered just one example of SAIC's vast array of leading-edge database technologies. If someone you know has faced the challenge of beating cancer or AIDS, SAIC has been active in the search for cures in its role as Operations and Technical Support Contractor for the National Cancer Institute's Frederick Cancer Research and Development Center. Or, if you surfed to a web site, the pathways your computer followed from your desktop to its ultimate destination were paved by one of SAIC's former subsidiaries, Network Solutions, Inc.

Some say that SAIC is the best company that most people have never heard of. On one hand, much of SAIC's mainline work has been on federal contracts—many of which involved classified programs that are intentionally kept out of the public eye. But on the other hand, SAIC is an incredibly eclectic company—a decentralized organization that explicitly encourages and rewards entrepreneurial upstarts and initiatives in new project areas and with new customers—and it has touched the everyday lives of many people in the United States and beyond, often in unexpected ways.

SAIC's environment is one where creativity, innovation, and entrepreneurship are more than management buzzwords—they are the company's core principles. Over the past 38 years, SAIC has managed and performed on tens of thousands of contracts and it has a hard-earned reputation for succeeding on the "tough" jobs—the very complex technical and important problems few companies are willing or able to tackle. Instead of focusing on only a handful of large customers working on a small number of large contracts, SAIC historically has taken a different tack, also engaging in thousands of relatively small-dollar jobs—representing an incredibly diverse array of different projects and customers across many market sectors.

This symbiotic mix of government and commercial business might be viewed by some observers as a vice, because of the challenge of focusing on so many different kinds of businesses with so many different customers. However, SAIC's diversity of customers and contracts was a virtue and not a vice, and it was a way of life for our employees. More importantly, it was

a key defensive mechanism for protecting the company from market and environmental changes beyond our control.

So, how did SAIC become the 800-pound stealth giant of American science, engineering, and technology businesses? It all began with a simple set of organizing principles (formalized a decade after being founded) that served the company well as it grew from a handful of employees in the Southern California seaside village of La Jolla, to more than 43,000 people in more than 150 locations around the world.

A SIMPLE IDEA, WELL EXECUTED

At one time, years ago, I might have been voted by my coworkers as someone "least likely to start up his own business." A nuclear physicist by trade, I was first and foremost a scientist, not an entrepreneur. I decided, however, to leave behind my comfortable career as chairman of the Accelerator Physics Department at San Diego-based General Atomic (GA) to start my own company. Before there was an SAIC, there was just SAI, which stood for Science Applications Incorporated. Only later—when we incorporated in Delaware—did the name become SAIC. We found it necessary to change the name because of the proliferation of the SAI label. Today there are many companies and other organizations that use the SAI initials, including Social Accountability International, Software Architects, Inc., and others.

SAIC was an unexpected happening. There was no grandiose plan for its future. It was just supposed to be a good place where I could work and maybe a few people could join me, so I could continue to live in San Diego and keep my wife happy.

From the beginning, SAIC was an employee-owned firm. In previous jobs with a national laboratory and then at a large corporation, I saw many people leave, taking ideas generated there to start their own companies. These entrepreneurs were quite interested in starting a company for financial rewards based on a new idea or product they had developed. They planned to start a company, grow it, and then sell it or take it public, and go on to the next business venture. That was hardly the optimal environment for research people, and it was not my intention in founding SAIC.

Our goal was to grow a company that would be stable—where the staff stayed with the company, even in hard times. In this company, creative research would be considered important, regardless of the size of the contract. Rewards would be fair. Everyone would share in the ownership of the

company based on their contributions to our success. That only seemed right, especially if we expected people to work long and hard to help build the company. Also, everyone would contribute to decisions affecting the company—profit would not be the main driver. We wanted to make enough money to run the business, attract outstanding people, and grow. In many respects, we were not traditional entrepreneurs.

We started SAI on February 3, 1969, with a couple of technical consulting contracts, one from Brookhaven National Laboratory, and the other from Los Alamos National Laboratory. I then had to make the fateful decision on whether or not to incorporate. It turns out that there are important legal protections if an organization incorporates. And after that, one thing led to another. A talented lawyer named Tom Ackerman at Gray, Cary, Ames and Frye helped me though the incorporation process. We had to figure out who would own the corporation. That was a decision I really didn't want to get into, because I didn't know anything about distributing founder stock. The only stock I'd ever owned came from some General Dynamics stock options awarded to me by Freddy de Hoffman (the founder of General Atomic and a world-renowned scientist), which became an important asset in financing the very early SAI. But I had to develop a totally new kind of stock system for this start-up enterprise. Many others who joined us knew far more about corporate stock systems than I did.

