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EXECUTIVE  
**AGENDA**

IDEAS *and* INSIGHTS *for* BUSINESS LEADERS



**ATKEARNEY**  
an EDS company

## LETTER FROM THE CEO

Exceptional forces are at work in the current business world. The continuing effects of e-business have now been joined by a global trend toward recession and additional pressure from the economic impact resulting from the September 11 attacks. It has been a long time since economic instability was so acute.

This raises the stakes for all business leaders. The decisions we make and the actions we undertake over the next few months will affect not only the companies we lead, but also the speed of economic recovery around the globe.

To that end, this issue of *Executive Agenda* contains a range of practical solutions that provide a map for how to deal with some of the most pressing business questions of today. How to put your customer at the center of your enterprise. How to create ultra-competitive cost structures. How to tighten links in supply chains.

It's our hope that the unconventional solutions we offer to these perennial business challenges are not just the recipe for the success of an individual enterprise—but the building blocks for a stronger global economy.



Dietmar Ostermann  
Chief Executive Officer  
A.T. Kearney

**FEATURES**

**Your Customer, Your Boss** . . . . . 5  
Read how a lifecycle philosophy for managing customer relationships can change your business.

**A New Generation in Cost Reduction** . . . . . 15  
Incremental cost cutting is often not enough in these uncertain times; more sweeping, structural change is needed.

**Balancing the Retail Portfolio** . . . . . 25  
A new A.T. Kearney methodology helps companies analyze their most valued assets—their physical locations—with the rigor devoted to investment strategy.

**What’s So Strategic About Sourcing?** . . . . . 33  
Sourcing only becomes strategic when companies take a closer look at all of their supply market options.

**ROUNDTABLE REPORT**

**A New Prescription for Healthcare** . . . . . 43  
Learn how the ripple effect of revolutionary changes in the healthcare industry is affecting the long-term strategies for all stakeholders.

**DEFINING MOMENT**

**FIFA Takes Soccer Into Cyberspace** . . . . . 55  
Soccer’s leading organization develops an e-strategy that offers useful lessons for companies on the global playing field.

**EXECUTIVE SUMMARIES** . . . . . 62

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*Taking Action*  
in the face of

# uncertainty.

From reeling economies to impatient investors to agile competitors—there's little margin for strategic or operational error today. In addition to other corporate challenges, we face the task of creating stability in a world where instability has taken on a sobering new meaning.

Turbulent times often mandate wrenching changes. But they can also provide opportunity for the bold. Now is the time to try new ideas and innovative methods that address enduring problems, to look closely at areas of business that escaped scrutiny in boom times—and to prepare for growth when the economy rebounds.

—*the Editors*



# What's So Strategic About Sourcing?

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Getting a great price on your copy paper? That's smart purchasing. Teaming up to buy eggs? That's strategic sourcing. When key purchasing decisions are handled creatively, bargains are just the beginning.

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**I**s strategic sourcing just a catchy marketing term—like calling prunes “dried plums”? It would be easy to draw that conclusion; many strategic sourcing efforts are about negotiating lower prices for office supplies, corrugated packaging and temporary services, or are about using new tools, like auctions, catalogs or exchanges. Where's the strategy?

Driving unnecessary costs from everyday purchases is always good management, and there is a lot to be saved. But it is a stretch to call that strategic. Sourcing only becomes strategic when companies examine supply market options to address critical business issues such as growth, innovation, achieving

synergies and unblocking or protecting key leverage points along the value chain.

How do you know if what you're buying should be sourced strategically? There are many criteria that help answer this question. Whether the purchase price represents a major part of the company's total expenditures, whether customers believe the item contributes significantly to a product's value, and whether a shortage or failure of the item would affect customer satisfaction—these are just a few of the considerations. Purchasing strategically can be a means of achieving or maintaining competitive advantage, as illustrated in the examples that follow.

### FINDING NEW SOURCES OF INNOVATION

By collaborating, companies use the expertise of key suppliers as an extension of their own design capabilities. But most companies still have a long way to go before we could truly describe their product development processes as both collaborative *and* innovative.

Innovation may require moving beyond links with existing suppliers to invite close interaction with new sources of creativity. This could mean, for example, separately acquiring the design, engineering and manufacturing expertise that was previously

to pour in. Because frog had designed the Th!nk as a buildable vehicle, not just a concept car, Ford was able to respond.

