Organisation and control in business

Collinson Grant Limited
Ryecroft
Aviary Road
Worsley
Manchester
M28 2WF
United Kingdom

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1 Structure and balance

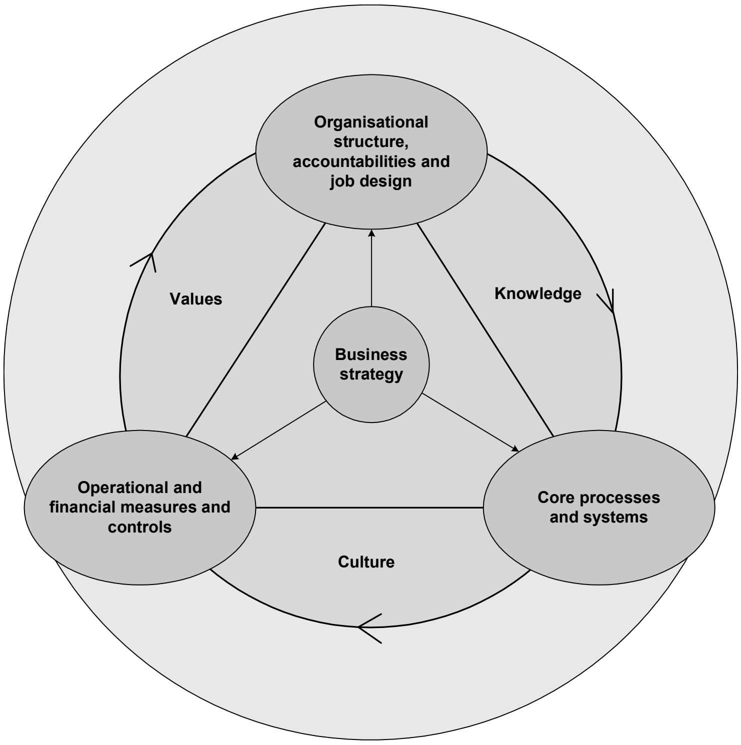
It is no surprise that the larger a company gets, the harder it is to decide what its optimal organisational form should be. For small businesses, there is little doubt what the priorities are:

- *What* are the things that we do that make us a profit?
- *How* can we sustain and improve sales?
- *Who* are the most important people in the business and how do we keep them performing well?

In a small organisation, it is relatively easy to answer these questions. In a larger one, it is much more difficult. Bigger companies have so many other conflicting strains and stresses that these fundamental principles become blurred and overshadowed by less critical factors. The result is often an organisational structure that patently does not work. Managers and employees are not really certain what they are supposed to be doing; processes act against the interest of customers rather than for them; there are inconsistent actions and responses to situations; and controls constrain entrepreneurial behaviour rather than encourage good decision-making.

Everyone who has worked in such a business recognises these characteristics. Unfortunately, so do many of their customers.

Understanding where and how profit is made, sustaining the sales effort and managing people effectively are not the only considerations in determining organisational structure, but they must remain at the forefront of managers' minds. The framework that offers a balanced *perspective* for all businesses is:



Each element is co-dependent on all of the others. Wherever you begin in the cycle, or make alterations to the status quo, it is always necessary to consider what consequential changes in structure, accountabilities, processes or controls are needed - and what the effect on the underlying business culture and values will be.

In a balanced organisation, equilibrium is only maintained when each component of the structure responds to the evolving strategy and to changes in the other elements. An overall structure is defined when managers' accountabilities and responsibilities have been determined; jobs have been fully specified; processes have been designed to meet customers' needs; and a powerful but simple suite of controls has been implemented to monitor performance and prompt the right managerial behaviour.

One of the important lessons of this analysis is that *re-engineering processes* is never enough to achieve sustainable improvements in profitable performance. It must be accompanied by a radical examination of managerial accountabilities and controls and, more often than not, by a reshaping of the overall organisational structure.

It is not too early to point out some other basic home truths on the design of business organisations:

- any business that does not constantly emphasise profit will ultimately make a loss
- poorly designed organisations waste good managers – they force round pegs into square holes
- structure can enhance or erode competitive advantage – a poorly designed structure is a millstone around the necks of managers who are striving to excel
- people tend to cluster on activities that have minimal impact on profitability
- the number of managers in a business, and the total cost of human resources, is a direct consequence of the organisational design
- the shape of a business should reflect the precise nature of its relationships with customers
- organisations, systems and people left undisturbed for more than two years become inefficient
- poor structure blurs managerial performance and accountability
- restructuring a business is an effective way of reducing costs.

1.1 People and performance

At its simplest, managers are entrusted with a set of assets and asked to achieve a certain return – better than competitors, better than the sector norm or better than some alternative form of investment. The way in which they set about this task determines how they will organise a business, create a structure, define jobs and measure results.

Senior executives have to decide:

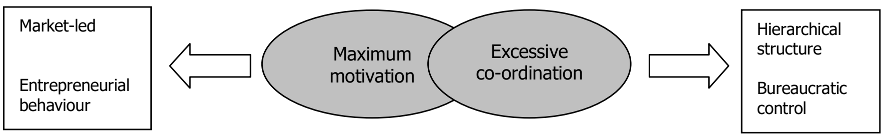
- where to deploy resources
- which markets to enter and which to withdraw from
- which technologies to develop and which to share with others
- which processes to excel in and which to outsource, and
- which skills they need in-house and which they can buy in from elsewhere.

For the largest companies, these strategic choices can profoundly affect the way that they do business and, in effect, change the fundamental nature of the organisation.

Motivation and co-ordination

An organisational model defines how a business assembles and co-ordinates resources in order to make a profit in its trading relationships with customers.

In essence, the 'organisation' exists to *motivate* its people and *co-ordinate* their activities. Every structure involves some form of trade-off between the inherent 'command and control' necessary to keep the business on the straight and narrow, and the ability to foster and reward entrepreneurial behaviour (at the right time and in the right place), which will allow opportunities to be seized and fully exploited. In the extreme, these drivers point in opposite directions.



A company's specific, measurable objectives will be concerned with customers, markets, sales and margins, but it achieves these by getting the best out of people, encouraging excellent performance, and exploiting and sharing knowledge efficiently. These factors are underpinned by the complementary aim of facilitating *good* decision-making and bringing it closer to customers and markets. And the overriding consideration is to achieve all of this at the lowest cost.

Since economic performance should be measured over the longer term, an organisational structure should also have the ability to sustain the business – to keep it going and make it stronger.

Most companies seek a middle way that achieves the best balance between *motivation* and *co-ordination*, within the context of the markets in which they are operating and their own underlying culture and history. The attitudes of managers to acceptable commercial risks are also influential. Strategic decisions are taken on which parts of the production or service chain to operate in, based on where competitive advantage is strongest, where most profit can be made, and where it can be sustained for the longest period. Analysing 'profit pools' is a useful illustration of this approach.

Profit pools

The concept of 'profit pools' is one way of testing which activities have the potential to generate most profit. It is a way of analysing the total sales in each of the different main activities in a sector in order to find out where most absolute profit is generated. This approach offers managers real choices on how to position their businesses and move along the value chain to more profitable domains.

