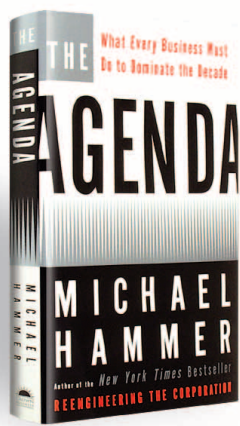


SOUNDVIEW Executive Book Summaries®

FILE: ECONOMICS



By Michael Hammer

What Every Business Must Do to Dominate the Decade

THE AGENDA

THE SUMMARY IN BRIEF

In the fourth quarter of the twentieth century, suppliers, who until then had dominated industrialized economies and set the terms of how business was done, lost their position of dominance to their customers. Customers refused to accept high prices, low quality and dreadful service just to get what they needed. The reason for the shift in power: The servitude of customers — who once stayed with familiar vendors because it was easier — ended when information technology allowed them to comparison shop. At the same time, technology changes dramatically shortened product life cycles, further putting suppliers on the defensive.

The end result is that supplier-dominated economies have been transformed into ones ruled by customers. This is the real “new economy.”

The nine agenda items presented in this summary create a map for surviving in today’s customer-dominated era.

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What You’ll Learn In This Summary

- **Make yourself easy to do business with.** Presenting a single face to your customers is just one of six ways to simplify customer interactions.
- **Add more value for your customers.** Your job is to solve problems, not sell products.
- **Obsess about your processes.** Don’t focus on individual activities; focus on how those activities fit together.
- **Turn creative work into process work.** Creativity doesn’t need chaos; on the contrary, it thrives better in disciplined, coordinated environments.
- **Use measurement for improving, not accounting.** Don’t measure to collect data, but rather to collect clues for performance improvement.
- **Loosen up your organizational structure.** Dynamic, respected leaders and motivated teams, not command-and-control hierarchies, are needed.
- **Sell through, not to, your distribution channels.** Too many organizations forget that intermediaries are not their customers. The end user is.
- **Push past your boundaries in pursuit of efficiency. Creative collaboration with outside partners is essential.**
- **Lose your identity in an extended enterprise.** Your company is not an isolated entity, but rather an element in a larger system.

THE AGENDA

by Michael Hammer

— THE COMPLETE SUMMARY

Run Your Business For Your Customers

To succeed, you must become ETDBW, or easy-to-do-business-with. Being ETDBW means that from the customer's standpoint, interacting with you is as inexpensive and effortless as possible. It means you accept orders when and by whatever means your customer wants to use, you make it painless for him to check the order, you send a simple bill, and your customer service representatives actually provide service.

For customers, price is only part of the cost of doing business with you. In some cases, the overhead involved in doing business with you may rival what you charge. If your way of working is designed for your convenience rather than your customers', they will pay the penalty, and in the end so will you. The harder it is to do business with you, the less competitive you become.

Becoming ETDBW requires adopting six practices:

- **Present a single face to your customer.** Many companies present multiple and fragmented faces to their customers. One section doesn't know what the other is doing. To avoid this problem, create an integrated team that deals with customers across all products and functions and has the authority to remove barriers that get in the customer's way.

- **Work in different ways for different classes of**

Managers Transformed Business

Managers responding to the rise of customer power have dramatically changed the way business is done. If Rip Van Winkle had fallen asleep in 1975 and awoke today he would find:

- ✓ **Just-in-time inventory management**
- ✓ **Total quality management and six sigma quality**
- ✓ **Cross-functional teams**
- ✓ **Supply chain integration**
- ✓ **Performance linked compensation**
- ✓ **Economic value added measurements**
- ✓ **Customer-supplier partnerships**

Progressive Insurance Succeeds by Measuring What Matters to Customers

Progressive Insurance, the nation's fourth-largest auto insurer, has adopted customer-focused measures and has benefited enormously. Before the change, it concentrated on internal measures such as adjuster productivity. Of course, that's not what customers cared about. They just wanted to get their claims handled fast. The insurer shifted from "Progressive time to customer time" by measuring the time from accident to adjuster arrival. Soon, adjuster arrival was measured in hours, not days. Customer satisfaction rose, and market share grew.

customers. In order to sell to different groups, many companies practice market segmentation. They customize the product and message to each group. But once a customer is captured, the company typically tosses the newcomer into an undifferentiated customer base and does business with him or her the same way it does business with the rest. Resist the temptation to treat customers as if one size fits all. It doesn't.

