

The Case for Risk Management

In today's tough economic times, companies considering operational innovations can reduce their uncertainty with a solid risk management strategy.

By Matthew Ryder, Senior Managing Director,
NKF Consulting



Where some see challenges others see opportunity. This truth may be one of the only certainties in this otherwise uncertain economic environment. We are seeing it already in the resiliency of innovation.

Despite unpredictable consumer markets and the shifting focus from the top line to the bottom line, innovation lives. It just looks different. Instead of new products and services fueling top line growth, the innovation currently in vogue — operational innovation — allows companies to do more with less. For this reason, bad economic times heighten attention to operational innovation.

We are seeing many forms of operational innovation in the current economic environment that impact site and facility planning. For example, companies are redefining the boundaries between their own organizations and partners' organizations. Operations that were once closely held — such as research and development — are now commonly trusted to others firms. For those operations that remain within companies' control, the focus on achieving cost-effectiveness without sacrificing quality is yielding creative new ideas and solutions. Yet, in the current economic environment, companies face new barriers to operational innovation even though their motivation for efficiency is as high as ever. This point becomes clearer when we look at innovation with an understanding of what is required to achieve it.

One of the most interesting perspectives on achieving innovation comes from Gregory Berns, a neuro-economist at Emory University. Berns looks at innovation through the minds of individuals who accomplished things that others assumed to be impossible. In his book *Iconoclast*, Berns points out that iconoclasts have three remarkable characteristics: they see the world differently; they have a level of social intelligence that allows them to bring others to their way of thinking; and they tolerate the prospect of failure. Most companies that achieve operational innovation embody these qualities as well. In bad economic times the first two characteristics become easier to acquire, while the last becomes significantly harder.

Seeing the World Differently

Berns describes the brain as a “lazy piece of meat” because it draws on past experiences when possible to make perception easier. In management we call this “patterned thinking.” It impedes innovation.

Conversely, when a management team cannot easily rely on past experiences to help them perceive their current environment, innovation is enabled. It is difficult in our current economic environment to rely too heavily on past experiences. After all, the world looks a lot different now than just a year ago.

Operational innovations that impact site and facility planning start with a change in perspective. We witnessed this recently when a client challenged a longstanding staffing strategy. After more than 20 years of hiring only college-educated workers in its customer

service operations, this company's customer service centers were located in metropolitan areas with abundant college educated workers. The current economic environment — and this company's diminished margins — changed its perspective on the type of worker required to service its customers. The company hoped that relaxing the required educational attainment of its workers would result in two things. First, it hoped to find no significant decline in customer service. Second, it hoped that the company's labor costs would decrease as it stopped competing for college-educated workers in metropolitan areas.

Bringing Others to Your Way of Thinking

Berns describes iconoclasts' ability to bring others to their way of thinking as "social intelligence." Without this ability, iconoclasts cannot effect change in any meaningful way. Similarly, company managers who cannot bring members of their organization to a new way of thinking will not achieve operational innovation.

Operational innovation is broad-reaching within a company. Many departments, business units, and individual employees are impacted, sometimes negatively. The negative impact on individuals results from an effort to positively impact the organization as a whole. In good economic environments, where operational innovation is not critical, the motivation for change is often outweighed by the desire to avoid negatively impacting parts of the organization. In bad economic environments, operational innovation is often required. In these cases, the good of the whole company generally outweighs the good of its parts. Indeed, collectivism surrounds us in this economic environment in the form of layoffs, pay reductions, and offshoring.

For our client determined to move out of expensive metropolitan areas by challenging its hiring strategy, operational innovation would sacrifice many individual employees. In better economic times, this sacrifice may not have been worth the reduction in costs. In today's economic environment, however, where the survival of

the company was uncertain, management felt the sacrifice was warranted.

Tolerating the Prospect of Failure

Fear of failure can be paralyzing. For managers, fear of failure often stems from the uncertainty brought on by change. In unpredictable environments, the level of uncertainty for managers can lead to inaction. Such is the state of many companies in our current economic environment.

This can be readily seen in the large number of site and facility planning projects cancelled or put on hold in recent months. With the chaos of uncertainty diverting the managers' attentions, the prospect of increasing uncertainty through changes in companies' site and facilities strategies is often too much to bear. This makes operational innovation extremely difficult.

For our client attempting to reduce costs through operational innovation, the risk of failure nearly kept the company from implementing its new strategy. While the company could reduce its long-term costs by moving away from metropolitan areas, its short-term implementation costs would increase. This, coupled with an uncertainty about the effect on employee morale, customer service levels, and corporate image, created a mountain of doubt and fear. Managers needed some way of seeing into the future to determine whether their operational innovation would bring them relief or additional pain.

