Briefs

Balance–Sheet Fix: No Orphaned Orders

The boom-and-bust cycle of the recent past filled high-tech manufacturers' supply chains with excess materials, prompting them to collectively write off billions in inventory and hundreds of millions in purchase commitments. Yet a potentially greater problem still lurks in the form of off-balance-sheet inventory: goods ordered but no longer needed in the face of the global slowdown.

Suppliers possess contracts, orders, and even materials requested by the manufacturers but no longer needed. Traditional inventory metrics capture only goods on the balance sheet. As a result, excess off-balance-sheet commitments and materials — billions of dollars of supplier commitments — often are invisible to management and shareholders. The problem demands attention, as strapped suppliers and contract manufacturers want buyers to make good on their promises.

It is, therefore, critical to manage potential off-balance-sheet lia-bilities early and proactively. Recent events have shown that failure to disclose off-balance-sheet liabilities can be disastrous. Furthermore, once a supplier makes an actual claim, a manufacturer's options are extremely limited, and the likelihood of a cash payout is quite high, so getting in front of them is critical.

Purchasing organizations traditionally attempt to resolve such claims. But these efforts often are inadequate because they fail to take advantage of corporate leverage and potential "tradeables." Supply chain organizations don't always pay enough attention to looming unfulfilled forecasts and orders until they become real claims. Managing commitments earlier and proactively can help to reduce cash impacts.

Booz Allen Hamilton has identified a five-step process that makes off-balance-sheet inventories visible and allows manufacturers to deal with potential liabilities in an effective manner. Although this approach is designed for the proactive man-agement of potential liabilities, it can also be used to develop a bal-ance-sheet entry for supplier commitments. The steps are:

• Use a company-wide "radar screen" to make off-balance-sheet inventory visible; segment each item by risk of cash impact.

• Manage exposure, with different strategies for each type of potential liability.

• Negotiate at the corporate level with vendors to aggregate all potential liabilities.

• Leverage tradeables to defer cash outlay.

• Establish processes to monitor potential off-balance-sheet liabilities and to respond to problems as they arise.

To deal with off-balance-sheet inventory liabilities, companies must understand their magnitude and risk. Inventory liabilities that could require cash outlay range from "hard" to "soft." "Harder" liabilities pose higher risk, are more difficult to negotiate, and generally have a shorter term than "softer" liabilities. In brief, harder liabilities cost more; softer liabilities can be negotiated down and possibly away.

Potential liabilities tend to move from soft to hard. If obsoles-

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cence and forecast reductions are not dealt with in a timely fashion, they can turn into claims. Still, it doesn't make sense to go out and settle every potential liability claim.

The trick is to understand the threat and deal with it appropriately. Many potential liabilities will not turn into hard claims or may take a long time to do so. In those cases, it may be worth taking some risk to keep the cash. In some cases, the supplier doesn't even realize that a liability exists.

Knowing and acting upon the aggregate liabilities from a supplier is critical. Otherwise, you are at risk of getting picked apart by the supplier through many claims spread over time and across your facilities. Although minimizing the payout is one objective of resolving potential liabilities, it should not be the overriding one. Gauge the balance between the health of your balance sheet and the health of the supplier and incorporate it into the negotiation. Look for "win–wins" that will preserve a positive relationship.

In high-tech manufacturing, conserving cash is a high priority. Heavy debt loads, stingy capital markets, and reluctant customers have made cash king. Paying out cash to settle contingent liabilities, even for a fraction of the original promise, could threaten your existence. Since your suppliers want you to continue to be a customer, they may be willing to entertain compensation other than cash.

Managing off-balance-sheet inventory liabilities should not be a one-time event. The tech bust created excess inventory as demand fell off faster and farther than ever experienced previously. However, more than ever before, the tech world has to pay close attention to managing supply chains to optimize inventory levels. Supply chain management is more critical in technology manufacturing for several reasons:

• The popularity of high-tech products and specific configurations has become increasingly unpredictable. Bigger bets are required to capture the upside.

• Outsourcing manufacturing to contract manufacturers and consignment programs shifts on-balance-sheet inventory to off-balance-sheet inventory.

