

# Making a Difference At Caterpillar

By David Vance\*

*The economics group in Caterpillar operates in a decentralized organization where acceptance of its services is discretionary. Success depends on the satisfaction of their internal (or external) clients who pay for their services, and the payments must cover the costs of providing them. Services provided include assistance in constructing forecasts of regional sales and customer sales by industry. In addition, forecasts are made of inflation rates, exchange rates, interest rates and commodity prices and also special studies are prepared for specific needs. Underlying this approach is a statement of vision, mission and values that provides the direction and cohesiveness for a growing group in a decentralized environment.*

**M**AKING A DIFFERENCE has made all the difference to the Economics group at Caterpillar Inc. By helping our clients make decisions, we have enjoyed a steady increase in demand for our services since 1990, and all indications are that demand will continue to grow as the company grows. While there are many reasons for our success, this article will concentrate on two that are related: customer focus and a decentralized consulting structure.

Like many economics departments, the size of the group has fluctuated through the past four decades. The group began in the mid-1950s and reached a peak in the 1970s. The 1980-82 recession hit Caterpillar hard and the group was reduced to near its present size. We have three economists (soon to be four) and two economic analysts in Peoria and another economist located in Geneva. Responsibilities for economic outlooks, sales forecasts, special studies and consulting

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are divided geographically, which matches the organization of the marketing units.

As a group we had always had a keen interest in satisfying our internal customers, but this was raised to a new level by the company-wide decentralization in 1991. At this time the company abandoned its centralized functional concept (e.g. manufacturing, scheduling, pricing, etc.) in favor of decentralized, autonomous business units. Product business units (like excavators) were made responsible for designing and manufacturing product. Marketing business units (like a North American marketing group) were responsible for selling the product purchased from the product groups through our independent dealer system. And several service business units were responsible for providing the remaining centralized services to the product or marketing units.

The Economics group is part of the Corporate Services Division, which provides services like accounting, treasury, tax, and information. Some of these services like tax or accounting are provided free of charge to all business units, because participation in the corporate system is mandatory. Others like economics are discretionary, which means that clients can refuse the service we offer and instead purchase it on the outside or forego it all together. So in 1991 we began selling our services to our internal clients. (We also are free to sell our services externally.)

## CUSTOMER FOCUS

Our mandate was to provide desired services for a fee – and break even. If clients did not want our services or were not willing to pay our asking price, then we were responsible for cutting costs, including downsizing the group if necessary. On the other hand, if we could sell more services then we could add staff. A free market in economics services came into being as we began negotiating services and fees with our clients.

The process has worked very well and has guaranteed that we make a difference for our clients. After all, if we don't add value, they won't use us. We had several advantages from the beginning that helped us succeed:

1. We had a history of satisfying our clients – even though they weren't required to pay in the past. We had excellent relations with the marketing groups, especially our North American marketing group (about one-half of Caterpillar sales are in the United States). So, these clients were favorably predisposed to continue our service.
2. Our costs were very competitive, which was a good thing. We are charged for everything we use (rent, office services, duplicating, etc.), we cover the full compensation costs of our employees, and we pay for any inside or outside consultants we use. We found we could cover our costs and still charge less than an outside economic consultant.
3. Because we knew our business better than anyone else, we could deliver more value than an outside consultant. Our clients knew from experience that consultants require a "ramp up" period during which they are paid to learn our business. By using us, they avoid the ramp up period and work with people they already know and trust.

As a result of these advantages, we kept our existing client base and picked up quite a few new clients. The mechanics of the prices also contribute to its success by ensuring three things: relevance, scope and communication. Each of these has made us a better provider of service, enhanced the value delivered, and improved employee and customer satisfaction. For ongoing services, we meet with clients regularly to discuss the deliverables, identify emerging needs, check satisfaction and discuss fees. For projects, we first meet to understand the need and to scope out the work. Then we draft a proposal discussing the need, the deliverables, timing and fees. In either case, the clients know what they are getting, when, and how much it will cost.

