Getting Results Through Organization Design

E. Craig McGee, Ph.D.
Kathy Molloy, M.A., M.B.A.

Abstract

A critical success factor for organizations today is the ability to adapt their structures, systems and processes to capture new markets and expand existing ones. A critical determinant of strategic competitive advantage is organization design. This article demonstrates the strategic importance of organization design for business leaders; the impact effective design has on the bottom-line; and tips on how to design organizations for flexibility.

The article describes some key warning signs that indicate when an organization design is required and some tips for leading that redesign. The authors provide guidance on how to determine which design is right for your company, and how to avoid the common problem of outmoded organization designs. Case examples from several companies are provided.

Background

Jack Clausen, CEO of GreatSnack, Inc., a 45 year-old mid-size snack-food company, has just learned that his company has been replaced as the top performer in sales and market share in the industry, a position his company has held for the last 5 years. What is worse, the challenging company, ReadySnack, is a relative "upstart", having entered the market only 3 years ago! While Jack knew that GreatSnack was seeing some decline in a couple of key sectors, Jack thought, along with other experts, that sales would rebound as the economy improved. Instead, ReadySnack had achieved gains no one thought possible by way of leveraging its current distribution network into new market niches and the rapid introduction of new products.

Jack had been meeting with his senior team all day trying to understand the roots of this troubling situation, and determine an effective strategy.

In this example, Jack Clausen is like many business leaders, fighting hard to stay in the lead – even to stay afloat -- in the "white water" of this new century's economy. The competitive issues that GreatSnack is facing are different from what propelled it to success in the 1990's, when hard work in product quality and a focus on branding had really paid off. Now, Jack and his competitors are playing a different kind of game – one in which the key to success is the continuous, rapid deployment of resources and new products to capture new markets.

The strategic goal of this new "game" is creating and maintaining organizational flexibility, thus enabling rapid responses to new markets and responding to global competition. That flexibility must be created throughout the organization. Sales organizations must be able to package new products into total solutions for customers. They must develop new skills and employ new talent that reflects new technologies and markets. Research and development must explore new technologies and rapidly commercialize them based on what they hear from the marketplace. Manufacturing must be able to shift operations to sites/contractors that can produce products most cost effectively, and have the technical capability to do so. The CEO and the leadership team must develop "strategic flexibility", maintaining the ability to determine key markets and properly position products and services for those markets. Strategic organization design is a core business competency that identifies changes in the marketplace and consciously adapts the structures and processes of the organization to remain competitive.

This article was written for senior leaders and executives who are navigating their organizations in this turbulent environment. It demonstrates the strategic importance of organization design to business leaders; the impact effective design has on the bottom-line; and tips on how to design organizations for flexibility. Furthermore, it provides guidance on how to align the organization design with the business strategy.

Why should business leaders care about organization design?

A recent *Harvard Business Review*[1] article by Nohria, Joyce, and Robertson summarizes the results of a five-year study among companies from $100 million to $6 billion in market capitalization, of "what really works" to help businesses achieve sustained bottom-line results. These researchers identified four key components – *strategy, culture, structure*, and *execution* - which they called "management practices":

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[1]   Nohria, Joyce, & Robertson, *What Really Works,* <u>Harvard Business Review</u>, July, 2003

Successful companies, those that sustained marketplace advantage over time, use specific ways to manage these practices. In the area of *structure*, the focus of this article and a central component of organization design, the researchers found that the most effective structures are those that:

> ➢ Eliminate bureaucracy
> ➢ Simplify the environment, making it easy to work in
> ➢ Promote cooperation and exchange of ideas and information
> ➢ Put the best talent where the action is
> ➢ Establish systems for the seamless sharing of knowledge.

How well organizations align their structures, processes, management systems and cultures with a well-articulated strategy, greatly impacts their ability to execute and achieve bottom-line results. Exactly how organizations align structure with strategy is discussed further below.