### SUPPORTING INTERNATIONAL GROWTH

A U.S. consumer products company with an aggressive growth plan that included rapid entry into Europe stumbled against a huge obstacle: Local supplies of a key ingredient were priced much higher than in the United States. The ingredient represented a substantial part of the cost of goods sold, leaving the company with two options: reduce the cost of that ingredient,

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*Innovation may require moving beyond links with existing suppliers to invite close interaction with new sources of creativity.*

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purchased from a single supplier. Think of California-based company frog design: Hardly a traditional auto supplier, it is better known for designing Apple computers, Disney cruise ships and Head tennis rackets. But Ford asked frog to design the interior of its Th!nk™ Neighbor electric vehicle. The automaker's original intent in using frog was to get a creative interior design to help draw attention to the concept car at auto shows. Round seats and snap-on accessories such as picture frames and a backpack that doubles as a removable glove compartment gave the interior a look and feel that few traditional suppliers could have conceived. When Ford introduced the new Th!nk car at the 2000 Detroit auto show, orders began

or cut margins to maintain growth. Looking at alternatives to buying the ingredient as a finished product, the company examined raw material prices and supplier processing costs. It developed its own supply market, and began purchasing raw materials directly from low-cost suppliers in Europe—in effect, moving one level back in the supply chain. The company also worked with processors to implement U.S. manufacturing technologies that dramatically improved efficiencies and cut processing costs. When the company entered the market, it met both growth and profit targets.

### CRAFTING TECHNOLOGY STRATEGIES

The technology curve is clearly a powerful

force in reducing costs and enabling new options for business. But how do you know when to shift from today's technology to tomorrow's? Placing a bet too early could harm business continuity and customer service; moving too late could allow competitors to take the lead and lock up key sources.

In the telecommunications business, these timing questions emerge on a regular basis. For example, while the majority of voice traffic continues to move on circuit switches, there is a clear trend toward Internet protocol and softswitch technology. Many telecommunications companies prefer to be "fast followers," trading the potential upside of early success for the cost reductions gained by waiting. Unfortunately, the fast followers often encounter a very crowded marketplace when they finally decide to adopt the technology. Shortages, shipment delays and price increases occur as companies fight to feed at the new technology trough.

One integrated telecommunications company chose an early adopter strategy to introduce new equipment with the latest technology into its network. The plan required a different business model and capabilities for how the company thought about and worked with the supply markets. The telecom firm learned to build and manage relationships with venture capitalists and next-generation technology firms. It focused a research lab and a market-scanning staff to identify, test and integrate the new technology. It also formed a business development group to value and structure the deals.

This approach to the supply markets brought additional capacity and capabilities to the company's network sooner than competitors'—often on an exclusive basis for a period of time. There were spin-off benefits as well. Through stock warrants, the company has positioned itself to reap the rewards as the suppliers' businesses grow.

#### **BREAKING THE POWER OF AN OLIGOPOLY**

A leading manufacturer of industrial products saw no obvious alternatives to an oligopolistic supply market for a major component in its main product. Undeterred, the manufacturer formed a team to analyze the supplier's cost structure for manufacturing the component and for the materials the supplier purchased to make the component. The team sought out alternative suppliers; it also evaluated creating its own component manufacturing facility. It determined competitive and customer scenarios that might result from challenging the oligopoly.

After extensive analysis, the team determined an innovative use for a multi-factor Internet negotiation that focused on non-price characteristics (such as delivery time and product specifications) to unlock the competitive dynamic within its supply base. The team also masked the "market price" so that suppliers could not offer the new prices to the manufacturer's competitors. The company saved 11 percent on this key component. In this way, the auction tool added a strategic dimension to the company's sourcing efforts.

**LOOKING AT THE BIG PICTURE ON COSTS**

A leading consumer products manufacturer was grappling with two issues. It was trying to remove the bottleneck in its produc-

tion process to sustain growth in a highly profitable product line, and it was about to renegotiate a contract for a key raw material. Traditionally, a company might address each issue separately. For instance,