It took about $50,000 of my personal assets to start the company—a $30,000 loan to the company that was paid back to me, and a $20,000 stock investment. There were plenty of scientists and engineers available in San Diego at that time from Convair and other organizations—some from General Atomic as well—who were looking for a change. Some of those people joined us. The early SAI always paid employees a salary—which was unusual for a start-up—although mine was deferred for a year. Eventually we had cash flow problems, which is to be expected in a new company, and we needed to find additional sources of funds to maintain our operations.

Through Myron Eichen, one of San Diego's most successful entrepreneurs also with General Atomic origins, we got involved with Joe Young in the La Jolla branch of the Bank of America. Even though Joe was a great guy, he was no fool. When he lent money to the company, he wanted me to use my house as loan collateral just in case we didn't know what we were doing. And there wasn't any evidence that we did. So between the Bank of America, some cosigning on the part of the early employees who were joining us, and my own investment, we kept solvent and growing.

After a year, a surprising thing happened—we made a profit. I suspected something was the matter. We had a rather small board, and one of the board members—Harold Smith, who was and still is on the UC Berkeley faculty—said, "You know, Bob, you'd better get some help because you don't know what you're doing." All our accounting people were well trained. It's just that we couldn't believe that we had made $20,000 of profit so soon. We—being researchers—were often not exposed to profit making at our former employers.

So we brought in a highly recommended entrepreneur from the Bay Area named Art Biehl. It turned out he was not a big believer in widespread employee ownership. However, he gave us a lot of good advice. He thought like a traditional high-tech entrepreneur—he had dealt with venture capital people. He had done financing. He believed in a small number of people owning the company. He believed that people who came in after a while should get only a small piece of the company. He felt we should use venture capital financing to begin, and then take the company public. I agreed with none of this, but I listened to Art anyway because he was smart, was a real friend, and was trying hard to help us.

Art said that we should first seek a private placement to satisfy our immediate cash needs, and then do an initial public offering (IPO)—that was his recipe for success, and he'd done it successfully several times. I'm surprised the early SAI didn't go down the public track because Art was certainly exposing us to the wonders of IPOs. In addition, he made many valuable suggestions on the company's direction and specific research programs. But pushing the traditional venture approach was near the top of his list.

Something must have happened to stop me from buying into this traditional approach. I had observed that it can destroy a company, and harm all but a limited number of insiders—most often the top executives—who do very well financially. This fact usually doesn't concern most of these early employees. They may, however, feel some remorse about the fact that their original company is disappearing—being replaced by a new public company.

Joe Young was a little uneasy about us bringing in financing from another source in the early days, but Art Biehl felt strongly that we should do it, so we sold $200,000 of SAIC stock to a medical group that Davis Skaggs, a San Francisco investment banking organization, had assembled. It was one of those things you do in a start-up company. The medical group netted a 10-fold profit on their investment. I do not recommend the venture capital approach if you can avoid it because an inordinate amount of the ownership

ends up with disinterested financial investors. From that point on, and with a very generous new line of credit from Joe Young and the Bank of America, we would never need to use venture capital funding again.

Clearly, SAIC's employees resonated with this unconventional, yet simple idea. In a business world where it is rare for employees—particularly employees outside of a small group of top executives and board members—to own stock in their own companies, SAIC broke the mold with an astonishing percentage of employees who owned company equity. More than 80 percent of SAIC's employees own company stock, and over 90 percent has been the historical pattern for decades.

But this figure is just the tip of the iceberg for a company that most of the time has typically flown below the radar of most business observers. By several measures, SAIC's business performance speaks for itself.

SUSTAINED BUSINESS EXPANSION AND DIVERSIFICATION

Doing business with the government is a constant challenge for contractors. The end of the Cold War altered the contracts business landscape permanently. Many defense and federal government programs were scaled back, and frequently terminated, so contractors increasingly turned to the private sector and nondefense government agencies for new income streams. SAIC met this challenge, and not only survived but thrived. As defense conversion engulfed the defense contracting community, SAIC emerged as a diversified, financially sound corporation and launched a new cycle of growth in shareholder value. Its record of rapid and consistent annual revenue growth since 1969 (See Figure 1.1) is exceptional:

- In FY1970, SAIC's first FY end, total annual revenues were $243,000.
- In FY1980, total annual revenues exceeded $150 million (90 percent CAGR, 10 years).
- In FY1990, total annual revenues exceeded $1 billion, making SAIC one of the largest employee-owned companies in the United States.
- In FY1999, total annual revenues exceeded $4.7 billion, placing SAIC on the Fortune 500 list.
- In FY2006, total annual revenues were approximately $8 billion.

