The Myths of Operational Excellence

Where companies go wrong and how they can go right

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Rolling out an operational excellence program in response to a cost reduction crisis is a little silly. It's like seeing your house on fire and responding by mowing the lawn, or having your car battery die and responding by installing cup holders, or realizing your boat is sinking and responding by waxing the rail.

Why, then, do so many biotech and pharma companies persist in operational excellence programs that miss the point? Largely because of the many myths that surround operational excellence, two of which are particularly prevalent in the industry now:

Myth 1

If you face a cost reduction imperative and roll out an operational excellence program, everything will be all right. *The truth is that the proper response to a cost reduction imperative is to reduce costs.*

Myth 2

The power of the program lies in getting the right tools to people. *The truth is that genuine operational excellence/cost reduction relies on a transformation of the organization. The power of the approach lies not in getting the right tools, but in getting the right thinking.*

The Problem with Traditional Deployment

Simply put, traditional deployment doesn't really state what the problem is and how it's going to be fixed. It doesn't make sense to respond to a clear cost reduction imperative with anything but cost reduction actions.

Traditional rollouts of operational excellence do have some cost-savings aspect, but the programs are almost always positioned to fail. Why? Because the most likely source of cost savings is kept off limits.

A little analysis at a manufacturing location reveals that labor expense is responsible for roughly 50% of the cost base. Internal improvement practitioners like industrial engineers, operations research specialists, and some project managers know this, but they are stuck when it comes to what they can do about it. Human Resources (HR) doesn't really like one department designing an organization that eliminates certain jobs. Further, a reputation for recommending that your peers' jobs be eliminated does little for your social relationships. Understandably, internally-led operational excellence doesn't get near the real opportunity.

As an operational excellence program is deployed, staff members are eager to do their part to help. They all get trained for a couple of days in Lean or Lean Six Sigma (or an internal name for the same things). The staff then takes the tools back to their little corner of the universe and looks at applying them. What they quickly realize is that any work they do in their area will not come close to a significant cost reduction if they don't address the number of people allocated to do the work.

Everyone then begins to feel that the organization is in trouble because it's spending a lot of time and energy on these little tiny pieces that will reduce operating expenses by $40K or $50K and not spending time on anything close to the $10 million reduction the site has been assigned by corporate.

Even if the organization works in parallel to address the real cost reduction situation, this approach damages the workforce. Because staff members know that they are not being involved in the real work of cost reduction, they will view the activity called "operational excellence" as the flavor of the month that will soon pass. The employees also begin to worry whether there is a meaningful cost reduction plan. When they feel that they are not being involved in the process of righting the ship, they feel that something is wrong and begin to look for other opportunities.

The Problem Worsens

Sometimes organizations deliberately pursue this reduction by attrition because they don't want to confront directly the need for cost reduction. Instead, they spout platitudes about operational excellence while remaining vague about what the program will actually achieve in savings. The staff knows the numbers don't add up, which makes the good ones nervous — not about cost reduction but about not getting the straight scoop on cost reduction. Eventually, attrition rates hit 30% because the grapevine invents versions of the organization's future that are worse than the reality. With attrition at 30%, executives celebrate. They ignore the fact that the 30% includes 100% of the people who were put on the "high potential" list over the past three years, and that they now have a core team comprised of B- and C-grade players. The executives celebrate the fact that the headcount has been reduced and they didn't need to pay any severance packages and they didn't have to hurt morale by having a layoff.

Of course this process does affect morale, and the result is worse than a layoff because the organization doesn't get to decide who goes in this "restructuring via attrition" approach. The most employable go first; the most comfortable stay.

A Better Way

There's a far better way. You can start by calling cost reduction "cost reduction" and getting some help with the sensitive stuff. Tell the team what's happening to the industry and set about the business of adjusting the cost base. Surely everyone on the board knows what's happening in the industry, as do most general managers, but when you start to talk to the people that run the functions within a manufacturing unit, you hear something a little different. This is also where getting some help from the outside adds value. If you're a leader and you ask your staff whether they are watching costs, what are they going to say? They hear you say it all the time so they will parrot your words back to you. But when I talk to people inside client organizations before we begin a transformation, I often hear people say things like, "Yeah, I know, everyone is under cost pressure, but it's really tough to give up that shift differential. Did you hear they're going to take out the juice bar?" There is still a lot of lip service being paid to the problem inside of most organizations and it needs to be addressed or the unnecessary spending will work its way back in.

The better way begins by letting everyone know that this is a cost reduction activity. The next two steps are fairly standard:

1. Address process issues
2. Remove waste from the operating system

Although the subject here isn't process robustness or leaning out the operating system, two points are worth noting. First, if you currently have a variable process, then you'll always be chasing investigations. Any other changes you try to make will be blown apart by some unexpected process problem. Second, you should take full advantage of technology and ensure the effectiveness of the overall operating system. This includes all of your support business systems and processes. You'll find savings here by step-mapping the processes and removing the non-value-adding activity. (See, for example, "A Lean Version of Lean," Contract Pharma, June 2006.) You'll make sure that none of the systems will break down when you can least afford it.

