LEADERSHIP

THE ANATOMY OF OPERATIONAL EXCELLENCE

OPERATIONAL EXCELLENCE ENABLES AN ENTERPRISE AND ITS LEADERSHIP TO CONTINUOUSLY IMPROVE ALL AREAS OF PERFORMANCE. WHAT CAN WE LEARN FROM GM, CHEVRON, AND BAE SYSTEMS.

BY FAISAL HOQUE

Operational excellence enables an enterprise and its leadership to continuously improve all areas of performance, including decision-making, ongoing investment, profitability, customer and partner services and human resources capabilities. Operationally excellent enterprises possess the processes and structures—or the "intangible assets"—that give them the visibility, control, tools, and management practices necessary to drive greater operational effectiveness and efficiency.

Consider the following three examples:

Potential Failure: British multinational defense, security and aerospace behemoth BAE Systems could be jeopardizing its operational excellence with a proposed merger that would threaten a key market. BAE's biggest shareholder, fund manager Invesco Perpetual, warns that plans to merge with EADS, Europe's largest arms manufacturer and the maker of Airbus, makes no strategic sense for BAE. The deal with EADS, which is controlled by France and Germany, would hamper BAE’s manufacturer's access to the very profitable market for U.S. military contracts, according to Invesco, which owns about 13.3% of BAE, which generates more than 40% of its revenue in the U.S.

Return to Excellence: American multinational automotive General Motors bounced back to profitability in 2011, two years after emerging from a government-backed Chapter 11 reorganization and a year after making one of the world's biggest initial public offerings. Now GM is making a strategic decision to add 1,500 software and data management jobs at its tech center in Warren, Mich., as part of an sweeping effort to in-source 90% of its tech work. A month ago, GM opened a similar center in Austin, Texas, with plans to hire 500 workers. GM's focus on building a new age of automotive innovation could further improve its operational excellence.

Ongoing Excellence: Oil supermajor Chevron is engaged in every aspect of the oil, gas, and geothermal energy industries, and relies on core strategies across the enterprise. The company works with suppliers across the globe as a part of its 'Chevron Way' philosophy, which has helped it grow annual net income to nearly $27 billion on revenue of $253.7 billion in 2011, making it one of the world's largest corporations by revenue. More significantly, from an investor's perspective, Chevron had $41 billion in cash from operating activities in the bank at the beginning of 2012. There's speculation that Chevron may go on a buying spree with that cash, and it's essential the giant makes the best choices to maintain the same commitment to excellence even if it scoops up an inferior smaller company.

Looking Back to a Single Pin

Operational excellence had its genesis in manufacturing dating back to the pre-Industrial Revolution. In his 1776 magnum opus, *The Wealth of Nations*, economist and philosopher Adam Smith was among the first great thinkers to define this now widely used concept. Smith famously described a small pin factory where 10 workers, each specializing in a different aspect of the job, could produce over 48,000 pins a day. Left to make a pin on his own, each of these workers might not have manufactured a single one in a day, and certainly not

more than 20. The division of labor immensely increased the productivity of each worker. It's still true today that assigning different roles and responsibilities across an enterprise enables scale, lowers costs and leads to greater operational efficiencies.

Delivering continuous improvement in the marketplace among competitors and customers requires enterprises to identify, understand and create the capabilities, behaviors and focuses necessary for repeatable, continuous and measurable operational improvement.

Roadmap for Operational Excellence Journey

Being operationally excellent requires a focus on management capabilities to develop and promulgate standards, coordinate decision-making, optimize service delivery and to manage the workforce. Orchestrating these capabilities requires a unification of cross-functional management disciplines. These capabilities can be organized around the following core characteristics:

1. Visualize Key Operational Processes. Identify the key operational processes, including those that create value, growth or innovation as well as those that consume the most resources, time and assets. Develop visual operating models that show linkages both inside the enterprise as well as outside, to customers, suppliers and partners.

2. Design Workflow and Predefined Responses. Model the workflow for each key process, identifying the actions, resources and workers required for each step. Then define a standard response to handle large variations in workflow volume outputs or inputs.

