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Business Agility

*Sustainable Prosperity in a Relentlessly
Competitive World*

Michael H. **Hugos**

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To my wife Venetia

Microsoft Executive Leadership Series: Series Foreword

The Microsoft Executive Leadership Series provides leaders with inspiration and examples to consider when forming business strategies to stand the test of time. As the pace of change quickens and the influence of social demographics, the impact of educational reform, and the impetus of national interests evolve, organizations that understand and embrace these underlying forces can build strategy on solid ground. Increasingly, information technology is bridging social, educational, and international distances and empowering people to perform at their fullest potential. Organizations that succeed in the enlightened use of technology will increasingly differentiate themselves in the marketplace for talent, raw materials, and customers.

I talk nearly every day to executives and policy makers grappling with issues like globalization, workforce evolution, and the impact of technology on people and processes. The idea for this series came from those conversations—we see it as a way to distill what we’ve learned as a company into actionable intelligence. The authors bring independent perspectives, expertise, and experience. We hope their insights will spark dialogues within organizations, among communities, and between partners about the critical relationship between people and technology in the workplace of the future.

I hope you enjoy this title in the Microsoft Executive Leadership Series and find it useful as you plan for the expected and unexpected developments ahead for your organization. It’s our privilege and our commitment to be part of that conversation.

DANIEL W. RASMUS
General Editor, Microsoft Executive Leadership Series

Titles in the Executive Leadership Series:

Rules to Break and Laws to Follow by Don Peppers & Martha Rogers, 2008.

Generation Blend by Rob Salkowitz, 2008.

Uniting the Virtual Workforce by Karen Sobel Lojeski & Richard Reilly, 2008.

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Business Agility by Michael Hugos, 2009.

Generation X-ecutive by Rob Salkowitz, 2009.

Leading the Virtual Workforce by Karen Sobel Lojeski & Richard Reilly, 2009.

Preface

The implications of our global real time economy affect us all. Its rise has been much discussed for the last 30 years or so, and during that time this economy evolved in ways that were often slow and subtle. Sometimes it even seemed like the real time economy was more about words than reality. Now we know otherwise. The global economy has a life of its own; it lives in real time; and we are all a part of it. Hello, brave new world.

The technical and economic infrastructure that makes this economy possible has gone from something of academic interest and speculation to something that now sets the daily tempo and working conditions of our lives. This economy is at times a pretty harsh taskmaster. We wonder if there is a way to get back some of the personal control over our careers and our lifestyles that seems to have disappeared.

Our world is driven by the convergence of a host of forces that are transforming the way we live. There is relentless economic competition, outsourcing of white-collar jobs and manufacturing jobs to lower-wage countries, rising prices for basic commodities like food and fuel, and the climate change effects resulting from the actions of all of us.

Our challenge is clear enough. It is to learn to use this economy and the information and communications technologies that enable it to operate so as to achieve and sustain a good life, one that responds to our basic needs for sustenance and also responds to our higher needs for belonging, esteem, and self-actualization. In rising to this challenge, many things will change.

We are sailors on an ocean of change and the organizations we are part of are the ships we sail. We cannot sail against the prevailing winds, but we can learn to work with the wind and the waves and harness their energy to arrive at the destinations we aspire to reach. It is in this process of learning that some of our greatest opportunities lie.

The first two chapters of this book define the business challenges we must confront and also some of the new opportunities and technologies available to us to use in addressing these challenges. Chapters 3 and 4 outline operating principles and strategies we can use to respond to these challenges. Each chapter provides case studies and examples to illustrate the ideas presented.

The next two chapters are focused on illustrating different aspects of the operating model of businesses built to thrive in the real-time global economy—what this book calls responsive. Chapter 5 goes into further detail on how such organizations work, and Chapter 6 presents examples and discusses ways to make best use of technology to empower the people and operations of these organizations.

The last two chapters address two themes that are central to making the responsive organization happen. The first theme is desire, and the second theme is innovation. Chapter 7 examines barriers that test our desire and our collective will to create responsive organizations, and it presents techniques for surmounting these obstacles. Chapter 8 provides insights into the process so important for creating something new: innovation. The responsive organization comes partly from new ideas and partly from old ideas combined in new ways. This chapter presents those ideas in the form of five key characteristics that describe what a responsive organization is and how it operates.

My intention in writing this book is to articulate a handful of powerful trends that are shaping our businesses and our lives in this century and to offer a handful of simple yet equally powerful principles and techniques for responding to these trends. We live in interesting times. We live in the best of times. I am always glad to hear your comments, your questions, or your further insights on the subjects discussed here.

Please feel free to contact me via my website: www.michaelhugos.com, or at my blog "Business Agility & Sustainable Prosperity." My email address is: mhugos@yahoo.com.

