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Designing Organizations that are Built to Change

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As the pace of globalization and social change quickens, executives are correctly calling for greater agility, flexibility and innovation from their companies. Indeed, the premium on an organization's ability to adapt and change should be at an all-time high. But it is not. Largely ignored in the calls for more agility is that organizations are designed to seek sustainable competitive advantages and stability. Buried deep in the managerial psyche, and bolstered by decades of theory and practice, is the assumption that stability is not only desirable and effective, but also attainable.

In their classic book *The Social Psychology of Organizations*, Daniel Katz and Robert L. Kahn note, "one can define the core problem of any social system as reducing the variability and instability of human actions to uniform and dependable patterns." The popularity of process improvement efforts, from total quality management to Six Sigma programs, provides ample evidence of the consuming desire for stability and predictability in today's organizations. In fact, those are the very qualities rewarded by the financial markets.

It is not surprising then, that most large-scale change efforts fail to meet their expectations. When the demands for innovation -- and the change efforts that result from them – fail, most focus on developing more effective change models or seek the latest approach for overcoming resistance to change. They apply single-loop learning solutions to a double-loop learning problem. Even the most advanced change models stumble when they face organizational designs and management practices that are inherently anti-change.

A big determinant of change effectiveness is organizational design, or how a company's structure, processes, reward systems and other features are orchestrated over time to support each other as well as the firm's strategic intent, identity and capabilities. In a world that is perpetually changing, an organization's design must support the idea that the implementation and re-implementation of a strategy is a continuous process. However, a number of traditional organizational design features tend to discourage – and not encourage – change. Thus, to transform themselves into organizations that are "built to change," companies need to rethink a number of these basic design assumptions.

Managing Talent. Job descriptions are emblematic of stability and as a result are a poor fit for any built-to-change organization. Of course, job descriptions can be updated (although companies tend to be slow in doing so), but why go to the trouble of specifying job responsibilities in the first place only to have to tell employees that their latest assignment comes under "other duties as assigned"? Instead of telling employees what their jobs are, built-to-change organizations encourage people to find out what needs to be done. In lieu of job descriptions, frequent goal-setting reviews help establish what individuals and teams are expected to accomplish in the near future. Cascading throughout the organization, this process can be facilitated by an intranet-based performance management system.

When hiring people, built-to-change organizations seek individuals who are quick learners and like change. That's why companies like Southwest Airlines, Nike and W.L. Gore and Associates specifically look for people with initiative and the right attitude, including the desire for professional growth. Built-to-change companies need to have an employment contract that states that change is to be expected and that support for change is a condition of long-term employment.

One of the best things that former CEO Lou Gerstner did when he began IBM's massive transformation was to redefine the relationship between company and worker. Previously, IBM had a policy of lifetime employment but Gerstner changed that to employment for as long as individuals have the required skills and knowledge. Of course, people should be made aware of this type of employment deal before they're hired, so they can make an informed decision about whether they want to work in such an environment. Once they join, training should be a normal, ongoing process, focused on the skills and knowledge necessary to support change and other organizational capabilities, and aimed at the competencies that will help the company add value both now and in the future. Much of that training can be delivered “just in time” over an intranet.

Reward system. Pay and other rewards that are based on seniority stifle change. They do little but reward people for surviving. Built-to-change organizations utilize a variety of reward practices, including bonuses, stock and “person-based pay,” that encourage both current performance and change. Bonus systems can be particularly effective motivators during periods of change by establishing a clear line of sight between results and rewards. Individual plans that offer relatively large bonuses can provide powerful incentives for employees to perform well and to alter their individual behaviors when a new element of strategic intent calls for it. Group and business-unit bonuses can be very helpful in focusing team performance and creating a shared need for change.

In some circumstances, companies should consider one-time bonuses awarded at the completion of a strategic change effort. Members of a new-product development team, for example, could be given bonuses when the product ships. In other tactical change situations, short-cycle bonus periods (perhaps every three months) that target phases in the *implementation* of change often make more sense, for example, rewarding an IT team that hits key milestones in a project for installing a new system.

In comparison to bonuses, stock plans are likely to be less effective in motivating change because the line-of-sight between the desired behavior and reward is less clear. But broad-based stock ownership can provide executives with a better platform on which to stand and talk about the advantages of change than a stock program that includes only those in the corner offices. After all, when only senior managers have stock options, employees can’t be faulted for thinking, “Why should I listen to calls for change that only benefit those at the top?”