Human Capital: Real Cost Consciousness

In the kind of transformation that achieves real cost reduction, human capital is the most important component. Before I joined one of the world's largest biotech companies I was responsible for leading a business turnaround in the semiconductors industry. The industry had matured and settled into a characteristic of low-margin enterprises — a constant focus on removing cost from the value stream.

Once upon a time, semiconductors leaders likely looked at the lessons of the automotive industry and thought, "Those cost reduction tools don't apply here! We're not making cars!" By the time I entered the industry, cost pressure had certainly changed that tune. We were trying to squeeze pennies out of every process step and cost-consciousness was deeply ingrained in the organization. People no longer talked about the cost aspect of the business as a constraint — it had simply become part of their reality. Just as there is no word for "art" in Bali because art is so much a part of life there that it doesn't even have a name, the idea of reducing costs in mature industries now goes without saying. No one is standing around lamenting the loss of half-day Fridays or free T-shirts for every project they ever participated in. Instead, everyone is at work paying constant attention to three things: speed, quality and cost.

At the time I came into biotech, everyone told me that my learning curve would be around working in a regulated industry. In retrospect, there was some learning there but it was nothing compared to having to learn how not to hyperventilate about all the financial waste I was surrounded with on a daily basis.

During one of my first meetings with my new team, I presented a slide that stated our mission, something to the effect of, “We will deliver the right support, at the right time, and at a reasonable cost.” Some of my direct report managers began shifting in their seats and stealing glances at each other. After the meeting, I asked one of my managers why all the air had gone out of the room when I had put up the mission statement. He smiled and said, “It was the cost part. That just doesn’t make sense here. It’s the margins; cost doesn’t matter.” I got essentially the same answer when I followed up with other members of the team. When I casually brought the issue up to my peers and they said, “Of course cost always matters,” or, “We keep things under control,” but for the most part they, too, didn’t see any need to have a mission or set of objectives around cost.

That was in 2003 — not so very long ago. In other words, just five years ago you couldn’t say something as self-evident as “at a reasonable cost” not because it was a tired phrase or a downer, but because it was deemed irrelevant to the business. Today, the industry remains almost as far from true cost consciousness.

Learning How the Organization Makes Money

Consider a similar problem of consciousness at a bank that was failing to increase its “share-of-wallet” with individual customers. That is, there was potentially more business to be had from individual customers but the bank wasn’t getting it. Some simple internal surveying revealed that they were not taking full advantage of a major customer contact point — the tellers, who talked to their customers more frequently than anyone else in the banking organization and had all of the customers’ information at their fingertips. The tellers knew how much money each customer had with the bank, what accounts it was in, and where it might make more money for the customer and the bank. Nevertheless, tellers weren’t helping the bank to make more money from its services. One executive put it this way, “Our tellers will talk for 10 minutes to a retiree with 200 bucks with us, while the millionaire next door waits in line for those 10 minutes.” What this client needed was an initiative we came to call, “How banks make money.” We redefined the teller’s position and made tellers the business development people the bank wanted them to be by helping them understand what their role was and with whom they should be spending most of their time.

A similar consciousness-raising is needed in life sciences, so that the staff confronts the reality of doing pharma and biotech work in the commercial sector. The folks who worked in the bank needed to acknowledge that they weren’t performing a public service. They were servicing customers as part of their role in the commercial sector. Their job was to make money for the bank. Once they got this point, the details of delivering more income for the bank were easy.

In our industry the same adjustment is needed in human capital. For years, the people in operations at drug manufacturers have been defined as the people who ensure compliance and ensure supply. They still fill that role, but they are something else, too. They are the people who ensure compliance and supply at a reasonable cost. It seems simple but it’s not. It represents a fundamental shift of thinking and requires an acute focus on human capital. You can’t assume by writing a new goal sheet that your folks will step into the new reality.

Managers of Tomorrow

Einstein famously remarked, “No problem can be solved from the same level of consciousness that created it.” What that means to the human capital aspect of cost reduction is that the people who have brought us this far will likely not be the ones to carry us farther. I would love to believe the line about how all you need is to retrain the 20-year guy in plant engineering and he’ll be able to act like an agile businessperson. But it’s not true. The people who delivered gold-plated compliance, printed T-shirts, and stopped calls for productivity by hiding behind banners of compliance are not the same ones who can turn around and guide you to becoming a lean, cost-conscious organization. These are simply different people.