*MICHAEL HUGOS
Chicago, IL
December 2008*

CHAPTER 1

Responsiveness Trumps Efficiency

Today's global economy squeezes profit margins more efficiently than ever before. Electronically connected global markets are doing what markets do so well; the commodities traders and stockbrokers call it "efficient price discovery." That phrase means global markets are constantly finding the lowest price for all basic commodities and services based on current supply and demand—everything from blue jeans to fuel oil, and hotel rooms to accounting services—and constantly resetting those prices as conditions change.

This market driven efficient price discovery tends to relentlessly reduce profits and drives the prices people can charge for products and services closer and closer to their cost of production (sometimes even below their cost of production). Companies are always moving their production to low-cost labor markets and outsourcing activities in a scramble to lower the cost of production so that they can still make a profit at price points set by the market.

For this reason, the best profits for most companies no longer come from standard or commodity products; the best profits are now to be found in new and creative products and services. If these new products catch on, for a while they have no competition and there is lots of demand so prices stay high. But products and services are new and

innovative for only a short time. Then they become commodities because they get copied and offered at lower prices. And when that happens, profit margins drop again.

Most profitable opportunities in the global economy are, by definition, short-term opportunities. Companies need to respond and act quickly in order to capitalize on opportunities that arise. This has always been true, but now it is critical if a company is going to maintain its long-term profitability.

THE WORLD BEHAVES LIKE A STOCK MARKET

The Internet and the search engines and the trading and procurement systems that make global markets possible also do something else. They provide massive and continuous flows of data the likes of which we used to see only in connection with financial markets, such as stock and futures markets. Now our economy everywhere is generating similar flows of data. Companies generate data flows from their internal systems; e-commerce and supply chain networks generate more data flows that go between companies; and the Internet moves all this data from anywhere to anywhere 24 hours a day, seven days a week.

These real-time data flows cause the whole world to behave like a giant stock market with all the volatility and uncertainty that goes along with such markets. And because real-time data is available, we are all doing business in real time now whether we know it or not. Just as stockbrokers use real time stock market data to constantly monitor and react to their markets, so too can people in business use available real-time data to monitor their own markets and react quickly as situations change.

The very fact that more and more companies are connecting up with e-commerce and electronic trading networks means that the markets they work in are becoming more volatile. Because information is available in real time, people are learning to react more quickly. Change ripples through markets much faster than ever was possible in the industrial economy. Supply and demand data for products and services are communicated quickly so the prices of those products change quickly (just like stock prices). Gone are the days when people could confidently predict the price of any commodity for more than a month or two.

Companies that succeed are learning to make continuous small adjustments in their operations to respond as conditions change, and they are learning to continuously enhance their products and services with new features as their customers' desires evolve. They learn to make money from many small adjustments and from some occasional big wins—just as stock traders do.

Companies must attain and maintain a level of “good-enough” efficiency, but unless a company is the low-cost leader in its market, it cannot use efficiency alone to generate profits. For the most part, it is now customer responsiveness that generates profits in the form of customers paying slightly higher prices for products and services that they find more responsive to their needs. Since these products deliver more value, people are willing to pay more.

Opportunities to make money by being responsive have exploded. There are far more ways to use responsiveness to attract customers than there are ways to use efficiency and low prices. This is because there are so many different kinds of customers, and each is looking for slightly different mixes of products and services. Constantly changing environments

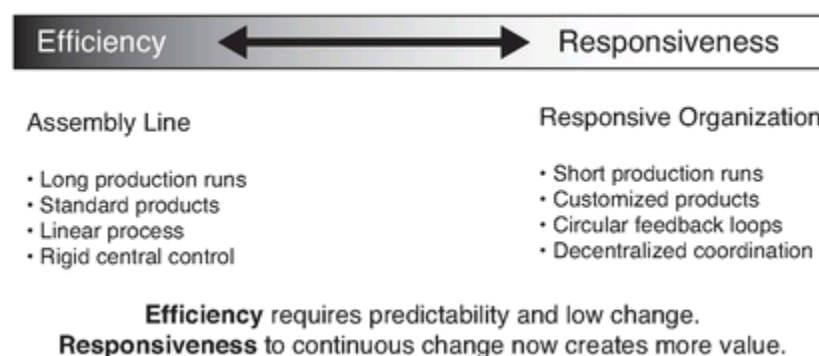
and customer needs enable responsive companies to offer continuously evolving mixes of new products and services.

Companies respond to evolving needs and desires of specific groups of customers by wrapping their products and services in tailored blankets of value-added services. Occasionally they find opportunities to introduce entirely new products and services. As profits on old products decline, profits are always to be found by creating new products that respond to new needs.

Responsiveness enables a company to consistently earn an additional gross margin of 2 to 4 percent (and sometimes more) than what it would otherwise earn for its commodity product or service alone.¹ This responsive focus on customer and market specialization is now the most promising and the most sustainable source of profits in our fluid, real-time economy. These ideas are summarized in [Figure 1.1](#).

