POLICY MANAGEMENT
ABE CORPORATION

(This case was written by Dr. S. P. Sharma purely for class discussion. Any similarity with company name or business is purely accidental.)

"This has been a good year for our company. Our sales are up 10% from last year in an economic downturn. While our profits are slightly down from last year, at least our per share earnings are comparable to last year, unlike many other companies. Our expenses are slightly above last year's, but that was expected because of revenue growth." Bob Hart wrote in company's yearly report. Bob has been the president of American Best Electronics Corporation (ABE) for the last three years. He had the reputation of being a tough manager in his previous job as president of MonaLisa Enterprise. ABE was one of the fastest growing companies, and its current revenues are approaching $500M. Five years ago, their revenues were only about $200M.

ABE had a near monopoly on computer recognition for handwritten characters technology. They hold some of the early patents on this technology and have, therefore, been very successful because of lack of competition and explosive market growth. The technology which ABE pioneered was a revolutionary breakthrough at the time when it was invented. It used templates to teach the computer the handwritten materials from several people in the office; the computer was asked to recognize letters; and if it made any mistakes it was instructed in correct recognition. This learning and relearning was so effective that after a while the accuracy of the system was better than 95%. The systems which ABE sold had two components—one was the hardware and the other was the software. ABE made more money on the hardware than the software. For several years, ABE had no effective competition. The customers had no choice except to wait for delivery from ABE and even accept some inferior quality products. However, recently there has been some remarkable new technology from the Far East which does not use ABE's patents. ABE's engineers have analyzed these products and have found them superior in every respect—quality and price. Over the last several months, there has been a tremendous concern in the minds of ABE's management and engineers to come up with a strategy to cope up with this new competition.

Mr. Hart's recent discussions with Wall Street analysts have not gone too well, and the stock has lost 50% of its value during the last six months. The shareholders and the Board of Directors are also concerned. Mr. Hart reacted to this challenge very swiftly and made agreements with the Far East competitors to cross license all the patents. This was a defensive move on the part of ABE Corporation. While this move assured that ABE's technology will not become obsolete, it did not resolve the basic problem ABE now faced. Its products were non-competitive in price and in quality. Its delivery was late, and its customers were not very happy. Mr. Hart was aware of these problems, but he did not know what to do.

Bob knew that he had to do something quickly; he has some time but not much. He called an off-site meeting of his Manufacturing VP, Jim Edwards, his Marketing VP, Jack Robinson, and his R&D VP, Jay Kumar for the coming weekend to discuss their strategy. In the meantime, he instructed his Staff Assistant, Nancy, to collect all the relevant data related to customer problems and asked each of his VPs to bring the data on their operations relevant to customer requirements.

Nancy had gone to a TQM course recently and decided to use some of the concepts she learned in that course. Her analysis led her to some startling conclusions.

1. The external environment was changing much faster than what ABE's culture could adapt to.
2. Customer confidence and satisfaction were at an all time low.

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3. Price of ABE’s system was 50% higher than competitors’ products.

4. The company’s profitability projections for the next several years were alarming unless something is done quickly.

5. Sales revenue will also decline after one year.

6. While ABE’s mission was stated to provide the best character recognition system in the market place with a fair return to stockholders, it was not clear what the company’s vision was for the future.

7. There was a tremendous cost pressure from Far East suppliers.

It was clear to Nancy that ABE’s culture to focus only on new technology without any regard to manufacturing quality and cost had to change. Nancy was interrupted in her thoughts by a call from the Marketing VP, Jack Robinson. Jack wanted to talk to Nancy about this upcoming meeting. When Nancy walked into Jack’s office, she found several other marketing people already engrossed in some heated discussions. Jack asked Nancy what he should prepare for the upcoming strategy meeting. Nancy was not sure what to say but uttered something about starting from what the customers wanted. She said that we should hear the customer’s voice and reflect it in our strategy.

As soon as Nancy uttered those words, it seemed as the floodgate had been opened. There were several people who started talking. Jack had to interrupt to maintain control. Bill Smart had the floor for a while. He said that our customers were complaining about the price. They can get a similar product for a lesser price than us from the Far East and that it was becoming very difficult for our salesmen to convince our customers that they should continue to buy from us. Jack mentioned that price was not the major issue and that what he had heard was that our systems did not work when customers plugged them in. About 10% of them were dead on arrival. Bill agreed that this was another problem.

Nancy said that Bob Hart had gotten a call last week from a very major customer complaining about our response to their complaints and needs. Looking into it further, she collected some data which showed that when a customer complained with a problem, it took them on the average seven working days to respond, and in some cases it took as long as 15 days. Sometimes, the customer complaints people could resolve the complaint in less than two days. Bob Hart has been extremely concerned about poor response to customer complaints from ABE employees.

“You know there is one more item which annoys our customers; it is the late delivery of the products they order. I have gotten several calls from our sales people during the last several weeks where our systems arrived late 20% of the time, and when they were plugged in, some of them did not work,” Bill Smart interjected.

“So let me summarize, our customers complain that our products cost too much, they arrive late some time, and when they are plugged in, some of them don’t work. In addition, when they complain, we are slow to respond to their complaints,” Jack said in utter disbelief. “I wonder why they buy from us other than the fact that at this time we have some edge in technology, but as this edge disappears, we will lose customers,” Jack continued. He knew the problem was serious but did not realize how serious it was. Nancy got another call and had to leave the meeting.

