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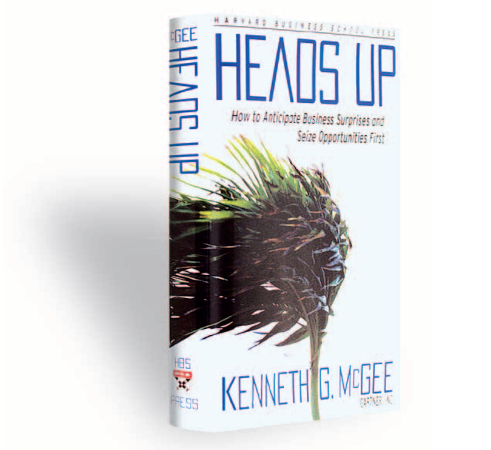
FILE: STRATEGIC MANAGEMENT



By Kenneth G. McGee

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How to Anticipate Business Surprises and Seize Opportunities First

HEADS UP

THE SUMMARY IN BRIEF

In 1900, Galveston, Texas, was destroyed and 8,000 people were killed when a Category 4 hurricane passed directly over the city. By the time anyone knew the hurricane was descending on them, it was too late to react.

In 2000, a financial hurricane wreaked havoc on stock valuations, mutual funds and retirement portfolios. Unlike the Galveston hurricane, the end of the meteoric rise in the NASDAQ Composite Index arrived after many years of warnings.

Today, supercomputers and satellites constantly monitor emerging weather patterns in real time and warn the United States of approaching hurricanes well in advance. The business world, on the other hand, is not much better at forecasting than in 1900. Business "surprises," such as the bursting of the Internet bubble, occur with alarming frequency and take a considerable toll.

According to Kenneth G. McGee, however, even the worst business catastrophes rarely happen without warning. In this summary, McGee describes how managers can break the pervasive pattern of surprises that are often followed by desperate responses. Instead of trying to predict the future, McGee explains, managers need to master predicting the present — understanding what is happening right now and how these current events and outcomes will impact future success. The result: Potential disasters are turned into opportunities.

What You'll Learn In This Summary

✓ **Data already exist that can be used to avoid surprises, to capitalize on opportunities, and to make midcourse corrections.**

✓ **Although many businesspeople are concerned about "infoflood," the amount of data that is *material* is relatively small and can be determined.**

✓ **Capturing and monitoring material data allow departments and organizations to "predict the present," or use material information about the present to predict everything else happening in the present.**

✓ **Departments and organizations can anticipate events and changes so they can adjust tactics and strategies to ensure that goals are met, opportunities are maximized, and disasters are avoided.**

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HEADS UP

by Kenneth G. McGee

— THE *COMPLETE* SUMMARY

PART ONE: ENDING BUSINESS SURPRISES

Turning Business Disasters Into Opportunities

Heads Up is about predicting the present. Predicting the present means taking raw empirical information, analyzing it, and determining its meaning and implications. However, managers don't need to know *all* the operational data to understand what the present situation is. Predicting the present is gathering enough information to answer the question, "Where are we *right now* in meeting our corporate goals?"

By recognizing that there is always warning, and therefore monitoring progress on a daily basis, managers can turn what would have been surprises into a whole new world of opportunity.

Opportunities to Improve Good Results

In the hands of a capable manager, current information about the state of the business always shows opportunities to improve good results or, at a minimum, to act to mitigate the impact of poor results. Therefore:

1. If you acquire the ability to capture, receive, monitor and analyze information about certain events, when those events occur, you can predict the present.

2. If you predict the present and identify the always-present early warnings of difficulties or successes, you will have identified an opportunity for better performance.

3. If you take effective action based on these opportunities, you will be engaged in real-time opportunity detection.

Real-time information is valuable because it gives the manager the most possible response options. Response options are actions that may be taken to mitigate the negative impacts or accentuate the positive aspects of an event before the impact of the event is felt. For example, if sales volumes are falling (event), a response option is to increase advertising to improve sales volume before quarterly revenue targets are missed (impact). As time passes after an event occurs, however, there are fewer and fewer responses that a manager can make to the event before the impact occurs.