- **Know what your customers will ask for before they do.** Predict what customers want, and have it ready when they ask. For example, a company customer service line can predict when a customer may need a bilingual operator. Using Caller ID, the company can see if there is a strong likelihood that the caller needs a Spanish-speaking representative, and routes the call to a bilingual operator. And if the caller doesn't need one, no harm is done, since the operator also speaks English.

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The author: An internationally renowned consultant and lecturer, Michael Hammer is the originator of the reengineering business concept and author of *Reengineering the Corporation*.

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Run Your Business For Your Customers

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- **Make your customers' experience a seamless one.** Customers shouldn't be treated as if they are new when you've been doing business with them for years. You must make sure that every employee who comes in contact with a customer can access relevant information about that customer.
- **Let customers do more for themselves.** One of the best ways to become ETDBW is to let customers do some of the work. Let customers enter and manage their own orders. Customers think it's easier.
- **Measure the things that customers really care about.** Measurements, to be meaningful, must matter to the customer. ■

Give Your Customers What They Really Want

Your customers have no interest in you or your company and only a little more in your products or services. You are merely a bit player in their lives. What your customers care about is themselves and your only excuse for existing is your ability to improve their lives. You must go beyond giving them your products and services; you need to help them solve the problems that motivated them to ask for those products or services in the first place. Give them more value-added (MVA).

All customers have problems that require resolution. You can visualize MVA as a ladder with your product at the bottom and the solution to your customer's problem at the top. The more help you provide your customer to

How GE Adds Value For Home Depot

When Home Depot wanted to sell large appliances to customers, GE responded to the need by doing more than selling Home Depot appliances. It solved a potentially problematic inventory problem for the retailer. Customers want a wide variety of appliance styles and colors to choose from, but keeping a large inventory is expensive in terms of retail floor and warehouse space and finance costs. GE offered to hold the inventory and take over responsibility for delivering the appliances from GE warehouses. Home Depot keeps a few samples on the floor. GE operates a computer kiosk from which customers can order other selections. In effect, GE is relieving Home Depot of some of its most profit-sapping burdens and freeing it to concentrate on selling GE products.

Add More Value For Your Customers

- ✓ Think of yourself as a provider of solutions, rather than of products or services.
- ✓ Distinguish between what you are selling and what your customer is buying.
- ✓ Take a broad view of your customers' underlying problems that go beyond you and your products.
- ✓ See what your customers do with what you give them, and either do it for them or help them with it.
- ✓ Price in terms of value rather than cost.

fill that gap, the more value you add to them, which differentiates you from your competitors. You must control as much of the ladder as possible so that the solution is an integrated one.

Trane, a division of American Standard, is a multibillion-dollar manufacturer of heating and cooling equipment. In the past, the company focused on providing the highest quality components, but as the industry matured it became difficult to differentiate on product quality alone. Trane set out to reinvent itself as a total heating and cooling solution. By acting as the general contractor and directly with commercial building owners, the company solves energy problems and recommends solutions. It then installs and services the solution, adding tremendous value to the transaction.

The MVA approach lets you bill customers on value rather than cost. Customers willingly pay for the value you have added. By removing administrative costs and hassle, companies that provide MVA can bill more and make more profit. ■

Put Process First

From the customers' point of view, a company exists only to create value for them. Yet in far too many companies, the actual creation and delivery of customer value is not the responsibility of any particular individual. Instead, the work that creates results for customers is broken into pieces and scattered across departments and units. One person takes the customer call, another gathers the needed information, a third decides what has to be done, a fourth takes action, and no one oversees the whole thing. If your company operates like this, it suffers from a crisis of process.

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Put Process First

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Process is a technical term with a precise definition: an organized group of related activities that together create a result of value to customers. Note that no single task creates the result. And the process is organized and requires working together. To make it work, all elements must be present in your process. You must design processes that specify exactly what work is to be done, in what order, in what location, and by whom.

Unfortunately, traditional organizations aren't friendly to processes. They are structured around departments, each focused on one task. Each unit speaks its own language and remains aloof from the others. As a result, customers' orders are like travelers passing through a series of rival kingdoms, where border guards give them a hard time before stamping their visas.

