The Organization vs. The Strategy: Solving the Alignment Paradox

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Photograph by Francesco Bittichesu

It's not vision that makes a company successful. What sets the top performers apart is the organizational models they develop to realize their aspirations.

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"There are few original strategies in banking," Sir John Bond, the chairman of HSBC Holdings PLC, said earlier this year. "There's only execution."

Although he was more direct than most corporate leaders, Sir John was articulating a feeling that is not uncommon among them. Senior executives at many — perhaps most — large companies routinely affirm, generally privately, that it is not the lack of a strategy that causes them to lose sleep, but rather their organization's inability to execute against a strategy, often long after they think they have expressed that strategy with near-perfect clarity.

Their nervousness is understandable. *Fortune* magazine estimated recently that about 70 percent of CEO failures are caused primarily not by flawed strategic thinking, but by failure to execute.

Consider the number of chief executives who are dismissed because of disappointing results unrelated to any major strategic move. Then consider how small the number is of CEOs who have succeeded because of a strategic insight that allowed a company to break out of the pack. There are a few, but such breakouts are rare, occurring at most once per decade per industry.

For companies in mature industries in particular, there almost certainly is no silver bullet. As Sir John recognized, in many industries the strategic challenge is relatively clear and well understood by all players. Nevertheless, these strategies by themselves often fail to markedly improve market and financial performance. In many cases, they actually hinder performance.

Yet in the field of management, strategy is exalted. Consultants in particular fall prey to the deification of strategy. Rarely if ever do we ask ourselves the fundamental questions that should begin each engagement — and, perhaps, take it to another level:

Why has a large organization composed of presumably smart individuals, who are much closer to the relevant products and customers than either senior management or the organization's consultants, not been able to implement the prior strategy successfully? And why do we believe the new strategy will be implemented more successfully?

When you ask these questions, it sends the search for improvement in an entirely different direction. (It also requires humility, which some might argue is in short supply among both senior executives and consultants.) Contrary to the central premise of many strategy studies, it is usually not the vision or aspirations of a successful company that allow it to stand out; these goals — more market share, more innovative new products, lower costs, etc. — are typically pretty similar for most firms in an industry. What sets the top performers apart is the "how" — the way they organize and operate to realize their aspirations.

Thus the answer to "Why haven't we been able to do better?" usually lies in the organization itself — or, more precisely, in the organizational model, our term for all the internal structures, frameworks, and operating practices that determine how work actually gets done in a company. (See Exhibit 1.)

Many of the issues that large firms face are in fact symptoms of dynamic and complex problems embedded in the company's organizational model. Such problems are inherently difficult to resolve, because they are rooted in the economics of organizing, the complexity of which

Exhibit 1: **The Organizational Model**
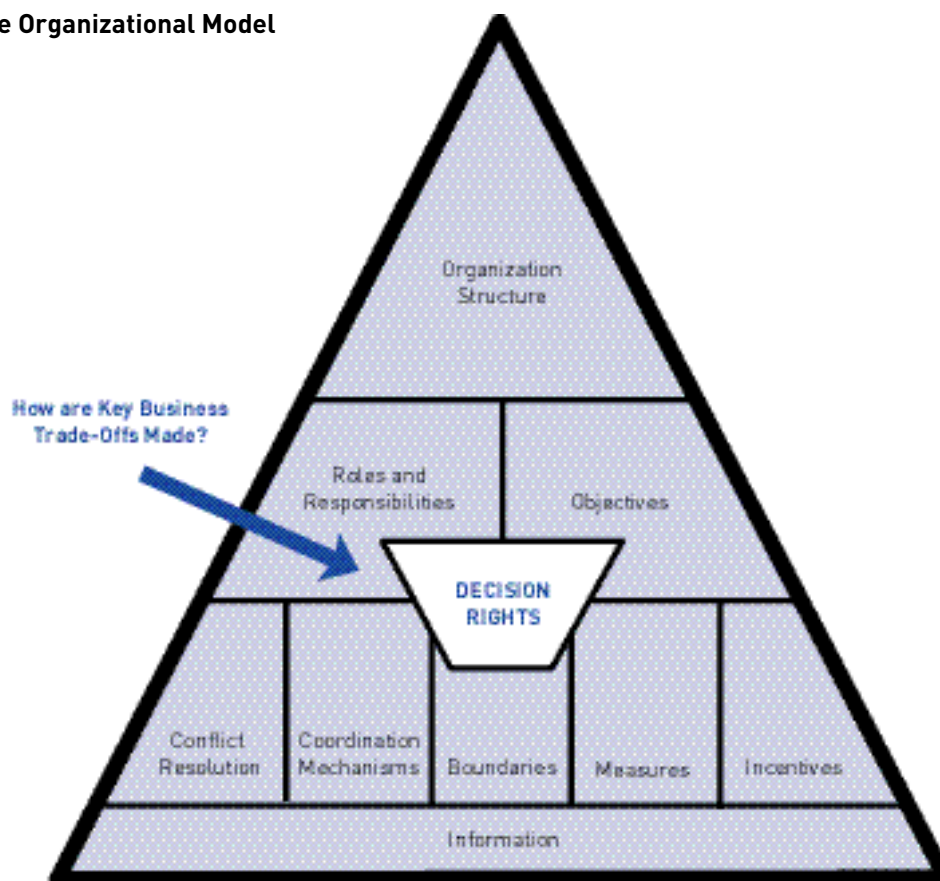
hinders effective decision-making.

