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Demystifying Organization Design

Understanding the Three Critical Elements

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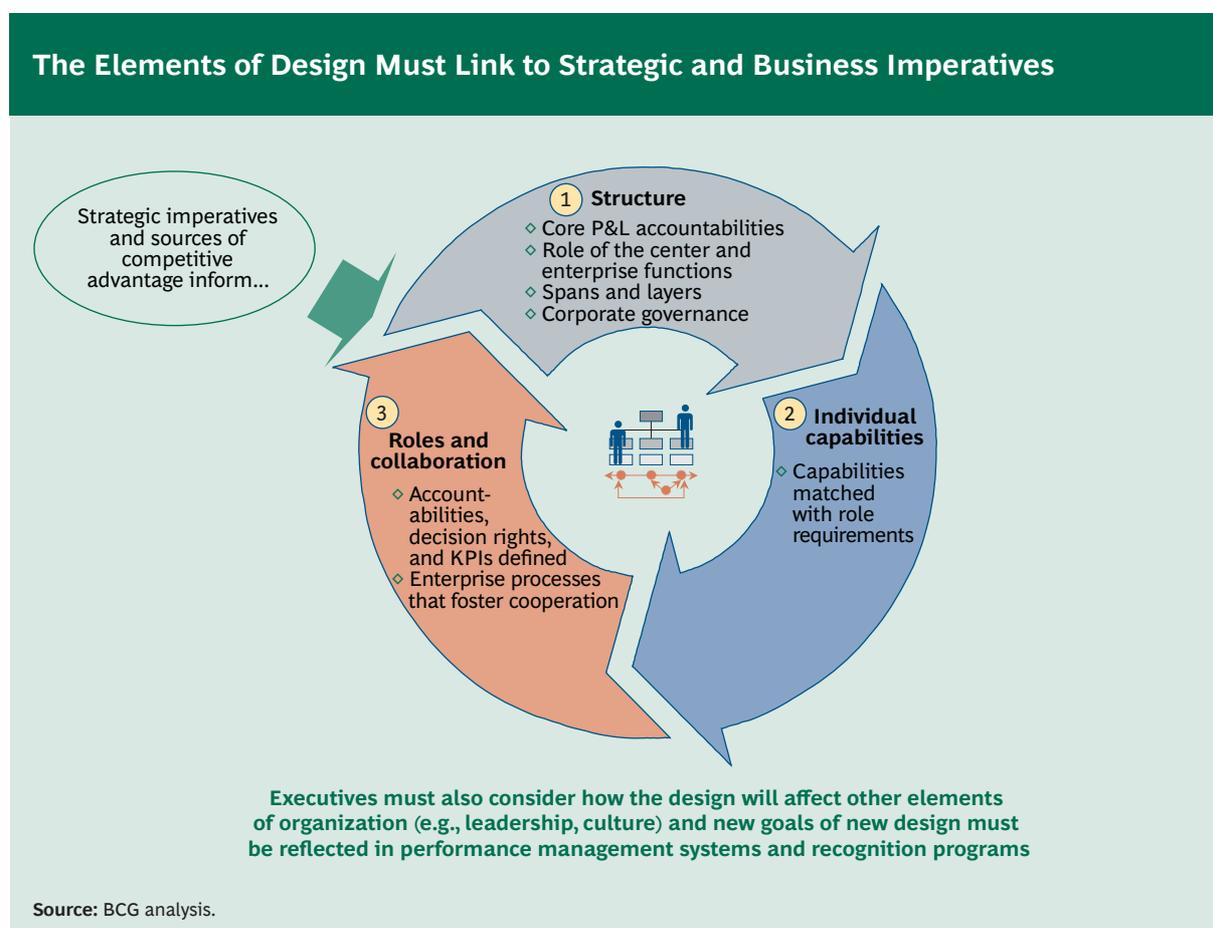
Understanding the Three Critical Elements

New strategies—or shifts in existing strategies—frequently require a change in organization design. Whether companies are winning new customers, launching new products quickly, achieving radical cost reduction, expanding globally, or accomplishing breakthrough innovations—organization design should be at the heart of their initiatives.