How do you make the shift from the old way to the new? It requires paying close attention to process development. Being organized as the definition requires means having concrete, specific designs for processes so that their performance can't be determined by improvisation or luck. Being together means creating an environment in which all process workers are aligned around common goals and see themselves as collaborators rather than adversaries.

The Four Characteristics of Good Process

There are four distinct features that characterize process thinking. First, processes are teleological. That is, they focus on the outcomes of work rather than on the work itself. Everyone in the company understands the why as well as the how of their work. Training and performance measures reinforce the outcome orientation of processes.

Second, processes are customer-focused. Thinking in terms of processes compels a business to see itself and its work from the perspective of the customer rather than from its own.

Third, processes are holistic. Process thinking transcends individual activities. It concentrates instead on how activities fit together to produce the best outcome. Superior value for the customer is achieved when warring departments are replaced with a seamless web of collaborators working together for a unified purpose.

Finally, process thinking is based on the belief that business success flows from well-designed ways of working. A company's success isn't attributed to a visionary CEO, a marketing genius, or a brilliant product developer. Instead, process companies institutionalize success by designing high-performance ways of working. They believe that a company achieves its highest potential by designing processes that mobilize everyone's abilities rather than depending too much on any

The Payoffs of Process Mastery

In a survey of dozens of companies that adopted the process approach, cycle times were reduced by 60 to 90 percent, and on-time delivery with no errors increased by 25 percent. Procurement costs were slashed by 80 percent, and procurement times by 90 percent. Successful launches rose from 30 percent to 50 percent and the time to market for a new product was shortened by 50 to 75 percent. These improvements in process performance paid off in the critical enterprise currencies of customer satisfaction, customer retention and corporate profits.

single individual, no matter how talented.

Creating the Process Owner

In order to work, every process must have a process owner — a manager responsible for ensuring that the entire process keeps flourishing from start to finish, over and over. He or she is in charge of designing the process, building its support, installing it in the organization, and making sure it operates as planned. The manager also designs and implements the measures to assure the process works. The process owner does more than design and measure the process. He or she also supports and enables the people who actually perform it by educating them and serving as a resource.

Process owners must be among the most senior managers in an organization. The position can't be given to a mid-level manager with no clout. He or she must be senior enough to have the authority to implement the process. Some companies are appointing senior executives to be chief process officers, or CPOs. A CPO is responsible for convening and chairing a process council consisting of all the company's process owners and key executives. The council resolves cross-process issues of politics, priorities and resource allocation. ■

Create Order Where Chaos Reigns

In many organizations, much work is best compared to Brownian motion, where particles bounce around completely at random. The reason is simple. They still operate the same way they did when they were much smaller and could operate informally.

With growth come problems. The company's old ways of working don't scale up. As more workers are hired, fewer of them know each other, or the customers. The company's employees soon find they know more and more about less and less.

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Create Order Where Chaos Reigns

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The key to continued success is coordination and discipline. Activities not only must be done, but they must fit together and be done in the right order. The critical work of selling and developing products must be built on discipline and structure — it must move from the ad hoc to the methodical. Making it up as you go is a recipe for disaster. By specifying a precise sequence of steps and pinpointing responsibility for performing them, you introduce composition and order into areas where chaos would otherwise rule. No longer will people need to put energies into figuring out how to work; they can concentrate on the work itself.

Discipline Encourages Creativity

Discipline does not eliminate the need for individuality or creativity. On the contrary, it actually encourages them by providing a framework that allows each person to leverage his or her own activities. Structure ensures that the parts come together as a whole. Structure is liberating. Discipline provides a framework that assures that creative and talent-intensive activities are done by the right people, at the right time, with the right information.

Introducing structure is important for another reason. Companies that do become less dependent (and hostage to) a small group of talented people, who often know all too well that they are close to indispensable. A company dependent on heroes can find itself in desperate straits if they suddenly depart. A disciplined process, however, belongs to the company. If some people go, others can be plugged into the system in their place.

Strong Leadership Is Key

Achieving a disciplined approach requires gaining a new perspective, a new set of attitudes on the part of everyone in the organization — managers and front line workers. People have to accept that they can't be a lone wolf, but must believe in the primacy of teams. It is the group working together that creates results. These are extraordinarily difficult adjustments to make for many people.