Enter Risk Management

Risk management for the purposes of reducing uncertainty in operational change has two components: prescriptive decision processes and experimentation. Companies seeking to overcome the fear of uncertainty use prescriptive decision-making processes to determine what information they need and how that information will be used to identify the best strategies from all possible options. The purpose of a prescriptive decision-making process is to create a solid hypothesis. The purpose of experimentation is to test a solid hypothesis in the real world to make sure it will hold up. Used together, prescriptive decision-

making processes and experimentation allow information to replace uncertainty and confidence to overcome fear.

Prescriptive decision-making processes for operational innovation need to focus on three key areas:

Team selection: Operational innovation affects several, if not all, parts of a company. Companies evaluating opportunities for operational innovation must do so with a cross-functional team of stakeholders who can collectively represent the entire organization. For site and facility planning teams, this often includes members representing facilities, real estate, finance, human resources, operations, and customer service.

Cross-functional teams can provide the breadth of information required to properly evaluate strategic options. Further, a decision supported by a cross-functional team will represent the company as a whole. This allows for easier adoption for individuals who were not directly involved in the decision-making process.

Decision framework: Complex operational analysis involves many different types of data. A decision helps stakeholders determine what information is needed and how individual pieces of information will work together to create a rich analysis.

In site and facility planning, there is often a tradeoff between cost and quality. For example, a reduction in facilities costs usually comes with some reduction in quality, e.g., a less desirable location, lower class property, less frequent maintenance, etc. The reduction in facilities cost is measured in dollars; the corresponding reduction in quality is not. As a result, determining a company's appropriate tradeoff requires an analysis wherein the impact of the reduction in cost and the impact of the reduction in quality can be fairly assessed.

Stress-testing the recommendation: There are two main areas of uncertainty when using a decision framework to analyze operational innovation. The first area of uncertainty is the team's prioritization of the information. For

many companies — especially in difficult economic times — the cost of operations tops the list when considering any operational change. There are, of course, quality aspects of operations that also warrant consideration. A decision framework helps to establish this as long as stakeholders can determine which objectives of their operations are most important and which are less so. Being able to stress test a recommendation based on various ranges prioritization allows stakeholders to see how well the recommendation will hold up if their priorities change.

The second area of uncertainty is the assumptions used to create the analysis. Examples of such assumptions might include the company's growth rate, changes in components of operating expenses, and the cost of capital. Stress-testing allows stakeholders to answer the question, how much would the unknown elements need to change in order for our recommendation to be different? And, once this is known, is it reasonable to think that those changes could be feasible? When a hypothesis stands up to stress-testing, it's time to further reduce uncertainty by giving it an even more rigorous test: real world exposure.

A Real World Example

Despite managers' ability to use

experimentation to rigorously test hypotheses with little risk to the company, experimentation is rarely used. Many managers feel that the speed of business requires good ideas to be implemented as fast as possible in order to achieve full benefit. And while it is true that experimentation can delay full implementation, the reduction in uncertainty, risk, and fear is often worth the wait. This is especially true in our current economic environment.

Operational innovations represent large-scale changes. Most often, however, the results of a change can be tested on a smaller scale. This means that a company can see the results and determine if the change is positive or negative before subjecting themselves to the change.

Our client used experimentation to gain a higher level of trust than it had from its hypothesis alone with very little risk. Instead of shuttering its customer service centers in metropolitan areas and moving them to smaller cities, the company first tested its concept in an outsourced operation. It hired a mix of customer service representatives in a small Midwest city, trained them using the company's protocol, and waited six months to see the results. The results were staggering.

Not only was there no statistically

significant difference in the productivity of the representatives without a college degree, but also the turnover rate of these employees was lower. This meant that over a longer period of time, our client would incur lower rehire costs for representatives without a college degree. Adding this savings to the reduced labor and real estate costs amounted to a 23 percent long-term reduction in operating expenses for our client's customer-care operations. And for what it's worth, it also represented the achievement of an operational innovation.

As the recession drags on and financial pressure on companies continues to build, many other companies will find innovative ways to do more with less. Site and facility planning will be at the core of many of these innovations. Together these innovations may represent a great deal of advancement for our industry. Perhaps that's the one thing we can all be positive about these days. ■

Matt Ryder is a senior managing director at the operations consulting firm NKF Consulting, a Newmark Knight Frank Company. He leads teams focused on operational innovation and change and is a frequent speaker on these topics. He can be reached at 404-926-1091 or by e-mail: mryder@newmarkkf.com.