A Paper of Importance to Organization Leaders by Lanny Goodman

# Internal Customer/Vendor Relationships

## Unleash the Power of the Marketplace in Your Organization

### The Opportunity

Wouldn't it be nice if all your employees saw themselves as service providers who held themselves to a high standard of customer service excellence when interacting with their internal peers and subordinates? Ever wonder why so often they don't? There is a good reason. The reason is the only person they have been trained to take care of is their boss. There are many consequences to this fact, most of which are negative in terms of the overall functioning of the organization. Just a few examples:

1. Bill is loathed by virtually everyone in the company but Bill's boss thinks he's terrific so he remains bulletproof.
2. Suzie's boss religiously conducts her performance reviews, but in fact, the vast majority of transactions Suzie has daily is with her peers, not her boss. Her boss actually knows less about Suzie's actual performance than almost anyone in the company.
3. Joe complains to Deborah's boss that she is routinely late with her commitments to him. Deborah's boss has always had good experiences with her and tells Joe that he doesn't see it as a problem but he'll "look into it" (corporate speak for "don't hold your breath").

All of these and many more such experiences are common to anyone who has worked in any kind of organizational environment. Does it need to be this way? Absolutely not. The greatest failing of organizational reality is the assumption that these dysfunctions are "just how it is." Any dysfunction is by definition symptomatic of either poor or outdated organization structure, system or process design.

All human institutions have been designed. Often poorly, usually not very intentionally, but all such designs typically become institutionalized quickly and become an invisible part of the organizational reality. The dysfunctions resulting from these design flaws are then just seen as an immutable part of life's realities.

When we see or experience dysfunctions in organizations we should treat them as symptoms and hunt for the root cause of the disease. The reason most leaders don't is because first they were never trained to and second, they are products of the dysfunctional system and have learned to prosper in it. But the productivity cost, the human costs of stress and frustration, the distractions from the core strategic focus of the organization are costs we can no longer afford.

Conceptually the answers are relatively simple even if the implementation of the solution is not. In this paper, we address one crucial dimension of organizational behavior (or lack thereof): internal customer service and the relationship between internal customers and their vendors.

To understand the problem and its solution, let's look back 230 years or so…

Seventeen seventy-six was a watershed year. The United States was born. And a Scotsman named Adam Smith published *The Wealth of Nations*. In his book he coined the phrase "the invisible hand". The term describes the almost magical way in which millions of people in pursuit of their own self-interest interact in extremely complex ways in a free market economy such that the right products wind up at the right place at the right time at the right price.

In scientific terms this is called emergent behavior. This means behavior of a system that just shows up spontaneously. We have seen in the past century in the former Soviet Union, the cost of trying to centrally manage an economy. It just doesn't work. While a free market economy, while not without its limitations, has shown itself to produce the greatest value for its participants.

W. Edwards Deming and others who built the foundation of the modern quality disciplines (Total Quality Management, Lean Manufacturing, Six-Sigma, and so on) described as a fundamental principle, the existence of a dense web of customer/vendor relationships inside each organization. By this they meant that every time one employee performs a service, passes on information or paperwork, or in a manufacturing environment passes on a product for further work, finishing or packaging, they are, in effect, a vendor to the people downstream from them. If they do a poor job in terms of quality or timeliness, the downstream "customer" suffers the consequences.

This was an important observation and the quality disciplines make an effort to clarify and define that relationship. But there is a problem. If we look closely at what creates emergent behavior in the marketplace, it is clear that the customer/vendor relationship is the primary driver. The reason is simple.

Customers have recourse.

If a customer is unhappy with a product or service they have all kinds of avenues of recourse. They can complain, they can demand a refund, they can vote with their feet and dollars, they can tell all their friends, they can sue, they can call the investigative reporter at the local TV station, they can complain to the government. Vendors understand this and try never to lose sight of the fact that customers have other options in the marketplace. However, when we look internally in our companies where these same customer/vendor relationships exist, do we see the same level of recourse? Virtually never.

Imagine for a moment how your organization might be different if each of your internal customers had the kind of recourse customers have in the marketplace. If each internal vendor understood that their tenure with the organization hinged totally on the satisfaction of their internal customers, might their behavior be different? You bet.

How might such a thing be accomplished?

Three things are necessary: education, a feedback mechanism, and something desirable that equates to a vote of confidence that can be taken away from employees who fail to meet their customers' expectations.

