

The New Common Sense¹

by Russell Redenbaugh and Rachel Budd

I. The Coming Productivity Surge

We are headed toward an explosion in commerce, a tremendous surge in productivity. The clustering of a large number of technological and pragmatic innovations will bring to service work and the general management of business the same tremendous explosion in productivity that produced the industrial age and the automated factory. We are not there yet, but we are beginning to be there.

We are in an interregnum, the period between kings. The prior "king" was the king of mass industrial production, based on the technology of Newton, the electricity of Maxwell and the theories of Taylor. We have yet to arrive to the new "king" of management and productivity based on an understanding of organizations as networks of commitments.

Transitions always produce confusion. The rules that worked under the prior "king" no longer make any sense and the world looks complex. The new rules, once they are worked out and understood and they become part of the common sense, will produce a world that is simple, understandable and predictable.

Those who see these new rules early can adopt winning corporate strategies; invest in predators, sell the prey; and develop more clarity and certainty about the future

In this chapter we begin to show the new common sense and examples of companies that are already demonstrating portions of this.

II. Business Today: Crisis in the Service Sector

There is a structural crisis in the service economy. This crisis is a crisis of know-how. Productivity in the United States has been falling - not in manufacturing, but in the service sector. Managers and executives who have been very good at knowing how to make and move "things" have the wrong common sense for managing service companies or the service component of manufacturing companies. Continuing with old strategies and doing more of what used to work in the past has only accelerated the collapse in these industries.

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Contrary to popular belief, the U.S. is not in the midst of an industrial crisis. This is a myth. During the last 120 years, tools of production - tools used for making and moving things - have increased the productivity of the average worker by 3 percent per year. This may not sound like very much, but it has produced a 45-fold increase in real wages, generated the middle-class, and immunized the majority of the industrial world's workers against the virus of Marxism.

Some say that this process is stopped in the United States, that Japan and West Germany are eclipsing the United States. This is not true. Japanese and German gains in productivity have been tremendous, and we can expect further gains from these countries, but the United States has continued to advance. During the 1980s the rate of gain in manufacturing productivity in the United States approximated 4 percent per year and industrial output increased by 40 percent. Currently, the German and Japanese economies are still contracting while U.S. income, output and employment are still rising.

While our industrial sector is in excellent shape, there is a crisis in the service sector and a crisis in labor markets. The headlines show the failure of our service companies, not our industrial companies. Productivity in the service sector is falling, down 3 percent during the '80s. Real incomes for the unskilled and the uneducated fell substantially in the last decade and the jobs of middle managers, especially in our largest corporations, are being permanently eliminated.

The coming surge in service sector productivity, which is already underway, is important for the entire U.S. economy, and for all industrial economies, because approximately 75 percent of jobs are in the service part of the economy - retailing, banking, insurance, finance, medicine and governments. If a zero rate of growth is maintained in service sector productivity, a country's employment base, middle-class, national competitiveness and even national security are at risk.

It is a social as well as commercial imperative that we bring the kinds of productivity gains that have been produced in manufacturing to the service worker, and particularly to the office worker. To do this we need a new common sense and new tools.

Why do we have a crisis? Why has there been nearly zero increase in productivity in the office despite the estimated \$1 trillion invested in office automation over the past 10 years?

Measurement Error: In part this is a measurement error. We can't measure the productivity increase because we don't have the right "instrumentation," the right tools for observation. Yet, our common sense tells us that we are doing more, higher quality

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work, with better graphics and fewer spelling errors thanks to our word processors, laser and color printers, spreadsheets, fax and electronic mail systems and more.

But largely, we have accomplished little here. Look at all the things I just listed - word processors, laser and color printers, spreadsheets, fax and electronic mail systems. These all have to do with the improvement, the automation, and the acceleration of pieces of paper.

In the past decade we have spent close to \$1 trillion in automating the service sector, in automating offices. The Department of Labor can measure no improvement in productivity in office work, in fact they can actually measure a decrease of about 2 percent, in spite of this trillion dollar investment.

