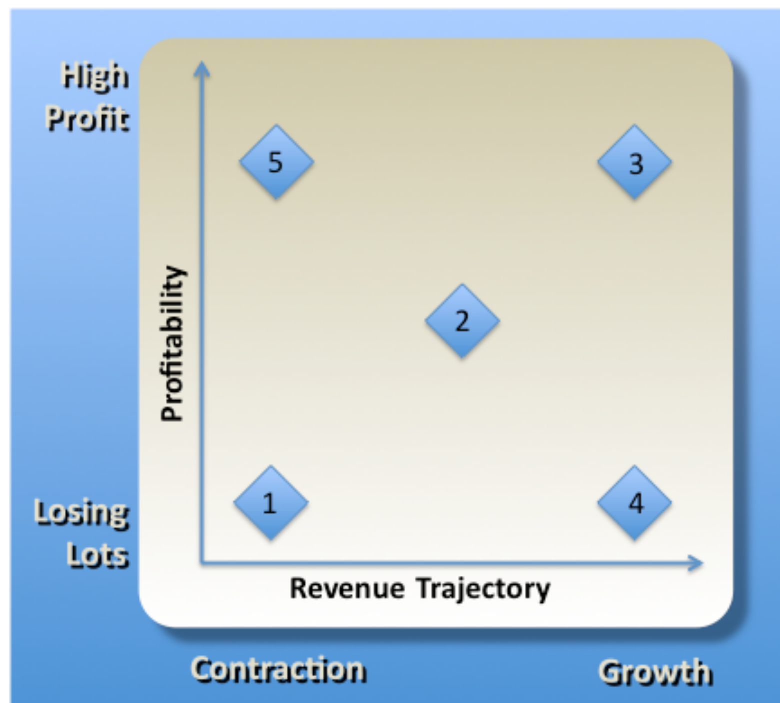
KEEPING YOUR EYE ON THE BALL

INTRODUCTION

It is trivial to say that strategy be supported by core competencies. In practice, the real art of management is the ongoing selection, maintenance and growth of core competencies to support your strategy. This strategy, by definition, must evolve to keep pace with a changing marketplace. This management challenge can be far more difficult in technology fields, where the business environment often changes very quickly. We will discuss problems that occurred at different stages of company growth and profitability trajectories.



Our examples include a (1) highly successful business model that suddenly failed, (2) a high-flying company medical company that gradually lost focus, (3) a successful company where competencies narrowed during a business ramp, (4) a rapidly growing start-up where the technical team rejected the direction set by the management staff, and (5) a large successful company where the core competency became non-competitive.

THE BUSINESS MODEL DOESN'T WORK

During the 2001-2002 time-period, the revenues of telecommunication companies collapsed, in many product lines revenues declined by as much as 90%. The larger players began losing massive amounts of money and struggled to cope with the changing business environment. Within one of the large component companies in the telecom world, the overall strategy was to make business units break even and generate a modest amount of cash.

One of the groups within this Company was a highly technical component unit located in the northeast. Like all of the units of the Company, this business was facing huge revenue declines and losing substantial money. As we began planning the restructuring process for the unit, it became obvious that the financial realities meant very deep and difficult cuts. While we did not use the language of core competencies, everyone was aware of the unique attributes of the division, and that the path of cutting to the point of achieving our financial objectives would mean a substantial diminishment of the technical team. We did push ahead with a restructuring plan, closing facilities, moving both the wafer fabrication and packaging pieces of manufacturing, and eliminating the vast majority of jobs.

Many people worked hard to close facilities and to transfer different production processes. The unit did successfully restructure, eventually getting to a position of cash generation.

Looking back upon this process, many things were done right. Our forecasts for the revenue stream of the business were solid. Our understanding of costs within the business was good. The restructuring plan was well conceived, and the people that remained with the Company worked very hard to successfully transfer product manufacturing. The process did lead to relative stability in a very difficult business environment.

However, key employees left the Company, in large part because they recognized that the cuts diminished the core competencies of the group to the point that the available options for the surviving business were considerably narrowed. A nimble and flexible start-up was eventually formed from the nucleus of talent that had left, creating a future competitor to the Company.

It is not clear that a better outcome could have been achieved, but broadening the range of options considered would have been appropriate. We should have stated more clearly to employees that the current business model was broken. In simple terms, like many pieces of Telecom, the profit generated by selling products was insufficient to properly maintain the core competencies of the business. In addition, by recognizing and openly discussing why the business model did not work, and maintaining ongoing dialog with key employees, we could have explored different strategic options. This discussion would have taken longer, but would have led to us considering options such as the closure of the business, a divestiture of the unit, a joint venture with an outside company or a business model that would have allowed these talented folks to spend time investigating businesses outside of Telecom.

Many businesses, including the current Telecom industry with its large number of competitors and highly technical products, simply do not have a business model that funds the maintenance and

growth of core competencies. In these situations, the numbers have to be faced, first and foremost, and to achieve the best possible outcomes, we strongly encourage that non-traditional strategic options be considered, since stubbornly "staying the course" is simply a recipe for pain to both investors and employees.

THE MUSCLES FADE AWAY

Our second example describes a venture-funded medical diagnostic manufacturing company. A strong development group, good field applications support and strong execution led to a successful IPO and several profitable years as a NASDAQ public company.

It had a strong reputation for its technological breakthroughs in the medical diagnostic field. Its field applications engineers were widely respected by customers for their product, application, and medical knowledge. The ability of the R&D team and the Applications team to roll out and educate customers about how their new technologies could cost-effectively improve patient care drove expanding sales of expensive, high margin equipment. Early in the Company's history this helped the Company establish itself as the market leader.