Right Time Versus Real Time

When discussing real-time information there is an unfortunate tendency to mistake real-time information for real-time response. It is critical to understand what parts of the process need to occur in real time and which need only to occur at the "right time." In the ideal business context, the following processes happen in the background between an event happening and the impact of the event being felt:

1. Monitoring of information related to the event.

2. Capturing a change in the information.

3. Analyzing the information.

4. Reporting the information.

5. Responding to the information.

When discussing real-time information, the goal is to move the capture, monitoring, analysis and reporting steps not just earlier in the process, but into real time. Moving these steps into real time allows the most possible response options and enables choosing the best response from among them. A real-time response without due deliberation can sometimes be more harmful than the original situation. A "right-time" response can be far superior to a real-time response.

Although real-time information on events is always helpful, real-time response has shown in a number of cases to do more harm than good. Overly aggressive

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Turning Business Disasters Into Opportunities

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responses to real-time information may yield no better results than those achieved without any real-time information at all. Monitoring, capture, analysis and reporting of critical information must move to real time so predicting the present and real-time opportunity detection can take place. They will determine the "right time" for a response to achieve maximum positive results.

Opportunities Versus Disasters

There are different types of events that occur in business: surprises, opportunities and disasters. The difference between an event we call an opportunity and one we call a disaster most often depends on which of the categories the event falls into. These categories include:

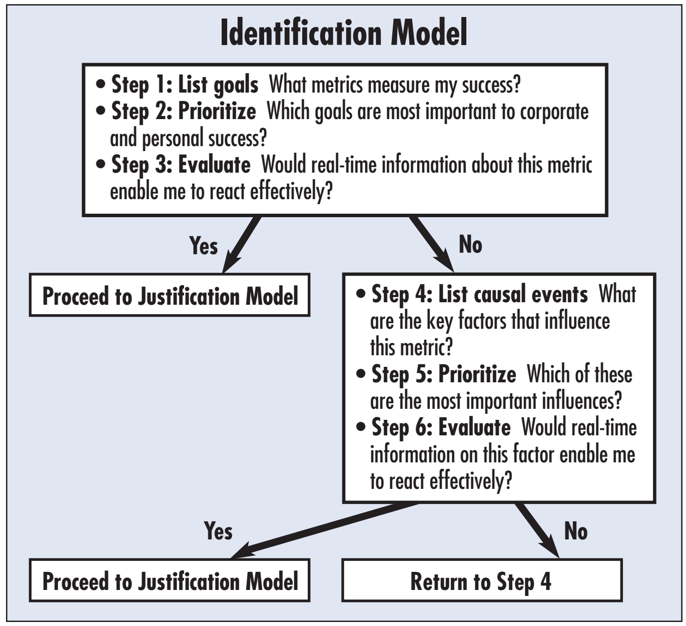
- **Surprise event:** The event is not reported, in some cases because it was not monitored, captured or analyzed. Three Mile Island, *Challenger,* and September 11 are examples of surprise events.
- **Suspected event:** The event is monitored, captured, analyzed and reported but too late for effective action. The Galveston hurricane and the Internet investment bubble were suspected events.
- **Surmounted event:** The event is reported in time and effective action is taken.

To end business surprises, managers must receive a heads-up about the present — a few vital elements of data about what is happening right now in their business. Using this information, a manager can successfully understand the big picture at any given moment and predict the present. Using this real-time understanding of what is happening in his or her business, any manager has the chance to take action to prevent surprises and turn them into opportunities. ■

Identifying and Justifying The Right Real-Time Information

A manager looking to guide his or her business to the successful attainment of goals needs real-time information about *some* but not *all* aspects of operations. There are far better ways to utilize limited resources than monitoring every operational variable in real time, even though advances in technologies such as radio frequency identification, portals, wireless communications and Web services are driving down costs. Over time, the resources that are limited will become less financial and technological and more time-based.

Managers will not have the time to track all the information they can affordably monitor. Only a small percentage, perhaps 5 percent, of the potential operational



data is required to predict the present and begin real-time opportunity detection. The difficult part of choosing real-time information candidates is determining which 5 percent to monitor.