Part of the problem is that the Department of Labor can't measure productivity in this area. They do not have good criteria for measuring the productivity of office work, the criteria are not well defined. They are measuring the wrong thing. So, part of the problem is a measurement error.

Automated the wrong thing: The other part of the problem with the automation of the office is that we have automated the wrong things. Typically, we have automated the mess. Now we can do faster what were doing before. Clearly there have been some big improvements - in the quality of word processing, spell checking, graphics, fax machine, fedex and modems, etc. We can definitely do the wrong things, make the wrong offer to the client at a higher and faster rate.

When we decided to automate the office 20 years ago we called in the people we had used to automate the factories of the world. As a result, we got systems for automating the paper flows in offices similar to the systems for automating materials of a factory. We looked with industrial age eyes, and we saw what we saw in factories, which is that you need to automate the movement of components, moderate the components and sub-assemblies through inventory and flows and combine the whole thing so that at the end a car comes out.

We automated paper flows with things like word processing and copying. Then we also automated, at the same time, the information processes. We got the people from IBM who could show you how to do that in an elaborate, sophisticated, complicated and expensive way. We tried to maximize getting the right data to the right people to make the right decision, and we built these input-process-output models. Well, that didn't seem to work very well either, we can't seem to find that we got any rate of return on that. Again, part of this is measurement error, but the real problem is that we didn't define and automate the business processes that produce customer satisfaction.

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Many executives have the wrong understanding of how to produce customer satisfaction and profitability. The crisis in the service sector is also a crisis of coordination. *The solution to this crisis can be found by discovering the fundamentals of coordination and building tools and systems which return our organizations to their capacity to coordinate effectively and produce customer satisfactions.* This new understanding is a new common sense.

III. The New Common Sense

When we refer to a new common sense we mean the automatic way we have of thinking about the world, the metaphors we use, the explanations we have and the assumptions that we make that are so automatic that we never see they are assumptions.

For example, we assume that we need departments in companies rather than process oriented teams. As recently as ten years ago, we all assumed we needed banks for banking, now we bank with our brokerage firms and buy mutual funds from our banks. We assumed that there was no market for personal computers, that no one other than engineers needed a small personal computer, and no one needed one at home. We once assumed that three square meals a day - meat and potatoes, the four food groups - constituted a healthy diet. For any of us who are middle aged, if we think back over our life we can see the overturning of one assumption after another.

A new common sense is one that overturns old assumptions; it is one that allows for innovations that generate new products and new practices. *A new common sense in business that is bringing success is one that sees customer satisfaction, rather than quality, cost reduction or profit increase, as the mission for the organization.*

Customers pay for satisfaction, not merely for quality, flexibility, reduced cost, reduced cycle time or some other factor such as variety. *Companies that are succeeding are those who "listen" to their market and "listen" to their customers.* These companies determine what it is that produces satisfaction for their customers, understand their process and work continuously to improve them.

The Mayo Clinic, for example, is the only brand name in the hospital business. They have something that they call the "Mayo way." In addition to the most sophisticated treatment in the country they also know how to listen to the needs of their customers. Paperwork is completed after the patient is cared for, not before. They do not assume that the process of producing satisfaction starts at their door, but much before then. From the airport facilities to curb cuts on the streets, the town of Rochester, MN is influenced by Mayo and designed to support its customers.

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To service their distant clients they have opened clinics in Florida and Arizona, staffed these with their doctors who are trained the "Mayo way" and supported them with technology that allows them to converse with and advise their colleagues to better serve their patients.

Successful companies are those that produce better ways of coordinating, both with their customer - by making it easier for their customer to do business with them - and amongst their employees and vendors so that they can reduce the cost or shorten the cycle time of satisfying their customer.

LensCrafters, for example, improved coordination with the customer by situating themselves in malls across the country and making it convenient for customers to purchase new glasses. Since LensCrafters promises one-hour turnaround on all orders, customers can shop while they wait.