By subordinating, at least temporarily, the quest for a strategic fix, and repairing these deeper problems instead of addressing the symptoms, a few innovative companies have been able to create and capture enormous value for their shareholders.

These firms share a few characteristics. First, they deeply understand the nature of the challenges confronting them. Second, they frame and understand these challenges as organizational in nature. Third, they address these challenges through customized designs that push the frontier of the underlying trade-offs and allow their companies to operate on a "better curve." This type of approach to improving performance, with its initial focus on the organizational constraints, is the key to overcoming the shortcomings of traditional strategy approaches.

Understanding Decision Rights

Organizational performance is the result of all the effort and activity that goes on inside a firm. These actions constitute thousands of decisions and trade-offs, made every day at an individual level, which interact with each other (and the outside world) to determine how well the company performs. Yet each action takes place in an idiosyn-

cratic environment; each individual has access to different information, has different objectives, and may face different consequences from his or her actions.

When strategies are not implemented effectively, corporate leaders, in an unarticulated way, may tend to consider these people irrational. However, you should assume these individuals — your workers and managers — are rational actors. Their choices reflect sensible decisions in the context of what each knows, sees, and understands. While their actions in any given situation may seem wrongheaded or random to an outside observer who is able to see the big picture, as a rule they make sense to the individual decision-maker. Consequently, the key to improving performance is not restating aspirations or exhorting the organization to do better. Rather, the solution lies in changing the organizational environment to encourage decision-making that is aligned with the overall objectives of the company.

Central to this alignment challenge is the concept of decision rights: Who gets to make what decisions; and what information, constraints, tools, and incentives affect the way they evaluate those decisions? Understanding why and where the current set of decision rights (usually informal, not consciously designed) leads to suboptimal

The key to improved performance is not a restatement of aspirations. It is changing the organizational environment to encourage the right decisions.

decisions is, then, the core insight required to redesign the organizational model.

Applying this perspective requires an approach that must differ in several ways from traditional strategy efforts. It does not start with reexamining aspirations, for these are rarely the cause of performance shortfalls. In addition, the initial data-gathering effort should be internal, not external, because the key problems with the organizational model usually can be found in current operating practices, not in some heretofore hidden piece of market intelligence. Last, it is not a search for a single "solution," as this can lead to an oversimplified view of the real issues, and cause serious, unintended consequences when implemented.

Developing the right organizational model instead requires defining the activities essential to achieving the strategy, and then defining the organizational attributes that must be present to encourage those behaviors. Giving that model the required level of detail mandates moving beyond platitudes like "culture," "mind-set," and "weak bench," and restructuring the motivations of individuals in multiple roles within the organization.

Finding the proper organizational model for a given firm is inherently difficult, but not impossible. If aligning the organization with the strategy is necessary for success, then finding out how the organization is impeding the strategy can lead to important insights about what has to change. Most organizations were not built by master designers; they have evolved over time in response to forces they see in the market. Thus, investigating how the organization really operates and understanding why can lead to important insights into what must be changed to unleash the firm's potential.

The result will be a much more "market-like" organ-ization that allocates resources effectively and is naturally self-correcting. Not only is the strategy more likely to be realized, but it will develop over time as the organization adjusts to feedback from the outside world.

A Case Study in Realignment

Most traditional approaches to strategy assume a company's performance will improve once the right strategy can be found and described in sufficient detail. In essence, business strategists are banking on finding the big idea no one has thought of before. They fail to address why the organization has been unable to realize its current aspirations.