How do you make it happen in the face of resistance? The critical ingredient is unswerving executive leadership and constant reinforcement. An occasional memo will not do. A new way of thinking and behaving must be repeated and stressed by the company's leaders, who must make it plain that there is no going back. The cultural shift must also be reinforced by readjusting the compensation system. Compensation can encourage changes in behavior and send a signal of what's important. Even when people get the right results, they must not be rewarded if they succeeded in the wrong way. ■

Measure Like You Mean It

A company's measurement systems typically deliver a blizzard of nearly meaningless data that quantifies practically everything in sight, no matter how unimportant. It often is so voluminous as to be unusable, is delivered too late to be of any use, and languishes in briefing books without being put to any purpose.

Make measuring part of managing, not accounting. Although measurement systems were initially developed to let companies report financial results to shareholders and tax authorities, the systems were inappropriately pressed into service to support management decision-making. Using financial measurements designed for accounting is like trying to manage a baseball game today by using last year's win-loss record to tell you whether to call a hit or bunt.

Today there is relentless pressure from shareholders and customers to improve performance immediately. A company's measurement system must be able to reveal the sources of performance inadequacies. Companies need a new approach to measurement, one that is tuned to the demands of the customer economy. The purpose of measurement is not to know how a business is performing but to let it perform better.

Contemporary measurement systems should provide no data without a purpose; people must know why things are measured and what they are supposed to do about them. Companies will need to develop business models that link overall goals to specific things they can control. Then they must identify the key elements in that model and develop measures for them. Design measures that are objective, timely, easy to calculate and easy to understand. ■

Managers on Useless Measurements

Here are some real comments by managers on their companies' attempts at measuring:

- ✓ "We use two percent of what we measure. The rest is CYA."
- ✓ "We are masters of the micro. We measure paper clip acquisition times."
- ✓ "If you want to know my inventory levels on March 2, I'll tell you in mid-April."
- ✓ "Business leaders don't concentrate on measurement because they were turned off by accounting in business school."
- ✓ "It's hard to do measurement right because our executives don't believe it's important."

Manage Without Structure

Corporate managers definitely don't play well with others. They are as territorial as lions and wolves, and the more senior they are, the more territorial they become. This behavior isn't genetic; it is induced by the ways in which companies are organized. Executives typically divide their companies into pieces and assign a different manager to each. The problem with this scheme is that it narrows the focus too far. Those managers often ignore everything outside their domain and defend it from all intruders. They reluctantly accept orders from higher-ups but exhibit intense animosity toward other managers who are competing for resources, attention and promotion.

The time has come for managers to worry less about organizational structures and charts and more about marshaling their resources for the benefit of the customer. That an enterprise as a whole can be decomposed into independent units is an outmoded idea. Emerging in its stead is a structure far more subtle and complex, in which no manager has complete independence. Those at the top collaborate for the benefit of the entire company.

New Management and Leadership Skills

This new kind of non-structure needs a new kind of manager with a new set of skills. The traditional managerial role bestowed authority and power on whomever happened to be filling it at the time. No longer. Now management roles are only what the incumbents make of them. If they are forceful representatives for their constituencies as well as effective team players, then both they and the company will succeed. If they are not, they will be relegated to the sidelines.

This new kind of structure is virtually structured and essentially unstructured. It is responsive and flexible and

requires very little overhead to make it work effectively. What it does require is a dynamic and strong leader. Structure-less does not mean leaderless. A true leader, not a bureaucrat or a dictator, is an absolute requirement if the enterprise is to harness the power of structural ambiguity. A strong leader provides the cohesion that otherwise would be provided by formal structure.

This kind of business leadership is a new requirement. In the new customer economy, a rigid organization led by a traditional manager will fall apart at the seams. Today's leader must hold the enterprise together, because nothing else will do it for him. ■

Focus on the Final Customer

Do you know who your customers are? In a great many industries, companies simply have no idea. They are shielded from their real customers — the people and companies that make use of their products or services — by their distribution chains or channels — the wholesalers, distributors, retailers, dealers and other intermediaries that come between them. The great majority of products and services reach their final destination only after passing through the hands of one or more intermediaries who buy and resell.