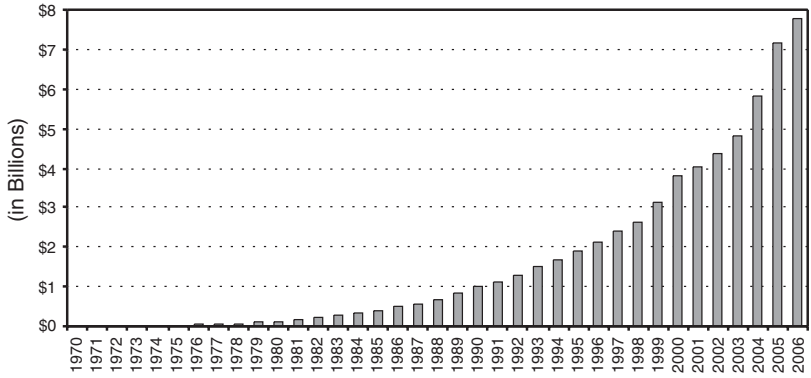

FIGURE 1.1 SAIC Revenue (1970–2006)

SAIC's FY2006 results represented the thirty-sixth year of continued revenue growth, demonstrating SAIC's position as one of the most successful employee-owned companies in the United States. Revenue and earnings grew at a compounded annual growth rate of 33 percent over this time period. SAIC grew into a Fortune 500 company within 30 years and only had three years (1998, 2001, and 2002) that resulted in single-digit annual revenue growth.

Aside from a couple of remarkable years during the dot-com boom, operating income growth was consistent with revenue growth, meaning SAIC maintained fairly consistent margins over this time period. The margins might be less than other comparable companies at any given time, since I was interested in guaranteeing future revenue growth. SAIC was in the business of selling brainpower, mostly to federal government agencies that did not generally pay high contract fees to begin with. I made a conscious decision to build SAIC around selling the expertise and smarts of our employees and not selling widgets. This meant foregoing higher profits while building significant revenue growth. Even so, SAIC never had an unprofitable year.

STEADY STOCK PRICE GROWTH—DOUBLE-DIGIT TRACK RECORD

SAIC has posted remarkable stock price growth since its founding in 1969. From the end of that first fiscal year until 2006, the company's

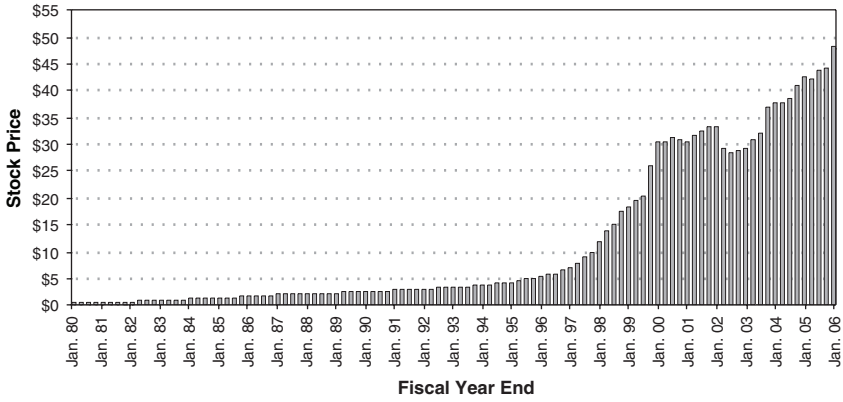

FIGURE 1.2 SAIC Stock Price: 26-Year History

stock price rose by an annualized compounded rate of 34 percent. An investment of just $100 in 1970 would be worth more than $3.5 million in 2006. And when the stock market crashed in 1987—losing 20 percent of its value—SAIC lost only 5 percent.

Consistent with its can-do, "if it doesn't exist, let's invent it" philosophy, SAIC's management team created Bull, Inc.—a wholly owned broker/dealer subsidiary, registered with the SEC and NASD, that conducted quarterly internal market trades for employees who wanted to buy or sell shares of SAIC stock. This internal market increased the liquidity of the stock while the company's steady performance kept its price moving upward in almost every quarter of the company's existence. (See Figure 1.2.)