Identification and Justification

Given that every attempt to monitor any piece of information in real time costs resources, the manager must identify what information should be monitored in real time and whether the effort required to obtain and monitor the information in real time is justified.

To determine which of the wide variety of influences on reaching goals is necessary for predicting the present and worthy of being monitored, captured and reported in real time, managers must filter all the possible information candidates through the Identification and Justification Models to determine which are worth monitoring in real time. The Identification Model includes:

The Identification Model

- **Step 1: List Goals.** Determine and list the goals for the planning period and determine the metrics by which achievement of the goals will be measured. (See graph above.)
- **Step 2: Prioritize.** Look at the list of goals and ask, "If I could reach only a few of these goals, which ones would be most likely to ensure corporate and personal success."
- **Step 3: Evaluate.** Ask of each candidate: "Would real-time information on this metric enable me to react differently?" Assess the relationship between the event-impact lag (the amount of time separating an event and its impact) and the response options available.
- **Step 4: List Causal Events.** If it is determined that the response options for the event in question do not fit

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Identifying and Justifying The Right Real-Time Information

(continued from page 3)

in the event-impact lag, the manager must determine the causes of the event originally considered.

● **Step 5: Prioritize.** The manager must take all the relevant causal events and prioritize them. The desired outcome is to choose only the causes that are crucial.

● **Step 6: Evaluate.** The manager must ask whether real-time information about the cause would enable him or her to respond effectively.

The Justification Model

Each candidate generated by the Identification Model must pass through a further series of tests — the Justification Model. (See graph on right.) The Justification Model acts like a funnel, further narrowing down candidates from the Identification Model. Each step is a more stringent test that fewer candidates pass.

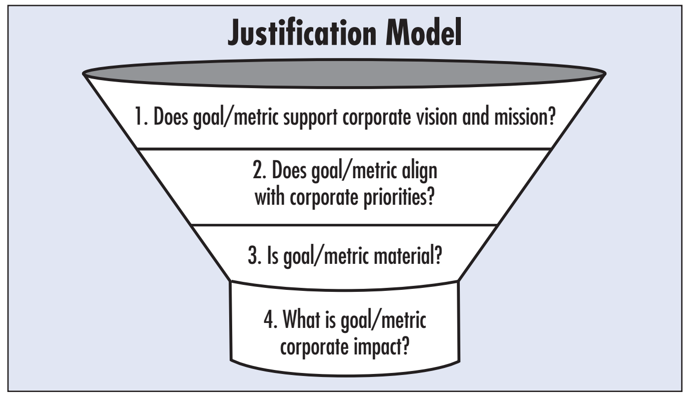
● **Question 1:** Does the goal the information will help you achieve support the corporate vision and mission?

● **Question 2:** Does the goal align with current corporate priorities?

● **Question 3:** Is the information material to the goal, *or* would this information alone propel you to take action?

● **Question 4:** What is (or the rank of) the corporate impact of achieving (or not achieving) the goal?

Having completed both the Identification and Justification Models, the manager will have a list of the very few metrics that should be monitored in real time properly prioritized. Having used the Identification Model to determine what should be monitored and the Justification Model to determine whether the items are worth monitoring, the cloud of information will have been reduced to the 5 percent that will enable predicting the present and real-time opportunity detection. ■



PART TWO: REAL TIME IN THE REAL WORLD

Surprise Events: Missing the Warning

On Feb. 24, 1994, the nation was shocked at the arrest of Aldrich Ames on charges of espionage. Ames was a fairly high-ranking CIA officer who, it was later revealed, had been spying for the Soviet Union and Russia for more than nine years. While we may never know the full extent of the damage to U.S. intelligence caused by Ames, the director of the CIA told congress that at least nine U.S. clandestine agents in the Soviet Union were executed, the identities of many U.S. agents were disclosed to the Soviets, and many sensitive intelligence reports were handed over.

