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**THRIVING ON TURBULENT AND
ACCELERATED CHANGE**
*Multi-Sourcing as a Vital Tool in
Successful Transitions*

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Executive Brief

"An analysis of the history of technology shows that technological change is exponential, contrary to the common-sense 'intuitive linear' view. So we won't experience 100 years of progress in the 21st century—it will be more like 20,000 years of progress (at today's rate)."
--Raymond Kurzweil, *The Law of Accelerating Returns*

The pace of change – in economics, business, technology and other spheres – is accelerating. In his celebrated 2001 essay *The Law of Accelerating Returns*, Ray Kurzweil estimates that the rate of technological change is in fact doubling every ten years. Change also has become less predictable. Enterprises of all kinds are now struggling to anticipate or adapt to unexpected change – whether it is driven by the “disruptive innovations” that constantly transform business today, heightened competition in a global economy or other political, environmental and security related factors that create instability.

Even anticipated change – sparked by new management initiatives, mergers and acquisitions, partnering or outsourcing – requires executives to make difficult decisions in the face of much uncertainty in order to ensure continuing growth, profitability and shareholder value.

Market leading enterprises that have failed to anticipate and adapt to change have suffered stunning reversals, decline and defeat. It is the companies that have learned to anticipate change – and thrive on it – that have endured and prospered. Some have even introduced the emerging discipline of “change management” or “change leadership” into their organizations. They have discovered that it is possible to not only adapt to turbulent and accelerated change, but to turn their agility into a competitive strength.



Looking ahead, we can see that one way of effectively managing turbulent transitions and adapting to change is through intelligent outsourcing. Outsourcing has enabled market-leading companies to maintain critical systems while continually reinvesting resources in the capabilities that provide competitive differentiation.

1.0 Transition Points -- Confronting Dramatic Change

Change comes from many directions, some anticipated, some not. One key factor to understand is that the rate of change is accelerating, introducing unpredictable factors into the marketplace. Among the forces of change that enterprises must now confront:

- **Market Shifts:** The heightened pace of technological change is a key factor in the introduction of “disruptive innovations” that have dramatically changed markets. The advance of communications and computing capabilities has further contributed to the speed at which change happens. Companies with new business models, innovative products and superior business processes have learned to attack incumbents and upset their privileged market positions. These are often unanticipated changes that market leaders often dismiss or diminish until it is too late to adapt. And while the number of new business starts continue to steadily rise, so does the risk of being overtaken in the marketplace. According to government statistics, the number of firms failing annually rose from 10,000 in 1978 (a number that had been stable since 1950) to 73,000 in 1998.
- **Globalization:** The spread of globalization comes in multiple forms. It is experienced in both the opening up of new markets around the world and the emergence of new forms of competition.

The movement of capital – financial, human and resource-based – influences the patterns that emerge in the world marketplace. While the trade of physical products once represented the most significant factor in global competition, now the spread of cheap communication and computing has created increasing competition in the world trade of services and labor. At the same time, new consumers, particularly in developing nations, are becoming participants in the economy. The race to serve these emerging markets is now intensifying in many industries.

- **Economic Factors:** While economies have always gone through cycles of expansion and recession, some experts now argue that economic volatility has risen as a result of global capital flows, currency fluctuations and new forms of asset speculation. Clearly, the vast bubble of the dotcom era demonstrated the potential for dramatic economic growth and collapse.
- **Regulatory Factors:** There have been significant changes in the regulatory environment for a number of industries in recent years. To a large extent, banking, telecom, media and other businesses have been heavily deregulated – opening up new market opportunities for some and undermining the strong market position of others. More recently, corporate accounting scandals have precipitated the introduction of new regulations on corporate governance that come with severe penalties on executives.
- **Wild Card Events:** The searing experience of 9/11 vividly demonstrated the risks that all enterprises face in today’s environment of heightened threats and conflict. The economy suffered heavily from the psychological and financial impact of those events.



Airline, shipping and insurance industries were heavily affected.

- Similarly, the extraordinary damage of recent hurricanes such as Katrina and Rita showed how economies, industries and lives could be severely disrupted by the forces of nature.

Of course, change often happens gradually over time but remains unaddressed. This was the case with the Detroit automakers who saw their stronghold on global sales radically over time by Japanese automakers that had made deep commitments to quality. Having made a comeback, the Detroit automakers again seem to have been undermined by large operating and healthcare costs. Ford and General Motors are now struggling to remain competitive and address the competitive forces they now face.