That has to change, simply because each step in the process adds cost, but no value. An air conditioner is no better because it was sold by the manufacturer to the distributor and then to the contractor. In addition, using intermediaries means that goods must be warehoused. Consider the dry groceries industry. Dry groceries are the packaged items in the central isles of most grocery stores. On average, more than 100 days pass from when the product comes off the production line until the consumer buys it. The problem is not slow trucks. The problem is that the foods are moving through lots of hands. More than 40 percent of all food items stop at least twice between the plant and the retail shelf. Each time it must be loaded and unloaded, adding cost but no value.

Using Intermediaries Differently

In the days when customers were weak and powerless, the traditional intermediary system worked. However, customers won't put up with it any longer. Companies must be closer to their final customers in order to hold them, up-sell and cross-sell them, and get the high-margin follow-up sales. They need to be closer so they can serve them quickly and accurately, and to drive out huge costs and inefficiencies.

The answer is not to eliminate intermediaries entirely, but to use them differently. Manufacturers and intermediaries must collaborate to leverage each other's capabilities in the interest of creating a distribution system

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End the Tyranny Of the Organizational Chart

- ✓ Get over the idea of sharply defined business units with autonomous managers.
- ✓ Redefine managers as representing markets, products or processes, rather than having total control over them.
- ✓ Make managerial teamwork and cooperation the rule rather than the exception.
- ✓ Teach managers to put the needs of the enterprise as a whole first.
- ✓ Employ rewards that emphasize the group over the individual.
- ✓ Substitute inspirational leadership for formal structure.

Focus on the Final Customer

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that maximizes value for the final consumer. You must begin to think of distribution from the customer's point of view.

Remember, the real purpose of a distribution channel is not to get products to final customers, but to solve customers' problems. Consider customers who need cell phone service. To help them sort through the variety of choices of plans, equipment and price, customers need help. They can turn to the sales people who distribute cell phones for that information. If these distribution channels and service providers work together, customers will get what they want and need, and everyone in the chain wins.

The Distribution Community

One furniture manufacturer has turned to the Internet to successfully use intermediaries when necessary, but reaches customers directly for some purchases.

The company has divided its products into furniture and furnishings. Furniture, which customers want to see and touch before buying, and furnishings, such as lamps and other small items that don't need to be touched before selection and are easy to ship, are marketed differently. A Web site lets potential customers see the selection of furniture styles, but directs them to local retailers to try them out. Customers can then order directly or through the retailer.

In both cases, the goods are shipped to the retailer for delivery. The retailer remains an intermediary physically, but not financially. He doesn't have to buy and inventory the furniture. The retailer gets a commission

Duke Power Gets It

One company that understands how to make a company work is Duke Power. At Duke, neither a process owner nor a regional boss has complete autonomy. The former controls the process design while the latter controls the people who carry it out. This requires extraordinary cooperation between the two. In designing the process, the process owner must take into account the regional staff's capabilities. The regional boss must take into account the requirements of the process when hiring people. Neither one can say to the other "Do it my way." If either tries to assert total control or usurp the other's responsibilities, the enterprise fails. Duke does not have a hierarchy with clear lines of authority. Instead, its executives float in a soup of shared accountability. If the process owner and regional boss work well together, both succeed. If they don't, both fail.

for delivery and service. Furnishings are ordered directly from the Web site and then shipped directly to the consumer. But the local retailer still gets a ten percent commission, in exchange for promoting the brand and the Web site.

These new relationships need a new name. They are no longer distribution channels. Rather, there is now a distribution community. Driven by a customer focus, and enabled by new technology, channels have evolved into communities, or groups of companies that work collaboratively to meet the final customer's needs. ■

Knock Down Your Outer Wall

If you are like many other companies, you have been systematically stripping out all the nonsense activities that degrade business performance. It wasn't easy but now you feel you are lean and mean, flexible and efficient, stripped of fat down to the bone.

Dream on.

Things may in fact be better than they were a decade ago. But in the larger scheme of things, you have just begun. What degrades your performance is no longer how you work internally, but how you work on your boundaries with customers and suppliers. Getting rid of this overhead is the Next Big Thing in improving your operating performance. Now you must destroy the walls between enterprises, especially those that separate you from your suppliers and customers.

