CHAPTER 39

DESIGNING A BUSINESS FROM THE CUSTOMER BACK

A Post-Industrial Management Competence

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I am honored by the opportunity to add my two cents to this ritual of existential angst that marketing celebrates periodically—over a period of at least thirty years and counting, in my experience.

It strikes me as bizarre that, just as companies are beginning seriously to confront the issues of discovering and coproducing value with customers, the marketing function is increasingly focused on justifying its existence. The marketing concept, now a half-century old, is becoming the business concept. But marketing departments, the natural home of customer-centric knowledge and initiatives, seem to have largely devolved into a sales support function—and an expensive one at that. One chief executive officer recently discovered that his marketing department, having outsourced most of the real work of advertising and communications, was still spending two thirds of its budget *internally!* Unable to imagine what possible value was being created by an internal staff that didn't actually *do* anything, he immediately simplified marketing's problem of justifying itself by reducing the marketing budget by 50 percent.

How did this happen? How did it come to pass that the highest priority for academic research in the minds of MSI Trustees has become "marketing measurements"—a.k.a. self-justification arguments and techniques? And this precisely in a time that straddles the historical transition from an industrial to a postindustrial economy. If ever business needed academic help in reconceptualizing the theory and practice of managing its relationship with customers, it is now.

Let me suggest that the way for marketing to earn its keep in the twenty-first century is to return to its mid–twentieth-century roots: to the marketing concept. One might frame the challenge as one of reinterpreting for the Information Age the axiom that businesses exist to create and keep customers. I will use this chapter as a call to action for the Academy, because I don't think the current generation of business leaders is likely to do this on its own—too much Industrial Age baggage and too many three-month performance horizons. So implementing a managerial transformation will probably fall to the next generation of executives—the one that business schools are now educating. But for that to happen, academics must be prepared to provide the next generation of leaders with a postindustrial MBA curriculum (PIMBA). This PIMBA will be a new managerial framework, based on new axioms, concepts, and profoundly different prescriptions. I will briefly indicate some of the major discontinuities and differences between it and the current legacy framework.

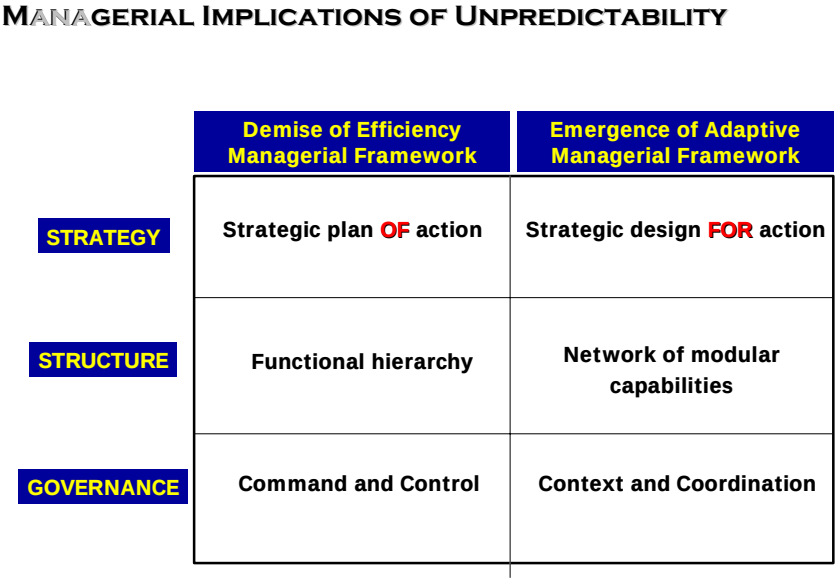
We're about halfway across the great divide between an industrial and a postindustrial society and economy. The transition was formally, forcefully, and convincingly announced by an academic, Daniel Bell, thirty-two years ago. Since then, the academic and business practitioner communities have identified new forms of behavior, new technologies, new techniques, and new leadership qualities to address the imperatives of the postindustrial economy. But we are trying to bolt these new adaptive ideas, technologies, and behaviors into an Industrial Age managerial framework that systematically discourages them.

Peter Drucker (1991), who codified the Industrial Age managerial framework of the mid–twentieth century, wrote that "No new theories on which a big business can be built have emerged . . . but the old ones are no longer dependable."

There is now at least one successor candidate—the name I have given it is *sense and respond.* Its premise is that rapid, unpredictable, and often discontinuous change is baked into the logic of an information economy. As a result, businesses must learn how to respond effectively to what individual customers want/need/prefer *now*, rather than execute efficiently plans that are based on predictions about what markets will want in the future.

If you buy that as a premise, then the concepts of strategy, structure, and governance must change radically (Figure 39.1).