The CIA not only missed capturing evidence of the risk Ames presented before he reached a position of significant responsibility in the counterintelligence department, but it also did not monitor the very clear evidence of Ames's spying once it began. That evidence included a house Ames bought for more than $540,000 cash, and the fact that he spent $1,397,300 between April 1985 and November 1993, even though his salary during that period totaled only $336,164.

WorldCom

While spying dominated the national news in February 1994, allegations of business fraud and images of former corporate executives in handcuffs dominated the business news for much of 2002. The largest bankruptcy in U.S. history, that of WorldCom, precipitated by fraud committed by senior executives, was one of these stories. As the Ames case was clearly an unnecessary surprise brought about by an absence of monitoring or reporting of key information about an employee of the CIA, WorldCom and other cases of corporate fraud can hardly be considered surprise events.

Business fraud usually originates because of the surprise of disappointing quarterly or annual results and the exhaustion or absence of legal response options. This is exactly how fraud played out at WorldCom. First, reserves allocated for line costs were reduced. When results continued to fall below expectations for several quarters, line costs, which according to generally accepted accounting principles must be booked as operating expenses, were shifted to capital expense accounts, changing WorldCom's reported results.

Earnings Expectations

The role of earnings expectations in this discussion is critical. Fraud is often inseparably linked to the belief that expected goals must be achieved at all costs. Although real-time opportunity detection has no influence over the belief, it can have a marked influence on:

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Surprise Events: Missing the Warning

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- the expectations that are set in the first place, and
- the response options available for ensuring that expectations are met.

When any company decides to raise capital in public stock markets by selling shares, it not only prepares to meet regulatory requirements, it hires an investment bank (or banks) to represent it in the financial markets. The analysts of the main underwriting investment bank or of other banks involved often assist in the selling of the company's stock by issuing a research report that reviews the prospects and other data about the company and most important, enumerates future revenues and earnings of the company in the opinion of the analysts.

If the stock becomes widely traded, more analysts from more firms issue reports. These reports are heavily influenced by the stated expectations of the company's management as well as the analysts' confidence in the expectations in the face of prevailing market conditions. The research reports are often blended together to determine the *consensus earnings estimate* for a company.

Changing the Game

Real-time opportunity detection *can* influence the earnings and expectations that are set and the response options available for ensuring that expectations are met, thereby reducing the number of times an executive has to report the potentially devastating news of not reaching earnings estimates. The critical first small steps toward fraud are brought about by the combination of the market power of earnings estimates with the surprise actual results are to most executives. They do not know what their final results will be until well after the quarter has closed because real-time monitoring, capture and analysis of the elements that make up the results are not taking place. By this time, other response options are impossible.

Real-time opportunity detection cannot guarantee the absence of fraud, but it can reduce the likelihood of fraud as revenue-related surprise events are eliminated. Companies that engage in real-time opportunity detection can also achieve significant market valuation advantages over competitors as the market rewards these companies' ability to consistently meet expectations.

The Airline Industry

Many recent problems in the airline industry, including announced losses of tens of billions of dollars, are the result of the industry not monitoring the right information in real time. Many expenses in the industry are fixed, such as labor contracts, airline purchases, and jet fuel. In 2001, contracts were signed to increase pilot, flight attendant and mechanic pay while evidence indicated that the most profitable group of customers was cutting back. Due to the fixed cost structure, operating revenue in real time did not provide adequate warning for the industry. By the time operating revenue decreases were evident, cost increases were already locked in.

Ending business surprises depends on determining the right information to monitor and setting up the processes and procedures for monitoring, capturing and analyzing changes in that information. The airline and financial industries arguably monitor more real-time information than all other industries combined, yet they are still victims of surprise events. Although the case for real-time information is relatively straightforward, these examples clearly show that simply making the case for real-time information is not enough. Monitoring the right information is the only way to end business surprises. ■

For Additional Information on how the airline industry tracks information, go to: http://my.summary.com

Suspected Events: Reporting Too Late

Imagine if Henry Wadsworth Longfellow's famous poem "Paul Revere's Ride" was written with a slightly different scenario. Revere had arranged for real-time monitoring, capture and analysis of British troop movements in Boston. However, once he received this real-time information, rather than acting immediately, he spent several hours shoeing his horse and dressing for his ride. If Revere had behaved this way, by the time he reached the towns of Middlesex County, his warnings of the approaching British would have come too late. Or imagine that rather than crying out a warning to the inhabitants of each town, he had simply nailed a letter to the door of the town church for the townsfolk to read in the morning. Each of these scenarios, although seemingly ridiculous, is not far from reality.