The automotive industry offers a helpful illustration. Its activities range from making vehicles, distributing, financing, leasing, servicing, and insuring them, to selling spare parts and fuel. But those elements that generate the largest revenues are not necessarily the most profitable. The biggest manufacturers recognised this a long time ago. Car leasing is by far the most profitable activity and other financial products, such as insurance and loans, also earn above-average returns. Consequently, all major car makers in the United States and many in Europe have moved aggressively into financial services. Ford in particular has earned a substantial proportion of its profits from this source.

This form of analysis can be useful in many industries. It offers powerful guidance on opportunities to exploit new 'profit pools' and indicates the future structure and tactics that businesses should consider adopting.

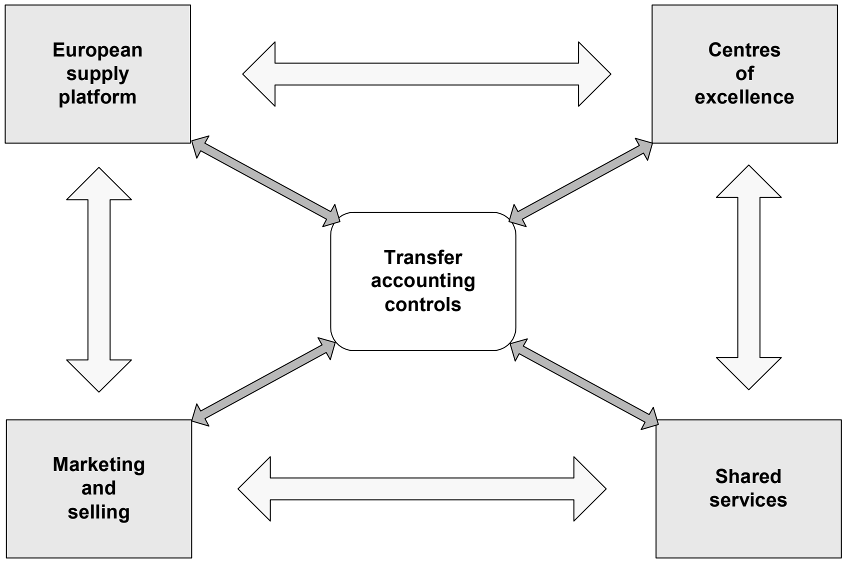
1.2 Pan-European and global businesses

In organisational design as well as customer service, 'one size does not fit all'. Businesses are clearly shaped to fit the characteristics of the markets and customers they serve. In turn, these affect the specification of products and services and the processes used to manufacture and deliver them too. These criteria may change significantly when companies start to operate in larger regional or global markets. Often the difficulty is that these businesses have been assembled from a series of smaller, national building blocks.

Our particular experience has been in helping companies to exploit European 'single markets'. The business model for a pan-European company is market- and cost-driven. It needs to have country-by-country spans of control and should:

- consolidate resources
- be structured as a single entity
- use transfer accounting as a control framework.

The key tasks are to determine where responsibility for profit resides, define managerial accountabilities, clarify the structure of costs and implement effective reporting mechanisms. The principal building blocks are shown overleaf:



This simple model has applications in many different types of business. It can operate as a fully integrated whole - a single profit centre - or as a series of autonomous units under the guiding control of a strategic centre.

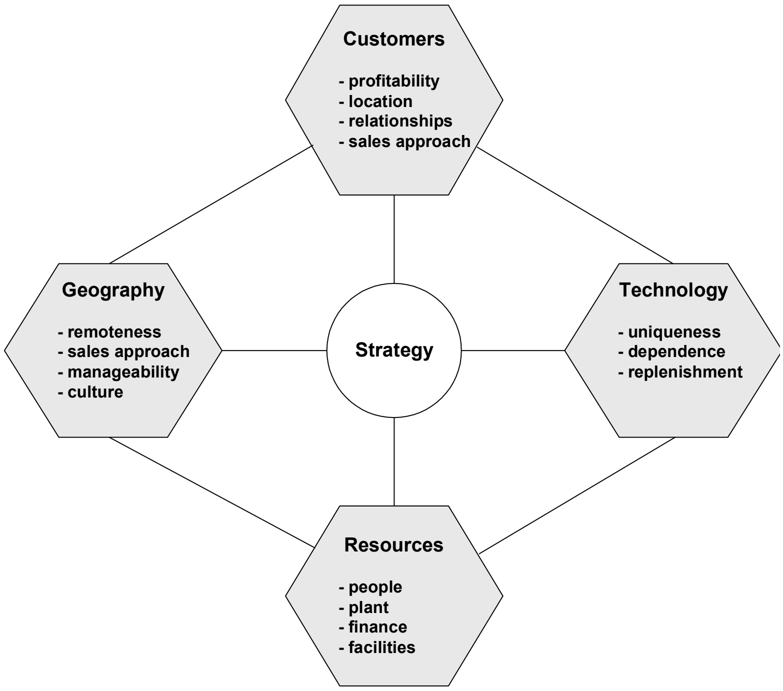
Pushing out the boundaries

The quest for ever-cheaper sources of labour is extending the boundaries of businesses throughout the world. Low cost is not always low skilled. India has been at the forefront in selling its relatively well educated and English-speaking workforce to western companies. Its rapidly growing economy supports activities in computer and telephonic services as well as more traditional manufacturing industries. The organisational options range from completely outsourced functions to autonomous divisions or wholly- or partially-owned investments in different countries. But even this may be a temporary phenomenon. Rapid wage inflation is likely to erode current cost advantages more quickly than at first thought.

2 Organising for profit - the fundamentals

Clarity

Above-average businesses get above-average performances from their managers and other employees. What underpins this should be an unambiguous understanding of what the business is trying to do and how this is translated into managerial accountabilities. For senior managers, this means being entirely aligned with the company's strategy and values, and having absolute clarity on whether they are managing costs or margins. A number of interrelated factors have to be assessed before how, or whether, a business should be divided along these fundamental criteria is determined:



The discussion that follows highlights how these factors are taken into consideration to inform the fundamental decisions about organisational structure - on profit centres, commercial and supply operations, the degree of centralisation, and managerial and financial controls.

2.1 Profit centres

If the purpose of a business is to make a profit, then how and where that profit is to be managed and measured is a fundamental factor in organisational design. This principle leads to the underlying concept of the *profit centre* – a self-contained, relatively autonomous unit whose leader (chief executive, managing director, unit manager or even depot manager) is responsible for achieving a budgeted net profit.

Profit centres can be large – effectively encompassing all of a business's operations – or small, where a company is subdivided into a number of separate units. It is crucial to determine their precise structure. Profit centres are the fundamental organisational building blocks. They determine where profit is measured, who manages it, and who manages cost. Disparate business activities are often best organised into separate, independent profit centres. The managing director of each trading entity will have accountability for setting prices and for marketing and selling, as well as for delivering the products and services. This approach has simplicity and encourages entrepreneurial behaviour. It allows maximum responsiveness to local markets, gets decision-makers closer to the customer and creates the facility to link managerial incentives directly to profit.

