

When Everyone Agrees, But Nothing Changes

Aligning People, Incentives, and Knowledge to Overcome Organizational Inertia

Senior executives continually lament the amount of time they spend wrestling with organizational problems rather than building their business. From the CEO on down, business leaders routinely express variations on the same fundamental themes — “We have the right strategy and a clear action plan, but we can’t seem to execute,” “Our industry is undergoing tremendous upheaval, but our people either don’t recognize it or won’t do anything about it,” “The merger is supposed to be behind us, yet even Wall Street recognizes that we’re still acting like separate organizations” — in essence, “Why is it that everyone agrees, but nothing changes?” Addressing these concerns — or rather the critical organizational constraints that underlie them — is often the key to unlocking superior financial performance.

Of course, this is easier said than done. To resolve persistent organizational problems, executives must first understand where critical breakdowns are occurring and why. They must then determine what changes to the existing operating model are necessary to create the conditions for optimal performance. In designing these changes, they must be mindful of the ripple effects that can cascade across an organization once one element of its architecture is altered. In sum, executives need to determine how to effect deliberate and major change ... and how to drive and support that change across the enterprise.

Universal Problems

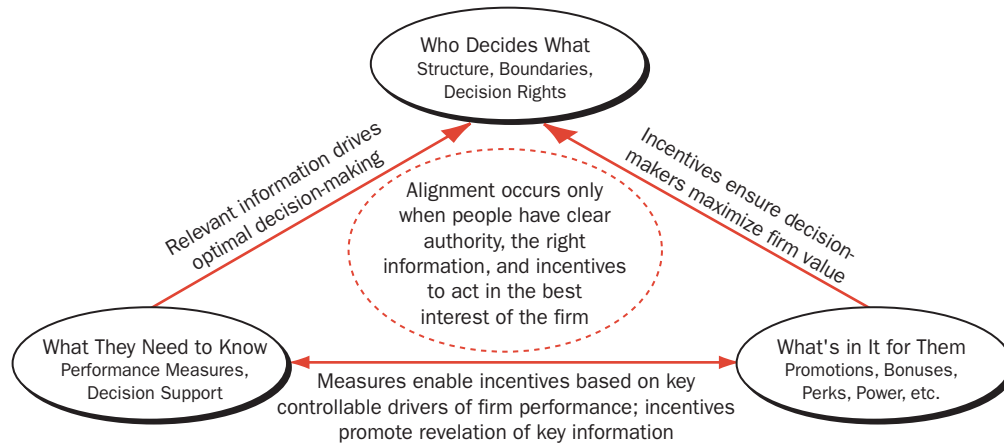
Anyone who has worked in an organization, whether in the public or private sector, has seen firsthand the counterproductive behaviors that impede

performance. We have all sat in meetings where someone advances his or her own agenda over that of the firm. We’ve collectively suffered when decision-makers — overburdened or lacking access to the right information — inject delay or inefficiency into programs and processes. Everyone has experienced the struggle to get different organizational units or functions to work together toward a maddeningly elusive common goal. Individually, these behaviors are irksome; collectively, they can spell the difference between spectacular success and abject failure. Yet few organizations have discovered the right formula to fix these common problems. Most of us, sadly, are still living inside a Dilbert cartoon.

Despite the wealth of material touting teams and teamwork, our experience, as well as modern economic principles of agency and information asymmetry, suggests that most organizations are collections of individuals who act in their own self-interest. These individuals each make decisions that are limited by their ability to process the information available to them, and they rely on others to act on their behalf or in coordination with their efforts. The challenge in motivating superior organizational performance, then, is to align individual actions with the actions of others and the interests of the firm as a whole. This challenge increases as companies grow, partially offsetting advantages such as economies of scale and knowledge specialization. Growth, while a laudable goal, increases complexity, making coordination and alignment of interests more difficult and giving rise to many of the problems firms experience today.