It has been demonstrated repeatedly that organization design – the process of consciously defining and creating that alignment – can significantly impact competitive advantage. Consider the ill-fated reorganization of the sales force in Xerox in the late 1990's. Customers became confused, sales personnel disgruntled, and revenue and stock price dropped precipitously. Similarly, Honeywell, during the planned merger with GE, adopted many of GE's design principles (e.g., a span of control of 1:19) without deliberate analysis. Significant management talent was lost, and when the merger was not approved, Honeywell lost significant market share in many key sectors. Conversely, the U.S. military showed remarkable flexibility in how they organized their forces during Gulf War II. This enabled them to capture Baghdad in relatively short period of time with little loss of American lives. Also consider Hyperion, a company that develops and installs business management software[2]. In 2001, the company had lost money in two of the three previous quarters and its stock was trading at $14. The CEO, Jeffrey Rodek, led a dramatic redesign that reorganized the company from five overlapping business units into one. As of July 2003, the company has been profitable for seven straight quarters and its stock trades at $35.

One could argue that there is no time for organization design. After all, who has time to really think all these connections through, when the world around us is changing so quickly? *The above study, along with the authors' experience and the examples above, indicates that organization design is a powerful way to position organizations for sustainability*. It enables organizations to adapt and thrive in turbulent change, so that they won't be swept away by the forces they face. In other words, effective organization design helps build strategic capability.

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[2] Adapted from Business Week, July 23, 2003, p. 70.

Many CEOs agree:

> *"Our strategy is our organization. In the old days companies had the luxury of stable, long-lived strategies. No longer, strategies continue to shift to reflect changing market conditions. Organizations that succeed have structures that are as supple and adaptable as the strategies they reflect."*

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Sir John Browne
CEO, British Petroleum

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Similarly Fred Smith, CEO of Federal Express, utilized a highly innovative organization design to create a whole new industry (overnight delivery), and achieved leadership in the industry despite larger, better-established competitors.

Ultimately, organization design is the job of the top executive team, whose main focus must be creating and articulating a well-tuned strategic direction, along with ensuring the ability of the business to execute that strategy. In order to reposition GreatSnacks for success, Jack Clausen must not only create a strategic direction to address the challenges from ReadySnack, but also to determine the structure(s) and culture needed to execute that strategy.

What is strategic about organization design?

In a word…everything!!! Strategy cannot be successfully executed without the right organization design. Take Nokia as an example. In response to significant market shifts and dropping market share, Nokia implemented a significant reorganization into product focused business units. This reorganization produced several benefits:

> ➢ *It provided greater ability to carefully allocate resources (people and money) to specific areas to drive strategy*
> ➢ *It ensured that the right information was reaching the right people at the right time*
> ➢ *It provided greater transparency in the financial performance of its key products and technologies that in turn enabled it to track the effectiveness of its strategy*

Let us explore the Nokia situation in more detail.[3]

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[3] Extracted from Business Week, July 1, 2002

In 2002, Nokia was facing a dramatic slowdown in sales of wireless phones and equipment. Previous competitors such as Motorola, as well as new Asian manufacturers, were siphoning off significant sales and reducing Nokia's revenues and market share. At the same time, Microsoft was trying to push other phone makers to adopt a version of its Windows software, previously a competitive advantage for Nokia. The company needed to maintain the entrepreneurial thrust from the 1990's and generate more new products with advanced technology.

Needing a new kind of strategy, structure and business model, Nokia took a dramatic step. In line with a strategy focused on products and technology dominance, Nokia broke its monolithic phone unit (generating $21B and accounting for 75% of revenue) into nine business units. This new structure provided each business unit with its own product R&D and marketing. These functions enable the business unit to more rapidly identify and respond to customer needs in each niche, ranging from high-priced corporate S*mart Phones* for corporate clients to low-price barebones handsets for developing countries.

To maintain and advance its core technologies, Nokia retained a 4,500-person central research lab for basic technology and product design. To maintain efficiencies of scale in procurement and manufacturing, all business units share operations and logistics.