However, it can degenerate into a patchwork of fiercely independent territories that, in the extreme, start to compete with each other, particularly if high profitability actually reflects the generous margins available in soft markets rather than operational efficiency. And there can be other significant downsides:

- ineffective application of the company's total resources
- minimal exploitation of economies of scale
- poor, and sometimes misguided, strategic direction
- minimal sharing of ideas and experience.

The example below shows how two, radically different, approaches to allocating responsibility for profit can be successful in the same market at the same time.

Profit centres in practice

One of our longstanding clients has adopted the approach of independent, local profit centres for many years. It has been successful in a UK-wide distribution and wholesaling market, where its chief competitor has a more highly centralised business model.

The managers of each branch - called 'Profit Centre Managers' - each year negotiate a target for net profit with the company's UK-based senior managers and its overseas owners. Only minimal support services are provided from the centre. The company has a national brand but also local variants (based on customers' traditional loyalties).

There are a small number of sacrosanct financial and trading controls, but Profit Centre Managers are allowed wide-ranging discretion in purchasing, product range, pricing and local expenses. A fixed proportion of the branch profit is available for bonus payments - again allocated with considerable discretion by the Profit Centre Manager, who can earn substantial rewards for superior performance. The results at each site are published regularly, so that employees see the fruits of their labour. The approach suits the market well. Managers get to know their customers, competitors and markets intimately - they have the authority to take critical decisions quickly and fully understand their likely impact on profit.

On the other hand, the main competitor - with a significantly different business model - has thrived in the same market at the same time. Its managers are constrained within more rigid working practices, and are less profit-oriented. However, it also has some particular competitive advantages - it is better placed to secure contracts with customers who wish to negotiate nationally rather than locally and is more easily able to exploit technology, for instance in creating a strong, internet-based sales channel.

2.2 Separating commercial from operational activities

The most recognizable alternative to highly independent profit centres is the division of a business into separate customer-facing and supporting functions. A series of 'commercial' units, which generate margin, are separated from 'operational' units providing products and services. These may be organized into divisions or a matrix, and are fundamentally different from profit centres in the managerial approach, style and values they require.

Monitoring performance in this case requires some form of transfer pricing between the internal 'supplier' and 'seller'. In more complex businesses, there will be a chain of internal suppliers. These arrangements can become a major source of conflict, prompting disruptive behaviour that jeopardizes the profitability of the overall business. A functional mindset can override commercial priorities. When effectively implemented, separate commercial and operational units offer powerful incentives for managers.

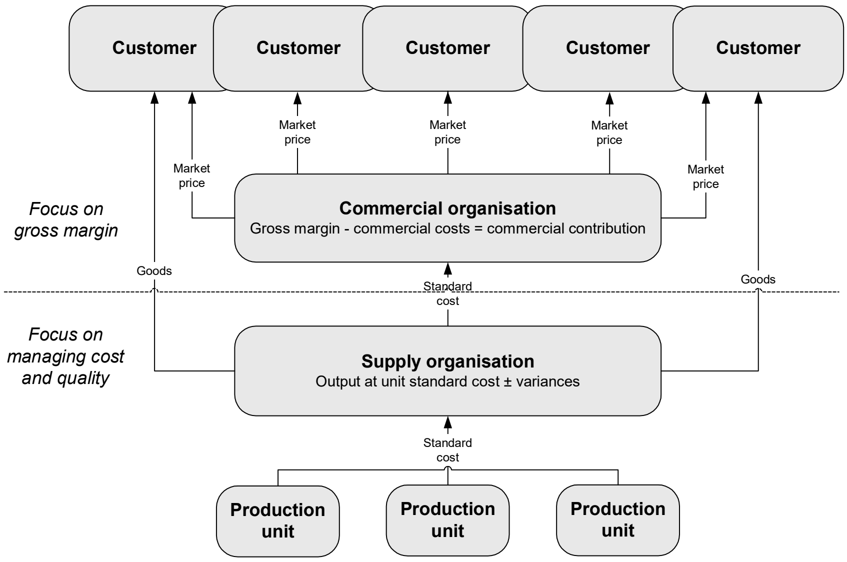
Commercial → Increasing gross profit margin through improved pricing, a better mix of products and reduced costs for serving customers

Operations → Driving down the unit costs of designing, producing, delivering and supporting products and services, while optimising service to customers

The separation of operations and commercial activities can also help:

- to clarify managers' accountabilities by providing clear measures of performance
- to simplify accounting and the measurement of margin and profit
- to strengthen relationships with customers, through more highly focused commercial activities.

Clearly separated production and supply activities



Applying transfer pricing

Transfer pricing reinforces the organisational strategy, sets out the managerial disciplines and underpins the underlying culture of the business. It requires firm rule-setting from the centre and can help in applying a strong downward ratchet on costs. There is benefit in using transfer prices set at actual or targeted unit costs that incorporate fully-absorbed overheads. Margin is best not 'shared' or 'allocated' between commercial and operational units, as this obscures accountability. However, this apparently simple principle is fraught with practical difficulty for implementation. Such problems include:

- deciding who should be accountable for each part of the value chain
- determining the basis for creating unit costs - and sticking to the rules
- establishing how transfer 'prices' should be maintained
- calculating how margins should be calculated and monitored
- investigating the impact of changes in product and mix on the underlying cost base.

Transfer pricing as a control system

Large, decentralised businesses can be controlled by a small central team, when transfer pricing:

- emphasises accountability and managerial focus
- squeezes cost out of the system
- challenges Sales to manage margins: and Production to manage costs
- allows margin to be measured without being clouded by issues of cost
- achieves tighter control of unit costs, regardless of buoyant sales
- prevents accountability for costs from seeping from Operations into Sales and Marketing
- maintains a rational system for measuring the internal transfer of value
- ensures that periodic costs are managed flexibly
- provides an effective basis for managerial incentives.

2.3 Centralisation or decentralisation?

Any business above a certain size has to make decisions about the degree of centralisation that is desirable, regardless of what other form of structure it is considering. Defining decentralisation is difficult. Decentralising along divisional lines has a different impact from running a number of profit centres. Selling may be decentralised, while marketing is not. Full decentralisation is rare. A company fully decentralised in personnel matters might be highly centralised in management accounting. There are legitimate arguments about the boundaries of 'a business' and its 'centre'. Does the centre see itself as an investor or a manager? And what is its stance on information and related flows?

Decentralisation is based on the proposition that the primary responsibility for results rests with the general managers of individual profit centres or businesses, rather than with central and senior managers (directors). Operating decisions should rely on knowledge of specific products and markets. 'Ownership' of tactics at the business unit is enhanced, while managers at head office deliver promises and formulate financial strategies and direction. This may be generally desirable, but decentralisation depends on two key conditions:

1 There must be a definition of success and clear criteria for intervention. Otherwise decentralisation becomes abdication of responsibility.

2 Unit managers must know how 'good performance' is measured. Unless there are firm targets, decentralisation cannot be effective. Interventions from the centre will be seen as arbitrary because expectations are vague.

What managers do must be consistent with the results they want. Doing what they have always done will only produce more of the same.