Deluxe Check is an example of internal coordination. The company has established internal standards and designed their systems to assure that checks go out error free and within forty-eight hours. In order to do this they moved manufacturing closer to the customer and set up sixty-two plants nationwide that are electronically linked to receive orders. Orders for each day are printed on a different color paper to better track that orders go out on time - if Wednesday's color is still around and unfilled on Thursday afternoon, the full court press is on.

Another essential component of the new common sense is the focus on managing commitments made to the customer, and not merely moving pieces or things around. Companies that know they are working to take care of their customer organize themselves in an absolutely different way - their practices and technology center around tracking and managing the completion of commitments, not the movement of paper or data around the organization.

Federal Express, the famed overnight mail carrier, is an example of pure coordination. The promise that the company makes to its customers is to deliver packages by 10:00am and to always know the location of your parcel. Above and beyond promising to get the package to its destination on time, however, Federal Express is very clear that it is promising to take care of the customer and his concerns if the package is going to be late.

For example, when a snow storm prevents your package from arriving on time due to closed airports, they will call ahead to alert you to the breakdown, inform you of a new arrival time and check to see if, given the delay, it would be more convenient for you if they delivered the packaged to an alternative location. They are very clear that they are

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not merely delivering a package, but delivering a service and their systems are all designed to coordinate and fulfill their promises.

IV. ActionWorkflow: A New Method For Understanding Commerce

ActionWorkflow is one of the new approaches emerging today for understanding organizations. It is an approach that brings clarity to what may seem to be confusing business situations. It provides a simple way to understand and duplicate what may seem to be rare or unusual skills of a few select companies. This new approach is based on the new common sense that sees organizations as networks of commitments designed to produce customer satisfaction, rather than hierarchies of reporting relationships.

This new approach understands that for every transaction that produces satisfaction there are four elements. These elements are: customer, performer, the conditions under which the customer will be satisfied and time. These elements constitute a universal structure for the basic unit of trade or commerce: the transaction. This structure is called the "Basic Action Workflow." (See diagram)

In its most basic form, the ActionWorkflow loop is made up of two transactors (the "customer" and "performer") and four stages of the process - Preparation, Agreement, Performance and Satisfaction. Each loop represents an exchange or commitment between two people for work to be done where the "customer" for the transaction may be someone internal or external to the company. The movement through all four of these stages describes a completed transaction that produces customer satisfaction.

Once you begin to look at a company as a series of workflows linked together then you can map the essential business processes of the organization. When an organization is interpreted in this way, a map of the commitments shows at a glance areas of confusion and incompleteness, inefficiency and ineffectiveness. You now have a structure in which to ask: "How long does each step in the process take?" "Where are the bottlenecks?" "Where are we not taking care to fully satisfy our customers?" "What elements might be missing and what might we improve?"

With the simplicity and clarity of a map in hand, reengineering can begin by designing those loops or workflows that are necessary to produce customer satisfaction at reduced cost, shorter cycle time, enhanced quality and flexibility.

V. Predators vs. Prey

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Companies are dividing themselves into predators and prey. Predator companies include Mayo Clinic, Deluxe Check, Federal Express, LensCrafters, State Street Bank, AAA, IKEA, Marriott, AMP, Harley Davidson (one that was prey but that turned itself into a predator and made a tremendous comeback), and Wal-Mart.

Examples of prey are IBM, DEC, Wang, Unisys, Kmart, Sears, GM, Macy's and most banks and S&L's -- not all but many, because they are stuck in the old paradigm, they are doing what doesn't work, in some cases faster.

The prey are trapped in the old common sense which is based on a different orientation - one that is vertical, functional and departmental, instead of horizontal, process driven, and oriented to the customer. The old common sense emphasizes pricing the components, departments or functions of the business, not the flows. The old common sense, based on mechanics, electricity and the movement of objects, called for a type of assembly line production that was efficient, but for the most part rigid and inflexible. The kind of managerial structures that were developed to support these kinds of companies were rigid, hierarchical and unresponsive.