Finally, companies should consider shifting the basis of pay from the job (and seniority) to the individual (and what he or she can do). In work environments that call for changing task assignments, paying the person -- as opposed to paying the job -- is a much more effective approach, particularly when it comes to retaining the right people. After all, people have a market value; jobs do not. People can change companies for higher pay; jobs cannot.

Perhaps the most important benefit of person-based pay is the effect it has on organizational culture and on employees' motivation to change. Instead of the organization rewarding people for expanding their jobs or for moving up the hierarchy, it recognizes them for increasing their skills and for developing themselves. This reinforces a culture that values growth and personal development; the result is a highly talented workforce that is receptive to change. Those characteristics are particularly valuable when an organization needs to improve its competencies and capabilities, because the company can adjust its reward system to encourage individuals to develop the necessary skills.

The implementation of a person-based pay system must start with a clear model of the competencies required to meet current customer and environmental demands, as well as a notion of the kinds of skills and knowledge that employees will need in the future. This information can guide professional development activities that are tied to the reward system. One indirect effect of person-based pay is a decreased emphasis on hierarchy because individuals don't need to be promoted to receive a significant raise. Instead, they can develop a new expertise. Among the positive results of that change are fewer individuals jostling for promotions merely because they want higher salaries.

Organization Structure. Built-to-change organizations must be in close touch with the market and other environmental demands to continually define and redefine a series of short-term competitive advantages. To achieve that, all employees -- not just senior managers -- must observe and report on market trends and identify competitive opportunities. They need to think constantly about potential alternative futures, creating a variety of short- and long-term scenarios. Thus, instead of scheduling static annual reviews of the environment, built-to-change companies must adopt flexible and reconfigurable organization structures.

The key design principle here is to maximize the "surface area" of the organization by connecting as many employees as possible with the external environment. Structures that accomplish this increase the external focus of its members; bring in critical information about trends, opportunities and issues; and prevent people from becoming ossified in their roles. Thus, as many employees as possible should have contact with regulators, suppliers, the local community, watchdog groups and, most importantly, customers. Built-to-change firms are anxious about being caught off-guard, so they place everyone close to customers and the environment. That way, when the time comes to alter the direction of the organization, everyone moves together based on a common understanding and felt need for the change.

A variety of companies, including IBM, Nokia, American Healthways, and Lord Corporation, have increased their surface area by adopting front-back, process-based or network structures that increase the centrality of customer and other external demands. In addition to coordinating functional, product, service and geographic issues, these multi-dimensional structures continually ask employees to consider the interests of customers and other outsiders in the decision-making process. For example, the "front end" of a front-back organization creates flexible, cross-functional and customer-facing teams to sell and configure unique products, services and systems. The "back end" develops new technologies, products and systems; maintains the supply chain; and conducts other activities that support the front end. As a result, customer requirements, supplier relationships and other environmental demands have an ever-present influence (either directly or indirectly) on nearly everyone in the organization.

In a process-based structure, cross-functional teams address the requirements of both internal and external customers. At American Healthways, for instance, each core process -- understanding the market, developing new businesses, building solutions or delivering value -- must balance current demands for efficiency with future market needs. Although each process within the organization might have a slightly different focus, successful execution requires the application and coordination of each function in service of customer requirements and corporate objectives.

Network structures consist of individual organizations (or units within a company) that have been pulled together to exploit specific opportunities. An integrating organization coordinates the activities of the different entities, much like a studio assembles and coordinates the work of actors, screenwriters, camera crews and other groups necessary to create a movie.

Opportunity networks, such as those deployed by Li and Fung Ltd., the Hong Kong-based consumer products trading company, are particularly effective for enabling an organization to think global but act local. As the integrator, Li and Fung has an overall perspective that is decidedly global, constantly monitoring trends in fashion accessories, toys, sporting equipment and other goods, while each entity in the company's network concentrates on what it does best (for example, developing a local marketing campaign for a particular product line). In general, a network structure leads to organizations with large surface areas because of all the alliance relationships that managers and employees must address.

Other companies have maximized their surface area by deploying multiple independent business units, outsourcing and matrix relationships. For instance, Berkshire Hathaway, with its wide range of autonomous business units faces multiple markets and can adjust its corporate portfolio relatively easily without the angst and grief associated with traditional downsizings and re-sizings of integrated divisions. Similarly, W.L. Gore's small, interrelated divisions ensure that each unit is maximally exposed to its relevant market. Internal matrix relationships can also increase an organization's surface area because, when employees from different functions or programs interact, they often must deal with a variety of alternative market perspectives.