Structuring the organization in this way enabled Nokia executives to make more refined choices about allocating resources to execute its strategy. For one business unit (the time-division multiple access technology segment - TDMA), they elected to maximize Nokia's 50%+ share of a declining market, while making only minimal new investment. Conversely, in the code-division multiple access unit (CDMA…the heart of the new, advanced 3GT and future products), they elected to boost investment in this growing market to increase their current 9% market share.

The Nokia case illustrates some key benefits of strategy-driven organization design:

➢ *It provides greater ability to carefully allocate resources (people and money) to specific areas to drive strategy*. Also, think about the situation facing Jack Clausen at GreatSnack (see introduction above), who, in order to develop new markets, should redesign his organization to move people and dollars quickly.

➢ *It ensures that the right information is reaching the right people at the right time*. In the Nokia illustration above, each business unit has its own market research and product R&D groups that enabled it to sense and respond to market and technology trends rapidly. Important decision-making has been retained within the business unit.

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➢ As market and technologies shift, *the right structure provides executives the ability to reallocate resources and adapt to market shifts.* In Nokia's case, maintaining a centralized technology center ensured that it continued to develop leading edge technology to be commercialized by each business unit that better meet the requirements of their customers. This is the kind of strategic flexibility that differentiates leading companies from their peers.

➢ *It enables the development of a high performance culture*: the line of sight among employees to strategic goals is not blocked by barriers created by ineffective organizations. With Nokia, it became clear that product performance is the most important goal and each business unit had clear financial targets for its product family.

➢ And, it *provides greater transparency in the financial performance of its key products and technologies*, enabling executives to better track the execution of their strategy. It is clear which products and markets are providing a revenue/profit stream and which ones are not.

Some warning signs – is a redesign needed?

There are several situations in which creating a new design or restructuring is self-evident. These include:

➢ Startup of a new business, subsidiary, or venture
➢ Significant growth, or conversely contraction in the business
➢ Shift from a domestic to global company
➢ Merger or acquisition
➢ Spin-off or divestiture of products and businesses

However, organization redesign is often needed during the normal course of implementing business strategy. Existing organization designs can lose relevance as market conditions change, leadership changes, and processes change to increase efficiency. These changes can occur slowly, "sneaking up" on the company and accumulating to the point where a redesign is needed. And a key problem for leaders is that by the time they recognize the need for redesign, it may be too late…like the "frog in boiling water" analogy! Leaders need to respond early to the increases in temperature in their environment and take the needed actions.

Some typical early warning signs that call for an organizational redesign include:

> ➢ Slowdown/difficulty in meeting business plan targets
> ➢ Disconnects in key processes as they flow across different departments or work groups
> ➢ High levels of conflict within and between organizational units
> ➢ Difficulty obtaining and sharing resources across the organization
> ➢ Lengthy, cumbersome decision-making processes
> ➢ Role confusion/turf issues
> ➢ Metrics are hard to define or overly complex
> ➢ Productivity declines

What these indicators all point to is a fragmentation in the smooth flow of information, materials and decision-making. These are signs that the structural boundaries are located in the wrong places. Leaders should monitor these signs and initiate redesign efforts sooner versus later. This will enable them to respond more quickly and effectively to market changes.

Also, when employees and leaders begin talking about "communications" problems in the organization, take note. The root of these communications problems is often an inappropriate structure, either at a macro-organizational level or involving specific roles within the organization. Structure creates inherent barriers to the free flow of information. Executives need to make careful, thoughtful choices around where to place boundaries to balance the need for the free flow of critical information without creating information overload in the company.

Important considerations when developing an organization design

As executives lead redesigns there are some critical things to think about and do.

1. Start with a statement of strategic intent

Many leaders believe they have a coherent organization strategy*.* And while most do have a strategy in mind, they must also communicate it adequately. We often hear that managers and peers do not "get it" – they do not really understand the strategy and its implications for day-to-day business. Often strategies are vague, or lack the direction for *action* needed for effective execution.

We work with clients to develop a *statement of strategic intent* prior to a redesign. The statement of strategic intent is the vehicle for clarifying an underlying strategy for all the leaders and employees of the organization.