2.4 Recognising core business processes

There is a natural tendency to organise businesses around common skills and types of work - sales, production, purchasing, finance et cetera. This makes departments easier to control because managers are supervising employees with experiences and competences with which they are familiar. This arrangement is also a sensible approach to the co-location of similar assets and facilities.

However, the core business processes that determine the competitive performance of a business usually span more than one department. So there is a strong counter-influence to structure the business around the few, but important, processes that ensure that customers' needs are met. This minimises the loss of momentum, quality and managerial accountability that can occur at the artificial interfaces between departments.

This approach also prompts a systematic analysis that:

- identifies each main task and its supporting activities
- establishes the costs of aggregated tasks and the main elements of each process
- allows a cost model to be developed, indicating the sensitivity to fluctuating volumes
- suggests where and how managerial controls should be deployed.

Understanding the full extent of a core process and designing the organisational structure around it can help managers to control costs better and deploy resources efficiently. It also helps them to appoint members of staff who should have a better idea of how their jobs contribute to the company's aims and objectives. And successful initiatives to improve performance are often centred on rethinking core processes and reviewing all their inputs and outputs.

In large, non-devolved businesses and in non-commercial organisations there is often a compromise between the 'vertical and functional' and the 'horizontal and process' strands. Some managers will have dual responsibilities, but their critical managerial accountabilities (and key performance indicators) should be closely linked to the efficiency, effectiveness and outputs of customer-driven processes.

2.5 Keeping things under control

Whatever the 'shape' of a business, the underlying managerial and operational controls will determine whether or not it achieves its aims. Too many corporate disasters have illustrated how a lack of effective control in any business courts financial ruin. Directors have become over-reliant on external financial auditors to validate the controls in their companies.

Some managers know little about what is actually going on in the operations for which they are accountable. There is nothing better than 'seeing and touching' day-to-day activities: walking through an office, service centre or manufacturing shop-floor reveals a lot. But even when this is possible, it is nowhere near enough. Tracking trends in a few vital indices paints a much fuller picture. It provides valuable early warning of potential trouble and creates the opportunity to intervene before it is too late.

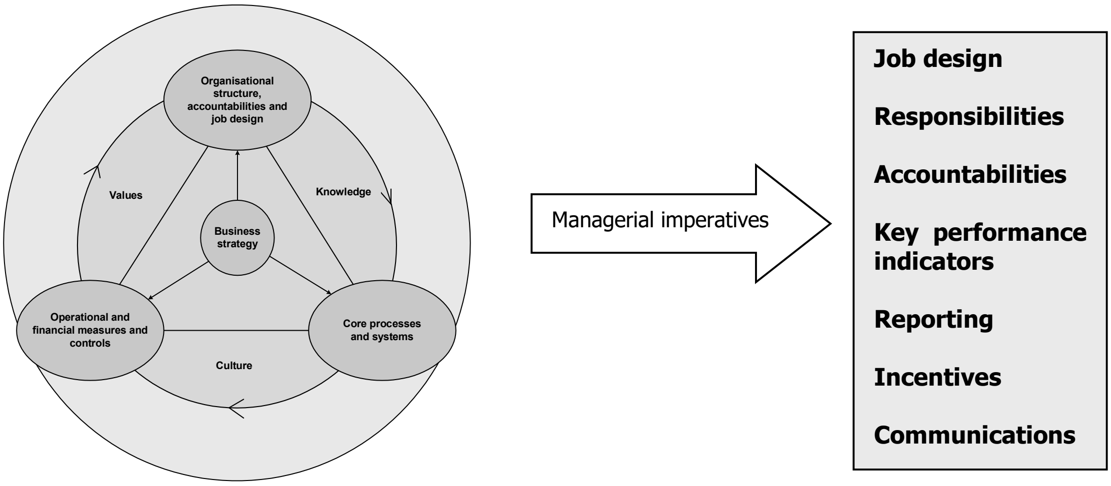
Measures of performance should be like beacons. They are the most visible signs of what managers believe is important. When they are also linked to financial incentives, the light shines so much more brightly and can become, mistakenly, the sole focus of attention. And if measures have been inappropriately defined or are administered poorly, they become a total distraction.

Accountability and control

Structure should determine the relationship between the scope of each managerial job and its associated accountabilities. Organisational charts frequently do not reflect the way in which a business actually operates. The formal channels are complemented by an extensive, informal network of communications, influences and alliances. Nevertheless, the prescribed structure is a major influence on managerial behaviour and sets the framework for costs and accountabilities. It can provide the differentiating factor for competitive advantage, if designed with sufficient understanding of the market and of the strengths and weaknesses of the organisation.

The structure also takes account of the core business processes and systems, and illustrates to all those in the company how profit is measured, gross margins are generated and costs are controlled. Managerial controls need to integrate power and authority with responsibility. They can provide powerful levers for encouraging managers to perform better and for rewarding excellent performance.

An organisational structure in balance again illustrates the interdependencies:

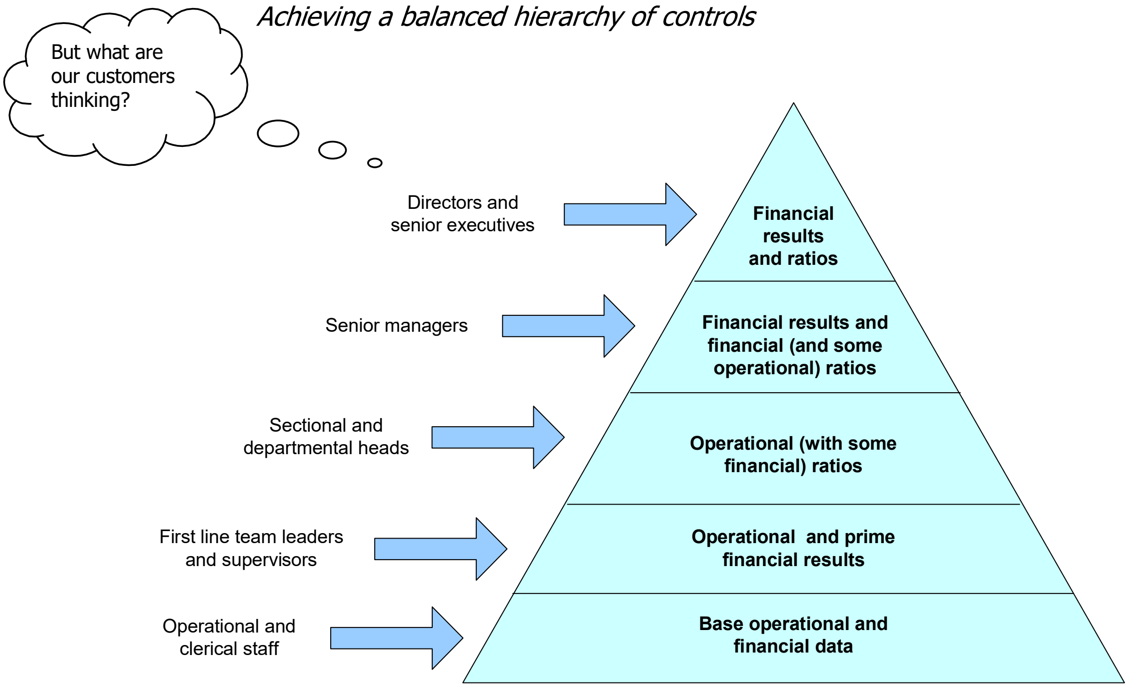


In a balanced organisation:

- the line structure is designed so that it is capable of properly managing the organisation's processes and functions
- there are relevant and meaningful measures for each job in the structure for which the jobholder can be held accountable
- the effective measures for managing processes and functions are the same ones for which managers are held accountable.