The forces of change create *transition points*. These are critical moments in which enterprises are faced with decisions and challenges that may very well determine whether or not they survive. Among the ways they confront them:

- **New Management Initiatives:** These anticipated initiatives are introduced and designed to help drive growth, profitability and shareholder value. Some companies have introduced customer or quality initiatives. Others have sought ways to reengineer their processes or reduce operating costs. Some have introduced initiatives to “digitize” or “globalize” their businesses. All such efforts depend on successful change management if they are to achieve their objectives. And yet, weak leadership and management of organizational change remains one of the most widely acknowledged failings of such initiatives in recent decades.

- **Mergers and Acquisitions:** In the wake of deregulation in recent decades, the M&A movement has driven vast amounts of change in various industries, particularly through mega mergers in areas such financial services, telecommunications and media. However, business analysts argue that two-thirds or more of all mergers fail to achieve their objectives. As companies have found over time, it is extremely difficult to consolidate organizations, cultures, processes, practices and systems. Nevertheless, enterprises continue to consolidate in order to address competitive challenges and commoditizing markets as well as capitalize on anticipated synergies.
- **Partnerships and Outsourcing:** Yet another means by which companies address dramatic change is through partnering and outsourcing. Such approaches enable them to leverage the capabilities of external parties as opposed to buying or building them. By creating alliances with specialists, enterprises can acquire the capabilities they need to effectively compete in demanding markets – all without bearing all the risks that would be associated with building them internally. Similarly, outsourcing enables enterprises to concentrate on the core capabilities that differentiate them in the marketplace while ensuring that non-core, yet nevertheless critical and supporting systems are effectively managed. Through such moves, companies can both anticipate and react more rapidly to market change.

While all of the approaches to confronting change that are mentioned above represent significant risk in their own right, there is perhaps more risk associated with failing to act. As the varying experiences of several well-known companies attest, it is critical to recognize transition points when they occur and take the necessary steps to address changes they signify.



2.0 Left Behind: The Costs of Failing to Act

It's worth considering the contrasts we now see in various industries where some recognized companies have confronted change, while other equally recognized firms have largely resisted or ignored it. Of course, markets will always have winners and losers. The question is what category any given company will fall into.

As the pace of change accelerates, it seems apparent that the winners and losers will be distinguished at an increasingly rapid rate. The rise and fall of fortunes also will accelerate. While turnaround stories are certainly waiting to be told, here are some of the apparent winners and losers at this point in the evolution of three industries:

- **Retail: Sears vs. Wal-Mart.** Having built an astounding enterprise over more than a century that brought goods to Americans through its catalogue and retail stores, Sears began to falter in the 1970s and 1980s. The company tried to diversify into financial services, lost billions, and then divested the operation. It didn't see the retail opportunities that were emerging in rural locations and other sites on the periphery of cities. It couldn't see the potential of offering "every day low pricing." Nor did it invest in creating highly efficient supply chains that could deliver products to stores for less. Those advances were left up to Sam Walton to demonstrate, eclipsing the fallen colossus of Sears in the process. When Sears acquired K-Mart in late 2004, the deal did nothing to persuade industry analysts that the company could make a meaningful comeback. The frontier in retailing now finds Wal-Mart fending off still newer competitors such as Target, Costco and Amazon.com.
- **Airlines: United vs. Southwest.** Soon after the devastating events of 9/11, the new dynamics of the airline industry were laid bare. United Airlines, which had been a leading carrier for the past few decades, was now on the verge of bankruptcy – seeking financial support from the U.S. government. Southwest, by contrast, had built a highly efficient airline based on low fares and predictable service. While United's unwieldy cost structure has hampered profitability and reinvestment, Southwest, which has never had a layoff, has kept its costs 20-40% below those of the so-called legacy carriers. Indeed, Southwest's \$12.5 billion market cap nearly triples all the other major airlines' combined.
- **Automotive: GM vs. Toyota.** While *Fortune Magazine* recently ran a cover story describing the "tragedy" of General Motors, it ran a feature story in the very next issue describing the "triumph" of the Toyota Prius – a hybrid car that was brought to market in a rapid fashion to capitalize on emerging concerns about the environment and fuel prices. General Motors, which lost \$8.6 billion in 2005, held nearly 50% U.S. market share in 1980; it now holds only 25% and dropping as it labors under the heavy weight of health care obligations and concerns about possible bankruptcy. Meanwhile, Toyota, which earned \$11.4 billion last year, is manufacturing 50% more automobiles than it did in 2001 and appears poised to soon surpass GM as the globe's largest car company in terms of volume.

Although Toyota is known as a relatively conservative company in terms of its own rate of change, it broke its own rules to get the Prius to market and capitalize on its competitive advantage in a changing marketplace.