When Nancy arrived at her office, she found Jim Edwards and four other people from Jim’s staff waiting for her. “We want to discuss a few issues for the upcoming weekend meeting.”

“Sure, have a seat,” Nancy replied.

“We are not sure what Bob Hart wants from us. We manufacture systems and ship them. We have nothing to do with customer needs determination. That is marketing’s job,” Jim started the conversation.

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"I am not sure what Bob has in mind either. But maybe we need to talk about who is the customer," Nancy said. "We have three sets of customers—end customers who buy our products, employees who can also be treated as customers, and certainly our stockholders are our customers also. Maybe you could look at the problem that way."

"I was only talking about end customers. Yes, we have employees and stockholders. But come to think of it, even for end customers we impact significantly on their satisfaction," Jim remarked.

"We impact on dead on arrival, and we impact on late delivery, I guess. But we are late because of material shortage, and the quality of incoming parts. If we had good parts and plenty of them on hand, we could make good products and ship on time," Jim continued.

"But if you have too many components on hand, won't your inventory go up? That would make our profitability even worse. And who is responsible for incoming components? How do you interact with the Purchasing Organization? Who is evaluating this information, and who shares it with vendors?" Nancy said.

"About 60% of our costs are in materials, and you are repairing a lot of good units before you ship because of bad quality. If you did not repair them, your shipping performance would be fine. And by the way, Bob Hart just had a report on the amount of overtime production associates had last month to keep up with the delivery. You had 20% overtime, and your shipping performance is still poor. Jim, do you remember last month that serious accident where two people cut their fingers which caused some shipping delay too. By the way, Bob wants to know what the rate of accidents is in our factory, and how we compare," Nancy continued.

"Well, aren't we confusing employee issues with customer issues here? I know I have some problems with employees, but I thought we were only going to discuss customer issues at the weekend meeting," Jim replied.

"I don't think you can separate out customer issues from employee and from stockholder issues. Let me give you another example. Price is an issue with the customers. Price is high because our costs are high. Costs are high because material quality is poor, and there is a lot of scrap and repairs as well as material prices are high. We are spending overtime because of quality and delivery problems—so the labor costs are high. High costs and poor quality impacts on the profitability, and the stockholders are concerned," Nancy counteracted.

"What I suggest is that you examine a few critical priorities for manufacturing before the weekend meeting," Nancy said.

The meeting lasted two hours but reached no conclusion. The discussion kept on coming back to the role of manufacturing in customer satisfaction. They discussed inventory levels, scrap, repair, quality and late delivery of incoming materials, and continuous shifting of production schedules. Finally, Jim was called in by Bob Hart to discuss a serious employee accident, and the meeting dispersed.

It was late in the evening, but Nancy decided to go and have a chat with Jay Kumar, the R&D VP. She asked him if he had given further thought to the issues he would like to discuss in the weekend meeting? Jay said that most of the problems are really with manufacturing and marketing and that R&D was not the problem from the customers' point of view. Nancy raised the following questions with Jay:

1. The percent of revenue from new products per year keeps going down. Does that not suggest that new developments are not meeting market needs?
2. We inspect all the products we ship, but when these products arrive at the customer's place, some of them don't work. Does it not mean that reliability is an issue? Design has a major impact on reliability and therefore on customer satisfaction.
3. The time to introduce new products has not gone down, and we are therefore losing the competitive advantage.

4. Some of the incoming components have low quality. Did the design organization consider the quality of the components they specified in their design?

5. The cost of the components is much higher than Far Eastern products. Did we find the right vendors at the design stage?

6. The manufacturing people complain that the number of defects in manufacturing traceable to design are very high, and they claim that design for manufacturability is not a major concern in design.

Jay interrupted Nancy and remarked that his people have talked about these things in the past, but they do not track all these things. "In fact I don't think we track too many measures in this business. We are so busy that we do little planning. I may have to think a little bit about all this." "Can we talk more about it tomorrow after I have given it some further thought?" Nancy agreed.

After dinner that evening, Nancy sat down and recollected on what happened that day. She realized that one of the major problems ABE Corporation had was that planning was not linked to customer needs, and they had no formal way to track their performance. There were a large number of issues people were working on, but there was no alignment of all these activities to customer, employee, or stockholder needs. In addition, there was not a prioritization process to narrow issues into a few vital issues. Lack of prioritization was a concern for two reasons: it impacted the alignment, and also because there were not enough resources (people, time, and money) to solve all the problems. Nancy also realized that their fragmented approach without cross functional involvement was not going to produce any breakthrough results. There were other functional heads, e.g., finance, quality organization, human resources, etc., which should also attend the weekend meeting. Her concern was that the problem is not understood and neither are the causes identified for action. In her view, this is a problem of the entire management and not individual organization's problem. How should priorities be identified, what results are to be achieved, and by what means? In her view, this is the first step in assigning cross functional responsibilities, and this deals with the way the business is run — i.e., the management system.

That evening Jay, Jack, and Jim were also searching for answers to some of the same questions. It was one thing to run a business when there was no competition, and they were the only game in town. But with competition in their backyard, they were realizing that they cannot run the business the old way. They need to find out ways to prioritize their activities and align them in a cross functional way for a common goal.

Before they meet with Bob Hart on the weekend, Nancy, Jay, Jack, and Jim have to do a lot of thinking as to how to manage the business. They have read and listened to some Quality Gurus. They wonder if Total Quality Management may help. But quality is not their only problem. They are not sure what to do. They are hoping that Bob Hart has the answer.