Measures should form an integrated hierarchy that reflects the structure of the organisation. At the highest level, measures are primarily financial: at the lowest they are operational. Integrating them properly makes it possible to drill down to gain greater understanding of variances and the action that should be taken. This is most easily illustrated in a simple triangular diagram:

Achieving a balanced hierarchy of controls



Designing and implementing managerial controls

Within a business context:

> **Measures** are ways of evaluating performance, often in the form of ratios and indices that relate two or more variables, with an accepted scale or unit of measure
>
> **Controls** are the reports, and other means, that are used to communicate performance to managers in a way that allows them to initiate action.

Measures, controls and the related action must fit together and be directed at delivering the business's goals. We frequently find that this is not the case.

Managerial controls report the performance measures that have been chosen for managing the business. The risks inherent in selecting the correct measures are often misunderstood. Many businesses measure and control performance frequently but poorly. There is no shortage of weekly and monthly reports, but they may be:

- expensive to produce
- difficult to understand
- too long and complicated
- incomplete
- misleading
- not directed at the required behaviours
- emotive but not motivational.

Managers will only change their behaviour if they understand their objectives fully and are committed to achieving them. To do this, they need the appropriate authority, adequate resources and the correct measures, backed up by effective financial incentives.

Measures should be an integral part of a rigorous cycle of control that allows performance to be judged against the criteria that will deliver the goals of the business. It is common to find that, instead, measures of performance encourage inappropriate behaviour or do not stimulate action at all.

Key performance indicators

Key performance indicators (KPIs) have become something of a holy grail. Many businesses are overburdened with tens, sometimes even hundreds, of KPIs that are guaranteed to confuse managers and dissipate energy as people seek to balance the results to fulfil the expectations of their bosses. Recent events in the United Kingdom's National Health Service have highlighted the difficulty of pursuing too many 'key' targets at the same time.

A KPI should reflect the factors that determine success and be a measure that relates some form of vital output to the critical input that generates it.

'Key' should mean critical, essential, important, selected and vital. Too often KPIs are little more than the paired permutations of readily available - not necessarily significant - statistics.

There are many other forms of control. Some are appropriate to the business as a whole: developing standard costs and equivalent units; improving performance from fixed reference points; and closely linking managerial incentives to exceptional results. Others focus on particular processes - for example the use of Moving Annual Trends and measures of operational effectiveness and efficiency. Benchmarking and the application of a 'balanced scorecard' are other popular approaches, although a surfeit of data may sometimes distract rather than inform.

Accountability and culture

The design of an organisation and its impact on managerial behaviour are seldom well understood. During periods of restructuring, this becomes critical and can turn out to be one of the principal determinants of the future success of an enterprise. But accountability as a managerial concept has different interpretations. In some countries – including several in mainland Europe – responsibility can be shared by a large and ill-defined group rather than assigned to a particular jobholder on the Anglo/American model. Both emphases have advantages. Having to obtain consensus can legitimize decisions for which personal authority alone might not command assent.

2.6 Culture, values and knowledge

Organisational culture and values are a product of the structural design of a company rather than the other way round. They should be considered as an output instead of an input. Well crafted jobs, accountabilities and controls will define how managers should behave and set out the ground rules for organisational standards and norms. The ability to link compensation closely to performance is another powerful lever. For businesses designed in this way, the 'culture and values' emanating from the organisational customs become a reliable thread to guide managers and others when they are exploring uncharted territory or testing out new ideas.

Clearly, the organisational structures and related processes and controls of some businesses do reflect the environments within which they are operating. Some nationalities prefer formal, written instructions: others expect no more than an oral briefing. Managers in publicly-owned institutions can feel restrained by excessive bureaucracy and control. But there are many examples of how ingrained 'company culture' has been turned round by the wholesale review of structure, controls and processes, and by a strong commitment to challenge the status quo.

'Knowledge' is the transformation of data, first into coherent information and then into something that can be used to take the business forward. Most organisations have difficulty in storing, sharing and exploiting business knowledge. Advances in technology, of which there are many, have not always helped. Again, a well-designed structure should clarify what knowledge is valuable and how it should be used and managed within the business. Considering knowledge as an asset is useful - but only if it is guarded and controlled in the same way as any other.

Knowledge is all

The term 'knowledge worker' has been around for 40 years. However, the knowledge society *is being* created in the 21st century.

- It will be borderless, because knowledge travels more effortlessly than money.
- The means of production will be knowledge. Knowledge workers will provide 'capital' in the same way as investors. The two will become dependent on each other.
- Organisations will form alliances and make different arrangements with employees and specialised contractors, many involving part-time employees. Command and control contracts will not be appropriate. Managing to maximise productivity will be a critical issue.
- Information technology will reduce the cost of transactions, eliminating the need for maximum integration. The need for shared services will be questioned.
- Power is shifting quickly to customers. This means that suppliers will cease to be sellers and will instead become buyers for the customer.

Attracting and holding employees will be difficult. Pay and incentives will not be enough. Lifestyle issues will be important. Employers will have to develop a different approach. Workers will be interested in understanding 'where the company is going and what it is trying to achieve'. They will also be interested in personal achievement and responsibility and will demand continuous learning and training. They will also want respect and to participate in decisions. The distinct roles of 'bosses' and 'subordinates' will blur.

3 Organisational options

Organisational design has been influenced frequently by managerial theorists and others without significant experience in the front line. Other fads and fashions owe more to temporary changes in markets than to long-term transformations in the ways that business is conducted or people behave. But many companies need to consider and/or incorporate elements of these, not exclusive, organisational options.

3.1 Managing in a matrix

Partly because of the imperative to manage and share knowledge efficiently (and possibly because there is a human tendency to complicate rather than to simplify), the last thirty years have seen the evolution of more complex organisational models. In a matrix, there are two, or more, organisational strands. One may be focused on products or technology, whilst the other is designed to exploit particular market segments. The potential weakness of such a structure is the conflict that can arise when one person reports to two bosses.

It is a sound principle that everybody in a business should have only one manager. There is sense in the Roman proverb: 'A slave with three masters is a free man'.

However, the looser structural form of a matrix helps to deal with complexity and has particular advantages. It fosters creativity, provides the right conditions for teams to thrive, and helps them and individual employees to act maturely and take decisions effectively. The matrix structure can be more adaptable when markets are likely to change quickly, and more effective in handling complex tasks, performed by numerous specialists. But matrices can also blur objectivity and hinder effective decision-making.

There is no perfect form for a matrix structure, or for any other organisational model, but there are some pointers to success.