However, the Company had free-spending habits, leading the company to losing substantial amounts of money. Turn-around teams were brought in to rectify the situation.

The second turn-around team was a group of financial experts, with little technical or market savvy. To get the company moving back into profitability, R&D funding was whittled down to a point lower than its competitors and product development fell behind its competitors. Product introductions were delayed and field applications personnel spent more and more time dealing with customer dissatisfaction issues, as opposed to customer training and presentations. The Company's reputation was damaged, market share was lost, and the Company slowly deteriorated until it was acquired by what was previously a trailing competitor.

In this case, the initial blow to the Company was the development of overspending habits throughout the organization. After this was painfully rectified, Management's lack of market and technology savvy resulted in underfunding key core competencies. It has to be stressed that financial numbers are a part of a company's scorecard, but financial, technical and market savvy are all required to guide a technology company over any extended period of time.

RIDING THE WAVE

In the time-period from 1995-2000, the telecommunication industry went through a period of enormous growth. We worked at an optical component company during this period that had solid core competencies in lasers, spanning many different markets; including printing, pumps for laser welding, and the satellite industry. When the ramp began, the telecommunication products were tremendous growth vehicles, producing both top-line and bottom-line growth that was extremely exciting to investors and employees alike.

However, the urgency of that growth meant that much of the talent of the Company focused upon what was, in truth, a limited product set. Development and market efforts outside of that narrow

product band were constrained, in part because of an internal shortage of technologists, but also because of a feeling that as much profit as possible needed to be diverted to the bottom line to meet investor expectations. It was also clear that using the profits of the telecom boom to dramatically increase investment in other optical industries would lessen the current valuation of the stock.

In effect, this meant that many sizable market opportunities were not pursued, and some staff began leaving the Company well before the peak of the telecom bubble. The Company did execute, and met their numbers, leading to the Corporation eventually being purchased for a great deal of money. However, after the deal was done, and after the bubble burst, it was clear that the underlying strength of the organization had been considerably diminished.

This example illustrates that market bubbles, and not just the inevitable market collapse afterwards, can erode core competencies. This strategy, of chasing the bull market, resulted in strong short-term profits and a diminishment of the long-term capabilities of the business. The merits of this kind of trade-off can be the subject of many discussions at many different levels; however, those discussions are outside of the intent of this newsletter. The larger point, however, should be that the combination of both vigorous growth and short-term strategic focus can simultaneously increase the present value and diminish the long-term competitive abilities of a company.

AGGRESSIVE TURN-AROUND

A start-up focused upon building the first reduced instruction set chip (RISC) computer was getting substantial design-win traction and was in the process of preparing for an IPO. However, the company was under substantial pressure because the execution of the company was not crisp, and the company was in danger of losing an excellent growth window.

The founders and the Board of Directors had a disagreement about strategic options for the company within a board meeting. Rather than taking the time to resolve their differences, the Board abruptly terminated the founders and the rest of the executive team.

From the employees' perspective a strong team, composed of the founders with strong technical talents, and professional managers with ties to the venture capitalists who funded the company, was gone on Monday. A turn-around team was brought into the Company the next afternoon. Needless to say, this was a shock to Company employees.

Each afternoon of that week, the key technologists were gathered for a meeting in an open area of what had been the executive office suites, and the turn-around team proceeded to pointedly critique the execution of the immediate past and to inform everyone of how things would be done differently going forward. The technologists, uncertain of their future and facing what appeared to be a hostile management team, began rapidly leaving the company.

By Friday of that week, so many technologists had literally walked out the door that the Company was below critical mass to operate. The turn-around team was left with the realization that too much knowledge has vanished for the Company to be viable. Rather than a turn-around, the Company collapsed, ending with an asset sale and the closure of the Company.

If executives fail to communicate coherent strategies and rationales for changes in direction in a respectful manner, the likelihood of keeping a workforce stable and productive is greatly diminished. Particularly in smaller companies, or in cohesive groups, a lack of strategy and communication can result in a core competency disintegrating in days.

EXECUTION SLIPS

The Company was a supplier of distributed processing computer systems that went through a very successful IPO. Following the IPO the company continued to have strong, profitable growth. It was a high-flying leading-edge technology company that profitably grew and had good market position, but in its growth cycle it lost the ability to manage and grow its core technical competencies, which gradually become dated as computer system architectures evolved.

The Company's solution to this problem was to acquire a small company with a robust technology team. However, the Company never understood what was not working with their own internal technology group prior to integrating the new group. The lack of understanding resulted in a very poor integration process. The new team, sensing a lack of direction and execution, began leaving the Company. The Company had now lost the prime asset in the new company they had just purchased, and was still missing a critical core competency.

This was not a situation of the Company's inability to fund the core competency or of not understanding and valuing the competency, but rather of not understanding how to manage and grow the technical competencies to continue leading in the marketplace. This left the Company floundering in its ability to roll out new products and pursue its strategy.

This inability to implement its strategy eventually led to the company being acquired by a large, well-funded company. Most of the remaining technologists were laid off or transferred out of state. The product lines were all discontinued in favor of the acquirer's product suite.

If you don't learn how to understand and manage your own core competencies, buying a new set of competencies is likely to fail.

CONCLUSIONS

Developing, maintaining, and growing core competencies are challenges even in the best of situations. The interaction of strategic plan directions and the identification, funding, and attention given core competencies are things that cannot be ignored, nor can they be evaluated once and then put on auto-pilot. In summary, the ongoing development and maintenance of strategy, structure and core competencies are the foundations of the ability of a company to consistently execute well.

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