Figure 39.1 **Managerial Implications of Unpredictability**



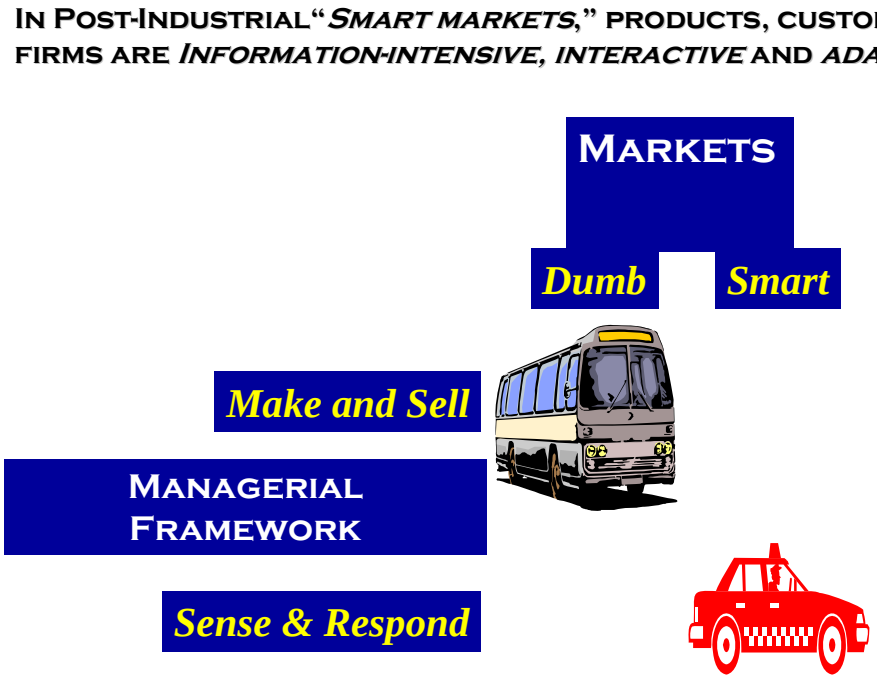
Strategy, instead of being a plan of action becomes a design *for* action. Structure no longer follows strategy, it *becomes* strategy—a strategy for transforming a network of capabilities into a system for coproducing customer value.

And finally, organizational governance changes from command and control, where the knowers are at the top and the doers are at the bottom of an organizational hierarchy of authority, to *context and coordination*, where leadership declares a global context within which people can improvise and self-synchronize to produce coherent behavior at the enterprise level. The purpose of this Context declaration is to make unambiguously clear the answers to three questions: what are we here to accomplish; how do we relate to each other; and what are the boundaries that govern, but do not dictate, the actions we take in pursuing organizational purpose.

Figure 39.2 depicts Rashi Glazer's way of representing that change (Glazer 1999). Rashi, as many know, talks about "smart markets." Smart markets are the postindustrial, information intensive markets in which products, customers, and firms become highly interactive and adaptive and information-intense. Dumb markets are not "stupid," but dumb in the sense of not being able to talk, not being interactive. Of course, there still are dumb markets, but we've got one hundred years of theory and practice to instruct us on how to organize a business to address those markets. I call that collective construct "make and sell." Plan, develop, make, and sell the products that you (and by the way, your competitors) can reliably predict the customer will need.

That frames strategy as a game against competition, and from Michael Porter (1980) we have learned that this is the right way to think about strategy in a world that is sufficiently predictable.

Figure 39.2 **Smart versus Dumb Markets**



Rashi and I use the icon of a bus to represent a company that uses advanced market research techniques to find out where most customers plan to be and where they plan to go; hires rocket scientists to figure out the most efficient way to get most customers from where they say they're going to be to where they say they're going to go; then invests in buses and hires drivers who they train to do what? To execute the schedule. The schedule is an early binding of capabilities that then is executed with maximum, ideally six-sigma efficiency. A few years ago, the *Times* of London reported on a productivity initiative by the London Bus Authority. It seems the authority had raised the bar so high that only one bus driver was able to meet all the requirements: He got the bus out of the barn on time, stopped everywhere he was supposed to at the time he was supposed to, got the bus back to the barn on time, used no more gas than the plan called for, and ran over no more pedestrians than the plan called for. The only thing he was unable to do—because there was no time—was to open the doors to let customers on and off. But he made his numbers, and his measurements had nothing to do with getting customers to where they wanted to go. In fact, customers were, truth be told, a nuisance. They would sometimes get sick, or want to change a $20 bill, or want to get off between stops—all of which were unpredictable and all of which were terribly inefficient. But this bus driver was an A performer precisely *because* he closed the door to customers. (How many businesses do you know today that use 800 numbers and websites to shut the doors on customers because it's considered too expensive to have real people address their problems? And because of this, how much more do you like doing business with a Lands End or the insurance company USAA –where you talk with a human being who has access to what these companies already know about you, and who seems genuinely interested in helping you do business with them?).