- Responsiveness, speed and clarity should be the primary advantages of new, matrix-based, organisational structures.
- There should be clear - concise but not bureaucratic - ground rules about what each axis of the structure can and cannot do.
- People working in matrices must accept that they will have to cope with uncertainty and shifting relationships, because the markets that matrices serve are usually less stable.
- Matrices work best when the market is most demanding. When there is less turbulence, employees working in complicated structures can become diverted and start to play political games – resources get allocated according to interpersonal strengths rather then merit.
- Some cultures – where there is a legacy of feudal control – will not readily accept more ambiguous forms of organisation. Other approaches should be adopted, at least initially.

A matrix structure must be able to achieve what any other form of organisational design can. It must have a focus on managing and measuring profit and it must promote desirable managerial behaviour - whether that is entrepreneurial or not. It should have simple and effective ways of determining margin and productivity across the grid and depend on reliable mechanisms for reinforcing common interests and linking them to incentives.

In entrepreneurial and strategic/tactical models, jobs are evolving all the time. The information technology revolution - still fast moving - feeds this adaptive process, whilst the proliferation of outsourcing and the displacement of other resources from within businesses call for different types of managerial skill. In this world of complex inter-relationships, authority does not reside in hierarchical status: it has to be earned by a contribution valued by peers. So tact, diplomacy and charm are needed to complement technical competence and/or business sense.

Career development needs to focus on the acquisition of multi-disciplined skills and capabilities and the experience of leading teams. Ideas for remuneration and incentives have to be redefined. For example, it may be necessary to reward staff for what they are capable of doing rather than for performance in the current job!

3.2 Outsourcing

Outsourcing is giving responsibility to an external organisation for the execution of a particular function or service for the company. Managing functions under a contract with an external provider should offer clear advantages in creating a disciplined and rigorous approach to monitoring and controlling costs. 'Increased flexibility' is frequently flaunted as another benefit. But there are other considerations. The scarcity of experienced professionals, particularly with skills in the newer technologies, has undoubtedly accelerated the rate of outsourcing. There is a notion that 'bought in' expertise will be easier to find and control. This can be an expensive misunderstanding. Services, however delivered, need adequate managerial disciplines and stringent measures of performance.

Outsourcing can have other serious drawbacks. It should be a given that decisions on organisational structure facilitate the ability to respond quickly to changes in economic circumstances. But is a contract negotiated annually with a third party as flexible as taking responsibility for managing 100 employees, each on one month's notice?

A decision to outsource whole functions is the next logical step in organisational design. Before proceeding, it is vital to create a single entity within the business where processes, outputs and costs can be properly measured. This allows a much better business case to be developed to support or reject the argument for outsourcing. Rigour is required in deciding whether or not to move complete processes or other internal services outside the 'formal' boundaries of the business. It starts with:

- **Formal review** - of those processes that are considered central to a business and those that are essentially secondary (or supporting) in nature
- **Analysis** - of the opportunities for reducing costs and achieving operational benefits
- **Recognition** - that some services could be delivered better and at lower cost by third parties.

What to outsource

Some activities have always been favourites for outsourcing: management of property and related services; catering; payroll; public relations; and legal services. These are tasks that are necessary for the business to keep going, but neither critical to its overall performance nor (usually) characterised as customer-facing. As the popularity of outsourcing has extended, more 'important' functions have come under the spotlight. The most common of these are IT services, distribution and transport. As sales channels change, every business has become more dependent on the reliability of its IT systems and the ability to get products to customers on time. Decisions to take these processes out of the direct, day-to-day control of your own managers must be weighed carefully. There should be high confidence that performance can, as a minimum, be maintained and preferably improved, while costs are ratcheted downwards.

Many organisations start by outsourcing one particular function, because it offers the most realistic chance of significant savings or perhaps has always been seen as a 'problem child'. But a decision to outsource just one major process can open up a whole debate about the nature of the business and its precise structure. Clearly, it is possible to get carried away in such exercises: before long, managers could convince themselves that it would be better to get somebody else to do everything, and the business would then become merely an investor in other companies. A more thorough approach is warranted.

Maintaining control

Some form of contract and/or service level agreement generally governs the outputs from outsourced functions. The arrangements need care in their preparation and implementation if the exercise is not to descend into a form of bureaucracy. The duration of the contract is an important factor - not too short and not too long. The development of the right kind of relationship with the external supplier, based on frequent and open communication, is the key to a mutually satisfactory outcome.

Uncoordinated outsourcing - a cautionary tale

Because outsourcing became such a managerial fad, some large companies got carried away with it. Managers were asked to identify, cordon off and jettison whole chunks of the company that were no longer considered part of the critical mass that defines every business. But things can get out of hand if these well-intentioned activities are poorly coordinated and undertaken without proper reference to any form of strategic plan.

In our work for a multinational corporation, we found that decisions on outsourcing were being taken too far down the organisational structure by managers who had insufficient perspective of the business as a whole. Different divisions were taking inconsistent approaches without considering some of the benefits of combining resources and getting better value for money. Our review found that the company could save several million pounds by combining contracts for outsourced services and, in some cases, bringing processes back into the internal structure of the business.

It is a reminder that, if something was once important enough for the company to allocate substantial resources to it, then it should not be delegated to a third party without a compelling reason.

3.3 Shared services

Shared services were introduced rapidly in many large organisations in the mid 1990s. They offered the prospect of significant savings in costs and more consistent and reliable internal services - promises that have not always been honoured.

This ultimate approach to 'centralisation' can generate real savings by reducing labour costs, implementing agreed standards and focusing on key, value-adding activities. A major benefit is to clarify the accountabilities of managers at the 'core' of the organisation after all other peripheral activities have been stripped out.

Shared services exploit economies of scale and provide the critical mass necessary for the cost-effective implementation of improved systems. But they are usually remote from their own internal customers and not exposed to day-to-day problems in the field. Every new structure within a business creates its own raison d'être and rigidities - and attracts its own particular costs. There can be other pitfalls:

- consolidating resources in one place tends to diminish rather than improve the flexibility to reduce costs quickly in difficult times
- a 'centrist' approach can discourage innovation and stifle the essential initiative to respond promptly to change
- service level agreements are not infallible; performance has to be measured and managed robustly
- costs can escalate rapidly when new tasks are taken on board without a thorough review of how else they could be delivered.

Savings in the region of 20% can be achieved from implementing shared services for transactional financial services and internal customer services such as payroll, purchasing and human resources. For other functions - training, legal services and property, for example - the benefit will show in improved service. Initial cost savings can be quickly eroded without rigorous control and clarity in accountability. To maximise effectiveness, managers should:

- install measures and related rewards
- analyse carefully the organisation's current costs and levels of service
- define the core processes with adequate flowcharts and supporting narrative description
- compare the cost and performance of existing practices internally and with external companies
- ensure that metrics are simple, tangible and acceptable to everyone
- focus on 'leading indicators' to forecast results
- establish processes for continuous review and improvement

and

- assess carefully the impact of proposed changes on the relationships with customers and agreed levels of service.

3.4 Lean and mean

Fewer managerial layers make for flatter and more cost-effective structures that facilitate better communication from top to bottom and from bottom up. In flatter structures, accountability is more sharply focused because it is delegated less. When there are more layers, it becomes much more difficult to justify the increasing sub-division of responsibility for measurable outputs.