Integrating Operations with Suppliers

If integrating operations within your company can produce greater efficiency, so can doing so with your supplier. Take, for example, a common scenario in business. You need to order supplies to use in the manufacturing process. You locate the supplies, prepare an order, send it out, and wait for the supplies to arrive. On the other end, the supplier gets the order, makes sure it is available, prepares an invoice, and ships the order. You then get the shipment, enter the information in your computer, and pay the invoice. Many of the steps in the transactions are redundant. These two processes (order and fulfillment) should be seen as one process.

The real power of the Internet lies in solving this problem, in integrating intercorporate business processes and the information systems that support them. This, in effect, takes a sledgehammer to the walls that separate companies from one another.

There are five guidelines that companies who want to collaborate more closely need to follow. These are:

- **The final customer comes first.** All members of the collaborative must be aligned around meeting the needs of the customer, whom they ultimately work

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Knock Down Your Outer Wall

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together to serve.

- **The entire process should be designed as a unit.** Any collaborative process needs to be thought through in holistic terms. Each participant can't design and implement its own part in the larger process. It must be done together.
 - **No activity should be performed more than once.** Eliminating duplication of activities yields savings.
 - **Work should be done by whomever is in the best position to do it.** Do what you do best, and let the others do the same.
 - **The entire collaborative should operate one database.** Everyone must share the same version of all information. ■
-

Extend Your Enterprise

While Henry Ford may have been sold on vertical integration, it doesn't work well today. The realities of scarce capital make it unrealistic to control every aspect of production. It simply isn't possible to finance a totally vertically integrated enterprise anymore. Vertical integration is being replaced with its polar opposite, **virtual integration**.

Instead of doing everything involved in creating a product or service, a virtually integrated business focuses on doing those things it does best. It works in close partnership with other organizations that also focus on what they do best. Companies stop being self-contained units that produce products or services, and become elements in a larger system.

Do More of What You Do Best

Outsourcing is an essential component of virtual integration, as is the notion of core competencies. Core competencies were originally those tasks that a company had to perform superlatively in order to succeed. Companies today are under intense pressure to outsource everything that isn't a core competency — to someone for whom the task or service is a core competency. The marriage of core competence and outsourcing means that companies are doing more of what they do best and less of everything else.

Combine increased customer value-added, inter-enterprise collaboration, and core competence-driven outsourcing, and the result is virtual integration: multiple companies working together to create the results expected from just one. From the inside, everyone can see that there are multiple enterprises at work. From the customer's point of view, everything meshes as though there were only one.

Prize Partnership

Virtual integration will require a radical cultural shift. Instead of the traditional values of haughty pride and suspicion of all outsiders, a company must prize cooperation, trust and partnership. It must eagerly share information and be able to sacrifice short-term gain for the benefit of the larger virtual enterprise of which it is a part. It must recognize that success comes to every participant or none at all. ■

Prepare for a Future You Cannot Predict

You cannot know what challenges will face your company in five years, or even next year. Just look at last year's strategic plan. Is it still relevant? Or are you responding to entirely different challenges than those you envisioned when creating the plan? That doesn't mean you shouldn't plan. It does, however, mean that you must begin to identify problems or opportunities before it is too late.

Do so by building a process to spot changes on the horizon that includes the following steps:

- **Create an early warning system.** Because most organizations regard change as an anomaly, none of a company's sensory systems are designed to watch out for it. Critical change tends to occur far below the sixteenth-floor suites occupied by company executives. These can include a sudden shift in customer preference, or a competitor's new product. You must make change watching a formal and explicit activity within the organization, a process.
- **Develop deep insight into your customers.** Part of the change process must be developing deep insight into your customers. That means identifying their real needs. You must see the world through their eyes and understand them better than they understand themselves.
- **Analyze potential competitors.** New competitors require serious attention. You must continuously scan the horizon looking for others that have the potential to offer competing products and services.
- **Look for the seeds of the future in the present.** There are always early indicators of change. Your job is to find them, and act.
- **Become proficient at responding to change.** There must be a disciplined process in place to respond to change. Waiting too long or moving too fast can both be mistakes.
- **Create a supportive organizational infrastructure.** In order for the processes of change recognition and implementation to succeed, they must take root in a corporate culture and structure that welcomes them. ■