Back to our bus driver, who can start work every morning without a customer. He doesn't need a customer because he has a schedule. A taxi driver, on the other hand, operates in sense and respond mode, and cannot start work without a customer. Why is that? Because without a customer she doesn't know where to go.

Who does know? Only the customer. And that to me is the fundamental transaction of the postindustrial economy; an exchange of information *about* value from customers for the production *of* value from producers. The tricky part of this is that in smart markets with smart products that change dynamically, customers often can't tell you what they need. They need diagnostic help. I have no idea what the best digital camera would be for me. I have no idea what the right telephone plan is for me. And I have no idea what kind of anti-spam software to use; nor do I trust any of those providers to give me an honest answer about it. I darkly suspect they want to sell me what they happen already to have made. How likely are you to agree to codevelop value with someone you think is more interested in extracting value from you?

That leads to the question of what we mean by value. Specifically, what do we mean by customer value? Much of the literature today takes it to mean value of the customer to the firm, measured as lifetime value (LTV), or by loyalty. But increasing the lifetime value of a customer cannot be the design point of a firm—LTV is a firm's *reward* for producing value *to* a customer.

If a firm is to operate as a system, you can't design it to produce a reward for operational excellence; and you can't design a system to optimize the function of one of its parts. It must be designed to produce a state change in an external system. Value to the customer is value produced for an external system, a value that can, and in this view of the world should, become the design point for a business. In a recent executive education session Glazer and I proposed what we modestly called the "fundamental equation of business."

$V = V_p + V_c$
V = Total Value Produced
V_p = Value to the Producer = LTV = Price – Cost
V_c = Value to the Customer = $\text{Benefits}_{\text{Relative}} - \text{Price}_{\text{Relative}}$

Value is the sum of value delivered to the customer, and value received by the producer. Value to the customer is benefits minus price, where *benefits* means the dollar value assigned to tangible and intangible effects, and *price* incorporates, similarly, such things as monetary price, inconvenience, and other intangible negatives. Value to the producer is price minus cost, which also incorporates such intangibles as loyalty effects and opportunity costs.

Total value can be thought of as a waterfall, and the purpose of the collaboration between customer and producer is to maximize the height of that waterfall by increasing the dollar value of the benefits received by the customer, and by reducing the cost to the producer of delivering them. The game with customers is to maximize total value through the exchange of information about value (from the customer), and the structuring (by the producer) of a value-producing system that incorporates customer and producer capabilities. Having maximized the height of the waterfall, the price is set, instance by instance, which determines for each instance how much of the value created will flow to the customer, and how much to the producer.

The concept of an organization designed to collaboratively produce customer value implies that a distinction is made between the design point of the organization, and the reward for a good design, which is what shareholders get. If you don't make that distinction, and you think enhanced shareholder value is the design point, you end up doing things like buying back your own stock, investing in the discovery and exploitation of loopholes in the tax law, and doing creative accounting—all of which are logical things to do if your design point is increasing the share price to the stockholders. Such logic is reflected in the strategy of several insurance companies, who now see underwriting risk not as its value proposition, but as a means of raising cash to invest in the money market. Making money has become, literally, their real business.

Networks are the generic structure of postindustrial organizations. They provide the basis for a modular design, and they provide connectivity. But they don't provide interoperability and coherence. The way to add these attributes is to transform a network of capabilities into a value-producing system, using the principles of systems design. These principles, which are related to but different than "systems thinking," specify the *interactions* between accountable roles necessary to produce a desired affect on a customer.

Applying the principles of systems design to create collaborative organizational structures for action will be a core competence of postindustrial managers. Two of these design principles are regularly violated in current business practice. The first: that you always design a system by decomposing its function into subsystems, and the subsystems into lower-level subsystems. You never, ever start with the capabilities you have, and try to bolt them together into a system. And yet that's what frequently happens in post merger integration projects. That's also what happens in most reorganizations. We look at the capabilities we've got, and we try to figure out how we can integrate those into a value-producing system. That is a flagrant violation of a first principle of systems design.

A second frequently violated principle: do not design the actions of the components, design the *inter*actions between them. The interactions between them are—at least in the sense and respond prescription—the exchange of deliverables between organizational roles. Optimizing processes focuses on designing and presequencing the *actions* of components, as opposed to specifying the interactions between them. Process optimization makes great sense in stable environments where efficient replication produces economies of scale. But in environments of unpredictable change, six-sigma execution of a process to accomplish what has become the wrong thing is a recipe for disaster.

The systems design of roles and accountabilities that transforms a network of capabilities into a value-producing system is the strategy document of sense and respond organizations. It is a design for action, not a plan of action. It uses some but not all of the capabilities in a given network, because some of them won't make the cut after decomposition of the value proposition into its constituent capabilities. The strategic design shows the interactions between, not the activities of, people who are accountable for the production of specified outcomes, and who are evaluated by the role receiving those outcomes. It is these interactions that produce the system-level effect, a state change in the form of an effect that constitutes additional value to the customer.