What characterizes the new common sense? What do the predators have in common? They have in common that they:

- 1) Listen to the customer and identify what it is that produces satisfaction;
- 2) Find better ways of coordinating, managing the network of commitments, both with their customers and amongst their employees;
- 3) Think horizontally, in flows rather than batches. They don't think about departments;
- 4) Continuously improve their processes;
- 5) Use technology to gain a competitive advantage.

To illustrate what we mean by these five elements we provide examples of "predators" below.

IKEA is exceptional at listening and coordinating with the customer. They were able to listen that people wanted low cost, well designed and stylish furniture. They were able to lower costs by having the customer assemble the furniture. To do this, IKEA must consider ease of assembly issues all the way at the beginning, starting with the design. They think about and streamline coordination issues starting from the design stage (identical pieces are used in different items to minimize variation), through manufacturing, shipment and sale all the way through to the customer getting it to their home. The parking lot is designed to allow you to back your car up to the warehouse where friendly customer representatives will help you put your new couch (yet unassembled) into the trunk. They provide tape measures for handy comparison,

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restaurants for those who get hungry and need a quick nosh and even playrooms for moms to drop off their kids while they shop. IKEA makes shopping easy and fun. They have thought through all the issues through to getting the piece to your home, assembled and in use. The results: in 1992 IKEA was visited by 96 million people and generated revenues of \$4.3 billion. Their profits have been at a startlingly high 8-10 percent.

AAA (American Automobile Association) is another example of successful coordination with the customer. AAA is really 159 different locally managed companies, but they are chartered by AAA and have to meet AAA standards and performance. To the consumer, this shows up as seamless and one company nationwide. This provides an enormous improvement in coordination for the traveling motorist. Each locale offers the same standard set of offers and services. With an advanced technology system, callers in need of help can call a toll free number and locate the nearest AAA certified service center in the area. Even if the caller does not know the number from which he is calling, the computer will identify the exchange and locate the closest service station.

State Street Bank is a company that thinks horizontally and uses technology as competitive advantage. State Street is a bank, but only one-seventh of its earnings comes from traditional banking. Eighty-five percent of earnings is from fee income and this is growing at least 16 percent a year. They use technology to provide custody and record keeping services for client financial assets; in 1993 this amounted to \$1.5 trillion dollars under custody. Their systems are designed to give customers computer access, in real time, to their custody account information. Because they don't think in terms of departments or compete internally for customers, State Street Bank "cross sells," they sell new services to existing customers and consider it a "win" for the entire company. Because they cross sell and increase business with existing customers, they can bid large custody clients at prices the competition can't match.

At AT&T they also think horizontally. The Network Services division has given up traditional departments and identified 13 basic processes that produce customer satisfaction. The company has organized their costing and compensation systems around these processes. The results: shorter cycle time, more flexibility

AMP's success - \$3 billion in revenues, exceedingly high levels of customer satisfaction, well above average profitability and double digit growth rate - comes from continuously improving the processes of manufacturing electronic equipment (components, connectors, surfaced mounted terminators) and designing the tools and equipment to install these in customers' products. AMP's engineers participate in design sessions with their customers. They have a toll free hotline for technical help and corporate jets for the service support staff. AMP's unequaled reputation for reliability exists because it continuously increases the manufacturing standards it requires of itself. AMP engineers

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continue to ask the question "How can we make this better, more reliable and with a lower installed cost to our customer?"

Marriott Corporation is another leader in continuous process improvement. They survey customers relentlessly and focus attention on improving processes. For example, any customer complaint is seen as an opportunity to improve the process, not to scold the individuals who were working in the process at the time. If customer complains that a wait was too long or a service was inadequate, Marriott employees and managers will examine the process together to determine what can be done to reduce or eliminate the delay and satisfy the client.

Companies that see themselves as a network of commitments that start and end with the customer will not only minimize common problems such as delays, errors and miscommunications, but they will be able to make entirely new offers to customers and/or gain market share. They will be able to focus on producing that which will satisfy the customer or, as Peter Keen calls it, "moments of value." A "moment of value" is the moment in which something of value can be created for the customer.

