The Accidental Company

Have you ever wondered why we hiccup?

I recently reread a fascinating book, *Your Inner Fish*, written by Neil Shubin, a professor of anatomy at the University of Chicago. In this very readable book, he describes how we humans carry the very real vestiges of our evolutionary past – hidden right in front of our eyes – in the way our bodies work every day.

For example, hiccups. Shubin writes, "If the odd course of our nerves is a product of our fishy past, the hiccup itself is likely the product of our history as amphibians… It turns out that the pattern generator [nerve controller] responsible for hiccups is virtually identical to one in amphibians. And not in just any amphibians – in tadpoles, which use both lungs and gills to breathe."

Shubin continues, "Tadpoles use this pattern generator when they breathe with gills. In this circumstance, they want to pump water into their mouth and throat and across the gills, but they do not want it to enter their lungs. To prevent it from doing so, they close the glottis, the flap that closes off the breathing tube…. They can breathe with their gills thanks to an extended form of hiccup."

In short, our hiccups are a vestige of our evolutionary past – when we shared an ancestor with tadpoles.

In another terrific book, *The Accidental Mind*, David Linden describes the evolution of the human brain, and shows how "the brain is not an optimized, general purpose problem-solving machine, but rather a weird agglomeration of ad-hoc solutions that have been piled on through millions of years of evolutionary history."

What does this have to do with business?

Your company's evolutionary past

It has everything to do with business.

If you really want to understand why a company does what it does, just look at its business challenges and situation five to ten, or more, years ago. Chances are that most of what the company does simply grew out of the way it met past needs, and that these business practices were passed along as part of the company's culture – "the way we do business" – over the years, without being reviewed and reconstructed.

I teach a very powerful case about this in my graduate course at MIT. This case presents a very complex optimization problem. Typically the students work hard on the optimization and come to class prepared to discuss their quantitative approaches. I surprise them by starting the class discussion by asking "What is the problem we need to solve?"

After a lengthy discussion, it turns out that the company no longer needed the process that was being optimized. The more complex the optimization, the less likely the students would be to think about whether the underlying process was actually needed.

The prime lesson of the class: the most important things a company does are determined tacitly, and are never seen, never questioned, and never examined. Within this tacit, historically-determined framework, a lot of tuning up takes place, but the framework itself – "the way we do business" – is almost never examined.

What's most important is that the *really big money* lies in changing the tacit framework, not in tuning it up. But almost no one operates at this more fundamental level.

In fact, a prime objective of my course is to sensitize students to this enormous opportunity in every company, and to teach them to identify the really big benefits that come from operating at a deep level of understanding. My companion objective is to teach them how to manage the paradigmatic change that is needed to transform a company's fundamental way of doing business.

What Margaret Mead said

To emphasize the point about the pervasive unseen influence of the past, I tell the class a Margaret Mead story. When I was a student at Columbia, I took an anthropology course offered by the famous anthropologist, Margaret Mead, in the last year she taught. The course was about how culture was transmitted through the generations. We studied a variety of interesting situations, from Pacific Islanders to Morris Dancers.

Toward the end of the course, a student raised his hand and asked whether Americans had any traditions that were passed unseen through the generations. When Professor Mead asked what we thought, she heard responses like "hot dogs" and "baseball."

She then gazed out at the lecture hall with about 500 students in attendance. She asked everyone who was born and brought up in New England to raise his or her hand. I was brought up in Western Massachusetts and Connecticut, so I raised my hand. I looked around and we New Englanders were ringed around the sides and back of the room like a horseshoe.

Why did this happen? She explained that in the early days of town meeting government in small New England towns, the selectmen asked for volunteers to do the town's work. If there weren't enough volunteers, the people who sat in the front and middle were called upon to help.

So over the years, New Englanders started to sit on the sides and back of the room – and this tacit behavior was passed down through the generations *without anyone realizing why*, even long after people stopped going to town meetings.

The problem with zero-based budgeting

Several years ago, zero-based budgeting was very popular with managers. Its logic, on its face, is very sensible: all expenditures should be evaluated as if there were no pre-existing practices. I think of this as the "if I could only wave a magic wand" approach to business.

The problem with this seemingly obvious approach is that it is almost impossible for managers to penetrate below the surface business procedures to examine and question the more

fundamental “way we do business.” Managers almost always get so stuck in their traditional way of doing things that they become unable to carry out the objectives of zero-based budgeting. Hence, they fall back on tuning up existing practices for small incremental gains.

Breaking the mold

How then can a manager see more clearly his or her company’s tacit set of business practices, in order to take a real zero-based look at the company?

The answer is a technique that I call profit mapping, which gives a crystal clear picture of the company at a very granular level. A profit map shows the profitability of every product in every customer, and identifies where re-thinking and resetting a company’s “way of doing business” is most needed.

Every company is an “accidental company” in the sense that it is built to a surprising extent from old business practices. In my consulting and research, I’ve found in industry after industry that even in leading companies, 30-40% of the business is unprofitable by any measure, while 20-30% provides all the reported profits and subsidizes the losses.

Why does this occur in so many companies?

Because in our prior Age of Mass Markets, profitability was a function primarily of sales volume, which created economies of scale in everything from production to distribution to advertising. Prices were set by manufacturers, and distribution costs were very homogeneous because products were simply delivered to the customers’ receiving docks.

In the past 30 years, we have moved into what I call the Age of Precision Markets, in which everything changed. Prices are negotiated, and often vary by account and product. Costs also vary widely, as suppliers form very different relationships – ranging from arm’s length to highly integrated – with their customers.

At the same time, the traditional broad accounting categories of revenues and costs, which worked so well in the prior era and which work well for financial reporting, are completely inadequate for understanding granular profitability today. Yet we continue to manage as if we still live in the prior era.

What you get is the familiar pattern of “islands of profit in a sea of red ink,” that is the vestige of doing business in a way that worked years ago, but no longer fits. Just like hiccups and sitting on the sides of an auditorium.

Profit mapping

The power of profit mapping is that it yields an extremely powerful view of the company as it really is today – where it is working, where it is not, and why.

I describe profit mapping in detail in my recent book, *Islands of Profit in a Sea of Red Ink*. In essence you create a set of cost tables, and develop an “income statement” for every invoice line. Because you can identify the invoice line’s account, product, sales rep, and other factors, you can develop a very powerful database that shows the profitability of every product in every account.

When you see this very granular picture of your company's profit landscape, you will immediately realize where your company's activities – its "way of doing business" – fit today's business needs, and where they are deficient because they are essentially continuing to apply old ways of doing business that are vestiges of the past and no longer appropriate.

With this detailed profit picture, you almost can't help but take a real zero-based look at your company. Of course, you can't just flash-cut to a new way of doing business. But you will be able to develop a sound step-by-step plan to bring your "way of doing business" into alignment with today's business needs.

And this is where the *really big money* is. How big? The upside is often a profit improvement of 30% or more year after year. All self-funded by the cash flow you will generate. The best of all worlds.

New profitability

What's the timeframe for profit mapping? In a few months a small team can analyze a company and develop quantum profit improvements.

And because these actions are rooted in an intuitively clear, granular profit picture, you can be confident that they will work.

Without a hiccup.