As these examples demonstrate, few companies can expect to live long on the legacies of the past. Markets are dynamic and turbulent – prone to something Austrian economist Joseph Schumpeter once called “creative destruction.” That’s even more true now than it was a century ago when Schumpeter said it. The acceleration of change only enhances the vulnerability of today’s corporate giants, while empowering and enabling challengers to compete for new market opportunities. Given these circumstances, enterprises must learn to specialize in the management of ongoing change.

3.0 Anticipating the Unexpected -- Confronting Tomorrow's Transitions

As one might imagine, the acceleration of change in today’s markets is generating new thinking about what it takes to strategically lead, anticipate and manage change. “The amount of change in organizations has grown tremendously over the past two decades, and the rate of change will only accelerate in the next few decades,” writes John Kotter, professor of leadership at Harvard Business School, in his best-selling book *Leading Change*.

He argues that successful change requires forceful and distributed leadership. Change leadership, Kotter explains, “cannot be confined to one larger than life individual who charms thousands into being obedient followers. Modern organizations are far too complex to be transformed by a single giant. The leadership effort must have support from many people who assist the leadership agenda within their sphere of activity.”

To assist change leaders and change agents within organizations, Kotter offers eight steps for effectively transitioning or transforming an organization:

3.1 Establish a Sense of Urgency. Evaluate market and competitive dynamics in an effort to identify crises, potential crises and significant opportunities.

3.2 Form a Powerful Guiding Coalition. Assemble a team with the power to lead the change initiative and encourage active collaboration.

3.3 Create a Vision. Create a compelling vision that provides a framework for change. Devise strategies that will enable the organization to achieve the vision.

3.4 Communicate the Vision. Actively communicate the new vision and strategies. Teach new behaviors by demonstrating them.

3.5 Empower Others to Act on the Vision. Eliminate obstacles that stand in the way of effective change. Change systems and structures that present hurdles.

3.6 Plan for and Create Short-Term Wins. Seek quick and visible performance improvements. Recognize and reward employees engaged in those improvements.

3.7 Consolidate Improvements and Produce Still More Change. Leverage new credibility to drive change in systems, structures and policies that are not supportive of the vision. Hire, promote and support people who lead and support the vision. Sustain and strengthen the initiative with new projects, themes and champions.

3.8 Institutionalize New Approaches. Articulate the links between new behaviors and organizational performance gains. Commit to the development and succession of new leadership to build on achievements.

Interestingly, the acceleration of change today may be assisting those change leaders and advocates who are trying to address step one: *Establish a Sense of Urgency*. Market turbulence – which may be vividly reflected in stock prices, quarterly numbers or a hostile takeover threat – certainly can create urgency.



Then again, some companies tend to slowly unravel – incapable of making the kinds of turnarounds that Louis Gerstner made possible at IBM in the 1990s. The first challenge, as Kotter points out, is to establish that a reason for significant change exists.

Despite the necessity of being able to lead and drive change, there's a significant risk that employees might suffer from what change specialist Eric Abrahamson calls "repetitive change syndrome." In his book *Change Without Pain*, Abrahamson warns of "initiative overload, change-related chaos and widespread employee anxiety, cynicism and burnout."

He contends that these factors can fatally undermine change efforts. "Not only do relentless tidal shifts of change create pain at almost every level of the company and make organizational change harder to manage, more costly to implement and more likely to fail, but they also impinge on routine operations and render firms inwardly focused on managing change rather than outwardly focused on the customers these changes should serve."

Rather than embracing radical and painful approaches to change, Abrahamson favors efforts that incrementally build on existing strengths, assets and capabilities. He calls his approach "creative recombination" – making the case for a "smoother, more cost-efficient, less painful" approach to change. "Rather than obliterating and then reinventing anew, creative recombination seeks sustainable, repeatable transformation by reconfiguring the people, structures, culture, processes, and networks the company already has," he contends.

The key lies in making agility and adaptation a core competitive strength for the enterprise. As these capabilities are ingrained in the organization, they prepare it to anticipate and respond to change as necessary without suffering the fatigue and anxiety that pervades many companies. To the contrary, continuous market change becomes a key opportunity to outmaneuver competitors and demonstrate market differentiation.

4.0 The Lever of Outsourcing: Leadership through Transition Points

One of the key levers of change – as mentioned earlier – is outsourcing. "Outsourcing is, first and foremost, a tool for organizational change," contends Michael Corbett in his book *The Outsourcing Revolution*.

Corbett explains that outsourcing can bring a full range of benefits. At a basic level, outsourcing can reduce costs. Half the executives that use outsourcing state that cost reduction is the top reason for their decision. While cost savings can be passed on to customers or shareholders, such actions also are a critical first step for many organizations that must redeploy and reinvest their capital to address new market challenges – anticipated or unanticipated – and remain competitive.