GROWTH, MARKET LEADERSHIP, AND THE RANKINGS TO PROVE IT

While SAIC's customers and competitors in government and business closely watched SAIC's performance, this story is about a company that flew below the radar until its reputation could no longer be concealed. More than a few successful companies have copied elements of SAIC's business model. Even so, SAIC remains an enigma to many of the company's com-

petitors, and it can be very difficult to develop win strategies when competing against SAIC:

- SAIC is the largest employee-owned research and engineering firm in the United States, and the third largest majority employee-owned company in the United States, after Publix Supermarkets and Hy-Vee.
- By 1999, SAIC had joined the Fortune 500 list as number 347. Six years later—in 2006—SAIC reached number 285 on the Fortune 500 list.
- *Fortune* ranked SAIC number 4 among America's most admired information technology services companies in 2006.
- *Federal Computer Week* ranked SAIC the second largest systems integrator for the federal government in 2005.

Since its founding in 1969, SAIC has had few peers in the markets serving government and private sector clients, especially compared to other privately held companies.

HERE, THERE—EVERYWHERE

My original vision of building a good place to work led to the creation of an entrepreneurial environment that led the company to engage in numerous remarkable business initiatives—from acquisitions to product development, from domestic markets to global ventures. Far-ranging in their scope, some of these business opportunities were experiments for SAIC—and some of them succeeded beyond all reasonable expectations:

- *Defense transformation:* SAIC established a leadership role working closely with the Department of Defense during the Cold War, and then helping to transition the military and other federal agencies into the post-Cold War era. Today, the company develops leading-edge concepts, technologies, and systems to solve complex challenges facing the U.S. military and its allies in the twenty-first century, helping them make decisions according to new rules in a new warfare environment and transforming the way they fight.
- *Intelligence:* SAIC develops solutions to help the U.S. defense, intelligence, and homeland security communities build an integrated

intelligence picture, allowing them to become more agile and dynamic in challenging environments and produce actionable intelligence.

- *Homeland security and defense:* SAIC develops technical problem-solving approaches and provides systems integration and support services to help federal, state, local, and foreign governments and private-sector customers protect the United States and allied homelands.
- *Energy and environment:* SAIC brings science, engineering, policy, and information-management skills to some of the most difficult energy, environmental remediation, compliance, and energy infrastructure issues in the nation. Expanding beyond the early days of Superfund projects, SAIC is today a full-service environmental, health, and safety provider.
- *Logistics and product support:* SAIC provides logistics and product support to enhance the readiness and operational capability of U.S. military personnel and weapon support systems.
- *Systems engineering and integration:* SAIC provides systems engineering and integration services to help its customers design, manage, and protect complex IT networks and infrastructure.
- *Research and development:* As one of the largest science and technology contractors to the U.S. government, SAIC conducts leading-edge research and development of new technologies with applications in areas such as national security, intelligence, and life sciences.
- *Health and life sciences:* SAIC supports government and commercial customers in all phases of drug development. SAIC is the support contractor for an NCI research and development center, advances vaccine research and manufacturing, integrates disparate scientific systems, and supports regulatory affairs for drug, biological, and device products.
- *Commercial services:* SAIC helps its customers become more competitive, offering technology-driven consulting, systems integration, and outsourcing services and products in selected commercial markets, currently IT support for oil and gas exploration and production, applications and IT infrastructure management for utilities, and data life cycle management for pharmaceuticals.

Subsequent chapters explore a number of SAIC's technology and innovations—in the areas listed previously—as well as major acquisitions including Bellcore/Telcordia and Network Solutions.

A HISTORY OF INNOVATION—FOR TECHNOLOGY AND BUSINESS

SAIC's success was the result of the convergence of innovative technology and innovative business practices. When I decided to start the company, my motivation wasn't financial. I wanted to create a company that would attract talented scientists and engineers who would tackle nationally important scientific issues. And they would stay at SAIC because of the challenging problems and a work environment that encouraged creative thinking.

As this unique workplace evolved, a number of business principles and practices emerged. These principles and practices, explored in greater depth in subsequent chapters, are summarized here:

- *People first.* Over its many years, SAIC put people first—the organization was expected to serve customers, employees, and owners (who were employees), not the other way around. The basic formula worked exceedingly well: Hire very smart people, encourage their entrepreneurial spirit, let them focus on customers, and reward them for their contributions.
- *Freedom (with strings attached).* SAIC was specifically designed to be an organization where managers and employees would be free to pursue work they were passionate about—to start, operate, control, and grow their own business units under the umbrella of the parent company, and unleash their own energy and creativity. While they were encouraged to build and run their own business, employees were expected to follow company practices for bidding and contracting and adhere to the highest ethical standards in the process to protect their customers' and the company's best interests.
- *From science to solutions.* SAIC was a company founded by scientists, and it used science and engineering to provide the most effective, efficient, up-to-date, and highest quality solutions for specific client problems. The company put a premium on hiring the most talented scientists and engineers it could find, pointing them toward problems of national importance, and then getting out of the way. We believed in and valued small beginnings. As our experience showed, small things often beget large things. Although SAIC eventually performed on a wide variety of projects, science and engineering has always remained deep within the company's core.