3. Develop Metrics and Gauges. Establish measures for normal workflow and develop systems or methods that report workflow volume outside the normal ranges. Ensure that workflow reports are received by the stakeholders responsible for each operation.

4. Operate Functionally, Measure Systemically. The functional operating manager responsible for workflow, using the predefined responses, operates the workflow by making any changes necessary to adapt to changing volume, inputs or outputs. Functional managers interact with upstream and downstream operating mangers to ensure optimal end-to-end performance.

5. Drive Continuous Improvement. As operating experience grows, make adjustments to the workflow design, predefined responses and performance measures, to continuously improve overall system performance.

If business agility enables rapid adjustments to effect change, and sustained innovation allows an organization to stay ahead of the competition and market dynamics, then operational excellence is the epitome of fiscal discipline, maximizing the use of resources and the assurance of revenue sustainability and, ultimately, profitability.

Managing Operational Risks

To manage most business operations, enterprises must cultivate a culture of risk management that is vigilant in its pursuit and disciplined in its execution.

Today's businesses are learning hard lessons about operational risk: BP Deepwater Horizon oil spill, naked credit default swaps and more than $63 billion in failed U.S. technology projects, are but a few of the high-profile cases that demonstrate the perils of failed risk management and poor operational execution. Each of these disasters and debacles caused billions of dollars in value destruction, yet each of them happened on the watch of skilled risk managers who appeared to do their jobs properly. Each had compliance systems, regulators and oversight mechanisms expressly designed to mitigate risk. So what went wrong?

In two words: systemic failure. Systemic operational risk originates in the complex interactions among the components that constitute a system. An individual component can function flawlessly while the overall system experiences a massive failure, or the system functions as an impact multiplier, magnifying the effect of a single component failure.

Managing systemic risk requires a culture of operational risk management that extends beyond the individual components to the edges, seams and overall system behavior. Mature risk cultures are characterized by a set of essential management practices that ensure the framework of the enterprise functions at a consistently high level. These include the following:

Step 1: ***Identify the risks.*** Operational risk identification is the process of identifying of sources of risk from all directions, internal and external. Risk identification is an inherently creative process, and as such, it requires the collaboration of diverse minds and different perspectives that represent all constituencies.

Step 2: ***Establish a control system.*** Risk mitigation is an analytical process that devises a control system to mitigate each identified risk. Control systems range widely. They can be designed to respond to a risk event, to reengineer the process to eliminate or transfer the risk, or to detect the risk early, before it can cause significant damage.

Step 3: ***Test, test, and test again***. Control systems require compliance to be effective, and testing simulates risk events and the control-system response. Test results are fed back into improved and more effective control systems; they also serve to identify new sources of risk, each of which requires a corresponding control system.

As our knowledge economy expands and global interconnections increase, complexity grows exponentially. Business leaders and operating managers must proactively manage complexity by constructing

control systems that not only function in complex environments, but also adapt and evolve along with them.

[*Image: Flickr user Jonathan Bliss*]

FAISAL HOQUE

Founder of SHADOKA and other companies. Newest book "Survive to Thrive – 27 Practices of Resilient Entrepreneurs, Innovators, And Leaders" (Motivational Press, 2015).
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COMMENTS

FRANCISCO E SOTO > **FAISAL HOQUE** 2 YEARS AGO

Faisal,

First of all, I really like what you have written here. I certainly agree that systematic risk originates from the interactions of different systems within a complex environment. My only contention is that the process you outline is not truly the path for operational excellence. I can say that because each of the examples you give for failures, BP in particular since you did not explicitly call out anyone else, would have told you prior to their incidents that they were following all 3 steps of a mature risk culture. You don't think BP had extensive risk identification and control systems in place that they continuously

tested and tried to improve? BP's executives even conducted a "safety tour" the day of the Deepwater Horizon explosion.

Operational Excellence requires quite a bit more than just having a control system - it requires operational discipline combined with a control system that is adapt to the modern complex environments we operate in. Unfortunately many companies lack the Operational Discipline, and the control systems they utilize are completely inept at rooting out complexity and instead lead them down a vicious complexity cycle where every control adds more complexity which adds more risk, so on and so on.

Francisco

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