## Breaking the Mega-Supplier Stranglehold

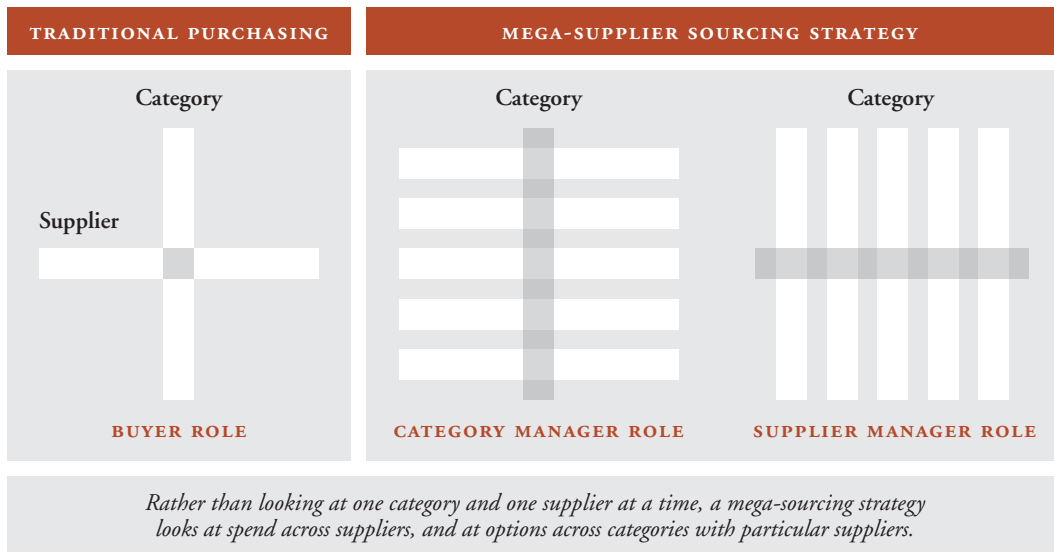
In order to meet earnings goals and generate cash for growth, BellSouth needed to cut costs on its purchases. In fact, it established a goal to reduce the cost of externally procured goods and services by US\$1 billion over 24 months. Given the size of its spend, this target was viewed as aggressive, but realistic. There was a challenge,

though: A large percentage of BellSouth's expenditures—and the ones with the most significant potential for savings—were concentrated with a few mega-suppliers that provided multiple categories of product to the company. In many cases, the original purchase required BellSouth to buy related items (such as parts and acces-

sories) from the OEM in order to continue using the equipment. Previously forged “strategic commitments” to these suppliers left large portions of spend exempt from competitive market forces.

Although these suppliers may be the appropriate strategic partners, the lack of competitive forces left BellSouth paying premium prices. Several

Figure: *Evolving From Order Taker to Supplier Manager*



Source: A.T. Kearney

the solution to the bottleneck might require a major capital investment in equipment, which might be delayed as it competed for scarce investment funds. The raw material solution would certainly involve intense

negotiating with suppliers to wring out further price concessions.

Instead, this company looked at both issues simultaneously, determining that in-house processing of the raw material was

top suppliers, representing more than 20 percent of total purchases, were a lynchpin to achieving the overall savings targets. Yet, high switching costs meant that most purchases could not be competitively bid in the short term. New growth areas could be made available to new suppliers. However, these areas represented a small portion of the total spend, and adding suppliers would increase the complexity of managing the quality of the network. BellSouth, and more importantly its suppliers, saw the telecom company as “stuck today” with the incumbents. How could the company possibly achieve its overall savings objective?

A mega-sourcing strategy turned out to be the answer. Rather than sourcing each category in isolation, BellSouth formed a team of supplier management and category management experts that examined the entire portfolio of goods and services

that were available from the top suppliers (*see figure*). Researching price, quality and service levels for supply alternatives gave the company insights into its options. Some items were indeed “stuck” with the incumbent suppliers—but others were more commodity-like and ripe for competitive bidding or represented deferrable expenditures. Still others represented opportunities to swing additional business to major suppliers in exchange for other concessions. The team also considered opportunities for top suppliers to expand their share of BellSouth’s total purchases, especially in the attractive new technology space. At the same time, it carefully orchestrated a communications plan about the approach, which was delivered to internal and external audiences.

Armed with its new knowledge, BellSouth surveyed its options: It had several “carrots” to offer its top suppliers,

including new revenue sources. It also had some “sticks” that could be used to take away business. BellSouth developed detailed scenario analyses to quantify the impact on the suppliers’ profits and on BellSouth’s savings to balance the carrot and stick combinations and package proposals for the top suppliers. Through intense negotiations, broad agreements were reached with key suppliers. The company achieved double-digit percentage price reductions from several suppliers, while simultaneously addressing service and quality issues.