But there are other reasons for outsourcing that also are consistent with adaptive leadership in an era of accelerated and turbulent change. Indeed, the second most frequent reason stated for outsourcing is to explicitly shift resources to core capabilities and operations – the activities that provide a unique competitive advantage. Southwest Airlines, for instance, was the first airline to lease – rather than purchase – its aircraft. Southwest outsourced 90% of component maintenance, enabling it to concentrate on customer service, cost containment and other market differentiators.

Another reason for outsourcing is to adopt a variable cost structure. Rather than being saddled with high fixed costs in internal operations (which is now a key problem for United Airlines, American Airlines and General Motors), an enterprise can adjust expenses to respond to changes in a marketplace.

Access to skills is another valid reason for outsourcing, particularly as the costs of hiring, developing and retaining talent continue to climb in critical areas. Outsourcers have the ability to leverage their talent and skill base across an array of clients.



This enables them to invest in the continuous development of talent in a way that would not be economical for most companies.

One last benefit of outsourcing is the capacity it allows for driving innovation. As the story of Procter & Gamble suggests, companies can both turn themselves around and establish new levels of competitive differentiation through outsourcing.

Having experienced a growth slump in the late 1990s and watched its stock collapse, P&G, the world's largest manufacturer of consumer packaged goods, embarked on a series of far-reaching change initiatives. The company began globalizing its activities – creating a global shared services model to replace the geographically managed, multi-national model that had previously been in place. This effort set the stage for a series of new outsourcing partnerships that would enable the company to concentrate on its core capabilities of design and innovation.

P&G signed large agreements with Hewlett-Packard to manage IT infrastructure and accounts payable. It inked a ten-year agreement with IBM to provide employee services, including payroll, benefits, relocation and travel support. Jones Lang LaSalle was given a five-year deal for facilities management services, including maintenance, remodeling, security and mail services. In addition, P&G brought in dbaDirect to handle aspects of its data infrastructure management.

“In the days that followed the signing of the contracts – and every single day since then – we have worked to understand each other's cultures, respect new approaches, and share ideas, frustrations, concerns and rewards,” says Filippo Passerini, CIO and global shared services officer of P&G. “On a regular basis, we assess the health of the partnerships, measuring nine different dimensions – with leadership teams from both sides working together to ensure it gets better and better.”

Such leadership has provided the foundation for P&G's present effort to look externally for research and development capabilities that can heighten its ability to innovate. With the firm backing of P&G's senior leaders, the company is now generating as much as 35% of its innovations through an approach it calls “connect and develop.” This open model of innovation ultimately is aimed at obtaining half of P&G's new products from its own labs and half through external parties. The rationale behind the initiative? “With a clear sense of consumers' needs, we could identify promising ideas throughout the world and apply our own R&D, manufacturing, marketing, and purchasing capabilities to them to create better and cheaper products, faster,” explain Larry Huston and Nabil Sakkab, two leaders of P&G's outsourced endeavor, in a recent issue of the *Harvard Business Review*.

The results have been phenomenal. “Through connect and develop – along with improvements in other aspects of innovation related to product cost, design and marketing – our R&D productivity has increased by nearly 60%,” state Huston and Sakkab. “Our innovation success rate has more than doubled, while the cost of innovation has fallen... And, in the last two years, we've launched more than 100 new products for which some aspect of execution came from outside the company. Five years after the company's stock collapse, we have doubled our share price and have a portfolio of 22 billion-dollar brands.”

Such stories demonstrate the power of looking outside – through outsourcing and partnerships – to obtain the necessary capabilities to adapt to and thrive on market change. Procter and Gamble was confronting a transition point in its marketplace. The company realized it couldn't meet its growth objectives of 4-6% – the equivalent of building a \$4 billion business in one year at this point – by relying solely on its internal resources. It needed to focus on core capabilities and more effectively leverage its existing assets to reach its growth objectives. It accomplished this goal through active new partnerships and outsourcing.

5.0 What's Next: Turbulence, Transition and Transformation

What is increasingly clear is that the rate of market change is accelerating – and the vulnerabilities this creates for enterprises are escalating. Not only is change coming fast and furious, success and failure are being revealed at an ever-increasing rate. The only way to remain strategically differentiated in such markets is to remain focused on core priorities and capabilities.

While organizations must in fact strengthen their ability to manage transitions and change effectively in order to adapt, they also must be prepared to take steps – such as outsourcing and partnering – in order to enhance their own focus and agility. They will look outside not only to reduce costs, but to access the scalable capabilities, skills and even innovative capacities necessary to succeed in the markets of tomorrow.

Dramatic, turbulent change is inevitable. The question is which companies will take the steps necessary to successfully manage the transitions and transformations necessary to thrive in world of accelerating and often unpredictable change.

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