Because they are driven by the market to scrutinize costs, they only engage our services if they believe we will make a difference. Bottom line, will the value added by our work be worth the cost of the effort? If not, don't hire us to do the work! This immediacy guarantees relevance and efficiency but also employee satisfaction. How often have we all worked hard on a project only to have the final results placed in a binder on a shelf – with no action taken? We don't do this any more. Nobody can afford it. The work we do now has passed the internal market test of value – our results are worth at least the project cost to someone who needs to make a decision. And that makes the work exciting and satisfying!

#### Growth in a Free Market

This setup also has allowed us to grow. We are adding another economist this year, and we have vastly expanded the use of outside consulting services as well. Growth has been even more dramatic in our Business Intelligence Group, which encompasses Marketing

Research, Information Systems, Forecast Coordination and Trade Association work as well as Economics. The size of this group has almost doubled since the decentralization. Such growth would have been difficult under the old regime, because it would have been hard to convince our executive office that demand for our services really had expanded this much. Even if our clients confirmed their demand, the executives would still have to make a judgment about whether adding full-time positions in our group was the best way to meet this demand and whether the new positions were worth the cost.

Under our current system, the "free market" works relatively unfettered (so far anyway). We prepare a business plan each year based on meeting client needs through agreed-upon fees that covers our anticipated costs. For the past several years, each plan has included new positions, and each year we have gotten approval to add new positions. The executive office basically defers to our clients. If our clients want us to provide the services and they (our clients) can still meet their profit targets while paying for these additional services, then our plan is approved. (For this reason, service centers go last in the business plan approval process.)

Of course, decentralized opportunity also means decentralized responsibility. The focus is on the bottom line, in our case at least breaking even. In our current competitive environment, we are not able to raise the prices we charge our internal clients (they are not bashful about this), so we manage costs carefully and continuously improve productivity. Every year we have to find enough productivity improvement (or costs that can be reduced) to pay the merit increases our employees expect and to pay for higher overhead charges.

We also need to manage revenues and costs through the business cycle. Caterpillar is committed to remaining profitable during the next recession (we lost \$622 million in 1991 and 1992), and as a group we must be prepared to break even as existing clients reduce their work with us. In the event of a downturn, we would of course first try to find new clients to keep our workload steady. We have developed marketing brochures, and we would use these to launch a concerted campaign to find new internal customers. We also would target external customers, whom we so far have not had time to pursue. We have also increased our use of both consultants and flexible work arrangements, which provide some opportunity to reduce costs. All that said, though, meeting targets in a downturn is always harder than it sounds, and we will be grateful for several more good years to "get ready."

#### DECENTRALIZED CONSULTING

So, what kinds of services do we provide that clients are happy to purchase? Primarily, we help our

clients forecast sales. This usually takes the form of industry demand where industry equals Caterpillar plus all our competitors. We start with an economic outlook for each region of the world, focusing on the sectors important to our business like construction and mining. Then we decide what this implies for industry demand: up (how much), down (how much), or flat. Finally, we communicate the essentials of the economic outlook and the industry forecast. Basically, we tell a story. It needs to be internally consistent, it needs to make sense, and it needs to be clear. In short, we add value by distilling the economic news, analyzing it from our perspective and communicating its meaning to Caterpillar.

It wasn't always so. Once, in the days when information was scarce, clients would have paid us to gather economic information and share it with them. In general, this is no longer the case because information is absolutely abundant. Clients get it in newspapers, magazines and on the Internet. Banks and investment houses distribute more data, economic outlooks and special analyses than you can hope to read – frequently and for free. So now there is a wealth of information at little cost. Our clients won't pay us to duplicate this. Our clients also won't pay for us to maintain macro models, and they shouldn't. That is not our specialty.

Instead, we read as much as we can, do our own analysis, and decide for ourselves what we believe the economic outlook will be for a region. Often this means deciding which of the many views already out there we believe to be correct. Occasionally, it means taking a stand apart from the consensus. Next, we determine the implications of the economic outlook on the industry. Here we focus on construction, mining, forestry, agriculture and petroleum – sectors critical to our business. And we conclude with a forecast of industry demand that serves as the starting point for our company shipment forecast. We present the economic outlook (focusing on indicators key to our business) and the industry forecast in both verbal presentations and written reports. Equally important, we share our thoughts on upside opportunities and downside risks, often through the use of scenarios (especially for long-term forecasts). We maintain all the outlooks and summaries real time on our intranet web site so our clients can access the most current forecast at any time.