For example, as Peter Keen shows, McKesson entered a new business and stole part of the insurance industry's market share by adding insurance claims processing to its pharmacist electronic order service. By supplying their pharmacists with this capability, they were able to dramatically shorten the time to the payment of claims. This has become a competitive offer for McKesson and that firm has "stolen" business away from the "traditional providers."

ATMs are another example of creating a moment of value. Rather than having to go to banks during their open hours, wait in lines, etc. ATMs allow banks to be "open" all the time and available to complete transactions. Now any bank that does not offer ATM service is less competitive, if around at all. These "moments of value" are examples of using technology and increasing the coordination of the customer.

Lets look at two examples more closely by comparing the approaches (the common sense) of Kmart and Wal-Mart. Fifteen years ago Kmart dominated the industry it invented and Wal-Mart was a company you didn't even know. Wal-Mart has organized themselves very differently. In 1979 Kmart absolutely dominated the industry that it had developed - the mass merchandising, discount store. They had close to 2,000 stores. Now Wal-Mart is absolutely dominating the industry, showing tremendous increases in profitability, earnings and stock price.

Wal-Mart places a very high value on coordination and communication and a very low value on control. They have their own fleet of airplanes so that they can fly employees to

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headquarters and other stores to exchange ideas and strategies. They have a satellite video conferencing linkage so that they can not only see old video tapes of Sam Walton, but so that the store managers can talk to each other. They have their own fleet of 2,000 company owned trucks to speed goods to the customer. They put 85 percent of their merchandise through their own warehouses. They have a system called cross-docking where the delivery truck comes in to the freight dock on one side of the warehouse and the merchandise is moved straight across to another truck for distribution to the Wal-Mart stores. This system lets them restock their stores twice a week, instead of the industry average of twice a month. It gives them an overall average of cost of goods sold that is 2-4 percent lower than Kmart's.

On the other hand, Kmart has placed control over coordination. They are changing now, but historically, they have been functionally organized to have strategic business units and separate departments. They did traditional cost analysis which concluded that rather than building long term relationships with suppliers, it would be cheaper to shop price, change suppliers, and put only 50 percent of the merchandise through the warehouse. In this way they could get big suppliers to ship direct to the store. They also determined that it was cheaper to contract out their trucking, rather than owning their own trucks.

Kmart says it is making some changes, however. They feed 75 percent - 80 percent of their merchandise through warehouses, with a goal of 90 percent by 1994 or 1995, replenish merchandise in 48 hours and deliver daily to all stores except those in Puerto Rico.

At Wal-Mart they are always asking the question: "What do we do to satisfy the customer? How do we flow products to market faster, with better service and at lower prices?" Wal-Mart uses a different set of merchandising questions ones based on the fundamentals of the new common sense. They don't have geniuses at headquarters who figure out what will sell. Rather, they use kind of a pull system - a system that allows them to listen and react to the customer.

Kmart is moving fast to catch up, they are spending heavily but they have a long way to go. Wal-Mart's profitability, measured by return on equity is two times that of Kmart's.

VI. What we are learning?

The new common sense that lets us see organizations as networks of commitments shows us a new, more simple view of how to build and manage businesses. Here are some ways to get started.

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- 1) Listen to your customer. Find out what your company that is dissatisfying. Find out problems your customer has.
- 2) Coordinate with your customer. Coordination is a fundamental problem confronting business. Today, the problem is of coordinating organizational commitments not manufacturing processes. Improve your systems for communication, listening and checking for completion and satisfaction.
- 3) Don't cost functions, cost the whole process. This may mean you destroy your departments. They are islands of miscoordination anyway and the lines between them are foreign borders with enemies on the other side. If you think horizontally, or process, departments may disappear.
- 4) Continuously improve your processes. Map the process. For each task ask "Who is the customer and who is the performer?" Then, ask: "How can we do this better?" "Why do we do this the way we do?" "What would happen if we eliminated this step?"
- 5) Use technology for a competitive advantage so that you bind your customer to you, decrease your cost, increase flexibility improve coordination, lock out competition. Sometimes you need to ignore ROI.

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