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Managing Through Uncharted Territory

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Recently, I had a chance to see Ken Burns' PBS special on the Lewis and Clark expedition. I was struck by the similarities between the challenges those early explorers faced and the challenges that managers are facing today. Lewis and Clark had a good idea of where they wanted to go, but no good map of how to get there. Ultimately, they had to rely on their courage, skill, and ability to work together as a team to get them safely through their journey.

Managers are in the same boat these days. They have a sense that they, too, are at the edge of the known world and need to set foot into the unknown, but they have no reliable maps to guide them. They know that if they keep doing business in the same old way, they will eventually be out of business. And if they want to stay in control of their own destiny, they will need to summon the courage to chart a new course.

How do companies find their own "Northwest Passage" through the turbulence and complexity of today's dynamic markets? The old methods for planning and managing that were designed for a more orderly, stable, and predictable environment aren't up to this task. None of the old maps seem to help very much, either. Most of the guidance available in local bookstores is misleading, suggesting that it will be smooth sailing if they just follow in the footsteps of someone else who made it and if they just get over that next big hill.

Over the past several years, I've been experimenting with some different approaches to managing through uncharted territory. Instead of working with managers to engineer the business to move along a straight path from point "A" to point "B," I've been trying to help them discern where the business is heading naturally, and what obstacles are getting in the way. My assumption is that the future (or vision) isn't "out there" somewhere, in some dream state or vague platitudes, but already emerging in the organization in some form. As a result, breakthroughs in performance come not by applying massive force to impose a new order and to overcome organizational resistance, but by amplifying what is emerging and removing whatever is blocking the system's natural energy for moving forward. Using this approach, small efforts can have a major impact on the performance of the overall system.

Basically, managers need to learn their way into and through the uncharted territory, developing a deeper understanding of the dynamics of the business and the market as they go. What seems to make the biggest difference is whether they take the time to "think together" about where the business is heading and what's getting in the way. It also helps to run a lot of experiments to check their assumptions and fine-tune their thinking.

This approach to managing the business requires a set of tools that can help teams make their thinking more explicit, keep track of it as it changes over time, and check it against reality. These tools make it possible for teams to see the deeper patterns in their own thinking, do a reality check on their assumptions, and gain new insights into how the business really works.

Northbrook Story

Probably the best way to illustrate what I'm talking about is with an example. A couple years ago, I was involved in a project with Northbrook Property and Casualty, a large carrier of commercial insurance. At the time we started working with them, they had been losing money for several years, and their parent company was threatening to sell them off if they couldn't get things turned around. However, instead of panicking and becoming hyperactive or circling the wagons, Northbrook's leadership team decided to take some time to rethink the business.

The company wanted to believe that their problems were a function of the soft market, and that the business would turn around as soon as the market firmed up. Yet, a few of their competitors were still managing to make money, even in the soft market. When we arrived, Northbrook had been working with McKinsey and Co. to develop a new strategy designed to boost them into this elite group. The work with McKinsey had uncovered some important dynamics in the market.

First, there was growing competition for business at the high end of the market, where Northbrook had historically focused its efforts. They had built the business by selecting low-risk customers at or above the market price, then retaining them with good service. Competitors knew this and were stealing Northbrook customers with lower prices, knowing that the risks would be good. Other low-risk customers were opting to self-insure or pool risks with other companies. Competition at the high end of the market was also intensifying due to an increase in the number of carriers in the industry, despite the slow market. Furthermore, the percentage of business being written by independent agents, who Northbrook depended on, was shrinking. And some large independent agents were beginning to perform functions like claims handling and loss control that were traditionally performed by insurance carriers.

It was clear that Northbrook couldn’t survive by doing business the same old way. Building on what other better-performing companies were doing, they developed a new set of strategies designed to achieve consistent, moderate, profitable growth. The strategies were an amalgamation of various approaches that seemed to be working for their competitors.

To help implement these strategies, the leadership team developed a new set of performance measures. They first identified the key factors that would contribute to the success of each of the new strategies. Then, they slotted these factors into a balanced scorecard framework that focused on customers, shareholders, employee effectiveness, and innovation.