Custom Solutions

Our experience with clients around the world confirms that organizations win when the right people — armed

Exhibit 1**Organizational Dimensions Must Be in Alignment**

Note: Adapted from Brickley et al., "Managerial Economics and Organizational Architecture," McGraw-Hill/Irwin, 1997

with the right information and motivated by the right incentives — possess clear authority to make critical decisions. This view — captured in Exhibit 1 — suggests that organizations need to align themselves around three critical dimensions: People, Knowledge, and Incentives.

How organizations go about achieving this alignment will vary from company to company. There is no right answer or universal prescription. The same company could design any number of successful operating models and achieve similar results *as long as these three dimensions — People, Knowledge, and Incentives — are in alignment.*

If any of the three dimensions falls out of kilter, however, a company will not achieve its full potential. Moreover, it is the interaction among these dimensions that defines the trade-offs among different organizational models.

Dimension 1: People: Who Decides What

"We have to assemble ten executives in a room to make routine business decisions."

As noted, organizations are essentially Hobbesian cultures: communities of individuals and groups that act, more or less, in their own self-interest. Therefore, if you want to change the operating model, you must first understand how authority is distributed among organizational units and roles. This investigation takes you quickly past the lines and boxes of the organization chart into the underlying mechanics of how and where decisions are truly made (see Exhibit 2).

As organizations strive to clarify and refine the assignment of authority and roles, they must actively

consider and address potential trade-offs. For example, the complexity of the information processing required in a single position may dictate decentralizing authority in that arena. Organizational units may have to be combined in order to reduce interdivisional transaction and coordination costs. Myriad such issues attend the assignment of not only decision-making authority in an organization, but also the distribution of relevant information.

Dimension 2: Knowledge: What They Need to Know

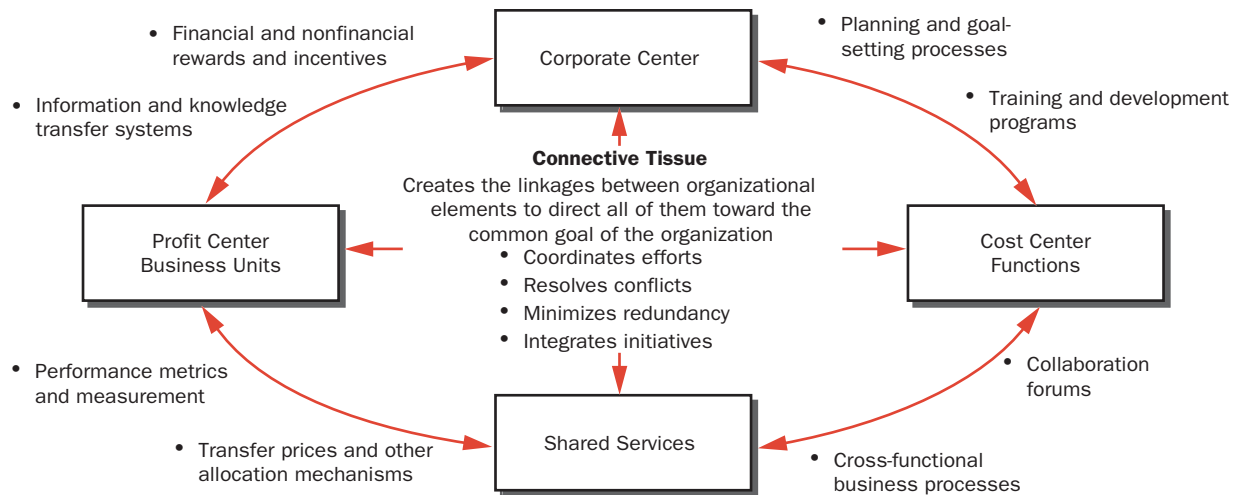
"We never have the data we need to make key corporate decisions."

Information is the lifeblood of the large modern corporation. Almost every manager has been in a situation where, despite having the best intentions and explicit incentives, she simply did not have the right information to make an effective decision. The key to success is to identify the critical information required to make the correct decisions and to ensure that this information is in the decision-maker's hands if and when she needs it.

Dimension 3: Incentives: What's in It for Them

"We changed strategy, but no one seems to behave any differently."