To understand this lapse and why it happens, let's look at a typical strategy development approach — with or without the assistance of consultants. The following sequence is an amalgam of strategic planning techniques and is not meant to mirror the methodology of any one firm, but it should sound familiar:

- First, conduct several brainstorming sessions to talk about the aspirations of the company; maybe write (or rewrite) a mission statement.
- Next, collect lots of data. Get information on the market, competitors, customers, suppliers, substitutes, benchmarks, etc.
- Synthesize a few findings from the data, usually identifying issues that are, at some level, already known (e.g., your top six customers represent 80 percent of your sales, or your customers are unhappy with your delivery policies).
- Formulate a few hypotheses or alternatives in response to the identified issues.
- Select a "solution" from among the alternatives, often with an implicit preference for something that sounds

like a "big idea."

- Detail the selected solution, frequently using the process-based consulting approach that is a vestige of the reengineering boom of the late 1980s.

Undoubtedly, this approach and its variations can achieve positive results. Very often, it identifies improvement opportunities in specific functions or discovers pockets of value. However, as often as not, it fails to get the organization moving in a new direction. It also may generate improvement in some area but unwittingly sacrifice effectiveness in other areas.

Consider the case of a media distributor. The company had just been through a major restructuring designed to focus on its most profitable business — managing the music category for major mass merchant retailers. However, even after the decision to focus was made, the company had to face the challenge of creating value beyond physical delivery if it hoped to preserve a viable position between increasingly concentrated music companies and mass merchant retailers. Its reason to exist was now premised on managing the complex and dynamic music category in more than 5,000 individual mass merchant and discount stores, each with a unique set of consumer preferences. As a rack jobber, this distributor had a great deal of latitude in selecting from nearly 300,000 compact disc and cassette titles to merchandise and manage about 3,000 items in a typical store.

To do this effectively, the company had to balance the interests of three key constituencies: music vendors, chain retail customers, and individual store customers. While the three constituencies' interests are aligned in the long run, they can conflict significantly in the short run — with major financial consequences for all the players.

n light of its potentially precarious position, coupled with recent concerns about financial performance, the distributor brought in a major consulting firm for help. The consulting firm documented how retail consolidation had made the company dependent on an ever-smaller number of mass merchant customers. What's more, the consultants found, through interviews with these customers, mixed levels of satisfaction with the company's performance. The interviews highlighted particular concerns about the distributor's ability to keep the right products in stock, as well as concern over relatively high product-return rates. These interviews also underscored the threat that the retailers might decide to eliminate the role of the distributor entirely.

To address these issues, the consulting firm recommended the creation of powerful customer teams charged with satisfying the mass merchant customers. New team processes were designed, and the teams were staffed and launched with the objective of becoming valued category managers for these key retail accounts.

The strategy seemed airtight — as both management and consultants said in response to internal objections. Who could argue with being more responsive to your most important customers?

But although the objectives were right, it soon became clear there was a problem. The customer teams now coexisted with a strong purchasing department, which still largely controlled which titles were bought and in what quantities. Given its established relationships with the music companies, purchasing would maintain its ability to "force out" product in response to "breaking" hits. The field personnel, who visited individual outlets, were left to serve these two masters and were reduced to an execution arm of two centralized, competing decision-makers.

Faced with making so many individual decisions for such a large number of stores, the new customer teams had to rely primarily on national average data. Consequently, their decisions were, at best, right on average — but could be significantly off-target at some individual stores. Opportunities to stock titles or launch promotions that might be effective in some subset of stores were often overlooked. At the same time, other stores consistently received too much product in specific music genres because their local tastes were not understood by the central decision-makers.

Worse yet, the centralized decisions were not always coordinated. Because of a new overlap in responsibilities,

the purchasing department and the customer teams could respond to the same stimuli and unwittingly place duplicate orders. Heading into the busy holiday season, many stores were visibly overstocked. Field representatives could see the problems in stores; they bore the brunt of store complaints, but there was little they could do. They completed their assigned routes and performed the mandated tasks, but as the problems persisted, they did so with less enthusiasm.

At about this time, our firm began to look into these performance issues. Our conclusion was that the core problems were primarily organizational, not strategic. The previous consultant's "solution" ignored the information being processed every day by the field reps who actually visited the individual stores. Since most of this information is tacit and idiosyncratic, the answer to the distributor's dilemma was not to build a gigantic database for use by some central decision-maker. Rather, the field

needed to be empowered to act on this information, within clearly defined boundaries, and develop customized responses for individual situations.