Although the leadership team managed to reach consensus on which measures to include in the balanced scorecard, they had some lingering doubts about whether the measures they had selected were really the drivers of business results. If not, they worried, they could steer the business in the wrong direction and undermine all of the work that had gone into developing the new strategies. They also wondered which measures offered the most leverage, what the tradeoffs were among them, which direction to move them, and what the appropriate targets ought to be. Without answers to these questions, they knew it would be difficult to manage the business, even with the new measures.

Modeling the Business

The leadership team decided to build a computer simulation model of the business to get answers to these questions, and to do a reality check on their strategic assumptions. Ultimately, they planned to make the model available to all of the branch offices as a tool to support their planning within a common strategic framework. They invited a team from Ventana Systems, Inc.[i] to help them construct the model.

To build the model, two teams, one from a branch office and one composed of top leadership, each met for six half-day strategic dialogues to build two separate models of the business. The rationale for building two separate models was to see whether the field had a perspective on the business that was different from corporate leadership. If so, those differences could generate important insights into how to manage the business better.

The basic structures of the model emerged from these dialogues, so that the computer model became a visual representation of people's assumptions about how the business worked. The model-building process imposed structure and discipline on the dialogue. During the meetings, we probed the logic, consistency, and accuracy of people’s assumptions, and explored differing perspectives within the teams. The exercise of trying to capture each team’s thinking in a single model tended to flush out differences in team members' assumptions. Data collected at both the branch and brand level provided a reality check on those assumptions.

By adopting a more interactive approach than usual to building the model, we hoped to overcome defensiveness and gain greater acceptance of the modeling process and the output from it. Previous projects had shown that the output of computer modeling projects, no matter how accurate and useful, is frequently rejected or dismissed by organizations because the conclusions often run counter to the conventional wisdom. Our approach was designed to promote ownership of the simulation model as something "home grown," whose insights could not be so easily ignored or dismissed.

Emerging Patterns

After meeting for several weeks, some patterns began to emerge from the dialogue. Within each of the teams, there was disagreement on how the business worked and what it would take to make it a success. The disagreement tended to focus on the relationships among five key variables: price, volume, losses, expenses, and profitability.

The conventional wisdom was that market success comes from selecting low-risk customers at or above the market price, retaining them with good service, keeping volume up, and keeping expenses down. It maintained that price was dictated by the market; thus, profitability was a function of what was happening in the market, and out of the organization's control. This logic had held sway for some time, and there were structures in place to support it. The branch offices were expected to increase the volume of business annually by 15 percent. They had also been tasked to reduce expenses by 15 percent several years earlier, and felt under constant pressure to do more with less.

But, the dialogues showed that many people were starting to question these assumptions. They worried that continuing to increase the volume of business would make them less profitable, because it would require them to write riskier business, which would drive up losses. They also worried that high prices would leave them vulnerable to their competition and drive down volume. If volume fell, layoffs would follow. The memories of a recent downsizing were still fresh. Because nobody had offered any explanation at the time, people believed that their co-workers had been laid off because volume was down and expenses were high. They assumed that if volume fell again, the cycle would be repeated and there would be another round of layoffs.

Finally, people believed that if they cut expenses, that would reduce service levels and make it hard to maintain strong customer relationships, which they saw as key to maintaining volume and price. In particular, the field was coming to believe that increasing underwriting and claims adjusting capacity was the key to their future success. Yet, these functions had taken hits in the earlier round of downsizing.

These conflicts over the fundamental logic of how to move forward had never been directly addressed. When they came up in our work together, people would usually laugh nervously, then slide off onto some topic that seemed more manageable.

The strategy work with McKinsey and Co. had never bumped into these internal conflicts because it had focused only on what was happening in the external market. What we were bumping up against were the internal dynamics of the business itself, in particular the different assumptions that people held about what was required for the business to succeed.

As we worked our way through the different assumptions, it became clear that there were two distinct "stories" about how to grow the business. One story was basically a continuation of what had worked so well in the past and which all of the current systems were designed to support. It maintained that a higher volume of business at the high end of the market, along with lower losses and lower expenses, would lead to higher profitability.

However, a new story was emerging from focus groups with customers and from experience in the field. It maintained that if Northbrook increased its claims and underwriting capacity (adding to expense), losses would fall, risks could be managed more carefully, prices could be determined more accurately to achieve profitability, and volume would be maintained through stronger agency relationships.