A rider named William Dawes set out from Boston at the same time as Revere with the same news, but did not stir the famous response that led to the battles at Concord and Lexington. Why? Because he failed to report his information to the right people.

The imagined delays and Dawes's experience are similar to the situation encountered by many organizations today: Even when enterprises have the facilities for monitoring, capturing and analyzing the right real-time information, many do not report it to the right people in real time. These companies are tracking critical business information in real time but are still the victims of unanticipated problems or lost opportunities.

Sears

Sometimes executives are aware of changes around

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Suspected Events: Reporting Too Late
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them but a suspected event still occurs, as it did in October 2002 at Sears. In 2001, Sears's credit division accounted for 60 percent of operating income. The large credit division was at the root of Sears's fall 2002 earnings surprise when it not only missed expectations for profitability, but it announced a loss due to the need to write off $222 million of bad debt from its credit card business. Since Sears does not write off debts until they are 240 days old, too late for the credit division president to take action to change operating income for the positive, his only course was to increase reserves for delinquencies that would negatively effect operating income. Sears decided that the damage caused by inadequate monitoring and reporting on the credit portfolio had surprised the company too many times, and in July 2003, got out of the credit card business entirely.

The Contingent Road Map

One key strategic planning tool for situations where the future is uncertain and estimates are required is the contingent road map. A contingent road map specifies several possible courses of action with specific triggers for taking one course rather than another as time passes and actual information replaces estimates.

Suspected events are the most maddening of surprises — the data to stop the surprise were there; they were just not in the right hands. Real-time reporting plays a critical role in ending these types of surprises. All managers must seek information that already exists in their organization that may give them a heads-up about an approaching disaster or opportunity that would otherwise be a surprise. Information sharing is crucial to successful real-time opportunity detection.

To end surprises not just for individual managers but for the corporation as a whole, traditional silos of information must be broken down and real-time data shared. ■

Surmounted Events: Getting It Right

The notion of monitoring, capturing, analyzing, reporting and responding to critical information is not an alien concept in our day-to-day activities. From clocks, thermostats and fuel gauges to tachometers, smoke detectors, and gas pump meters, we are surrounded by examples of real-time monitoring, capturing, analyzing, reporting and responding to events.

Despite the damage caused by business surprises attributable to an absence of real-time information and the prevalence of real-time information in our personal lives, little is being done to change the culture and processes that tolerate surprises and to begin using real-time opportunity detection. However, in companies across the economy, managers are predicting the present, detecting opportunities in real time, and what were once surprise events or suspected events are becoming surmounted events.

Amberwood Homes, a large custom builder in Arizona, has made some significant changes to its processes and culture to eliminate scheduling surprises. Over the years, each construction superintendent at Amberwood had developed his or her own process for tracking progress on a house and setting subcontractor schedules. In fact, according to Dan Johnson, Amberwood's construction manager, many subcontractors maintained no schedules at all. Johnson saw the opportunity to significantly improve operations by centralizing progress reports and making real-time adjustments to schedules.

Today, each of Amberwood's superintendents and more than 50 subcontractors use a real-time scheduling system to ensure that no unnecessary trips are made and everyone on a job knows what the current status is at each house under construction — typically 20 to 25 at any given time. Superintendents update progress on a job site as each step of the process is completed. A new schedule is generated as adjustments are made. Each morning, subcontractors check the schedule to ensure they are going to the right houses at the right time. Amberwood's savings from the program have boosted margins approximately 20 percent.

