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## ORGANIZATIONAL STRUCTURE – FIVE TOPICAL QUESTIONS

*Creating a structure that matches the scope of the business and the shape of the market it serves is a defining duty of management and an indispensable lever for overall efficiency and success. And the economic globalization and instability marking the current decade put the challenges this entails in a new light.*

### Are structures adapted to future challenges?

The past few years have brought radical changes to the environment of most businesses.

Expansion in Eastern Europe has become a key priority or even the exclusive focus of business-development strategies, while ever more alliances are taking shape in R&D, production, and other areas of business. At the same time, offerings are being redefined in efforts to counter softening demand or narrowing margins – even as the trend to greater and greater reliance on outsourcing continues, along with the rationalization of the brand portfolio and business units.

However, the overall logic of business organization has not always kept step with these developments. In many cases, adaptation has been limited to the operational requirements of change, without a complete reengineering.

The tendency is for adaptation to take shape only gradually, with new competencies allocated on a case-by-case basis to particular areas of operation. Where this happens, an overall review will generally reveal scope for efficiency gains, for example by combining resources and expertise in new ways. To take an example, a strategy centered on the development of the services associated with the company's products may be more effective if services are structured as a distinct line of business rather than fragmented product line by product line. The same may apply to the development of specialties to supersede a commodity offering, even when this concerns several distinct segments.

Businesses that have understood the need to rethink their organizational models have reaped rapid rewards. Nestlé has thus been able to gather internet expertise through its GLOBE program, while Peugeot has reorganized design and styling for its two brands under the unified responsibility of group management.

New patterns of growth and the frequent need to deal simultaneously with contraction in some areas of business and expansion in others mean that it is more urgent than ever to make the right choices regarding the number and scope of business units within the overall organization.

The first question is what the appropriate level is for the allocation of independent resources – division, country, business unit, etc.? If business units are too large, there is a danger that responsibilities will be diluted, and this can only increase as they expand over time. The opposed risk is that of too many business units with differences of approach standing in the way of synergies and widening over time. The solution adopted by a number of businesses has been to set up profit centers at a fairly low level, while leaving control of resources higher up the organizational structure. This may involve, for

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example, the creation within a product division of several units responsible for sales and direct costs, but sharing resources with others making up the division as a whole.

Another increasingly common concern that has come with a shift in geographical balance is the need to preserve corporate culture, to find ways to adapt structure and attitudes to a situation where the majority of employees and even managers are, for example, from Asia rather than Europe. It can be a testing challenge to maintain a culture of innovation developed in one part of the

world with new management teams that have had nothing to do with its development. Many international groups are now aware of the need to adapt structure to local culture in areas such as the length of lines of command. But in general they have still to bring their underlying business project up to date.

### **Is the driving force alive?**

In a successful business, the entrepreneurship that provided the initial momentum is renewed over the years. After several decades in operation, this driving force lies in the capacity of key managers to take the initiative and move into new areas. But the organization chart reveals nothing of this. Does this driving force really live up to the ambitions of the business? Is it still intact after restructuring and changes in the scope of business? Are there structural obstacles standing in its way? Does it match that of competitors?

Obviously, the profile and motivation of management are part of the answer to these questions, but the issues are also structural.

The driving force within a business is often identified with its CEO, as illustrated by the success of Jack Welch, Carlos Ghosn and Lou Gerstner in leading their companies to the top of the international league. Yet in each case their achievements rewarded their ability to develop new dynamics within management teams and unleash the potential of the business.

It is always important to appraise the following areas, although some compromises will often be needed:

- the scale of management resources needed to fulfill the ambitions of the business;
- human resource policies ensuring the empowerment of managers;
- the impetus provided by management at the head of divisions and subsidiaries.

### **Top management – under one roof or several?**

The many strategic variables of an uncertain environment combined with demands for higher standards of corporate governance

have made the separation of board and management powers increasingly the rule in most countries, as it is in the US and the UK.

Without going into all the arguments for and against the type of organization that separates strategic and operational authorities, with the former supervising the latter, it would appear ill-suited to the needs of the many businesses for which the main strategic challenge is to keep up with constant and often abrupt changes on supplier and customer markets.

This would seem to argue in favor of an organization where the chairman remains in close touch with operational units. If a single chief executive heads all units and functions, the chairman's contact with business realities will tend to be almost exclusively through that chief executive.

