What World Are We In?

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The New Economics 2nd Ed., Appendix

Three worlds in which a purchasing decision is to be made.

Criteria used for making the decision are different in the three worlds:

1. There are no differences between what is supplied (costs of use are the same), choice of supplier will be made on the basis of purchase price. Example: food in a package.

2. The product can be supplied as specified by several suppliers, all offering the product at the same price. Choose the supplier who offers the best service.

3. The purchase price is not the only cost; there are also costs of use. The decision will be based on serving the aim of "continual improvement of quality along with lower [total] costs."

***Any theorem is true in its own world. But which world are we in? Which of several worlds makes contact with ours? That is the question*.**

W. Edwards Deming, *The New Economics 2nd Ed.,* Appendix

There are numerous situations in which context governs the bases for decision making or selection of practices to use.

In other situations, there is choice available as to what context to create.

Supplier Selection

Offshoring

Purchase based on price, including transportation

Heavy dependence on forecasts

Example: weather-related seasonal demand

unusual weather (cool summer)

Example: printed material

company opted to offshore printing
in spite of having local capacity

outsourcing to Asia required forecasts
far ahead of introduction for sale

unsold inventories written off

Cost and price should have different meanings

Sourcing

Outsourcing

Two types:

- contracting out a particular business activity to another company
- public services contracted out to for-profit organizations (e.g., operation of prisons)

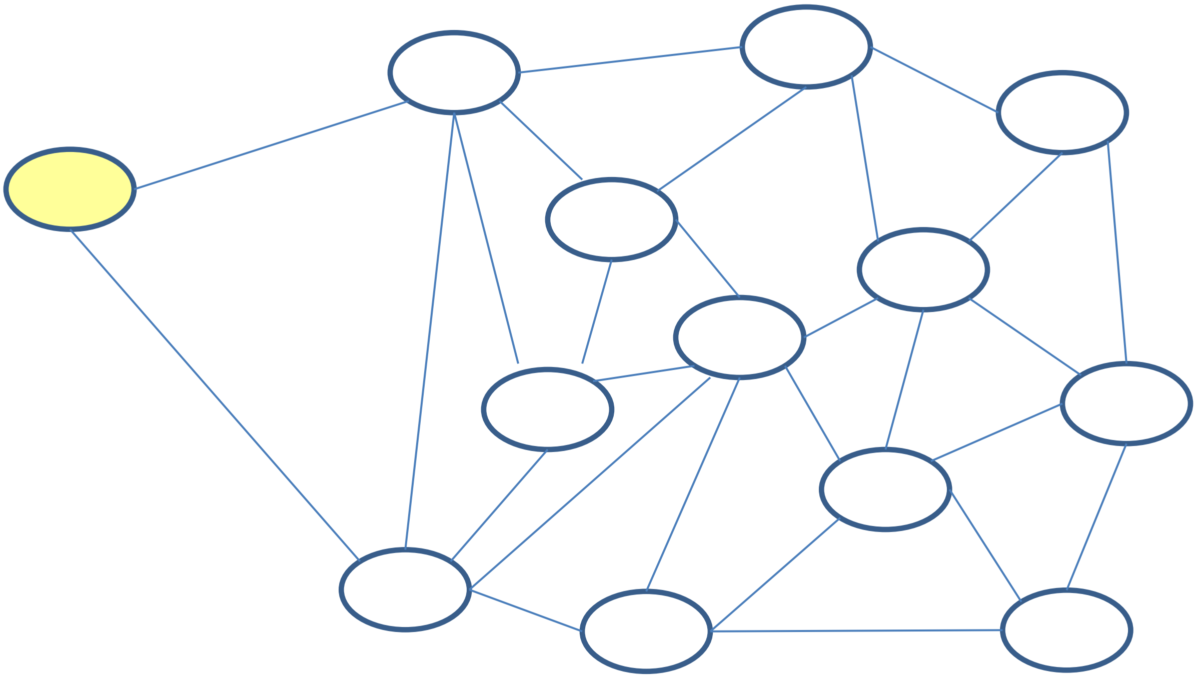
Argument:

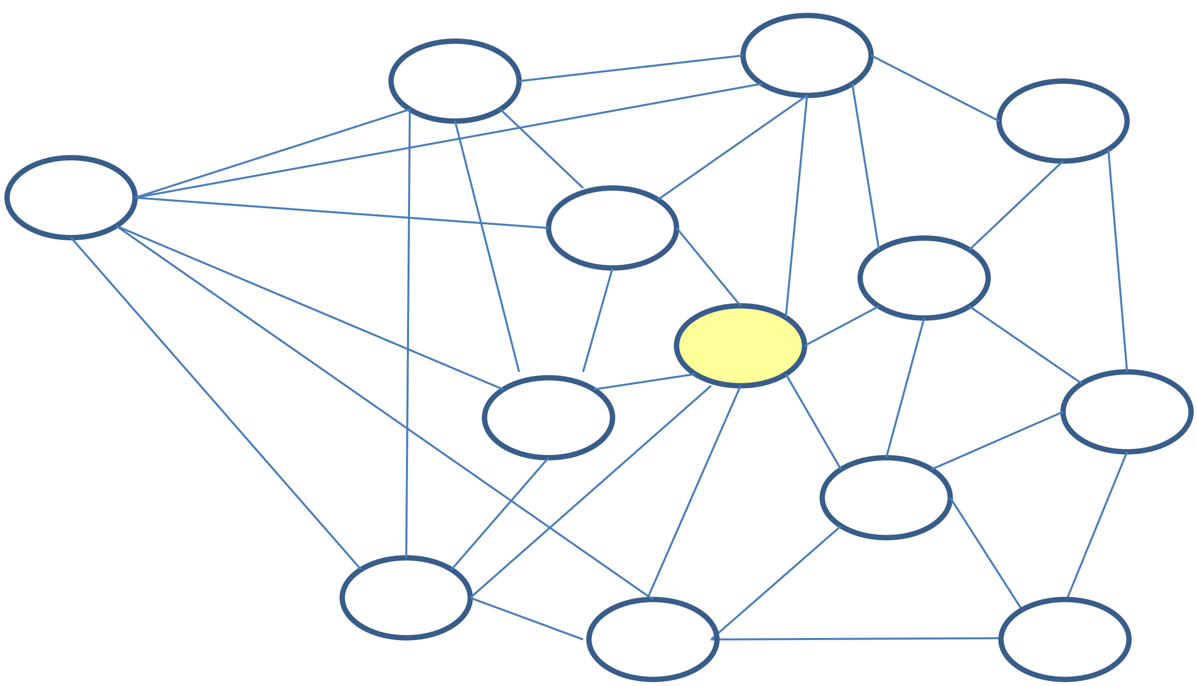
- economies of scale
- greater expertise

Reasons:

- change fixed costs into variable costs
- free up money for core work

Sourcing





Sourcing

Is our department next?

Call centers do not fix core process problems

Toyota Kata: Improvement
Coaching
(Mike Rother)

Variation

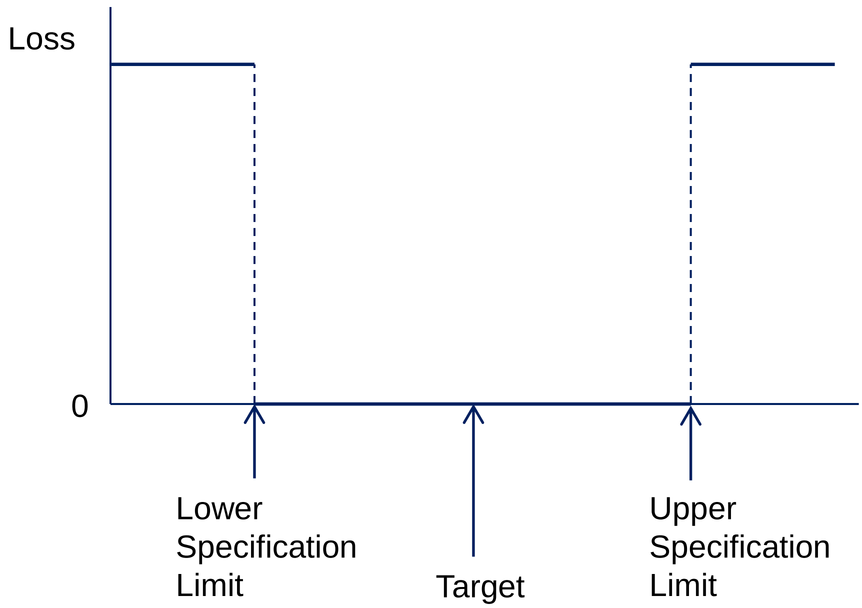
"Once statistical control is achieved (no indication over a long period of time of the existence of a special cause), the next step is improvement of the process, provided the economic advantage hoped for will be a good investment, in view of the expected cost of improvement. Improvement may be defined as:

1. Narrower variation.
2. Move the average to the optimum level (see p. 225)
3. Both.

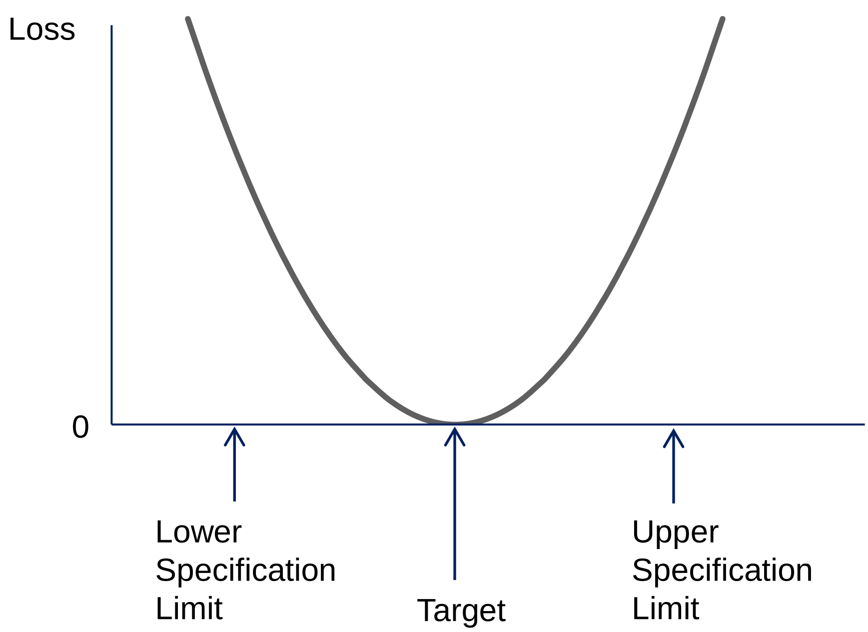
The cost of improvement may be trivial; it may be outlandish, not worth the foreseeable economic gains."

Deming, *The New Economics*, 2nd Ed., p.177

Variation



Taguchi



Variation

Is narrower variation necessarily an improvement?

Cases in which no variation is risky:

- Biological world – monocultures

- Organizations – mental monocultures

  "If everybody thinks the same,
  nobody thinks very much."
  Diversity of education, knowledge,
  thinking, experience may be desirable
  - IDEO

Cases in which no variation can be costly:

- "Common" – good for original purpose

Goals and Targets

Stretch goals – pros and cons

Stretch goals are a good thing because they help people understand business as usual won't be sufficient to accomplish what is necessary to solve a problem, achieve an improvement, or stay in business.

Stretch goals are damaging because they may

- introduce fear,
- be seen as outrageous and introduce cynicism,
- lead to competition and conflict

Goals and Targets

In what kind of world could stretch goals be <u>beneficial</u>?

- Goal setters acknowledge responsibility to provide or access resources needed to achieve the goal
- Goal setters understand they have a responsibility to make system changes that will make the goal achievable
- It is O.K. to fail – people are not punished for failing to achieve the goal; instead ask what were the barriers, how can we remove them?

Goals and Targets

In what kind of world would stretch goals be <u>damaging</u>?

- Goal setters see themselves as having no responsibility to achieve the goal
- Goal setters see themselves as having no responsibility to change the system to make achieving the goal possible
- If the goal is not met, those who are expected to achieve it are penalized; fear of failure inhibits innovative thinking and encourages competition and conflict
- Goals are not thoughtfully set

Same ideas apply to numerical targets

Relationships

Competitive or cooperative?