Together, we and the company used this insight to develop and implement a new organizational model. (See Exhibit 2.) The new organization features empowered district managers, each of whom runs, in effect, a 60-store music chain. They have input into nearly all decisions that affect product flow into their stores, and are encouraged to develop new and innovative ideas, such as niche product merchandising and custom promotions.

The other key innovation was the creation of a core merchandise planning function. Its sole purpose is to coordinate transactional decisions between purchasing, the customer teams, and the field. Merchandise planning both responds to field-generated requests and decides when to order merchandise for a specific store, based on information that may not be available to the individual
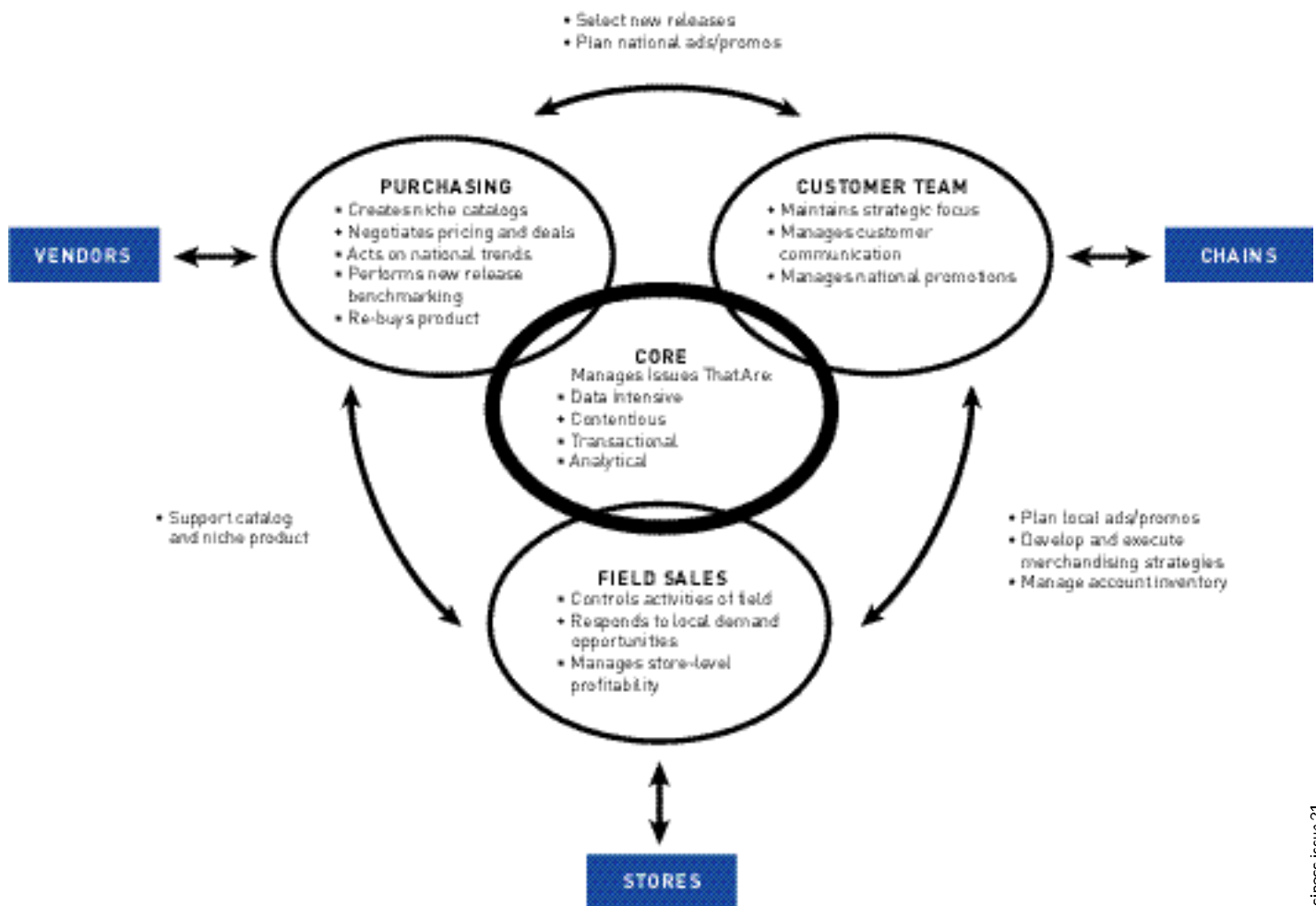

Exhibit 2: **A Media Distributor's New Organizational Model**

**A music distributor grew 10 percent
in an industry that grew 2 percent.
The strategy had remained intact,
but a new organizational model
had been implemented.**

sales rep. This function provides a central coordination point for all order streams, and over time is well positioned to spot and react to trends in demand patterns. The natural tension between departments was not eliminated, but this new function helped channel that tension to make it a constructive force in developing highly tailored responses to specific situations.