Perhaps most critical to the mega-strategy approach was the ability to engage, excite, inspire and align BellSouth’s senior-level decision-makers and stakeholders. The chief executive officer, chief technology officer, chief procurement and supply chain officer, and numerous business unit leaders all participated quite actively in developing and executing the mega-strategy. ●

a major contributor to the production tie-up. The company identified suppliers to provide pre-processed material that entered the production process after the bottleneck. By taking an innovative look at the situation, the company avoided the capital investment, freeing up funds for other uses. And through sophisticated sourcing techniques, such as price-versus-performance comparisons for products with slightly different specifications, and analyzing the supplier's cost structure to shore up the manufacturer's negotiating position, the manufacturer also lowered the cost of the more refined materials it would purchase in the future.

Companies that don't think strategically about value chain costs risk missing opportunities. One consumer electronics retailer was in the throes of an aggressive cost-cutting campaign. Purchased goods for resale were under the microscope, and significant savings had already resulted from tough negotiations for certain categories. However, on one major product line, past decisions had boxed the company in from achieving major gains going forward.

The retailer's business model used up-front marketing allowance payments from suppliers to help increase cash flow and boost current period earnings. To get the marketing allowances, the retailer bought and took possession of the goods far in advance of when they were sold to customers. High inventories tied up working capital and made for inefficient distribution, while rapid new model introductions forced the retailer to deeply discount to move stock that was only a few months old.

Analysis of purchases showed that profits from that line could be boosted substantially by streamlining the company's ordering process and flow of goods. As a result, the company could realize better retail prices for selling newer models. A leading supplier of this product line already offered such a program to the retailer's main competitors. However, the change in ordering patterns would mean a major one-time cash flow and earnings hit by the retailer. Despite the long-term benefits, the retailer chose not to take the short-term risk to the stock price. It remains competitively disadvantaged in this product line.

#### DISCOVERING THE VALUE CHAIN CHOKES POINTS

One of the world's leading global technology firms has a network of 40 procurement teams that gathers supply-based industry intelligence on key strategic issues. It uses the network to determine where to capture a technological edge, where critical capabilities are in short supply, and from what direction the next technological breakthrough is emerging.

In one case, the manufacturer discovered and created advantage in a supply market three levels back in its supply chain that provided critical production equipment for suppliers to the manufacturer. At the time, the market was unusually concentrated and capacity constrained. By locking up a long-term contract for the output of one of these equipment suppliers, the global technology firm was able to block its competition. Suppliers to the manufacturer got priority

when demand boosted production equipment orders; suppliers to its competitors waited in line. The firm was able to ramp up its production and get to market faster than its competitors.

In another example, reminiscent of the adage “for want of a nail, the kingdom was lost,” Chrysler found that the continued production of the Jeep Grand Cherokee quite literally rested on a mound of clay. When the automaker launched an effort to map and redesign the upstream supply chain that supported its products, it began with the V-8 engine of the Grand Cherokee. Although the company traced the supply

have found the choke point that threatened the production shutdown of one of the automaker’s most profitable models.

#### COLLABORATING ON SUPPLY

From a food ingredient standpoint, egg yolks and egg whites serve very different needs and markets. Yet chickens only know how to lay whole eggs. So an egg supplier and two food manufacturing customers collaborated to hatch a clever supply solution beyond the reach of any of the companies individually.

General Mills is a major purchaser of egg whites for its cake mixes and other products. Pasta and noodle manufacturers

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*By locking up a long-term contract for the output of one of these equipment suppliers, the global technology firm was able to block its competition.*