- *Employee ownership*. If freedom of movement was the incentive that drew talented people into SAIC, then employee ownership was the glue that kept them there. SAIC built a culture firmly rooted in the simple idea that those who contribute to the company should own it, and ownership should be commensurate with a person's contribution and performance. Without employee ownership, SAIC would not exist today.
- *Participation in decision making*. At SAIC, employees were not only expected to contribute their ideas to improve the company and the services it provided, but also to make decisions that would put their ideas into action. While there was certainly a hierarchy of various managers and employees, the expectation was that decisions would be made at the lowest level possible, and problems resolved at the lowest appropriate level, thus cutting red tape and providing customers with more responsive service.
- *Organized for growth*. Bucking the traditional rigid hierarchy of its contemporaries in each of its decades of operation, SAIC created a decentralized organizational model. At SAIC, the central organization provided essential policy guidance to its various business units and exercised substantial oversight and financial control, but otherwise kept out of the way as much as possible. This approach allowed its motivated managers to build their businesses free of the kinds of administrative restraints that would have fettered their efforts in most other organizations.
- *No grand plan*. Rather than following voluminous plans that laid out company initiatives years into the future, SAIC encouraged the organization to grow organically, following the interests and instincts of its entrepreneurial program managers. While a formal planning process was eventually put into place to ensure the most efficient use of company resources, flexibility and initiative were always considered more important than slavish adherence to "the plan."
- *Everyone a salesperson*. From its earliest days, SAIC's leadership put a premium on hiring scientists and engineers who didn't just do the work, but who also were responsible for selling the work. By enlisting the people who did the work in the selling process, SAIC kept close tabs on emerging customer needs, developed particularly close relationships with customers, and minimized the overhead expense that would have been required to hire and fund a large separate selling or-

ganization. Everyone in the company was expected to keep his or her eyes open for new work, and was rewarded for successes.

- *Extensive feedback and lessons learned.* SAIC put a formal "lessons learned" process into place to gather together feedback from employees who were directly involved in new initiatives or particularly complex programs, bringing insights to light and recording them for others to learn from. A variety of different meetings—the most important known as Management Council that occurred during the company's quarterly Meetings Week—created even more opportunities for obtaining feedback and learning lessons. These learning-based processes became essential features of SAIC's proposal review strategies as well.
- *Experiment constantly.* One of the hallmarks of SAIC has been the willingness of its leaders to constantly experiment with new business entities, corporate structures, and staff. To encourage experiments, managers at all levels of the company were annually given control over pockets of money (called "guidelines") that they could use to invest in growing their own organization. The extraordinary degree to which discretionary money and decision making were delegated to managers at the division level—the lowest level of the company—and all levels in between that level and the CEO, is unprecedented in the defense industry and rare for *any* business.
- *Expect reasonable profit, but with stock price growth.* While projects, divisions, and groups had to be profitable, the plan for profitability (as measured by margin percentage) at SAIC was generally lower than at most other companies of its kind. The company's values and financial model placed much greater emphasis on steady growth, customer satisfaction, and advancing the nation's interests rather than on squeezing its clients for every last dime.
- *Governance—sustainability or transition?* Numerous laws and regulations—recent and not so recent—are making corporate governance more time consuming than ever, while increasing the costs of doing business and hamstringing the ability of organizations to act quickly to seize opportunities as they may arise. SAIC's board of directors has long faced the challenge of positioning the company for the future while maintaining the values that made SAIC great—all while keeping up to date on the latest regulatory issues. SAIC's board was an important asset—useful not only in an advisory role, but as a key

instrument of growth. To these ends, members were recruited who could help the company achieve both its short- and long-term goals.

In the chapters that follow, we consider how each of these principles and practices led to SAIC's extraordinary success, and how the lessons that we learned over the years can help you create your own business success stories if you are so inclined. Finally, in Chapter 14, I take a look at the future of employee ownership, American business competitiveness, science and technology, and SAIC. As you will see, there is much to be hopeful about, and much work to be done.