Education is necessary because most employees who are not managers or supervisors (and sadly many who are) are not skilled at giving and receiving feedback. Also, creating a work environment where employees have real power requires a certain level of maturity and understanding of business and business processes. One of the critical lessons of the quality disciplines is that all employees work in a system that they don't own and don't control. The system is owned and controlled by a manager who doesn't live in that system. Therefore it is easy for managers to have expectations of employees that employees cannot meet because the system in which they work makes it impossible.

You can see that implementing customer/vendor relationships is not a trivial exercise.

Furthermore, it must begin at the top. It represents a fundamental culture change and that can only take root and prosper if it comes from the top down. So the organization's leadership must be committed to working together in explicit customer/vendor relationships.

Creating these kinds of relationships requires much more than lip service. It must be structural. How this can be done is to organize the company into Strategic Business Units (revenue generators) and Internal Service Units (e.g. accounting, marketing, HR, IT and in a manufacturing environment – production) that have a financially based customer/vendor relationship. The heads of all these units comprise a Leadership Team for the company under the umbrella of the CEO.

Strategic Business Units (SBUs) are best organized around specific market constituencies. For example, many businesses are geographically organized. A bank branch or dry cleaner can only attract customers from within a limited geographical area. Other types of businesses are best organized around their distribution network. Selling to national accounts, big box stores or through manufacturer's reps require very different approaches and could be distinct SBUs. There are two fundamental reasons for creating SBUs around markets:

1. The SBU must become highly expert in dealing with their specific channel or market. From a marketing perspective, narrow and deep will outperform broad and shallow every time.

2. The second is that we don't ever want our SBU leaders competing for or calling on the same customers. This is disruptive to organizational coherence and confusing and annoying for customers.

The Internal Service Unit (ISU) leaders clearly are there to support the SBUs that are the engines that pull the economic train in the company. The keys to creating genuine customer/vendor relationships are:

1. Internal customers pay for what they consume as negotiated with their internal vendor (as opposed to overhead being allocated through some formula)

2. If the customers are unsatisfied with the service they are receiving, they have a forum in which to air their grievances and get resolution either through the corrective action

taken by the offending unit leader (or termination if he/she fails to act) or the threat of outsourcing the function.

In this way it becomes clear to the ISU leaders that they are working in what amounts to a free market economy. They must be highly responsive, adaptive, provide real value at competitive cost in order to survive.

This is particularly true in manufacturing organizations where production traditionally sees itself as the engine pulling the train. Unfortunately, it is increasingly clear that the marketplace is sorting out into two kinds of companies: kick-ass marketing companies and companies that work for kick-ass marketing companies. Guess who makes the money? SBUs are marketing and sales organizations. When they come to production looking for a specific product at a particular price point and schedule and production says, "We can't do that" and then the SBU outsources production to someone who can (and will), this is a major wake-up call. Production is no longer a sacred cow that doesn't have to be particularly responsive because it has a captive internal customer base. It now finds itself competing in the open market against other production organizations for the business.

## Steps

Hopefully, in this discussion it becomes clear that by structurally starting at the top in creating real, financially based internal customer/vendor relationships, we will be developing leaders who are accustomed to working in that kind of environment and who will then support pushing those values down into the company. I mentioned earlier that there are three requirements to make the customer/vendor environment work. Education was the first. The second is a feedback mechanism.

Again in principle, this is relatively simple if a bit more complex in practice. What is needed is a team oriented performance review process conducted by the internal customers of each employee, typically five or six. The details of such a program are discussed in another Performance Reviews That Actually Improve Performance.

The essence of the process is that each employee's key internal customers are identified and form a review team. They fill out a questionnaire (open ended questions) on their vendor who also answers the same questions about his/her performance. All these questionnaires are collated and distributed with attribution to all team members. The reviewee is then responsible for preparing a proposal for a performance plan, convening a meeting of his or her review team, presenting the proposal and soliciting feedback. The review team collectively questions, challenges, modifies and ultimately ratifies the resultant plan as the charter for success for the reviewee from their point of view. The employee's boss is an important customer and would usually participate, but clearly not their sole customer.

The third item is something that can be taken away if the internal vendor fails to perform. The logical choice, if structured properly is participation in the profit sharing plan. Incentive compensation is addressed in more depth in my paper, Incentive Compensation, Creating Alignment from the Boardroom to the Broom Closet.

The high points however are that:

1. Participation in the profit sharing plan is a privilege not a right.
2. Adding a participant to the plan dilutes the shares of all other participants, therefore, membership must be granted by the other participants based on their perception that the applicant will add enough value to the organization to justify the dilution.
3. There is a vesting period during which the applicant must earn that reputation.

