InSite December 2008 Newsletter

First, from all of us here at InSite, happy holidays and best wishes for a great 2009!

The topic of our first letter is absolutely central to successfully negotiating the economic recession that we face. In many ways, the topic is obvious to the point that people quickly gloss it over, like checking tire pressure before a long trip.

Structure

The topic we want to discuss is the structure of your business, how it is chosen and the effect of your structure upon business performance. Quite often our discussions begin with the objectives for the business, then we evaluate the current structure in place and whether that structure is conducive to reaching those objectives. Typically, the first reaction we receive from people when we discuss the appropriateness of their business structure is a blank stare. To help get the topic centered, this month's newsletter is devoted to structure; what we imply with the word, how to understand what structures are appropriate for a particular business, and how to implement the structure to drive your business most effectively. Three case studies will be given for illustration.

Most simply, the structure of a business transforms inputs, things like customer needs, vendor pricing, and orders, into outputs like new products and shipments. Stated even more bluntly, your business structure must transform the needs of your customers into products or services that satisfy these needs. This must be done in a way that is sustainable and profitable.

When it is stated is this way, the next set of questions is very simple: who are the target customers, where are they located, and what customer needs are to be served? The next step is to construct the ideal structure, including what sites are needed, where they should be located, how manufacturing is approached, how distribution is approached, what corporate culture is required, etc. It is critical to do this as a clean, intellectually honest exercise, preferably with some fresh thinking, so that the exercise does not simply conclude that the present corporate structure is "ideal".

Only after this work is completed should a path to this structure be developed, i.e., this is when a restructuring or expansion plan is actually developed. Choosing a structure should come after a strategic goal is chosen, but before tactical programs and supporting metrics are put in place.

First, the standard complaint is that this exercise takes too long, and that action is "needed now!" Since we are talking about the structure of your business, its ability to serve customers, and the welfare of the people that are employed by the company, it would appear that any restructuring or expansion undertaken without this preparation is simply foolish. In addition, a reasonable understanding of your business objectives, and what kind of structure supports those objectives can be obtained in only a few days of hard work.

The next complaint about this is that it won't be possible to find a structure that meets the customer needs of the business while also meeting financial objectives. This line of logic approaches cost reduction as a way to "wait until the next up cycle". First, businesses can be radically transformed to greatly improve competitiveness, but we simply have never seen this truly happen without changing the structure of the business. In some sense, really focusing upon the structure question can produce business results beyond the expectations of current management thinking. However, if after going through this exercise, it is determined that no economically viable structure exists, then management at least has a workable understanding of what is involved with minimizing corporate cash consumption while waiting for a market upswing, and is well positioned to recommend a course of action to the a board or investors.

Perhaps the most dangerous complaint with this method comes from the CEO that views lackluster corporate profitability as only a "cost problem". This is most easily seen when in the somber staff meeting when the big guy announces a such-and-so financial miss, and that a 10% (or 15%, or 35%, or whatever) reduction is needed from every budget. This is defended in many ways- that decisive action is needed (as if a knee jerk is decisive), that this will force people to emerge with new ideas, or that it is how the CEO can get a feeling for the underlying capabilities of the corporation. While new ideas are needed, this approach isolates each executive and very rarely leads to the type of structural change that is dramatic, productive and enduring.

It should also be clear that there are times when the current corporate structure is appropriate, and that cost removal or business expansion can proceed without changing structure. In this case, the process of corporate development then turns to programs and metrics to achieve corporate objectives.

Optical Industry Restructuring

The first example involves the telecom depression of 2001-2003. The clear market leading optical company had been grown through a huge number of acquisitions. In the Spring of 2001, the company faced a radical downturn in its telecommunications sector, with revenue contracting by as much as 90% in many product segments. The company embarked upon cost reduction, and survives to this day.

What was not obvious to the outside observer was that the executive team ignored key structural issues that were obvious to the rank and file. The CEO resided in the northeast, while the CFO resided on the west coast. The company essentially had duplicate corporate headquarters in those regions, also. The company had two COOs, both stationed on the west coast, but at completely different sites, hours apart by either car or plane.

The company was moving quickly into China, but the facilities there, with many overlapping functions, reported into two different organizations. Pieces of the business were outsourced, pieces of the business had their own in-house manufacturing, but no strategy was clearly articulated describing when a particular approach was appropriate. Parts of the business operated as business units, other parts in a divisional structure.