Real-Time Technology in the Retail Industry

In retail, margins are tight, and the emphasis is on inventory management. Success or failure is often measured by no more than having the right products in the right store at the right time. Selling out of a product means lost revenue, often with no chance to recover. By the time inventories can be restocked, most customers will have found the item elsewhere. Protecting against

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eBay Uses Real-Time Information

On Sept. 11, 2001, five minutes after the North Tower of the World Trade Center collapsed from a terrorist attack, several listings were entered on eBay's site offering rubble from the scene.

Although the listings were probably fraudulent, the impact of the public revulsion for such crass profiteering would have reflected negatively on eBay. But eBay's reputation remains unscathed because, although many of us heard that rubble was listed, we also heard that "someone tried to auction rubble from the World Trade Center." The word "tried" makes all the difference. eBay remains trusted because it acted quickly to remove the items within minutes of the listings becoming available to users.

Surmounted Events: Getting It Right

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inventory shortfalls by overstocking leads to significant margin erosion as the goods left over have to be marked down or shipped to an overstock dealer. Wal-Mart's use of technology for efficient inventory management has set benchmarks for every industry and has put particular pressure on every company in the retail business, whether it is a direct competitor of Wal-Mart or not.

These companies provide clear evidence of the business benefits of ending surprises and capitalizing on real-time information. They rely on technology to differing degrees to accomplish real-time opportunity detection, but they are focusing on a limited range of information about the present to ensure that surprises are avoided and opportunities are exploited. Each company is applying real-time opportunity detection to only a limited part of their business, and although they are enjoying the results of their current real-time efforts, there is more they can do to expand real-time opportunity detection to become Real-Time Enterprises. ■

PART THREE: FROM REAL-TIME OPPORTUNITY DETECTION TO REAL-TIME ENTERPRISE

Following Through: Deploying Real-Time Opportunity Detection Across the Enterprise

Amberwood and eBay are both doing a great job of real-time opportunity detection. They have identified areas of their business where capturing real-time information and delivering it to the right managers can have an immediate impact in improving business results. Despite early success, they still have a long way to go to reach the ultimate goal — ending all business surprises by being Real-Time Enterprises.

The initial deployment of real-time opportunity detection is just the first of three steps on the road to becoming a Real-Time Enterprise. Real-Time Enterprises both move the detection of any event that affects their most critical business processes into real time and improve their ability to respond to these events when they occur.

To become a Real-Time Enterprise, follow these steps:

- **Step 1: Begin real-time opportunity detection.**
- **Step 2: Deploy real-time opportunity detection across the enterprise.**
- **Step 3: Overhaul processes to improve the organization's ability to respond.**

Although the three steps to becoming a real-time enterprise are logically distinct and appear linear, in practice the lines between the steps are not nearly so clear. Steps 1 and 2 can be combined by immediately looking at real-time opportunity detection from the corporate perspective. Steps 2 and 3 can be taken simultaneously — in fact, it will be necessary for many companies to do so as processes are redesigned to generate real-time information so that real-time opportunity detection can be implemented.

Deploying Real-Time Opportunity Detection

In the second step, executives and managers spread real-time opportunity detection throughout the enterprise so all critical business processes and functions are being monitored in real time. When deploying real-time opportunity detection to the entire enterprise (driven by senior executives rather than individual managers) so that all the corporation's most critical business processes are being monitored, several modifications of the Identification and Justification Models have to be made to properly direct resources.

Just as a manager cannot acquire real-time information on every important metric simultaneously, so too it is highly unlikely that any organization can undertake real-time monitoring of all its most critical business processes simultaneously. Therefore, prioritization is essential. One of the key functions of the Identification and Justification Models is to prioritize information to be monitored in real time. Specifically, in the models, the manager goes through at least two prioritization filters, the first in step 2 of the Identification Model, where the manager prioritizes his or her various goals, the other in question 4 of the Justification Model, where the candidates for real-time monitoring are prioritized by their corporate impact.

Modifying the Models

Corporate prioritizing, however, requires a slight modification to the models. In this case, rather than considering corporate impact as the last step, corporate impact is the mechanism for prioritizing goals in step 2 of the Identification Model. The easiest way to perform this step is simply to examine the firm's 10 largest expense-generating or revenue-producing processes. Information that affects the "top 10" should be the highest priority by far and is the most appropriate place to begin spreading real-time opportunity detection.