Frequently, however, organization design is an afterthought—or not thought of at all. Often, senior executives do not want to change the design of their organizations. Perhaps past efforts did not deliver, did not address root causes, or were too abstract. Maybe execution was messy. But it does not have to be that way.

Organization design can and should provide effective and practical resolution of many stubborn strategy and business-execution issues. If a redesign is to work, however, executives need to recognize that all three elements of design—structure, individual capabilities, and roles and collaboration—are essential in making a change. Indeed, there is a dynamic interplay among them. (See the exhibit “The Elements of Design Must Link to Strategic and Business Imperatives.”)

When structure, individual capabilities, and roles and collaboration are in alignment—and tightly linked with a company’s strategy and sources of competitive advantage—an organization is geared for performance.



Structure

Structure is more than the look and shape of an organization chart. Fundamentally, an organization's structure should reflect critical choices about achieving success in the marketplace and holding key executives accountable. Two specific questions should inform an organization's structure:

- ◇ Where should the accountability for profit and loss reside?
- ◇ What functions should report directly to the chief executive?

Accountability for Profit and Loss. Businesses are generally organized around products, segments, geographies, or channels. This reflects classic organization-design theory, but companies frequently get it wrong—or they are slow to change the company's structure in response to changes in the strategy.

Banks, for example, have traditionally organized around products, but it may make sense for them to organize around segments in order to deliver bundled products to customers. Likewise, many consumer-products companies have regional-based businesses, but the emergence of mega-retail chains means that it might now make more sense to adopt a global product-based structure that takes advantage of scale and supplier power.

There are two important caveats. First, each company's strategy will require a unique and nuanced organization structure. No single organization design is applicable to an entire industry. Second, while there is nothing inherently wrong with matrix structures, executives need to pay special attention to the nonstructural aspects of organization design—such as roles and collaboration—in order to make a matrix work.

Functional Reporting Lines. The role of the center and the location of enterprise functions within an organization depend on their importance. Functions should generally be centralized when consistency across business units is critical (risk management and branding come to mind), significant scale advantages exist (as they do for research and development and manufacturing), or the chief executive needs visibility into the activities.

While individual companies will configure P&L accountability and functional reporting differently, the structure of all organizations should be flat. This is the right design for almost any organization. A company that has more than eight layers of management and managers with fewer than seven spans of control will be sluggish and bureaucratic. A flattened pyramid forces people to focus on work rather than coordination, and activities that do not deliver value get eliminated. Flatter structures streamline decision making and foster clearer accountabilities.

Structural changes will often create second-order effects on leadership, culture, and other organizational elements that must be managed. For example, if spans of control are widened but executives try to manage many details—as they did when they had fewer direct reports—the goals of the redesign will be frustrated.

Individual Capabilities

Companies frequently fall into one of two traps when they undertake an organization redesign: they either reshape the organization around a few key executives or they fail to take into account the capabilities required for the new design to succeed.

The first trap is understandable. A rising executive, for example, may be given responsibility for a large part of the organization in order to groom him or her for greater things. While this approach may make sense for that executive's career development, it is unlikely to be the most effective structure for success in the marketplace—especially if the executive winds up leaving the company.

The second trap results from a failure of foresight. The best-laid design will collapse if the right people, with the right skills, are not in the right jobs. As part of a redesign, each key role needs to be evaluated to

determine the skills required *at that point in time*. At a high level, roles require one of four broad categories of capabilities: change management, flawless execution, specialized expertise, and people management.