So at the end of the vesting period for new employees they must go through an internal customer review to justify their participation in the profit sharing plan. Failure to win that approval is pretty much tantamount to one's peers suggesting you look elsewhere for work. At the very least it will provide the employee with a corrective action plan that, if successfully executed will earn them another pass at plan membership. An existing employee knows that his or her participation in the profit sharing plan is always at risk if he or she fails to satisfy the legitimate needs of his or her customers within the realities of the system in which he or she works.

Obviously, there need to be checks and balances in such a system, but what should be equally obvious is that all we have done is to translate a system that is well known and understood, the open market, and transpose it into the internal ecology of the organization. Our expectation is that this will change employee behavior. Since business success is ultimately a function of individual and collective behavior, we're on the right track.

Note also that with this approach, we have created an environment that is non-coercive, in which through a process of dialogue, agreements are made and cooperation is likely to be insured through potential expulsion from the tribe as opposed to the carrot and stick being wielded through a command figure (the boss).

## Be Aware of Some Issues

As I have mentioned a couple of times, implementing true internal customer/vendor relations is neither simple nor quick to implement. It has to start at the top. If there is not commitment from the CEO, efforts to implement genuine internal customer/vendor relations are unlikely to prosper. The importance of the educational component cannot be overemphasized. Implementing this approach to company leadership and management represents a fundamental change in the culture of a company. Not everyone will want to participate in a game with these kinds of rules. The leadership of the organization must be prepared for that.

All that having been said, the upside potential is enormous. The hard reality of management as we have always known it is that it was designed very intentionally to minimize employee input. "Check your brain at the door and do just what we tell you to do" is the hundred year-old legacy we have inherited from those founders of the modern discipline of management. As brilliant as they were in shaping the rise of American industry with all the benefits we enjoy, times and the world have changed and how we lead and manage our companies needs to change as well.

## Actions

Explore these ideas with the top management team of your organization. Unfortunately, there does not appear to be an extensive literature on creating this kind of culture from the top down with the necessary structural artifacts that need to be in place to make it work. The best resource is my book, **The End of Management**, *Have More Time, Make More Money, and Have More Fun by Creating a Company That Runs Itself*. In this book I lay out a systematic methodology for designing and leading a company that is designed from the ground up to highly leverage the full value of its employees.

## Conclusion

Establishing an internal ecosystem that fosters excellent internal customer service is the keystone of a company culture that intrinsically draws out of its employees the total talent, intelligence, creativity, knowledge, experience, energy and enthusiasm they are capable of bringing to the company. Each person has his or her talents and capacities. It is the work of leadership to create an environment that creates full value to the company for the compensation it has invested. We have all been taught to look at payroll as an expense, a necessary evil to get things done. It shows up on the income statement. I suggest we start thinking about payroll as an investment, something that hypothetically might show up on the balance sheet, something on which we would be expecting a return and would scrutinize with the same level of care that we would scrutinize a capital investment.

The world has changed drastically in the last hundred years. Management and leadership have not. Our understanding of how the universe actually works has changed dramatically over the last century. The underlying assumptions on which traditional management practice was built were derived from the reigning cosmology of the time, the mechanistic Newtonian universe. We understand now that the universe is ultimately not very machine-like. We need to build a new management design on current scientific thought, particularly the study of complexity theory. We cannot any longer afford the costs associated with traditional management practice.

## About Lanny Goodman

Since 1980, CEOs of companies large and small have consulted with Lanny around their strategic planning processes. Primarily focused on entrepreneurial organizations, Lanny's planning methodologies help companies focus their efforts, improve profitability, rationalize their operations and leverage their people.

In the late 1980's Lanny began exploring how changes in our understanding how the universe works might apply to how we lead and manage companies. Building on the principles of the new science of complexity theory, Lanny began working with his clients, researching and experimenting to create the first comprehensive system for creating companies that run themselves. Lanny's book, **The End of Management** lays out the logic of self-managing systems.

His company, Management Technologies Inc. provides comprehensive support services to organizations interested in creating companies built from the ground up to fully leverage their people. For more information visit www.lannygoodman.com.

Lanny's work has been the subject of a feature article in Inc. Magazine. He has been quoted there extensively as well as in Fortune Small Business and the New York Times. A compelling speaker, he has spoken at sixteen Inc. Magazine national conferences including five Inc. 500 conferences, celebrating the 500 fastest growing private companies in the country.

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