Importantly, customer teams remained a piece of the new organizational model — the discipline and consistency they required was, in fact, a necessary first step to improving performance. However, key decisions were now moved to where the individuals had better — and less aggregated — data, and were able to implement more targeted and timely responses to specific situations. Very quickly, the requirements for higher quality and more timely data forced major changes in the company's information systems as well.

Certainly, not every manager in the new model would make every decision optimally (especially at first), but, on average, the decisions would be dramatically better than the one-size-fits-all execution observed in the old model. And as new tools and training were developed and rolled out, the decisions made by key managers would only get better.

The results of this new organizational model have been powerful. In the first year following implementation, the company achieved revenue growth of 10 percent in an industry that grew by just 2 percent. In addition, because of the focus strategy and the organizational model that enables it, operating profits have nearly tripled. Beyond this, additional improvement is anticipated in the coming year as key elements of the system become better understood and more completely leveraged. The impact on employees has also been positive:

Turnover is down, and the sense of success across the entire organization is palpable.

When all the dust settled, the new strategy remained more or less intact. Its major elements — focus on the music category and customer teams — were unchanged. However, to be effective they needed to be part of a comprehensive organizational model that aligned decision rights with information to realize the strategy. In the end, the key to making the strategy work was finding a way to leverage the knowledge that already existed in the organization, but which could not be translated into action under the prior organizational model.

Optimizing Decision-Making
In a world where you are unlikely to uncover a shiny new strategy to remake your company, a new organizational model represents the next best thing.

While it may not immediately sound like a big idea, the properly designed organizational model will improve a company's ability to make the countless trade-off decisions it encounters. At some fundamental level, all companies must constantly manage trade-offs to optimize results over time. Frequently, these are not the big decisions that get boardroom attention; rather, they are the thousands of daily decisions that are individually small, but collectively huge. Examples include how to price a specific customer quote, which engineering projects to fund given a limited budget, and how much sales effort to devote to existing versus potential customers.

Competitors with inferior organizational models will continue to suffer from suboptimal decision-making and will always be a step behind. This may not seem like much, but like the difference between completing 40 percent of your passes and 60 percent of your passes, over

time it makes a big impact on the scoreboard.

It is part of management's role to see that all the interactions that take place internally are performed more efficiently than they could be in an open market. That is, the savings in transaction costs must be greater than the increase in administrative costs and the potential decrease in motivation. Many companies find that applying this logic to their organizational models leads to a rethinking of their strategies, and rightly so. If integration and centralization of authority are not adding value, then shareholders would be better off with a different firm structure.

Yet in our experience, most management teams do not fully appreciate the role the organization itself plays in improving performance. Nor do managers grasp the difficulty of their organizational challenges. Many leaders inherit organizational models, and lack the time and/or resources to develop a detailed perspective on how they really work. They may be frustrated by an inability to realize their objectives, but rarely do they identify the interacting assumptions, trade-offs, and motivations built into their organizations as root causes.

The problem is one of complexity. Corporations of any significant size cannot make all the necessary transactional decisions "with one mind." To provide manageable spans of control and to benefit from functional specialization, companies are forced to subdivide their organizations. Unfortunately, this subdivision fragments the information, decision rights, measures, and rewards that guide individual decisions. Rational individuals tend to strive for narrow optimums defined by functional or business-unit objectives, rather than by company-wide objectives. The result is often organizational silos and interdepartmental friction, driven by increasingly divergent views and objectives.

An organization built on this type of decision-making is incapable of optimizing for the company as a whole. The limits of the human mind make it nearly impossible to design the perfect processes and mechanisms whereby the disparate parts of an organization stay completely coordinated. Further, even if it were possible to create the ideal process, it would be wrong by the time it could be implemented, since the optimal trade-off would change with each new piece of information from the market.