In practical terms, the statement of strategic intent is a concise statement that communicates how the organization plans to differentiate itself from its competitors on the basis of products, markets, technology, pricing, or people. It identifies the key customers/markets and articulates the value proposition for those key customers. It is different from a mission statement in that it defines a specific *course of action* that supports the overall mission. Here are some examples of statements of strategic intent[4]:

> *"Make discounted investments in distressed cable companies in Europe and generate greater revenues by upgrading cable and interactive services. We are focusing on Europe because the market is fragmented, the cost per subscriber is low, and the technology/service level is low."*
> Liberty Media

> *"Lower costs by moving production out of the US to network of plants positioned to service global and local markets. Continually redesign the product to achieve technological differentiation, which would add value and command higher prices. Create new organization structure staffed with carefully selected management teams"*
> Auto Manufacturer Supplier

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[4] These represent the authors' interpretation of these companies' strategic intent drawn from public documents and publications.

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"Enhance mobile phone business as our primary business. Extend simple sound phone set to multi-media style phone containing computing function. Be prepared for the ubiquitous network environment created through the conversion of wired and wireless technology. Strengthen both wireless and cable communication. Consider grafting new technologies such as biotechnology and nanotechnology into the existing IT. Execute the product development process with incomparable speed by creating collaboration among engineering, technology, manufacturing and the supply chain."

Samsung

These all represent clear, concise descriptions of a one to three year strategy. These statements identify what markets the company will compete in, how the company will compete, and provide direction to all employees in the company. Moreover, the examples from Samsung and the auto parts supplier also identify internal sources of competitive advantage…their people capability. Successful companies develop explicit strategies for how they will develop the internal capability to execute the market/product strategy. In the opening example, GreatSnack needs a clear strategy that targets new markets, identifies what internal capabilities must be developed, and provides a clear mandate for action. That mandate will enable Jack Clausen to quickly direct the resources needed to explore new markets.

The statement of strategic intent is the basic building block for an effective organization design. It is the ultimate objective that the design is supporting. Without clear definition of the strategic intent, it is almost impossible to develop an effective structure.

2. Determine the high level organizational boundaries that support the strategic intent

Once the statement of strategic intent is agreed to, the executive can develop the "right" structure. If the strategy reflects a technology/product focus, the structure should reflect that. If the strategy is a mass-production, low cost strategy, a different structure is warranted. Understanding the strategic intent provides guidance to where to place organizational boundaries.

This is easier said than done. When developing a macro-level organization design (product/technology focused, customer/market focused, efficiency-focused, etc.) the key consideration is that it must enhance the primary competitive advantage needed by the company. Jack Clausen, for example, may want to move GreatSnack away from a primarily functional design to a customer/market-focused macro-design that enables

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resources to be allocated quickly and easily to rapidly changing customer wants and needs.

During the early design phase, structure/process modifications are often incorporated that address other core competencies, such as the need for production efficiency or brand/product differentiation. These modifications enable leaders to create unique organizational hybrid designs that can be shifted to address new market needs at later dates. The Nokia example was an illustration of maintaining core leading edge technology development in the centralized R&D function, while using separate product/market focused business units to commercialize that technology in different products that reflect the needs of different customers and markets.

3. Where you draw boundaries is critical to strategy execution

When designing your organization, pay attention to the key breakdown areas. A "breakdown" is a failure of the organizational system to operate as planned. Examples of critical breakdowns include:

> ➢ inability to translate customer needs into viable products
> ➢ high manufacturing production costs
> ➢ problems in cross-selling all products and services to the key customers
> ➢ problems in creating the right products for different geographies or customer segments
> ➢ frequent lack of communications between key functions/departments

If these breakdowns are preventing the organization from executing its strategy or achieving its business goals, "redrawing the boundaries" is required.

In one software development company, for which one of the authors consulted, the market requirements for new products were not being developed properly to guide the development effort. The requirements were late, lacked specificity, and were constantly changing. The company was continually missing its product release targets for key customers, and the products lacked the proper functionality for the customers.