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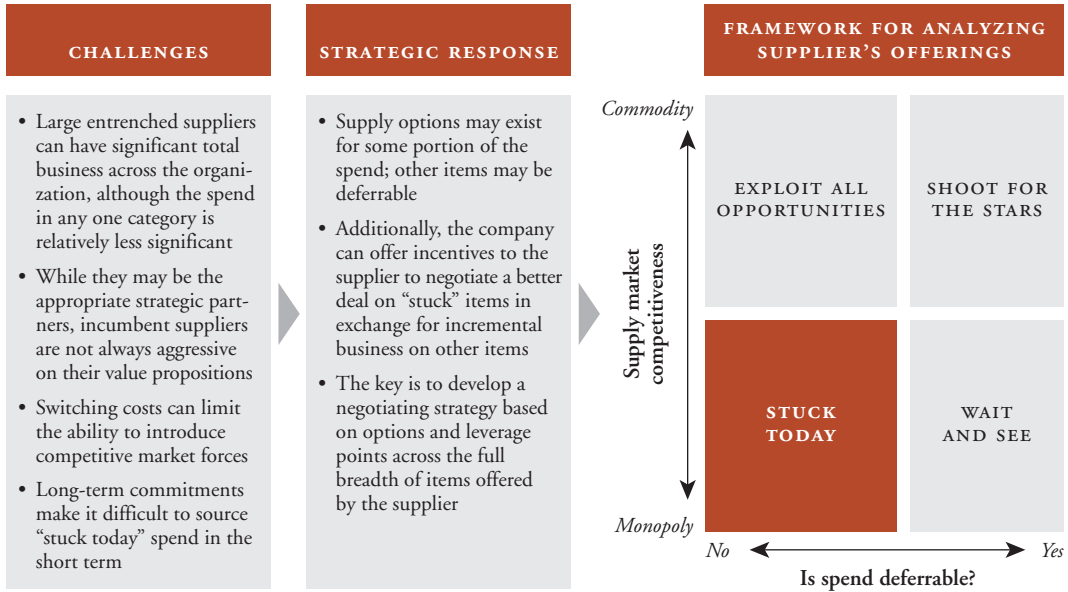
chain for hundreds of engine components, one part—a roller lifter valve—had a particularly interesting story. Eaton Corporation precision-machined the roller valves from castings sourced from a local foundry. Visiting the foundry, the Chrysler team learned that the casting process depended on a grade of clay with unique chemical properties. Tracing the supply chain farther back, the team learned that the clay supplier had been losing money on the casting clay business and decided to exit it without letting its foundry customers know. In fact, the supplier was instead making and selling kitty litter using the same raw materials. Without this strategic look at the supply chain, Chrysler executives would never

buy yolks for use in their products. So General Mills joined forces with an egg noodle manufacturer, and the two companies coordinated the purchase of whites and yolks from a single supplier. By collaborating on product specifications, they helped the egg producer reduce its costs, and both companies shared in the resulting savings. General Mills also used its skills in buying grain to reduce the cost to the egg producer of its major raw material—chicken feed—compounding the benefits for all three parties.

#### BUYER BEWARE

The decision to make or buy can be a tough one—with huge consequences. In the 1990s,

Figure 1: Are You Really “Stuck Today”?



Source: A.T. Kearney

visions of higher returns on capital and greater focus, coupled with numerous supply options, caused a near-stampede of companies outsourcing everything from manufacturing to distribution to R&D. Nowhere was the stampede more frenzied than in high-tech. Industry observers proclaimed that companies like Cisco, Sony and Nortel “got it right” by outsourcing manufacturing to the likes of Solectron, Celestica and Flextronics. Then, as the tech boom was reaching its peak, the outsourcing model began to fray at the seams. Parts shortages strangled customer deliveries and delayed new product introductions. Then the tech bubble burst, inventories ballooned and capacity sat idle. Cisco alone wrote off US\$2.2 billion in inventory in April 2001.

What happened? The challenges of

managing an extended enterprise model were largely to blame. Different operational goals, economics and success factors (such as long-term commitment versus flexibility) weakened the links in the value chain; the strains of boom and bust snapped it.

A final caution on outsourcing: Giving up too much control could have another downside. Magna Steyr (part of auto supplier Magna International) is noted for its vehicle engineering capabilities. It also provides vehicle assembly in Europe for the Jeep Grand Cherokee, Mercedes-Benz M, G and E classes, and (starting in 2003) the Saab Convertible. What would prevent a company with these capabilities from teaming with a brand name like Virgin, Wal-Mart, Sony, or even Microsoft to develop cars that compete with those of its customers?

### THINKING STRATEGICALLY ABOUT SUPPLY OPTIONS

Unlike sourcing of everyday purchases, there is no standard methodology for identifying, examining and acting on strategic supply options. Each company and each circumstance is different. However, the examples we've offered suggest several common themes:

- *Think broadly about what is strategic for your business.* What you don't know could hurt you. What do you buy that could disrupt your growth strategy? What is the weak link in the value chain for your most important products and services? What emerging technologies will redefine the products you can buy, and in turn, the products you should sell? How are past supply decisions affecting future financial performance?
- *Think creatively about your options.* Look beyond your immediate suppliers to uncover opportunities and risks farther back in the

value chain. Think out of the box; don't assume you are locked into anything. Figure 1 shows options that may not be obvious at first. Look at what you are, and aren't, outsourcing—and why. Consider in-sourcing, too: Keep or move an activity in-house, or sell an in-house capability externally.