In this high-change global economy, *responsiveness trumps efficiency*.

FIGURE 1.1 Companies Exist on a Continuum between Two Needs



EFFICIENCY IS ONLY HALF OF THE EQUATION

For the last few hundred years, the most important consideration in business was efficiency: producing products at the lowest possible cost. But now we are all part of a global labor force, and there are countries in Europe and North America that can no longer compete on efficiency alone because their labor costs (also known as people's salaries) are so high compared to labor costs in countries in Asia, Africa, and South America.

What is to be done? Will the economic boom for some countries be economic doom for others? That might be the case if the only economic force we considered is efficiency. But we are missing something important when we do this; in addition to efficiency, there is another economic force called responsiveness. Efficiency provides us with basic products and services at the lowest price. Responsiveness wraps those products and services in a blanket of value-added services that customize them to our particular needs and, in doing so, makes them more valuable to each of us.

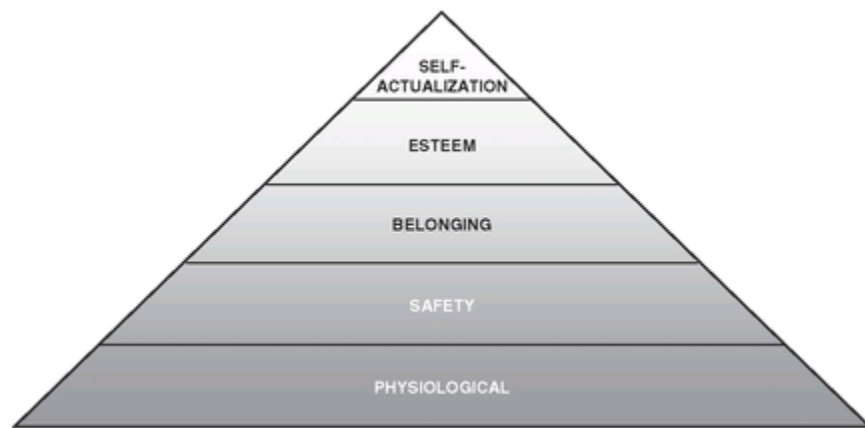
Everybody has needs that go beyond efficiency. As soon as people are able to acquire the basics, they want something more (see Maslow's Hierarchy of Needs² as presented in his classic article "A Theory of Human Motivation"). A basic pair of sneakers costs about \$20, but there are a whole lot of people willing to pay \$100 or more for sneakers that respond to their other needs. A basic new car costs about \$16,000 (or less), but there are many millions of people willing to pay much more to get cars that respond to their other needs.

People want what they want. They want a good price, but that doesn't mean they want the lowest price. People usually also want a tailored bundle of additional services and features wrapped around the basic product. They will pay extra for these other features as long as they meet expectations. Maslow's Hierarchy of Needs in [Figure 1.2](#)

shows that once a lower-level, basic need is filled, people aspire to filling higher-level needs.

Even the most basic commodity product can be wrapped in a blanket of value-added services that increases its value to particular customers because those value-added services provide features customers want. For instance, we have all seen how a commodity product like the coffee bean can be wrapped with a blanket of value-added services and so give rise to a whole industry. People will pay more for a good cup of coffee made just so and served in a cozy setting. And if the quality of the coffee and the coziness of the setting start to decline at one company, customers simply go elsewhere. People will pay more for a good product but they do not pay extra if they are not getting what they want.

FIGURE 1.2 Maslow's Hierarchy of Needs



Good customers (and most customers are good customers when you figure out what they really want) will pay a few percentage points more in order to get a carefully tailored bundle of goods and services from you that either solves an important problem of theirs or enables them to enjoy a major benefit. Who are the good customers in your business? How will you get more of them? What are the tailored solutions you offer them? How will you evolve these

solutions over time to keep up with good customers' changing needs?

And here is another thing to think about: If you don't have many good customers, how will you keep your bad customers from destroying your profits and your business? Is efficiency alone a sufficient answer to this question?

TRADITIONAL BUSINESS MODELS ARE COMING UP SHORT

Many large, established companies are demonstrating that their traditional focus on efficiency no longer shields them from market fluctuations, nor does it deliver the profits it once did. Their business models need to be redesigned. They follow business strategies based on twentieth-century industrial concepts of efficiency, such as spreading fixed costs across huge numbers of units sold, scheduling long production runs, and assuming there is a steady, predictable demand for their products.

In reality, things such as stability and predictability are conspicuously absent from our global economy. Yet companies continue their old industrial strategies and continue to struggle with rigid multiyear plans and projects as they drift farther and farther away from alignment with constantly changing market conditions.

Then, when the alignment between company operations and actual customer demand becomes seriously out of balance, when finances drift deep into the red zone, companies have no other options for responding except to make sudden and drastic cuts in their operating expenses. They sell off businesses, close down factories, and disband whole groups. They lay off thousands of employees at a time.