The debate on the optimum number of layers within an organisation and how many people should report to each manager (the 'span') depends on a consistent notion of what managers are and what they should do. In many countries in mainland Europe, managers and what they can and cannot do are legally defined and circumscribed. No such framework is available in the UK, where there is less respect for formal titles in business. Managers should be responsible for the work of others. If they perform the same tasks as those they manage, they are more likely to be 'team leaders'. If their work is specialist or they are classed as 'expert' and manage or supervise nobody or only one or two others, then they should not be called managers but placed elsewhere in the structure.

The number of people who report to a manager depends on the complexity and diversity of their jobs. A manager can handle a considerable number of subordinates who are performing identical tasks within a consistent process. But the amount of time available for developing more junior staff should not be jeopardised - the structure must be able to reproduce itself continually.

Lean operations

Lean Manufacturing was developed in large-scale production environments, but is now applicable in many other sectors. It is a collection of simple, but effective, operating principles, which, when applied, reduce waste and improve:

- the unit costs of manufactured products
- the productivity of labour
- quality
- the accuracy and reliability of delivery
- employees' intellectual contribution to the business, by eliciting their ideas for improving performance and reducing costs.

Although this approach has its origins in the factory, it is increasingly being applied in other organisations with less tangible products. To the fore is the financial services sector, where large processing centres can handle tens of thousands of transactions in ways that resemble an automated production line.

The implementation of lean principles removes, in a controlled manner, the buffers of work-in-progress and stocks of finished goods that allow businesses to operate while tolerating routine inefficiency. It effectively makes each step in a process into a 'bottleneck' and drives the business to improve its reliability. It also places operations at the heart of the business, ensuring that it receives an acceptable service from the rest of the organisation.

The five principles that Lean Manufacturing is based upon:

- just-in-time
- flexible manpower processes
- autonomation
- Kaizen, and
- levelled production

although centred on ‘processes’, nevertheless have a critical effect on organisational structure and managerial culture. Other initiatives to improve quality and performance - six sigma, total quality management, European Foundation for Quality Management, et cetera - should also influence decisions on the overall shape of a business, if applied properly.

3.5 Project-focused businesses

There is an increasing trend for businesses to be project-based. Rather than market a number of different products or services, they focus on the delivery of a small number of projects (and in extreme cases, only one). Each one is likely to represent a large proportion of overall turnover and hence margin, and its successful execution is critical to the survival of the company. The attributes of such businesses include:

- close contact with customers, often involving working in partnership with them on joint initiatives. A higher proportion of staff, including technical specialists, must have the skills to cope
- strong reporting disciplines that give early warning when agreed schedules are under threat
- a high ‘risk factor’ - poor performance is not reflected in one rejected widget, but in the possibility of the whole project failing
- flexible resources - skilled and experienced personnel who can be moved quickly from project to project to deal with unexpected contingencies
- opportunities to earn higher margins when projects are completed satisfactorily and ahead of schedule.

Project-focused businesses are often organised around a sub-set of multidisciplinary or cross-functional teams assembled to meet the demands of a particular project and customer. Many members of these teams may simultaneously belong to other teams working on separate initiatives. Supporting functions must be closely integrated with the front line, so that they can also respond quickly to changing circumstances.

Some of these arrangements are not new. Much of the construction and civil engineering sector has been working in this way for many years. But there are new manifestations of this approach, particularly apparent following the privatisation of whole elements of the public services throughout the western economies. One of the characteristics of such organisations is that they can grow rapidly. One new contract can double the size of the company overnight, bringing many problems with it. Unless these new forms of business quickly learn to cope with this scenario, they will die as quickly as they were born.

Managers, controls and behaviour

The organisational framework and underlying values of successful businesses reinforce entrepreneurial behaviour. In today's highly competitive marketplace, competent, ambitious and experienced managers are at a premium. They can choose whom to work for. They are distinguished by knowing that an effective framework of measures and controls offers an important mechanism for making their achievements visible.

Selecting, designing and implementing the right mix of controls promotes superior performances and offers opportunities to establish powerful incentives that drive the business forward. But it can be difficult to manage multiple goals and maintain a lookout on the wider horizon. Excessive, and often conflicting, measures can result if the strategy, tactics and targets are ambiguous and misunderstood.

4 Implementing organisational change

4.1 Why and when?

Some would say that there is no good time to change an organisational structure, but there are a number of events that frequently prompt action:

- the acquisition of, or merger with, another business
- the arrival of a new chief executive
- pressure from investors to improve results
- significant changes in markets, customers, competitors or economic conditions
- the development of radically new business processes
- the introduction of new technologies that alter previous ways of working.

In publicly-quoted companies, the pressure to improve performance is often overwhelming when brokers and other commentators make unfavourable comparisons with competitors and market trends. Managers can quickly form the view that measures to reduce costs have gone as far as they can - even though this should be a continuous process - and conclude that organisational change is the best option for achieving better results.

Organisational structures do evolve dynamically with shifting circumstances, but there is a danger that such changes may be unplanned and hence poorly co-ordinated. This can nullify the benefits aspired to, dissipate effort and frustrate managers. Whatever the circumstances that prompt change, managers need to take control of the exercise and confirm that it will yield tangible benefits within a reasonable timescale.

Legal pitfalls

Major reorganisations, prompted by acquisitions or mergers, often need some form of regulatory approval, but this is not the only potential legal pitfall. In most countries, workers are protected if part of the business is transferred to new owners who might want to change their terms and conditions of employment. In the UK this circumstance is covered by the Transfer of Undertakings (Protection of Employment) Regulations (TUPE), which are complicated and subject to frequent change in their interpretation. TUPE is always likely to be an issue when parts of a business are hived off, particularly when employees are moving from one company to another. Making a mistake can be costly - so careful preparation will always be rewarded.

4.2 Understanding risk

The risks of organisational change are so great that it should not even be contemplated unless a clear plan exists that describes fully how to get from A to B and what the benefits will be when you arrive. Changes to business structures can be made incrementally, but more often should be undertaken in a carefully planned way that takes into account the needs of the whole business and its customers and suppliers. The dangers of not adopting a cautious approach are legion:

Disruption of core activities that affect service to customers	**Lost sales**
Interference with the critical managerial and financial controls	**Lost margin**
Disturbed employee relations, leading to dissatisfaction and higher attrition	**Lost key employees**
Senior managers distracted from what is happening in the market	**Lost focus**
Unexpected problems that affect performance and heighten uncertainty	**Lost productivity**
Poor internal communications that raise concerns and lower morale	**Lost momentum**
Ineffective external communications, resulting in bad publicity if targets are not attained	**Lost reputation**

Any one or more of these circumstances can severely curtail any increases in performance that the reorganisation is expected to yield. It is not uncommon for businesses to suffer a sustained dip in results - from which some do not bounce back.

Commercial risks

The commercial risks of implementing significant organisational change can have the most important impact in the short and medium term. The relationships that keep the business going - with customers, distributors, wholesalers and suppliers - are the ones that must be preserved and enhanced at all costs. In order to ensure that sufficient time is given to planning the new sales and marketing structure, it is sensible to concentrate the initial efforts on non customer-facing parts of the business. Here there is more time to correct the inevitable problems that occur in making changes before they can have any detrimental effect on customers. When operational changes are bedded down and working well, there is a good platform to tackle more customer-sensitive functions.