Information and Decision Processes. Annual budgets are a poor fit for a built-to-change organization because they are typically inflexible and frequently outdated even before they can be put in place. There is no reason why the setting of spending patterns should be based on the time it takes for the Earth to revolve around the sun. Instead of relying on annual budgets to control costs, built-to-change companies should deploy profit centers and activity-based costing. Whenever possible, a P&L should govern each business unit. To ensure good decision-making, information needs to be transparent and up-to-date, indicating the current condition of the organization's capabilities and providing a clear view of how the company is performing relative to its competitors and its strategy.

Performance-based information systems are a particularly effective way to motivate and empower employees in a built-to-change organization because they facilitate moving decision-making to wherever decisions can best be made and implemented. A good example is *my*Siebel, a personalized information system created by Siebel Systems before its acquisition by Oracle. Each employee could log onto *my*Siebel and gain access to corporate, market and competitor information; data on current projects; and quarterly objectives for any individual in the organization (including Tom Siebel, the CEO). This widely available information allowed everyone throughout the organization to make customer-related decisions with the most up-to-the-minute data available, and it helped people to align their individual behaviors with corporate objectives. The system thus facilitated the goal-setting, performance-review and reward process.

Leaders. Executives in built-to-change organizations need to practice shared leadership -- what Mark Hurd, the CEO of Hewlett-Packard, has described as, “leadership as a team sport.” Viewing CEOs at the helm of a big ship setting direction and ordering people around is the wrong metaphor. It might be appropriate for traditional hierarchical organizations, but it does not fit a built-to-change organization. A better analogy is to think of the corporation as a community of people spread over miles of hills, fields and forests. To get everyone moving in a new direction, competent leaders need to be dispersed across the countryside, all connected by a shared sense of identity and purpose.

Shared leadership has three advantages. First, it effectively substitutes for hierarchy. Spreading knowledge and power across many people allows the organization to process and respond to information quickly without requiring a tremendous amount of top-down direction. Second, a shared approach builds a deep cadre of leadership talent. By involving everyone in strategizing, creating value and other activities typically performed mainly by senior execs, a company can develop leadership and management skills among a broad audience. Third, multiple leaders at all levels who understand the external environment and the internal capabilities of the organization often see important trends that call for corporate change before senior management does. Finally, and most importantly, shared leadership supports more effective change management. In any change effort, there is typically more to do than a single leader or a few leaders can handle. Shared leadership helps to solve that problem. Also, change efforts that are led by a single hero leader are fragile entities; if that individual falters or leaves, the change effort stalls. With shared leadership, competent others are always available to keep the momentum going.

To develop a shared leadership capability, a company has to implement a program for leadership development that involves many employees and not just a few “stars.” It also needs to share strategy information and business results with managers at all levels. Finally, it needs to obtain continually input from employees to develop and evolve its business strategy. When former CEO Lou Gerstner was implementing a massive change effort at IBM, for instance, he regularly led Web-based discussions to solicit feedback from employees.

It’s easy to understand why most models of organizational design tend to stress stability -- they were born in an age when environments were relatively stable or at least predictable. When the environment changed slowly or predictably, those models worked well. But the pace and uncertainty of change in today's world, spurred by increased globalization and technological innovation, among other factors, strongly argues for a new approach.

What is needed is an organizational effectiveness model built on the assumption that continuous change is simply business as usual. Such a model requires the right approach to strategy. Instead of seeking a single sustainable advantage, built-to-change companies must continually pursue a *series* of short-term competitive advantages. Moreover, to create value over time, they must constantly ask themselves the right questions. Instead of "what do we do well?" they must ask "what do we need to learn?" "how do our current capabilities need to evolve?" and "what new capabilities do we need to develop?" In answering those questions, built-to-change companies must constantly balance resource allocations for present performance against investments that will create future fitness. These tradeoffs will be made through "make or buy" decisions to add, modify or delete certain capabilities. And the execution of those decisions will be greatly aided – or hampered – by a company's organizational design. Simply put, firms with the right structure, employees, reward system, leaders and information systems will be equipped to implement the necessary changes, while those that lack them will tend to stumble.