The leader of the company talked about the "lack of communications" between Marketing and Engineering. But the problem was not a communications problem, or even a process problem. It was a **structural** problem. Effective performance required redrawing the structural boundaries so that the function of determining market requirements was shifted from Marketing into Engineering. The following year, eleven out of twelve new product launches were achieved on time. Three years later revenue had increased 10x.

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4. Include integrating mechanisms to ensure that the right dialogue occurs among groups

All organizational structures have inherent liabilities. Organizational boundaries often create new barriers to the free flow of information, materials and decisions. Yet, leaders often feel that once they have determined the key organizational boundaries, their job is done.

Effective organization design recognizes that mechanisms and structures must be implemented that cut across departmental boundaries so that information is properly shared. If people cannot talk to one another, and hold the important dialogues needed to achieve results, then the redesign is essentially useless.

Most people are familiar with the deficiencies of purely functional organizations, where "functional silos" prevent the free flow of information across functions. In response, cross-functional teams became a popular tool to integrate the flow of people and information across functions during the 1980's. Similarly, entities like *capital spending committees* and *product steering teams* were created in the 1990's to cut across organizational boundaries to ensure that the perspectives of all groups were represented.

Basic kinds of *integrative mechanisms* include:

> *Cross-functional teams…* often created to solve problems that cut across many different functions or organizational units.

> *specialized roles* (e.g., "Process Owner") to ensure that processes are implemented consistently across different business units, and continuous improvement of those processes occur)

> *standing meetings* (e.g., the "Session C's" that GE used to annual review leadership talent and move key executives across business lines)

Integration mechanisms play a key role in bringing diverse groups of people together, all of which own a "piece of the puzzle", enabling them to create the rich dialogue necessary for organizational productivity.

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5. While organization redesign is not about a "silver bullet" or a quick fix, it can generate quick results.

There are multiple examples of companies continually restructuring, trying to find the right structure to solve their problems. Centralize I/T, decentralize I/T, institute shared services, outsource, etc. Continuous restructuring is often the result of limited understanding of the true cause of the performance gaps or clear linkage with the statement of strategic intent. And while these redesigns may resolve some of the current issues, without proper analysis and careful deliberation, they often produce other consequences that then must be addressed. Similarly, an organization redesign may be done because other companies have done them, and claim success.

But creating an effective organization design is not about mimicking competitors. Rather, it requires being intentional and deliberate about your own organization's performance and positioning. Our friend Jack Clausen may not benefit long-term from copying the ReadySnack organization design, which may not capitalize on GreatSnack's strengths. Jack would benefit more from analyzing the performance of GreatSnack in its different markets, re-examining its strategic intent, and determining the organization's capability to achieve the strategy.

This does not mean that an organization design process must be a lengthy or resource intensive exercise. There are design approaches that accelerate the process and create results very quickly. There are sets of analytical tools available to guide the executive in determining the appropriate structure. These tools include process mapping, non-value analysis, variance analysis, responsibility charting, etc. However, these tools do not include the proverbial napkin on the back of which organizations are all too often designed!

6. Organization design is more than moving the boxes

The traditional definition of organization design is creating an organization chart. Yes, an organization chart is one manifestation of an organization design process, but quite a simplistic one. Organization design is a more robust process that focuses on aligning structures, systems and processes to achieve strategic objectives. Organization redesigns provide a good opportunity to examine critical business processes. In fact, analyzing core business processes often identifies where most of the critical breakdowns are occurring. Business process analysis becomes a tool for identifying where to place organizational boundaries.

When doing an organization design, executives should also address critical organizational systems that will ultimately support the structure. Some of these systems include: rewards, goals and metrics, decision-making, training and staffing. For

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example, having a staffing process in place that focuses on entry-level hiring in a company where more advanced technology and product development skills are needed represents a misalignment that will seriously impede results.

Similarly, we are all familiar with metrics that don't support strategy. The classic mistake is measuring individual performance and rewarding accordingly, when team behaviors are required.