A successful operating model must ensure that reward and incentive systems provide decision-makers with clear direction and compelling reasons to act in the firm's best interest. An organization's seniormost executives must assess not only how to allocate decision authority but also how to motivate the right decisions. These incentives should be defined broadly, to include both financial compensation and nonfinancial rewards, such as promotions, recognition, perks, etc.

Exhibit 2**The New Operating Model: More than Lines and Boxes**

Source: Booz Allen Hamilton

Moreover, incentives should be carefully crafted at all levels in the organization. At the line employee level, where decision authority is limited to (a) how hard to work and (b) how to manage the trade-off between quality and quantity of output, an optimal incentive program might be a variable pay structure based on quantity of output and number of defects. A division manager with much broader decision authority, on the other hand, might require a broader array of incentives, reflecting both divisional and firm performance: stock options, fast-track promotions, enhanced CEO exposure, etc.

Success Stories

We have helped many global clients align their organizations more effectively around these three critical dimensions. Recent examples include:

Case Study 1: U.S. Agribusiness Company

Using these organization principles, a U.S. agribusiness firm developed a new operating model to respond to pricing pressures from low-cost overseas producers. The key transformation in this company's operating model was to convert individual farms from cost centers into profit centers and redefine how corporate headquarters would support them.

All three dimensions of the alignment framework came into play. In an effort to co-locate knowledge and decision-making authority, the firm decided to delegate to the farm profit centers "local" decisions regarding planting and irrigation. Authority over harvesting schedules remained centralized, however, to promote more efficient utilization of harvesting equipment, mills, and grain elevators. A new bonus system motivated

farm managers to optimize production across a range of price levels. New decision-support systems provided farm managers the information they needed to make the best use of their authority. Shareholder value climbed 48 percent once this new operating model was introduced.

Case Study 2: Global Consumer Products Company

The dominant player in multiple mature product markets, an international consumer products company was looking for next-generation profit improvement opportunities. Working with Booz Allen, it developed a new operating model that not only significantly reduced overhead but also positioned its businesses to outperform the competition well into the future. This model pushed decision-making power outward and utilized detailed coordination mechanisms and common metrics to improve the cooperation and alignment among functional business leaders. It also redirected the agenda of top management, emphasizing vision-setting and leadership over detailed micromanagement.

Our Approach

Booz Allen has developed a two-stage approach to developing new operating models that can achieve significant and sustainable performance improvement.

Stage 1: Conduct Organization Diagnostic

We begin with a four- to six-week assessment of the current organization. Three steps are typically involved:

Understand Strategy

Developing a solid understanding of short- and long-term strategy ensures that the new operating model will be consistent with the current and future aspirations

of the company. Many performance problems stem from fundamental disconnects between strategy and organization model.

Identify Problems in Current Organization

The heart of the organization diagnostic effort is the application of proven diagnostic tools to identify problems and opportunities in the organization. This analysis addresses all three dimensions of organizational alignment.

Assess Degree of Change Required

Based on the diagnostic, senior management determines how much change is required. Sometimes only minor tweaks are needed, such as clarifying roles or implementing basic cross-functional coordination

mechanisms. Other times, the entire organizational model needs to be overhauled.

Stage 2: Develop New Operating Model

The scope of Stage 2 depends primarily on the magnitude of change required and specific change initiatives involved. The new operating model must address much more than just organization structure (see Exhibit 2, page 3).

While relatively minor changes usually can be designed and implemented over a several-week period, more significant changes generally require a major transformation with sustained support over a longer term.

What Booz Allen Brings

Booz Allen Hamilton helps clients across industries implement new operating models designed to improve their organization performance.

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for more than 80 years. Booz Allen combines strategy with technology and insight with action, working with clients to deliver results today

that endure tomorrow. With 11,000 employees on six continents, the firm generates annual sales of \$2 billion.

To learn more about the firm, visit the Booz Allen Web site at www.boozallen.com. To learn more about the best ideas in business, visit www.strategy-business.com, the Web site for strategy+business, a quarterly journal sponsored by Booz Allen.

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