• Traditional buyer–supplier agreements can create conflicting objectives and incentives that result in financial liabilities between layers in the value chain.

The best way to avoid off-balance-sheet inventory liability is to prevent it. Focus supply chain and product management processes on running lean rather than on scaling up. The recent past rewarded manufacturers with supply chains that could scale up and phase in new products quickly. The near future will reward those who run lean supply chains that are as flexible scaling down as up.

Ed Frey, Steve Nied, and Barry Jaruzelski

The Talent War Is a Losing Battle

Companies fighting the so-called war for talent believe if they attract and retain the best and the brightest individuals, they will win. But this presumes, first, that it's easy to identify the best people and their ability

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is a stable quality. And, second, it assumes that organizational performance is only the aggregation of individual performances. Neither assumption stands up to scrutiny.

As the *San Francisco Chronicle* sports commentator Ira Miller noted in a recent column, even in professional football (where one would think that individual ability could be assessed reliably), unlikely stars have emerged. Kurt Warner, who was the MVP one year and the NFL's top-rated passer, was not chosen by any NFL team in the draft and "once refused to go into a practice because he didn't have enough confidence in himself to throw a pass." Michael Jordan was cut by his high-school basketball coach. In sports, business, or any other competitive activity, neither ability nor motivation is ever static; in fact, both are strongly affected by how people are developed, treated, and led.

W. Edwards Deming and the quality movement long ago showed that an individual's innate ability matters less in determining organizational success than the attributes of the management system in which a person works. This is nicely illustrated by the General Motors Corporation's automobile assembly plant in Fremont, Calif., which was closed in 1982 and then reopened in 1985 as a Toyota–GM joint venture called New United Motors Manufacturing Inc. (NUMMI). When GM ran the plant, its work force was plagued by poor productivity, low-quality work, absenteeism, alcoholism, and drug abuse. Under NUMMI management, working with the same equipment and mostly the same people who had been in the GM plant, productivity and quality dramatically improved, and absenteeism and discipline problems plummeted.

Paradoxically, the system — organizational processes and social dynamics — unleashed in a war for talent doesn't seem to allow people to do their best. Companies preoccupied with determining best and worst performers often downplay attributes critical to building cultures and management systems that bring out the best in everyone.

People perform above or below their natural level depending on a myriad of factors. One of the most important is expectations. When an organization separates the best from the rest, people who could do better but aren't pegged as stars may become discouraged. Where do they stand? Why should they care about improving? Even worse, expectations of failure may cause anxiety that induces poor performance.

Another war-for-talent weapon — differentiated pay based on individual performance (which means the more one person makes, the less another makes) — discourages teamwork. If you are a plant manager with problems, are you going to signal you're in trouble by reaching out to colleagues for help? Not likely when you're in competition with each of them for salary and status. By the same token, what motivation do they have to help you?

Differentiated pay may also discourage learning. Much knowledge-sharing and learning in companies occurs on the job, in informal or unplanned conversations. Setting people up to compete against each other for status and rewards is antithetical to building the kind of trust and collegial relations that encourage spontaneous cooperative interaction. Companies that spend vast sums of money on training, intranets, and knowledge managers and do not benefit should wonder if differentiated pay, or another aspect of their management system, is part of the problem.

Why Bricks Dominate the Clicks

This is not to say that compensation tied to performance isn't important. Pay for performance works best if it is determined by how well a total system (e.g., organization, business unit, or plant) performs, rather than how individuals perform. This is fundamental to such pay systems as profit sharing, gain sharing, employee stock ownership, and plant-wide bonuses. Pay is still at risk if goals are not met, but a collective reward structure diminishes the internal competition that inhibits knowledge-sharing and collaboration. Such a reward structure also increases a sense of community and shared fate that encourages social bonds, which contribute to high performance.

The fundamental flaw in the war-for-talent logic is the belief that organizational performance is simply the sum of what the "best" individuals achieve. Complementary skills, personal chemistry, and leadership are far more important. With the right mix of these ingredients, there is plenty of evidence that a great team can outperform a loosely connected group of more talented individuals.