We also forecast inflation rates, exchange rates and interest rates as well as commodity prices. We work closely with our clients to use this information to advantage in structuring purchasing agreements, making hedging or investment decisions and placing/retiring debt. And we perform special studies and conduct project work – all in response to particular client needs. The bottom line in all this is that we provide more than numbers – we provide guidance, understanding and most importantly we provide an-

swers to their specific questions.

An example of meeting specific client needs arose several years ago when our North American marketing group was having difficulty gaining “buy in” for their business plan sales forecast. There are seventeen district office in the United States and Canada that work closely with our independent dealers to sell product to the end users. With the move to a decentralized company, the goal was to have the districts “own” their forecasts and be responsible for meeting them. In fact, their incentive pay would be based on it. So, the districts sent in their forecasts, and these were aggregated to U.S. and Canada levels.

But there was a problem. Based on our economic outlooks and industry modeling at the U.S. and Canadian levels, the view from Peoria was different than the view from the districts. Because the top level view was supported by our work, the marketing organization overrode the district input and submitted a business plan forecast based on our input. Then the district forecasts were adjusted to add to Peoria's total and the districts were held accountable for achieving Peoria's plan. You can imagine how this went over in the districts. They were now responsible for achieving a forecast that wasn't “theirs.” A typical comment was, “Next year, don't ask us to provide a forecast since you aren't going to use it anyway. And don't talk to us about empowerment.”

In response to this problem, we developed district level sales forecasts that we shared with them several months before their forecasts were due in Peoria. We told them what the important economic drivers were for their own district and shared with them both the history and forecast for these explanatory variables. And we encouraged them to run these forecasts for housing starts and other variables by local experts in banks and universities to see if we had agreement. In some cases, we found local experts not only had significantly different forecasts but that theirs made more sense, so we reran the sales model using their forecasts.

We have used this approach now for several years. The districts generally have submitted forecasts close to our recommendations, so the roll up has come in right where we thought it should. Consequently, there have been only minor adjustments to their forecasts, and the process runs much more smoothly. As a result of forecasting at a lower level, we not only got “buy in” but better understanding, which has led to better forecasts.

#### THE OTHER ELEMENTS FOR SUCCESS

So, the decentralized structure is in place, and we are successfully providing value-added services to our paying clients. What else is there? Especially for a growing group or a group with turnover, I would add

a Statement of Vision, Mission and Values. Just having the group discuss and agree on these will prove to be very positive, but the benefit will be more apparent down the road. In a decentralized environment everyone needs to be more independent – able to respond to customer needs and problems, deal with internal and external consultants, and create opportunities. This independence or empowerment can be a very powerful force and lead to high levels of employee and client satisfaction – as long as it is channeled appropriately. That is where the vision, mission and values come in. They provide the framework, the comfort zone, the boundaries.

The vision is what you would like to be, if not now, then someday. Our vision for Business Intelligence is: “Be the best client-driven provider of Business Intelligence.” This gives people an idea of where we are going. Next is the mission or purpose, which is more down to earth and immediate: “Provide our clients with the business intelligence required to make better decisions.” This pays the bills day in, day out. Last, but certainly not least, are our values. The hardest part about deciding on core values is keeping the list short. So you need to force yourself to choose those that are most appropriate for your particular group. We settled on these seven after much discussion, and they have worked well:

Treat people with Respect, Honesty and Dignity  
Be Open-minded  
Integrity  
Support one another personally and professionally  
Learn, Adapt, Develop, Grow  
Excellence  
Client focused

From experience, we have found that a values orientation can really make a difference if you take the values to heart and try to live them on a daily basis. Taken together, the vision, mission and values provide the direction and cohesiveness needed for a growing group in a decentralized environment. And, because customer focus is one of the core values, this approach reinforces the client-based, service orientation critical to our success.

This brings us back to the beginning. Customer focus and a decentralized structure have allowed us to really “make a difference” at Caterpillar since 1991. We have prospered in this environment by helping our clients make better decisions. This in turn has led to a greater demand for our services and a real sense of satisfaction among members of the group who know their work is truly appreciated. After all, the clients not only say they like our work but are willing to hire us to do more. And by maintaining our customer focus, we plan to continue making a difference.