Awareness of this situation has led a number of businesses to set up three, four or five central management units, some heading up operations and others responsible for key

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business functions such as human resources. However that may be, the fundamental issue is to determine the core group of managers able to:

- take a creative approach to the identification of key challenges for the business;
- define common positions on subjects concerning the business as a whole and intervene as necessary in day-to-day affairs;
- provide the impetus and direction to keep the business on course from week to week.

This core group, which is generally organized as an executive committee, will be made up of three or four senior executives working with the chairman. Regular involvement of the chairman is important to prevent the emergence of baronies in individual departments, carrying a risk of conflict and rivalry at the expense of efficiency.

### What about the “group effect”?

It is never easy to be sure how far the business as a whole is more effective than the simple sum of its divisions. But much can be learned from a tentative assessment. If the benefits of unity are substantial, underpinning synergies between different divisions or pooling resources for efficient central business functions, it warrants some added costs. But where they are flimsy, as may happen for example in a highly decentralized organization, headquarter costs must be kept on a tight rein and it may be worth considering whether decentralized units would be better left to themselves.

This question is rarely considered objectively, since it often appears rather theoretical. It is much easier to add up the measurable contributions of the existing group than it is to assess the qualitative benefits of the entrepreneurial spirit associated with an independent concern. But a business that has decided to leave its components a free hand should raise this question as it seeks

new answers, for example, concerning management compensation, that are attuned to its choice.

In very many cases, large businesses thus consider the “group effect” a basic feature of their operation. It is useful to take a look at what the benefits really come down to in practice – which means considering the strengths and shortcomings of synergies between divisions, the importance or not of the role played by central business functions, and the effectiveness of group-wide action plans relative to the efforts involved.

The existence of a “group effect” is always reflected in unified financial management, and often in R&D and human resources as well. Yet however indispensable such structures may seem, they may in fact not make a significant contribution to operating entities, either in the form of direct benefits or of cost reduction. But if the group

as a whole is able to capitalize on experience across the board and favor greater management efficiency for each of its components, this can yield substantial benefits at low cost in many areas from risk control and business alliances to industrial practice, expansion on new geographical

markets, the development of new purchasing methods, and innovation in all its forms.

Questioning the value creation resulting from the group as a whole and seeking ways to enhance it thus often proves a fruitful approach.

## Does the business structure fit the environment?

The degree to which business structure is attuned to the environment is reflected in relevance and rapidity of responses not only to developments in the field but also to the demands of continuing progress.

Adaptation of production capacity to demand, frequently considered a major priority, provides a useful example of what this can mean. The subject is complex, but in practice it is generally easy to see whether the company is moving ahead and has the problem under control or instead is getting bogged down in all sorts of difficulties or, worse, inexplicable inertia. Other projects such as rationalization of product ranges or improvements in products warranties can also provide telling signs of the organization's grasp of practical realities and its ability to deal with them as they arise – or instead its tendency to postpone action indefinitely. When a business sees that responses to operational challenges and opportunities are slow, haphazard or evasive, the first reaction is to redefine accountabilities. This may involve, for example, setting new sales targets for subsidiaries in new market segments or different channels of distribution. If sales remain disappointing, those in charge will be exhorted to step up their efforts and policies will be redefined after hearing their explanations. When that, too, fails, it is time to look for structural explanations.

Persistently inadequate responses are symptoms of structural shortcomings, frequently concerning both the scope of competencies

and the overall coherence of responsibilities. Remedies may be more or less fundamental, involving steps such as the creation of additional business units, changes in the scope of those that already exist, an overhaul of business logic, for example to structure organization around products rather than markets, or extended competence for support departments.

Diagnosis is not the difficult part. The quality and speed of responses can be fairly easily measured relative to a sample of opportunities, difficulties or pressures from outside the business or of in-house requirements in the form of business targets or action plans.

And, in fact, managers are often aware that problems exist. Yet they rarely attribute them to a lack of management responsiveness. Instead, they will point to conflicting priorities, unclear communications, tough business conditions or the sheer

volume of problems to be dealt with.

It is essential to see whether inertia reflects the excessive demands and pressures from the top or instead a more deeply rooted mismatch between the business structure and its environment.

*The issues we have been discussing concern management perceptions of the overall efficiency of the business. Responses have to be clearly expressed at the highest level and thus provide an undisputed basis for any necessary corrective action.*

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