- *Think deeply about how it will really work.* Look closely at the risks of the strategy and the ways to mitigate them. Understand how relationships with suppliers may need to change. Determine what has to happen operationally both internally and with the suppliers. Don't underestimate the effort; the devil is always in the details.
- *Act boldly and decisively.* This is not about buying pencils and toilet paper—it's about using the supply market to strengthen the company's strategic position. As with any strategic decision, a strong commitment and talented resources are critical to achieving the desired result. ◻

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## FEATURE

Your Customer,  
Your Boss*Michael Gorsage*

Page 5

Copernicus aside, good business strategists know what lies at the center of the universe: it's the customer. This article takes that thinking to a new level. The author asks executives to think of their relationships with their customers in terms of a lifecycle, much like a product lifecycle, that is fluid and able to change as customers' needs and desires change. And like a product lifecycle, there are definite stages to traverse in order to achieve a true, long-term customer relationship.

The article lays out these stages, beginning with defining customer relationship management, which requires sifting through several misconceptions and uncovering the hidden strengths—and weaknesses—of CRM. The next stage is to develop a strategy based on understanding what it takes to win customers. In the third stage, the importance of building the case for CRM is examined, and why it is better to base the case on increased revenue rather than cost cutting. In the fourth stage, the author discusses ways to build a customer-focused organization, highlighting the three most important aspects of a CRM architecture.

Finally, the author refutes the “delighting the customer” argument. He explains that creating a rewarding experience for all customers is a natural goal for CRM, but creating a consistent experience, one that ensures appropriate levels of service, will be much more profitable.

## FEATURE

A New Generation  
In Cost Reduction*Robert Nason and Neil Plumridge*

Page 15

Stand-out companies are seeking generational or structural cost reductions that will position them strongly once the economy rebounds. Not only are they assessing the cost structures within corporate shared services, the leading companies are strategically assessing expenses associated with customer service, product development and support, sales channels and other traditional core business areas.

Undertaking major structural reform and succeeding at it are, of course, separate issues. The litany of failures of slash-and-burn approaches popular in the late 1980s and early 1990s are evidence that execution is the critical element in any such program. Through our client work, we have found that next generation cost reduction efforts yield positive results when they are based on four key principles:

- **Develop wide-ranging hypotheses that require strategic assessments and decisions.** The size of the change is intended to be significant. The change will be “generational” and will align the organization with a new business environment.
- **Rigorously evaluate and prioritize opportunities against the entire cost base of the organization.** Companies that tackle the right initiatives in the right order will embark on a far more focused and successful effort than those that rely on their collective intuition.
- **Focus on execution and track costs out of the organization.** Any large-scale cost reduction project will require significant change—in processes, organization structures and so forth. These changes must be detailed enough for employees to move forward with confidence.
- **Drive change from the top and via internal teams, with appropriate external support of tools and methodologies.** Strong visible executive endorsement is required at the beginning and during the assessment and solution development phases. The senior executive team is also charged with evaluating the strategic options and making judgment calls based on organizational priorities.

## FEATURE

Balancing the  
Retail Portfolio

*Omer Abdullah, Thomas Dente  
and Christine Rivera*

Page 25

In business, retailers know the value of a good collection. From product assortment to product bundling, retailers strive to create just the right mix of goods and services. But retailers also work to create the best combinations and locations of stores.

In this article, the authors push retail decision making beyond simple, one-dimensional metrics to a comprehensive examination of their retail financials. The goal is to develop an optimal retail portfolio—a “fluid” collection in which each element is both strong on its own and an integral part of the broader collection.

Using their own retail portfolio optimization methodology, the authors lay out a step-by-step approach to identify marketplace potential of retail outlets on several fronts: examining among other things geographic location, regional performance and relative market attractiveness. The analysis points out the effectiveness of the company’s resource allocation by weighing the strength of an existing branch compared to the potential value of pursuing new opportunities.

The result from this broad-based approach is a clear guide that shows which outlets hold the greatest potential for the highest sustainable returns—and which should be closed. Indeed, the methodology represents an integral part of the COO’s toolkit; it provides the foundation for making critical decisions that enable the retail organization’s corporate strategy.