The second modification to the Identification and Justification Models involves choosing the right metrics for measuring the prioritized corporate goals. This change is necessary because the point of reference is no longer obvious. When deploying real-time opportunity detection across the enterprise, a specific manager or executive needs to be chosen as the point of reference for each prioritized goal. The proper metric to measure

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Following Through: Deploying Real-Time Opportunity Detection Across the Enterprise

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follows from that choice.

The final step looks at the process of responding as a whole and focuses on removing all unnecessary and costly delays. While real-time opportunity detection will enable individual managers to have a positive impact on their organizations, for the organization as a whole to realize the maximum opportunities for success, the real-time capture of critical data elements must join with revamped organizational structures, new management styles, and in many instances rebuilt business processes. The competitive advantage of Real-Time Enterprises will be the combination of the power of timelier monitoring and reporting of business events with the ability to respond to the events far more rapidly.

More Harm Than Good

It can't be said often enough that even in the Real-Time Enterprise, responses are not necessarily made in real time since overly quick responses can be more harmful than helpful. The real change that happens in becoming a Real-Time Enterprise is that the ability to make a decision about the proper response and to implement that response is vastly improved.

As part of improving its ability to respond, a Real-Time Enterprise does not just re-engineer response processes for efficiency: It redesigns them to both take advantage of and generate real-time information that will allow even more real-time opportunity detection.

General Motors

General Motors is one of the first companies to begin experiencing the power of bringing together the use of real-time opportunity detection across the entire enterprise and enabling much faster responses. The results, even at this early stage, are dramatic. On top of growing market share, General Motors has increased quality and productivity simultaneously, cut costs, and introduced an average of one new vehicle per month in 2003.

The best evidence of GM's success so far is the 2002 Harbour and Associates (an independent consultancy located in Troy, Mich.) report on automobile manufacturing. Here is an excerpt from that report:

"GM, with a 4.5 percent overall improvement, led the domestic manufacturers in assembly, engine and transmission productivity, which marked the first time in the history of the Harbour Report that GM finished ahead of Ford in the assembly and overall hours per vehicle (HPV) measures. Also for the first time ever, a GM plant (Oshawa #1, with a 16.79 HPV) led all North American car and truck plants in assembly productivity." ■

Solving the Challenges Of Deploying Real-Time Opportunity Detection

As companies begin to take the second and third steps toward becoming a Real-Time Enterprise, deploying real-time opportunity detection in all their most critical business processes and improving their ability to respond to the events detected, they will run into issues that are beyond their scope more and more often.

Even with a majority of managers engaging in real-time opportunity detection, some events that are critical to the organization's success may not be monitored. Although some managers may be monitoring events in real time, crucial information may not be passed to all relevant parties. In other organizations, the intersection of processes governed by real-time opportunity detection with those that are not yet real time will cause confusion and inefficiency.

Providing Up-to-Date Feedback

Changing a company's critical business processes to operate in real time, to provide up-to-date feedback on progress when necessary to end all business surprises, requires that the most senior executives of a corporation take an active role in the transformation. It requires that they take on three new roles to successfully navigate steps 2 and 3 of the path to becoming a Real-Time Enterprise:

1. **Real-Time Enterprise change leader.** In many cases, this function will begin to evolve as an extension of the duties of an existing senior executive, most commonly chief operating officer, chief information officer, or chief financial officer.

2. **Long-distance lookout.** The function of long-distant lookout will call for focus on following event-impact chains much further back than the average manager can or has the time to do.

3. **Internal monitor and reporter.** In companies struggling because of internal shocks, a new function will most likely emerge first. This new function will focus primarily on ensuring that corporate targets are measured accurately and reported truthfully to the rest of the organization, especially other senior executives.

A New Executive Officer

In many firms, a new governance structure will involve the creation of a new executive officer of the firm to take on all three functions, an executive we call the chief monitoring officer (CMO). The CMO will benefit the firm by single-mindedly focusing on the tasks described and these tasks alone, with the time to perform them well. ■