The good news is that some of your people, maybe even most, will be able to make the transition successfully. The challenging news is that you’ve got to do something about the others. I'll illustrate this point with an example from the financial services industry, where I was asked to design a training course for an entire company of auditors. The mothership corporation thought these guys should broaden their scope by giving consulting advice alongside their auditing service. The executives told me that the training course needed to teach the auditors how to coach their clients into assuming more risk.

Just to be clear, the executives wanted a course that would take these 45- to 55-year-old auditors – people who had chosen accounting as their life's work — not lion taming, hang-gliding, or day-trading, but accounting — and to run them through a nifty little program that would shoot them out the other side ready to ride a unicycle on a tight-rope while juggling knives and smoking unfiltered cigarettes.

Unfortunately, this request was based on the false premise that the only difference between a risk-averse auditor and a risk-loving gambler is a little training. The difference is often beyond anything that training can fix. In biotech and pharma, that means that managers need to be assessed for their ability to assume leadership roles in a cost-conscious organization. Telling you that they are interested is not enough. The question is whether they really are capable at a core level. It's not a question of commitment or intelligence; it's a question of wiring. We have a lot of people in place in the industry that need to be doing something else for a living — not because they are not good people, but because they are just not right for the current job.

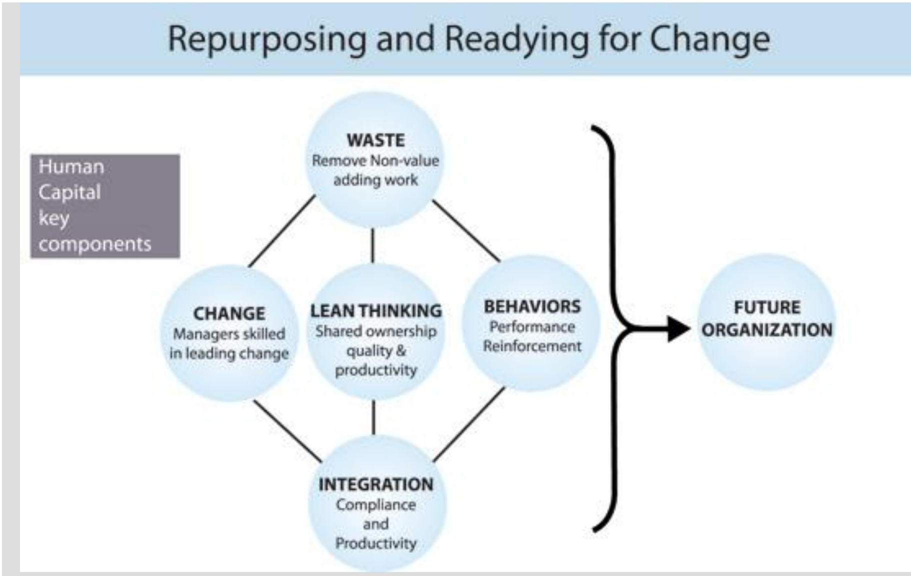
Human Capital Outline for Success

Transformation of human capital requires that you work along the four critical streams depicted in Figure 1.

Work on the organizational structure includes a thorough review of the entire organization with benchmarking across the industry. The benchmarking focuses on the number of employees other companies use to accomplish similar tasks. The goal isn't to strictly adhere to what everyone else is doing, but to get an indication of whether an area is worth a detailed review. For example, if a manufacturing site employs three more people in Technical Services than the benchmark, there isn't necessarily much to get worked up about. However, if a company discovers that one or two functions are 15 – 20% above the benchmark, they know where to focus initial efforts.

Even being above the benchmark isn't an automatic indication that a reduction is in order. The location simply needs to understand why they are out of the benchmark range. If the reasons are acceptable, nothing needs to change. More often, the company discovers some past behaviors that have piled up. In particular, companies often discover they simply didn't build their departments in line with the pull of the product flow. Instead, they focused only on supply and compliance. In short, they overbuilt and they need to do something about it.

Metrics performance and workflows must also be analyzed in detail. In ways that an SOP review cannot, a daily step-mapping effort reveals the reality of process execution, while interviews with subject matter experts (SMEs) reveal where the obstacles to efficiency lie. An organizational readiness assessment focuses on the team's ability to adjust to a new way of operating. (See Figure 2.)



The process is one of assessing management's current competence in the areas of Lean Operating Principles, Change Leadership, High Performance Management, and the supply – compliance – efficiency triad.

A good consultancy assesses this ability in managers and provides skill augmentation for those that need it. Also, this assessment will reveal when a person just isn't going to be able to make the shift from ensuring supply and compliance to ensuring supply, compliance and cost effectiveness.

The bottom line with operational excellence/cost reduction is: it's about people. By taking a direct approach to cost reduction and focusing ample attention on human capital, you can achieve the desired outcome. Everything else is expensive myth chasing.