A U.S. view?

Competition is necessary and sufficient for excellence.

Necessary?

Albert Einstein
Carl Fabergé
Leo Tolstoy

Sufficient?

Look at tennis courts and golf courses any weekend
American auto makers vs. Japanese

Deming: cooperate on common problems, then compete

Example: voluntary standards

Relationships

Competition inside businesses:

Limited resources for projects

Artificially established
Zero-sum games for rewards
and recognition

Yochai Benkler:

To remain competitive externally, it is necessary to learn and experiment

Requires productive collaboration

Productive collaboration comes from intrinsic motivation based on belief that the system is fair, not from command and control or incentive schemes

Yochai Benkler, *The Penguin and The Leviathan*

Interests

“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is run by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences are usually the slaves of some defunct economist.”

- John Maynard Keynes

Through publication and teaching, business school academics have provided the arguments that have led to “many of the worst excesses of recent management practices” [such as Enron and Tyco] and “ruthlessly hard-driving, strictly top-down, command-and-control focused, shareholder value-obsessed, win-at-any-cost business leader[s].”

- Sumantra Ghoshal
London Business School

Interests

Ghoshal

Current management theories taught in business schools have excluded ethics and morality

Two contributors to the current state:

- Chicago School of Economists led by Milton Friedman
- Agency theory originated by Jensen and Meckling

A quote from Friedman:
"Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."
- *Capitalism and Freedom*

Agency theory
To overcome 'agency problems,' managers' interests and incentives must be aligned with those of shareholders; e.g., make stock options a significant part of their pay

Interests

"Why don't we actually acknowledge in our theories that companies survive and prosper when they simultaneously pay attention to the interests of customers, employees, shareholders, and perhaps even the communities in which they operate?"

- Ghoshal

"This theory [stakeholder theory of the firm] maintains that the objectives of the firm should be derived from balancing the conflicting claims of the various "stakeholders" in the firm: managers, workers, stockholders, suppliers, vendors. The firm has a responsibility to all of these and must configure its objectives so as to give each a measure of satisfaction. Profit which is a return on investment to the stockholder is one of such satisfactions but does not receive special predominance in the objective structure."

- Ansoff, *Corporate Strategy*

"The aim proposed here for any organization is for everybody to gain – stockholders, employees, suppliers, customers, community, the environment – over the long term."

-Deming, The New Economics

Interests

Two worlds

Shareholder value maximization view:

A world of self-interest that ignores ethical and moral consideration of other stakeholders

Stakeholder view:

A world in which the contributions of employees, suppliers, community, government to the creation of value by a business are recognized

Recognizes a richer view of the motives and interests of people

Recognizes that people may actually wish to make a contribution to their work and their world

Innovation

Comparison of Practices

	Supports Innovation	Does Not Support/Suppresses Innovation
Aims	Stakeholder, societal benefit, learning	Primarily financial benefit
Objectives	Organizational	Narrow functional
Structure	Heterarchy, adaptable Interaction across functions	Hierarchy, rigid Functional reporting
Internal relationships	Collaborative, cross-functional	Competitive
Rewards, recognition	Non-competitive, celebrates organizational accomplishments	Zero-sum, competitive, focused on the individual, based on executing assignments and meeting targets
Treatment of failure	Treated as opportunity for learning, value placed on knowing what doesn't work, culture of intelligent risk-taking	Punishment, criticism
Treatment of success	Teamwork recognized, contribution to greater good celebrated	Ascribed to individuals
Time horizon	Long term as well as short term	Short term only
Basis for evaluation of investments	Consideration of potential markets, customers, competitors as well as financial evaluation	Use of common financial tools alone
Exploration for ideas	Wide-ranging search for new technologies and processes	Restricted to study of recognized within-industry competition
Experimentation	Encouraged, supported by education and training, time and coaching provided	Not recognized as a valuable practice

Improvement

- The man in the mirror

- The world
  - invitation/invasion
  - type of organization
    - publicly traded
    - private
    - government
  - heterarchy/hierarchy
  - structure (simple, complex)
  - culture(s)
  - skills, knowledge
  - costs/benefits to change