When staffing a redesigned organization, executives need to pay attention to the specific capabilities required of each critical role rather than just using compensation levels and job descriptions to match people with roles. Depending on its needs, for example, a company may require a head of sales who is a great “closer” and who can excite the field salesforce; or it may need a sound manager who can optimize salesforce effectiveness, upgrade the sales processes, and implement new sales-management systems. When choices about organization design are made, this pragmatic understanding of roles is too often missing.

Another missing ingredient in many designs is recognition of the dynamic quality of organizations. The required capabilities of roles will change over time, and so should the people who inhabit them. For example, the head of a start-up business unit should probably be skilled at managing change. In a few years, however, that role might best be filled by a manager with strong people-management skills.

Companies also frequently neglect to fully consider training, hiring, career paths, and job rotations. This typically occurs because staffing is done after a redesign or restructuring has been announced—and after senior executives have moved on to other challenges.

Finally, many organization redesigns need to leverage existing talent and develop key talent. Specifically, talented individuals should be offered roles that will be challenging and interesting and that allow the people to build leadership skills. When a key person is being offered a new position, it is worth asking, Will this person be excited by the role?

Roles and Collaboration

If an organization’s structure is its skeleton, then roles and collaboration make up its nervous system. Clarified roles and mechanisms for collaboration drive accountability and performance.

Organizations must hold their people individually accountable—and their teams jointly accountable—for results in order to avoid ambiguity about responsibilities and direction. The best way to provide this accountability is through a process we call “role chartering.”

As a first step in this process, the chief executive (or a business unit or a functional head) translates overall objectives into four related aspects of his or her role:

- ◇ Individual and shared accountabilities—that is, responsibilities for the completion of tasks
- ◇ Key performance indicators (KPIs) used to measure achievement of these accountabilities
- ◇ Decision rights necessary to meet the accountabilities
- ◇ Desired leadership behaviors for the role

These four aspects serve as the “charter” for the executive. He or she then meets with all direct reports, sharing the charter with and discussing the high-level objectives with each of these employees. Next, each direct report writes his and her own charter and then meets with the rest of the chief executive’s direct reports and the chief executive to collectively agree on each charter—and so on. This cascading process helps to build clarity for each role, speeds decision making, and reinforces strategic goals throughout the organization. To make these charters stick, companies must build them into performance management, compensation, and reward systems.

Collaboration provides the connectivity that allows different parts of an organization to work together effectively on key enterprise processes, which include strategy development, product development, innovation, resource prioritization and planning, target setting, and budgeting. Forums, councils, and

cross-functional teams are effective mechanisms for fostering this collaboration. In meetings of these groups—and in the key enterprise processes themselves—each part of an organization comes together to discuss progress against charters, reset expectations, and make course corrections. These gatherings should also provide an opportunity for teams to celebrate successes, build engagement, and common purpose. And, of course, they also serve as the place where employee disagreements are aired and trade-offs are made.

Key enterprise processes are too often seen as mere contests with winners and losers rather than as platforms for effective teaming. Instead, executives need to focus on these processes and ensure that the right people—with the right information and the right motivation—are effectively collaborating to get work done. The mechanisms for collaboration circumvent rigid structures and help prevent finger-pointing and “not-invented-here” resentment among employees. Well-designed mechanisms can mean the difference between the success and failure of an organization design.

As with organization structure, it may be necessary to address the impact that the design of these mechanisms may have on other organizational elements in order to institute effective change. A company with loosely defined mechanisms needs to carefully consider how it tries to impose discipline; strict enterprisewide decision processes may serve only to make employees likely to resist the changes.

Organization design is not just a matter of connecting boxes with straight or dotted lines. Effective organization design must recognize the relationships among all three design elements. It requires a process that starts with structure, proceeds to staffing that structure and then defining the roles and collaboration to make that structure work effectively. Along the way, executives must be attuned to other second-order effects and fine-tune other organizational elements, ranging from leadership behavior to performance management systems.

By following this focused and systematic approach, companies can avoid the frustrations of past redesigns while achieving superior execution and performance.

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