## FEATURE

What’s So Strategic  
About Sourcing?

*Bill Markham, Bob Tevelson  
and Tim Houghton*

Page 33

Driving unnecessary costs from everyday purchases is always good management, and there is a lot to be saved. But strategic sourcing is much more; it involves examining supply market options to address critical business issues like growth, innovation, achieving synergies and unblocking or protecting key leverage points along the value chain.

Many criteria help determine whether something should be sourced strategically. Whether the purchase price represents a major part of the company’s total expenditures, whether customers believe the item contributes significantly to a product’s value, and whether a shortage or failure of the item would affect customer satisfaction are just a few of the considerations. Through examples, the authors show how purchasing strategically can be a means of achieving or maintaining competitive advantage. Strategic sourcing can help companies accomplish a range of goals, from finding new sources of innovation to breaking the power of an oligopoly to eliminating the choke points in a value chain.

Unlike sourcing of everyday purchases, there is no standard methodology for identifying, examining and acting on strategic supply options. Although each company and each circumstance is different, several common themes emerge in the article:

- **Think broadly about what is strategic.** Look for emerging technologies, weak links in the value chain and potential disruptions to operations.
- **Think creatively about the options.** Don’t assume you are “stuck” in your current situation.
- **Think deeply about how it will really work.** Determine how relationships with suppliers may need to change and how your operations may be affected.
- **Act boldly and decisively.** Use the supply market to strengthen your company’s strategic position.

## ROUNDTABLE REPORT

A New Prescription  
For Healthcare*Raymond Hill, Marty Joyce  
and Simon Holt*

Page 43

Three new forces are rocking the healthcare industry: pharmacogenomics and care customization, healthcare consumerism and information technology. It's safe to say that their combined effects will soon revolutionize the delivery and management of healthcare around the globe. The challenge for healthcare's leaders is to embrace and explore the new opportunities presented by this revolution—while avoiding the dangers such radical change inevitably brings.

In this article, Raymond Hill, Marty Joyce and Simon Holt present the discussions of the first Healthcare Future Forces Leadership Roundtable, where healthcare industry leaders from around the globe met to examine these three revolutionary forces for change.

They outline the development of drug markets, which will likely evolve away from the current reliance on blockbuster drugs toward more diffuse families of customized drugs, each designed to work with a specific genotype. In addition, the authors predict that pharmacogenomics will lead to the increased development of predictive medicine and the subclinical treatment of illness.

When examining the effect of healthcare consumerism, the article discusses three areas of likely change: the increased demand for new high tech offerings and personalized care, the use of trusted third party brokers for some of their healthcare services, and a new tension over payment for these services. The authors then take up the impact of information and communications technology on healthcare. In particular, they discuss the probable changes to the medical education system and the use of technology to make healthcare more cost efficient.

## DEFINING MOMENT

FIFA Takes Soccer  
Into Cyberspace*Romil Bahl, Raman Mangalorkar  
and Adam Filkin*

Page 55

Scoring the winning goal is the dream of every young soccer player; taking the company into every corner of the world is a key objective for every CEO. They may be remarkably different aspirations, but FIFA (Fédération Internationale de Football Association) has some useful tips for young athletes and experienced executives alike.

As soccer's international governing organization, FIFA boasts a membership of 204 countries and more than one billion fans. Its mission is deceptively simple: "make the game better and take it to the world." To remain competitive, FIFA must adopt cutting-edge technology for its organizational structures, media coordination and marketing plans. But as it ventures into cyberspace, FIFA must simultaneously protect the purity of the game and the fundamental structures of its organization.

With A.T. Kearney's help, FIFA created the following six-plank e-strategy that meets these diverse objectives:

1. Teach member groups to be self-sufficient by providing them with technological tools and knowledge
2. Improve communication and cooperation among constituents
3. Create brand recognition to make FIFA synonymous with soccer and *the* leading gateway to the online soccer world
4. Build a community of various groups, particularly women, youth and other newcomers to the game
5. Maintain top position online as well as in the physical world to ensure quality, consistency and use of best practices
6. Improve internal processes to increase administrative efficiency

EXECUTIVE  
**AGENDA**

IDEAS *and* INSIGHTS *for* BUSINESS LEADERS

*Executive Agenda* is published periodically by A.T. Kearney to offer fresh perspectives and encourage discussion on subjects of interest to senior executives and opinion leaders worldwide.

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