Jeffrey Pfeffer

Two years ago, a few prescient retail experts audaciously predicted pure-play retail dot-coms were doomed, and traditional retailers with thriving e-commerce operations — call them hybrid retailers — would triumph. In *strategy+business*, I wrote that Toysrus.com would survive and eToys Inc. would fail ("Toys 'R' Us Battles Back," Second Quarter 2000).

Yes, the original eToys did fall, and, as it turns out, today the Web's retail storefronts do look more like a real-world shopping mall. Consider the 35 most visited online stores in September 2001, according to Nielsen//NetRatings Inc. Except for computer sites like Dell and Apple, which top the list, America's biggest earthbound retailers dominate in cyberspace: Sears, Target, Wal-Mart, Kmart, Victoria's Secret, Barnes and Noble, QVC, and Gap.

By far the most significant benefit traditional retailers gain from e-commerce is the ability to use their Web sites to manage inventory better and facilitate faster turnover of products. And for many store owners, inventory turnover is the most important performance metric.

Consider how Toys "R" Us handled the launch of Xbox, Microsoft's highly anticipated game machine, released in November 2001. Before Toysrus.com existed, Toys "R" Us had to blindly preorder items for its stores, guessing how many it needed to stock and losing money if it stocked too many or too few. To mitigate some inventory uncertainty, Toys "R" Us decided to use the Web for an exclusive Xbox preordering event. Beginning in August, three months before it would start selling the product in its stores, Toysrus.com offered the game player for sale, not as an individual machine with a $299 price tag (the store price), but bundled with software and accessories for $499. The retailer's entire first Xbox allotment — tens of thousands of machines — was snatched up in only 30 minutes.

The Web sale achieved two important aims. It produced more profit than Xbox sales in the stores would have because Internet pre-order customers also had to buy the higher-margin peripherals. And Toys "R" Us did not have to purchase this portion of its inventory without knowing exactly how many would be sold.

Almost every successful hybrid retailer is also implementing automatic markdowns or using product auctions to usher inventory quickly out of its warehouses. J.C. Penney Company's strategy is typical. To sell slow-moving store or catalog inventory faster, J.C. Penney uses jcpenney.com as an instant markdown bin. Prices for clearance products automatically drop several times over a period of days until supplies are depleted. To drive traffic to these discounts, the retailer sends e-mails to its customers. Store salespeople receive gift certificates for every 10 new e-mail addresses they collect.

Although jcpenney.com doesn't account for a huge portion of J.C.

5

Penney's overall sales, the online markdown strategy is a bright spot in the retailer's recent performance. As the company shuttered stores, struggled to redefine its customer base, and posted a minuscule operating income on lower sales, J.C. Penney's inventories based on comparable operations actually dropped in 2001 over the prior year by nearly 1 percent. Additionally, the retailer holds down Internet expenses by having its catalog division handle customer service for Web sales. (The Web site carries all 200,000 products in the catalog.)

In their initial Web strategies, many traditional retailers thought that only a completely distinct Web unit would give them the quick-charging personality needed to survive on the Internet. That notion has lost its allure because it made inventory coordination — let alone marketing, sales, and other key operations — impossible.

The Kmart Corporation is an object lesson. In July 2000, Kmart debuted bluelight.com as a separate company in San Francisco, far from the retailer's Troy, Mich., home office. But it quickly saw this distance was harmful. Because systems and operations weren't shared, overhead was high. Moreover, bluelight.com's strategic priorities were not aligned with the company's overall priorities.

Today, Kmart is banking on bluelight.com, now being managed from headquarters and operating under a much lower cost structure than a year ago, to become an essential inventory channel to move sharply discounted items rapidly and drive more customers, especially younger ones, to its stores. To brand the bluelight name, the retailer has reintroduced flashing blue lights to flag in-store discounts — a promotion it had discontinued a decade ago. And Kmart has nearly 4,000 online kiosks in its stores so shoppers can search and order items from bluelight.com that they can't find in the stores.

Hybrid retailers are linking bricks with clicks in many different ways. But operationally, virtually all are improving inventory efficiency so they can expand revenue streams while spreading the cost of systems, operations, and supplier relationships across physical and virtual sales channels.