Picking a Story

Both stories were living in the practice of the organization, side by side, causing a fair amount of confusion. The branch offices were being told both to increase volume and to not grow right now. They were being told both that the market controls the price and that they control the price through better underwriting. And they were being told both to cut expense and increase their underwriting and claims adjusting capacity. These mixed messages were causing people to feel stuck. Because there wasn't a consistent train of thought, people were reluctant to take initiative. They weren't sure how they could best contribute to overall success, because the fundamental logic for achieving success wasn't clear or consistent.

The leadership team had been right to call a time-out to check on their underlying assumptions. With the confusion about the underlying logic, introducing new performance measures could have aggravated the situation by introducing even more complexity into the system. Since people didn't understand the thinking behind the measures, they could have gone off in different directions or remained paralyzed by mixed messages about how to interpret them.

Several of the measures that had been incorporated initially into the balanced scorecard never came up in the building of the computer model. Four of the five key variables that lay at the heart of the conflict over how to move forward did not even appear in the balanced scorecard. And it was still unclear which direction they ought to be moved, since that depended on which story people believed about what the relationship ought to be among them.

Clearly, the leadership team needed to pick one story or logic and stick with it long enough to see if it could produce better results. But, what if they picked the wrong story and drove the business over the cliff? It would be months or years before it became clear whether they had chosen correctly, but their parent company was only giving them a year.

We ran some simulations using the computer model that we'd built. The results suggested that doubling the number of claims adjusters would significantly reduce losses, with a substantial net gain in revenue over expense. Similarly, the model suggested that increasing underwriting capacity would improve profitability, with a substantial net gain in revenue over expense. The idea that adding to expense would increase profitability was hard for some people to swallow, because it ran directly counter to their deeply held belief that cutting costs was the only way to increase profits.

The simulations suggested that the new story had strong potential for boosting performance. Unfortunately, before the leadership team at Northbrook was able to act on their insights, their parent company decided to put them up for sale. At that point, people's natural concern about their own futures took over.

Lessons

Regardless of the outcome, the work at Northbrook generated a number of useful insights that I continue to apply in other work I'm involved in:

- When companies get bogged down, the cause is not always dynamics in the external market. It can be dynamics internal to the business itself. In fact, even the best market strategy will be difficult to implement if there is internal inconsistency and lack of clarity about the fundamental logic of that strategy.

- When the logic isn't clear and consistent, people everywhere in the organization have a hard time getting engaged and taking initiative. People get engaged through open and honest conversation about where the business is headed, a clear picture of how they can contribute to its success, the autonomy to initiate actions on their own, and the opportunity to perform work that is personally meaningful to them and of value to the business.

- Developing a clear and consistent story requires that managers take the time to think together in a sustained and disciplined conversation. Building a model of the business can lend structure and discipline to that conversation, but it is not a substitute for the conversation itself. The model is only as good as the thinking that goes into it.

- A good computer model can perform reality checks on people's assumptions and help the organization move more quickly up the learning curve, without waiting for events to unfold over months or years. The computer simulations offered a more objective method for sorting out differences within the leadership team, providing an alternative to deciding based on raw political power or collective self-delusion. We were able to determine with some confidence that the emerging story had strong potential for making a breakthrough in performance. Further simulations could have yielded some quantitative insights into what appropriate targets might be for key variables.

- The greatest value for the business isn't in the model itself, but in the process of thinking together that it supports. It became clear after a while that just handing the model off to the branches would have limited value if they hadn't been part of the conversation that went into it. In a turbulent environment, the model will always need to be updated for the organization to sustain its performance over time. That means that the whole organization will need to be drawn into that conversation in an ongoing way.

- The balanced scorecard can be a powerful management tool if it incorporates factors that have high leverage on performance and if it reflects a coherent and sound business logic. Unfortunately, the usual approach to constructing the scorecard is often too superficial. Even though organizational systems are complex and dynamic, they tend to operate on the basis of a few rules that can be captured in a simple story. If the measures reflect these rules, then the scorecard can have a powerful impact on performance by reinforcing them. If not, then managing with the scorecard can have a negative impact by sending mixed messages and creating confusion. If the process of building the scorecard also includes the use of computer simulation to perform a reality check on that story, organizations can have even greater confidence that their balanced scorecard is helping them get where they really want to go.

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[i] The team from Ventana included Nathan Forrester, Martha Miller, Laura Peterson, and myself.