Of course, employees were released, restructuring plans were communicated, and over time many facilities within the company were eventually closed. However, this restructuring went far slower than it should have, employee morale suffered, and the most obvious candidate to consolidate the optical industry frittered critical time, market position and cash. Ironically, although many hard decisions were made, and much was accomplished, the lack of resolution of these key structural issues crippled these restructuring efforts.

This company is no longer the clear market leader, and while still in possession of strong technologies, is not the obvious candidate to consolidate an important, but fragmented and troubled industry. From January 2003, two years after the downturn, to December 2008, the company lost 85% of its value in the marketplace, approximately the same loss of value as much smaller companies in this industry.

This is an example of the consequences of attempting restructuring without fixing obvious issues with corporate structure. The structure of individual functions is also important, and we follow with two examples here: one in Finance and one in Sales and Marketing.

Structure in Finance

An example of a Financial organization where the structure was impairing the flow of information both within the financial organization and to the entire company could be seen in a small, private Midwest company that had its financial organization dispersed between the corporate headquarters in Illinois, with the person responsible for the final preparation of the financial statements located in Georgia, and the staff inputting the transactions located in Georgia, South Carolina, and Minnesota.

Most of the company's revenue transactions were tracked and input in Illinois, the cost of sales transactions were generated throughout several states and funneled into either Illinois or Georgia depending on the reporting line of the field engineer, who might report to either location, and operating expenses were generated and input in both Illinois and Georgia.

Although the reader looks at this example and puzzles how in the world such a situation could exist, in fairness many structural issues develop gradually with growth, with acquisitions, or with a simple reluctance to address problems. Most companies have quirks like this, and it is important to resolve them quickly to both improve corporate performance and to help the employee population understand that management is correcting structural problems.

This structure resulted in the slow preparation of the Financial Statements, no ownership of numbers on the financial or the operational side of the company, and no ownership of cash management. As a result there was poor understanding of revenue, profitability and continual "surprises" relative to cash spending.

In this example, a simple process mapping would have shown these difficulties, but it is important to recognize that simply adjusting the "process map" doesn't solve issues of clarity and ownership. The resolution of those problems required changing the structure itself.

Our next example looks at the structure of a distribution network.

Distribution in Sales and Marketing

Soon after his arrival, the new CEO of a publicly traded semiconductor company made a major change to the company's distribution structure by replacing the existing network of partners in Asia with a single, Pan-Asian Distributor. On paper what looked like a great decision, i.e. trading up to a larger better capitalized Distributor, turned out to be a disaster. Sales in Asia, negatively impacted by this sudden change in relationships, dropped by half over the next three quarters creating a revenue vacuum from which the company never recovered.

This management team learned the hard way that major changes in channel structure need to be studied carefully and from all angles before decisions are made and implemented. In this case, the decision was made after just listening to the new Distributor's presentation and on the basis on previous relationships with their management.

Clearly, management hadn't done their homework with customers and their existing network in making this decision. However, this example also highlights the fact that they didn't have clear goals or a strategy for the region. Without a clear strategy, which would have allowed clean critical thinking, they were seduced by a single great presentation.

Like any other aspect of the business, Sales and Channel decisions need to be made in the context of the company's goals and strategy. Good Sales VPs have many wrenches in their toolboxes for achieving different goals. For example, if a company is looking for the highest level of growth and the deepest relationships with their customers, they will hire a direct sales force.

Direct sales teams are the most expensive option (particularly in the beginning) and burn cash. Man Reps and VAR's are commission based (hence far less cash outlay and initial cost) and provide reasonable coverage but with less focus. If winning new customers for a new product launch is critical to the company's goals then dedicated support resources near the customer are critical. Again, clear goals will drive the right strategy.

In summary, make sure your channel strategy is consistent with your company's goals. When making changes in your strategy take the time to visit customers and partners to personally understand the impact and to let these stakeholders know you are committed to them. It will help you know you've made the right decision and position you to work issues as they develop. The downside risk of sales structure decisions are much too high to do otherwise.

Summary

Our focus here was a description of corporate structure as a critical part of business planning and operation. Following the development of a strategic plan, the management team must work to form a crisp ideal corporate structure to support the strategy. In this way, structural problems are resolved in a timely fashion, clearing the deck for good progress against strategic objectives.

In our January issue, we'll address another topic that many of you may be struggling with now. In that upcoming volume, we will focus on dealing productively with a board through hard and uncertain times.

Happy holidays and have a very prosperous New Year.

Cheers,

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