Jeffrey Rothfeder

Capturing Value In the Wireless Enterprise Market

Despite the delayed deployment of so-called 3G technology in the United States, wireless enterprise applications and e-commerce solutions are now available, generating revenues for their creators and new efficiencies for early adopters. Corporate America can profit from this technology today.

To be sure, interactive-rich media games and videoconferencing by cellphone must await the broad release of 3G, the generic term for broadband wireless access, which promises cable-modem-like speed. In Tokyo, NTT DoCoMo Inc. has rolled out what it called the world's first true 3G wireless network, and the company plans to make the technology available across Japan. However, no European or American carrier has announced a launch date for a similar service.

Nevertheless, many applications, from simple messaging to wireless extensions of existing CRM and ERP solutions, do not require high bandwidth to be of value. Data transmission speeds of 28K to 56K are enough to support 2.5G solutions being introduced today. Some applications can perform even at the far slower 14.4K digital cellular rate.

Rich wireless applications will break traditional wire tethers and extend the boundaries of the enterprise. Wireless modems add new utility to laptops. The value of sales-automation software increases when it's modified to provide an "always on" connection and a simple Web-based user interface. A busy employee can refresh contact histories and synchronize databases on the fly, without ever having to spend time dialing in and downloading.

A few farsighted, tech-savvy businesses have integrated wireless

technologies into mission-critical applications since the mid-1980s. This first wave of wireless enterprise applications enabled early adopters to incorporate wireless capability into the hearts of their basic businesses and operations (e.g., FedEx, UPS, Avis, and Hertz). In the mid- to late 1990s, the second wave enabled companies to provide consumer content wirelessly (e.g., CNET, Yahoo, Charles Schwab, and Fidelity).

The third and newest wireless wave will be characterized by the development of focused end-to-end enterprise solutions that facilitate critical applications. This will be achieved by leveraging already significant IT investments to deliver higher productivity, more sales, and better customer service.

Though the third wave is nascent, its potential is evident. Companies are already deploying such basic applications as messaging and e-mail to improve employee productivity outside the office. Omni-Sky, Research in Motion (RIM), and GoAmerica, whose services are used by enterprises primarily for messaging and e-mail, all saw their subscriptions rise substantially in 2001. RIM reports that the total number of BlackBerry subscribers on September 1, 2001, was 246,000 — a 50 percent increase in six months. Although the numbers are still small, RIM is capturing some quite high-paying subscribers.

In the U.S. alone, subscribers to such wireless enterprise services are expected to number 26 million by 2005. Growth will be driven by:

• advances in wireless application development and mobile security;

• key technology enablers, such as always-on connectivity, higher mobile bandwidth, and location-based services; and

• increased enterprise comfort with and demand for wireless applications.

Technically skilled, venture-capital-fueled, and B2B oriented, Wireless Application Development (WAD) companies to date have concentrated on discovering, developing, and delivering applications, the exact nature of which may not yet be apparent. Europe already has about 3,000 such firms, most less than two years old and employing fewer than 40 people.

Last year, Booz Allen Hamilton conducted the first major global study of the supply side of the WAD industry — the players themselves. Out of a carefully compiled "Hot 350" companies, 140 were interviewed in the U.K., France, Germany, Scandinavia, and the U.S.

This core of emerging hot companies may hold the key to unlocking the value of mobile data. For established players, the ability to embrace innovation could make the difference between winning and losing in the race to develop "killer apps." Yet, the report found many leading WAD vendors seem not only to be poor at capitalizing on the inventiveness of their industry, but also to be unwittingly stifling it.

Many firms exhibit behavior that threatens to stifle the young industry at birth: slowness to commit; an unclear position on other WAD players; and lack of focus.

Nevertheless, the wireless industry is forging ahead, investing significantly in applications as well as infrastructure. The always-on 2.5/3G packet-based networks will allow interactive services similar to those available in wired LAN environments. This capability will drive enterprises to adopt 3G data services earlier rather than later.

The value of truly mobile, real-time, higher-bandwidth access to business information is unmistakable, but it will be at least another year or two before the industry is ready to offer end-to-end wireless enterprise solutions. In the meantime, CIOs should consider the potentially significant improvements in sales force productivity, customer service, and supply chain and manufacturing efficiencies that can be realized today.

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