People risks

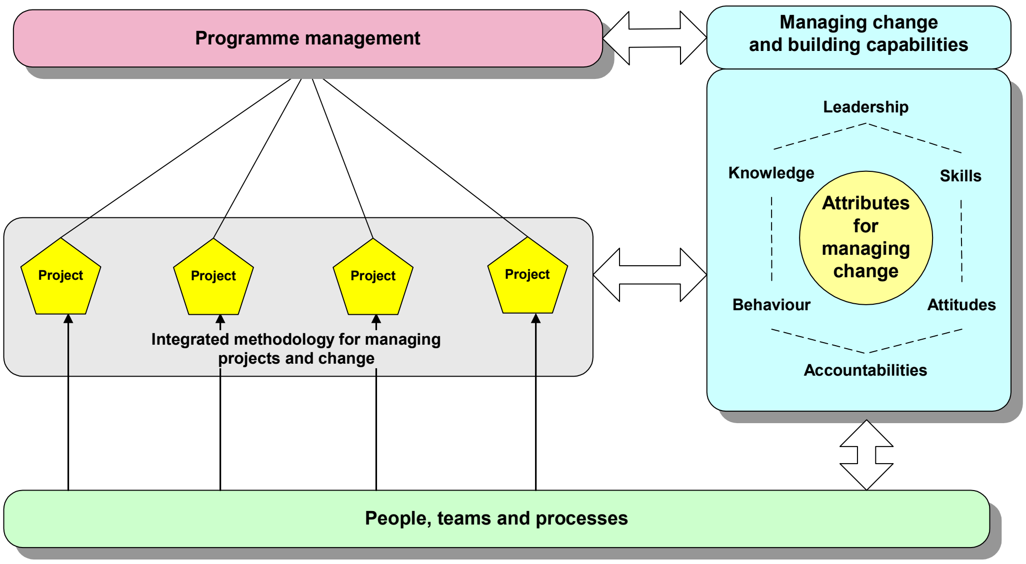
Because it is mainly about changing the way that people work, reorganisation is always fraught. There are winners and losers, people who think they have been overlooked, people who think that their new job is too big, people who are given jobs that they cannot cope with. In the early days, it is essential that all managers in a new structure should be supported properly, in an environment where making mistakes is not seen as failure.

The risk of key people leaving the business is obvious - senior and middle managers, technical specialists, and people who have strong relationships with customers. Each vulnerability must be evaluated carefully and short-term and permanent measures devised to tie people into the business, without adding excessive longer-term costs.

4.3 Managing organisational change

Organisational change demands leadership of the highest quality - clear goals, explicit instructions, properly delegated authority, and excellent and sustained communications.

Attention to detail should be paramount. The management of change is a critical competitive differentiator for any business. The company that can manage change quickly, flexibly and cost-effectively is more likely to be a winner and long-time survivor in today's highly competitive markets. Success depends on harnessing three core competences: the ability to manage specific projects; the capacity to develop and improve appropriate skills in managing change; and the ability to lead, co-ordinate and manage an overall programme. This is summarised in the model below:



Success is largely dependent on the motivation and performance of people. Having a team that can be trusted is vital for achieving results. It is essential to have confidence in the managers who will have to implement innovation and take unpopular decisions. Managers operating new processes need precise and tightly-monitored targets for performance, together with the autonomy to achieve them.

Despite the best planning, the latest technology and fully committed directors, success comes down largely to the energy, enthusiasm and skills of middle managers - 'the marzipan layer'. They must be given room to operate – to act, innovate and test – but they should also be disciplined enough to work within a formal control and reporting system. A framework of *loose-tight* controls helps to motivate action, stimulate ambition and reward endeavour while at the same time retaining essential command and control.

Reorganisation is also often associated with people leaving the business. Managing redundancies well benefits everybody. It fulfils commitments to employees who may have been loyal for many years. It helps protect a reputation as a caring employer. And, perhaps most importantly, it sends a signal to the remaining employees - on whom the business relies heavily - that everything is being done to help redundant employees through a difficult time.

Studies have shown that this has an important positive effect on employees who have seen their former colleagues lose their jobs.

5 Successful organisational design

Successful businesses are characterized by employees who know what they are doing, and by customers (and shareholders) who know what to expect.

If managers are achieving this degree of consistency in running a business, they risk changing its structure at their peril.

Attempts to explain the principles behind organisational design and how they are applied in successful businesses often cloud rather than illuminate some of the important issues. There are examples of many different approaches, some of them quite contradictory in their purpose and execution - yet all with ardent supporters who can demonstrate quite clearly their utility.

What such an exercise does bring out is that organisational design is never static. It changes as markets and customers change, it sometimes adapts to the whims and prejudices of senior executives, it evolves as new business processes are developed and improved, and it declines in effectiveness if not given sufficient, regular maintenance.

But, whatever approach is decided upon, it **must**:

- bring out the best in people throughout the organisation, so that they are inclined to, and achieve, the best possible performance
- allocate accountability explicitly, so that managers know what is expected of them

- not allow the acquired knowledge and experience of the business to be dissipated by ineffective communication and labyrinthine structures
- build for the future, by ensuring that its assets (chiefly people) are nurtured and protected, and
- cultivate a climate of responsiveness, so that the important decisions are taken by people who understand what customers need now and in the future.

Collinson Grant

For over thirty years Collinson Grant has been helping businesses to compete in international markets. Our objectives are simple: to retain a single-minded commitment to results and to achieve the highest standards of consultancy in our work.

We work throughout Europe and the United States. Most of our clients are national and multinational businesses, often amongst the best known publicly quoted companies in the United Kingdom. Some of the relationships we have built and sustained with their principals go back more than twenty years. We also have substantial experience in improving the performance of non-commercial organisations.

Collinson Grant supports clients in managing organisations, costs and people. Much of our work arises from initiatives to build pan-European businesses or to integrate acquisitions. We support senior managers on both sides of the Atlantic in implementing radical changes in approach and performance, helping them:

- to design and implement new organisational structures
- to reduce costs and increase profits
- to strengthen their competitive positions, and
- to deliver better results from investments.

Our principal disciplines are in designing and installing improved business processes, restructuring, implementing new managerial and financial controls, getting better performance from overheads, creating efficient supply chains, and managing human resources. A lot of our work is concerned with identifying, analysing and eliminating costs. We do not shrink from giving bad news or from championing ideas that are not universally welcome.

Collinson Grant's consultants are chosen from managers who have held senior jobs in manufacturing and service sectors - many with a background in managing international businesses. They are not career consultants. We have assembled a strong team - with sound knowledge, fresh perspectives on traditional business problems and the personal skills to help clients implement difficult decisions. We have a number of American, French, German and Italian consultants.

Collinson Grant Limited
Ryecroft
Aviary Road
Worsley
Manchester
M28 2WF
United Kingdom

Telephone : +44 (0) 161 703 5600
Web : www.collinsongrant.com
E-mail : postmaster@collinsongrant.com