7. Poor executive performance is often blamed for poor design.

Executives are generally replaced when they fail to achieve expected business results. Poor business results are often attributed to poor individual performance or poor leadership skills. After all, it is easier to change the person than the structure. The underlying problem, however, is often a poor design. A poor organization design can prevent the business unit leader from having full and adequate control over key resources (marketing, product development, etc.). Similarly, key business information may not be available to him/her, or decision-making processes may undermine his/her ability make critical decisions quickly, and with the proper level of accountability.

A client of one of the authors, the head of a unit in a global R&D organization, could not gain the support of some of the major business heads for her strategy. After months of failure, and discussions with her manager about her performance, she realized that a change in the roles of people in her unit would enable faster information flow and better teamwork. Since that change, she has risen to become a "star" in the organization.

How do you know an organization design is successful?

There are clear indicators for measuring success of organization design efforts. Here are a few of the results-based indicators that may be found as early as three months after a major redesign:

> ➢ There is a faster cycle time for developing the *right* products/services defined by company strategy.
> ➢ The company's resources move quickly when needed.
> ➢ Your business is able to adapt to changes in market conditions quickly, without creating a feeling of chaos to employees and suppliers.
> ➢ Work is getting done efficiently – without rework, excessive reviews.
> ➢ The right information is getting to the right people.

True bottom-line results indicators – achievement of revenue, and finally profit targets - may appear a year or more after the redesign.

Closing tips

What would we tell Jack Clausen as he begins a redesign of GreatSnack?

1. *Develop a statement of strategic intent* …the organization needs to understand what the key strategic foci are, both internally and externally. This statement would likely include elements that focus on developing the capability to expand the sales of existing products in existing and new markets, rapidly introducing new products in three categories (salted snacks, cakes and breads, and confectionaries), and developing the internal capability to rapidly reconfigure the organization to best utilize employees' talents and capitalize on specific needs/wants of target markets. Jack can develop this statement involving his leadership team and others in the organization, and then must develop a process to ensure that this statement is communicated throughout the organization and is clearly understood.

2. *Create a product-centric organization…*the statement of strategic intent drives the organization to more of a product-focused structure. One alternative for Jack is to reorganize his current structure (which is primarily functional) into three product-focused business units. Each business unit would have marketing, product development and profit/loss for one of the three product families (salted snacks, cakes and breads, and confectionaries). These would enable GreatSnack to "read" the market trends more quickly and develop products that address those trends.

   Jack can maintain a functional sales organization, that is, one that sells all three product families. GreatSnack's customers probably do not want to see three different sales representatives, and the sales representatives can easily develop the product knowledge for the three different product families.

   Regarding the structure of the manufacturing function, further analysis is needed. Jack should work with his staff to assess distribution costs of the different products, and the technology required to manufacture the different products, to determine if manufacturing remains an integrated functional organization, or if it is distributed into each of the business units.

3. *Create the right integration mechanisms to align the product structure with overall business objectives…*for example, there are likely common raw material requirements across the three product families. Commodity buying teams that cut across the three business units can identify common procurement items and negotiate better terms than segregating procurement within each business unit. Similarly, so as not to create business unit "fiefdoms" that replace functional silos, Jack and his staff should look to establish an integrated succession/manpower

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planning system. They should move people across different business units to cross-pollinate different ideas, create/propagate relationships across business unit boundaries and maintain an overall GreatSnack mentality.

4. *Review/design the metrics*…Jack should look at developing a new set of metrics that align with the product structure. Given the new strategic emphasis on product development, one metric could be the amount of revenue that new products generate. Similarly, business unit metrics can (and should be) established to provide the data to assess the effectiveness of the new product strategy. However, these should be balanced with metrics reflecting the performance of GreatSnack overall. Jack should also monitor the development of "unintended consequences" of the new metrics.

5. *Don't expect perfection…no design is perfect…*provide some latitude for adapting to changes that emerge during the design process. Over time, there will be more changes, creating a healthy organization that remains agile and flexible. After all, organizations are dynamic systems.

If Jack applies some of the basic principles of organization design he stands a good chance of regaining the market leadership GreatSnack once enjoyed.