Resolving this tension between individual motivation

Exhibit 3: **Classic Symptoms of Misalignment**

CLASS OF PROBLEMS	EXAMPLES
• Excessive organizational conflict that is resolved through "political" means, not economic means	• Cross-functional conflicts are routinely escalated to senior management for arbitration • One function or group is considered the dominant axis of the business and always has final say in major strategic decisions
• Oversimplification of decision rules	• Managerial behavior is constrained by policies that are right on average, but wrong in many situations
• Inability to identify and capture new opportunities in a timely fashion	• Information about how to respond effectively to changing customer demands cannot be gathered and analyzed in the relevant time window
• Inefficient use of resources	• Lack of mechanisms to allocate use of shared resources leads to overconsumption ("tragedy of the commons") • Poorly designed organizational boundaries create demand for redundant resources

and centralized control is not easy. In large firms, senior management is relatively distant from much of the information required to make optimal trade-off decisions on individual transactions. In this environment, management can still use a number of levers to maintain alignment — implementing standard operating procedures, for example, or mandating certain activities. But these levers generally constrain local action and thereby limit the organization's ability to sense and adapt to changing circumstances.

Top-down efforts to intercede usually fall short because someone in the executive suite simply cannot absorb and process all the information that has to be brought to bear against the myriad decisions that are made daily. As many executives have discovered, even

attempts to intervene in a single decision can be problematic because so much of the information behind it is tacit, idiosyncratic, and time sensitive. In addition, in most hierarchies, there is a tendency to filter information as it flows upward, further distorting the view from the top and exacerbating the problem. (See Exhibit 3.)

Fixing such problems necessitates a comprehensive organizational model, and is innately arduous. These efforts can be accelerated, however, by fully leveraging the knowledge contained in the current practices. If we assume that most observed behavior is rational, it provides valuable information about the environment in which decision-makers operate.

Any attempt to address a business weakness or strategic opportunity must explicitly address the underlying organizational reasons the current strategy is not working. The attempt cannot begin, as many traditional approaches do, with the conclusion that the problem lies in the strategy itself, and immediately concentrate on refining the aspirations or vision for the company. That difference in starting point, coupled with a recognition that the task is difficult, represents an opportunity to create an enduring competitive advantage over rivals, and leads to a fundamentally different way of thinking, not just about organizational issues, but about strategy.

Customizing the Organizational Model

Each organization's model is necessarily customized. It must be tailored to the competitive position, capabilities, and aspirations of the company in question. Although there is no single, best generic organizational model, applying the theory outlined above to our clients' situations has uncovered a set of practical design principles:

- A goal of creating a minimalist organization — limiting the activities performed within the firm to those required to achieve competency or avoid market failure.
- A strong bias toward decentralized authority — unless there are compelling information/market failure reasons to design it otherwise.
- A preference for market-like mechanisms to allocate resources and make decisions where possible.
- An appreciation for ownership as a way of imposing decisions' consequences on the decision-makers, thereby making decisions more "self-correcting."
- A concept equivalent to the rule of law, so that individuals can act with the confidence that the decisions they make will not be overruled, except in extraordinary circumstances.
- A willingness to embed the complexity of the business

in the institution, not the individual, in order to make it simpler for individuals to manage.

By customizing organizational models from these principles, companies can overcome the tensions and trade-offs usually embedded in their histories, capabilities, and cultures, and lead themselves to new levels of success. Sometimes, they will discover that changes in the overall strategy are required at the same time. But at the very least, they will create winning organizations that complement and enable their strategies.

While difficult to achieve, the results can be powerful. For the firms that get it right, the organization not only aligns with the strategy, but becomes a key element of the strategy. These companies find that this combination of strategy plus a complementary organizational model can lead to dramatic improvements in performance. These solutions often drive new growth opportunities by enabling and rewarding more entrepreneurial behavior at multiple levels and, over time, by attracting and retaining more qualified and motivated individuals. Ultimately, a new organizational model becomes the one sure way to align a company's people to its strategy — which itself is the one sure way to drive continual improvement. ✚

Resources

Jorge H. Forteza and Gary L. Neilson, "Multinationals in the Next Decade," *s+b*, Third Quarter 1999, www.strategy-business.com/bestpractice/99303

Gary L. Neilson, Bruce A. Pasternack, and Albert J. Viscio, "Up the (E)Organization!: A Seven-Dimensional Model for the Centerless Enterprise," *s+b*, First Quarter 2000, www.strategy-business.com/strategy/00106

For more discussion on organizational structure, visit the **strategy+business** Idea Exchange at www.strategy-business.com/ideaexchange/