Strategy as a system design for action *dissolves*, rather than solves, perennial issues that have plagued managers for decades. The issue of organizational alignment disappears, because alignment of the component parts is precisely what is specified in a systems design. Synergy is unavoidably produced, because the interaction of component roles produces an effect that cannot be produced by any subset of roles.

Clarity about roles, accountability, and authority, lack of suboptimization and fragmentation: These follow naturally from a systems design. But some make and sell "best" practices are flat out bad practices, because they are antisystematic, for example, line of sight measurements, which call for the same outcome from multiple subsystems, creating redundancy and making accountability for the outcome ambiguous. And one would never ask a question such as, what is the return on marketing investment? any more than one would ask the question of an automobile designer or owner, what is the return on investment of a gasket or a carburetor? Because they are parts of a system, the loss of any of them makes the system incapable of delivering its function.

In sense and respond designs, coherent, system-level behavior arises from quasi-autonomous, self-organizing behavior. ("Quasi" because these behaviors are governed, though not dictated, by the declared organizational context.)The manager/designer does not specify any level of subsystem design beyond that he/she feels comfortable with. Double-click on any one of those roles, and you will see their subsystem design, a design that can be a make and sell, highly optimized process that deals efficiently with a stable set of inputs and outputs, or can be another, highly adaptive subsystem within which improvisation is the norm. Because all roles are dispatched using a universal and general commitment management process, *how* the role produces its outcomes is not a strategic issue.

The effective incorporation of customer and supplier capabilities occurs because they become a part of the same design, as the decomposition of the design point customer value determines which capabilities are needed from the customer and which from the supplier. Once you've invested in instantiating the design,

each customer request can reconfigure the organization. Supply and value capabilities become "chains" only at the last possible moment—when dispatched by a customer-facing role. This achieves late-binding of capabilities. Products are the earliest form of binding of capabilities, designed and manufactured far in advance of a request by customers. Process design is a way of achieving later binding, where the sequence in which capabilities are linked is specified in advance. But dispatching capabilities in response to (or better yet, in anticipation of) a current request, like a taxi company does, provides maximum adaptability.

Ideally, dispatching is not only reactive to an articulated current request—but follows from the kind of sensing and responding that a doctor does when diagnosing your stomach ache as appendicitis. The doctor is not predicting that you need an appendectomy. The doctor is telling you what you need before you know it. He or she can interpret the data that you're sending out with your EKGs and blood tests and from his/her palpations and probes. The metrics that have emerged from early adopters of this managerial framework include:

- Response cycle time reduction
- Response quality (as evaluated by the effect created on customers)
- Scope and number of requests successfully addressed
- Organic growth in revenue and profits
- Win rates, auditability
- Employee morale

The first metric is the length of response cycle time relative to the opportunity change cycle. That's a vital sign, because keeping up with change is a survival trait. The second metric establishes that response quality is not measured by traditional customer satisfaction metrics; It is measured by the state change in value *to* the customer. The effect on the customer may or may not occur if you delivered the product or service you promised. But that effect is the design point, and the key question is: Did the customer realize improved responsiveness, quality, operational results, and so on?

The scope and number of requests successfully addressed is the focus of the third metric. It is important to keep track of the number of times you have to say "no bid" (because, for example, the risk is too great, or the capabilities aren't there). If the same request keeps recurring, this suggests how you might expand the value scope. And because your capabilities are modular, you have combinatorial mathematics working for you. If you incorporate a new capability into a new systems design to create greater value, you get a substantial increase in the number of possible requests that you can profitably respond to. That's a significant potential improvement in a firm's ability to grow organically.

The last two metrics are internal indicators of organizational health that should improve as a by-product of success in co-creating value with customers.

I have given a very high-level synopsis of the sense and respond managerial framework in order to make the point that a basis already exists for educating postindustrial managers on a new managerial theory whose premise is increasing amounts of unpredictable change. My exhortation to those in the marketing academy is to seize the initiative in introducing this to the next generation of managers. After all, designing adaptive customer-backed businesses is becoming a strategic competence and marketing ought to be the function that co-opts it. First, that's supposed to be our job: minimizing the gap between what the customer needs and what the firm can respond to. Second, according to Harvard's Kash Rangan, the competence of organizational design has not been picked up by any of the other disciplines in the business school. And third—perhaps most important—I'm convinced we really know how to do this. We now have a few case studies, and the start of a learning curve. But while we know the principles, we don't have a sufficient body of experience from which to develop best practices regarding the new set of choices managers must make in this new framework. There are an enormous number of researchable propositions awaiting empirical testing by the readers of this volume.

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