Linking Behaviour to Bottom Line Performance

Restructuring for Lower Costs and Greater Efficiency

There are always unforeseen risks associated with any corporate restructuring programme. In terms of a metaphor, restructuring can be seen as undertaking major organisational surgery, with all the attendant risks and uncertainties. One route to reducing the risks and raising the possibility of a successful outcome comes from gathering information on both the structural, tangible elements of the organisation and complementing this with a focus on the more subtle or intangible factors. Such an approach is likely to increase the chance of achieving the twin goals of short term cost cutting and long term efficiency and agility in a far more measured and precise manner.

Recent research has raised a number of questions regarding the different approaches companies adopt when going about their restructuring activities. Firstly, there is evidence that corporate restructuring programs are by and large unsuccessful at delivering other long term goals and that they can even cause damage to the business. Secondly, whilst companies are able to identify cost cutting measures, these programmes often fail to deliver corresponding increases in productivity and efficiency.

This article argues that the traditional measurements used by companies to identify cost and efficiency improvements do not facilitate long term performance benefits. Indeed, managers may inadvertently be using information that encourages an indiscriminate or haphazard approach to reducing costs. By extension, one of the key omissions companies can make is failing to factor in the intangibles of the organisation in any restructuring programme. By combining new methods for measuring apparently nebulous information such as communication, culture and relationships, a clearer path to identifying higher margin activities and increased efficiency becomes apparent.

This article also discusses the idea that better organisational information enables companies to adapt to a constant state of change and increased responsiveness in order to achieve the optimum balance of performance and efficiency. In the long run, organic change should be a constant within an organisation's culture, which, when aligned with clear communication and a measured strategy, in all but the most extreme situations negates the need for radical and traumatic structural change.

Why restructure?

Put simply, restructuring is a catch all term for significant organisational change.

Wikipedia states that "a company that has been restructured effectively will theoretically be leaner, more efficient, better organized and more focused on its core business with a revised strategic and financial plan."[1]

It is true that leanness and efficiency lie at the heart of any restructuring project. However, being able to do more with fewer resources is a compelling yet notoriously difficult goal to achieve. A restructuring programme can be triggered by obvious catalysts for change such as;

- A change in management
- A merger or change in ownership
- External economic factors
- New or disruptive technology
- Regulatory issues

There are also more subtle reasons to seek out structural change;

- Changing market conditions
- Perception of systemic weaknesses in the organisation

• Pressure from shareholders and other stakeholders
• The actions of competitors

It can be argued that doing things more cheaply is the simpler side of this equation. There is usually sufficient organisational data and management commitment to identify and push through measures to cut costs in the short term. That said, becoming more productive or efficient at the same time as reducing costs is the real challenge and its attainment may not necessarily lie in downsizing or redefining an organisation’s structure.

Inherent risks

With any restructuring programme comes some element of risk. While most restructuring is likely to lead to a short term reduction in costs, there is some chance that value is destroyed or diminished within the organisation and in the long term this could lead to;

• Damage to the ‘brand’ of the organisation
• Distraction and loss of focus at senior level
• Falling productivity
• Poor morale and decreased employee engagement
• The loss of key people

As a result, the organisation emerges in a weaker position with lower motivation, productivity and staff who are unsure of the direction that the organisation is heading in. These issues may then be compounded by a similar perception amongst other stakeholders.

Is restructuring the solution to combined lower costs and greater efficiency?

Recent McKinsey research[2] suggests that the organisations which launch radical restructuring or turnaround programmes rarely reap the rewards they hope for. The report suggests that within specific industries there is an archetype or dominant industry structure which the majority of companies have adopted and conforming to this archetype is likely to result in prolonged success. For example, the dominant structural model could be focused around products, functions or geographies. The report also suggests that the most successful companies in each sector adopt a hybrid approach based on the underlying industry archetype while incorporating some local or geographically specific elements.

The takeaway from this research is that organisations are most likely to benefit from structural reform only if their existing structure deviates significantly from the industry norm. By aligning organisational structure with the best models in the industry, organisations give themselves the opportunity to generate better results. The clear implication being that when looking to address poor performance, organisational structure is only one factor which needs addressing. McKinsey then go on to say;

“For many companies, structure alone is rarely responsible for problems such as sluggish decision making, a lack of accountability on the part of employees and management, or stagnant innovation processes. More often, the root causes of such difficulties are poorly defined responsibilities, misaligned incentives, or substandard management processes.
Companies should launch an organizational redesign focused primarily on restructuring only if they have compelling evidence that the current structure is suboptimal and only if they can't address this shortcoming less invasively—for instance, with increased accountability and better planning and performance-management processes. Meanwhile, businesses that deviate from the norm should take a hard look at whether an outlier organizational structure is truly beneficial. Only proven industry front runners should seek structural ways to maintain—or even increase—their advantage.”

Reading between the lines, the message seems to be that cost reduction through restructuring on its own is not enough to meet long term goals. Whilst restructuring may achieve cost cutting, there are likely to be unanticipated consequences with initial gains disappearing over time.

An alternative approach?

A leaner organisational structure is an enabler of short term cost cutting, up to a point. However, the research would seem to suggest that it is only of limited influence when it comes to the second goal of restructuring, namely improving productivity and efficiency.

With this in mind, the most obvious question centres around why companies would look to embark on such high profile, dramatic and risky changes when the evidence suggests that the chances of long term improvements are slim?

Perhaps the answer lies in the psychol-

ogy of managers? It is a natural human reaction to changing circumstances or when things go wrong that we look to change that which we feel we have most control over. In an organisational setting, management teams are likely to target structural systems and processes which are tangible and are apparently the easiest to remodel or influence, offering a quick solution to a pressing issue. In the case of restructuring, it is easy to see how managers will want to be seen by stakeholders as taking decisive and visible action.

However, by their very nature, organisations are highly complex and whilst it is relatively easy to get a good understanding of the structure, systems and processes, other key information and most likely, the information which is going to make a difference to long term performance is much harder to gather. In short, the information available to managers may enable short term cost cutting but it often fails to reveal the optimum path to long term efficiency.

In a recent blog post[3], John Hagel (Pareto Paring) highlights this issue, pointing out the 80/20 principle that states 20% of the inputs generate 80% of the results. In his article, Hagel poses a number of questions that companies should be able to answer.

"The 80/20 rule provides the foundation for a relatively simple exercise for executives. It involves answering the following questions:

- Which 20% of the products or services generate 80% of the profitability?
- Which 20% of the customers generate 80% of the profitability?
- Which 20% of the geographies generate 80% of the profitability?
- Which 20% of the assets generate 80% of the profitability?

These are powerful and revealing questions, yet few companies today are able to answer these questions given the way their accounting and information systems are set up. As a result, the answers are generally hidden from management view. Unfortunately, the questions themselves rarely get asked."

The Hagel article, alongside the McKinsey research implies that the success of an organisation lies only partly its structure and more in its intangible factors such as behaviours, relationships and culture. If an organisation's structure is not enough to explain variability in performance, by definition any problems and difficulties are likely to be hidden and invisible to standard organisational measurements.

If restructuring is not the complete answer to long term lower costs and efficiency, what is?

Whilst corporate structure is one area where it seems to pay dividends to follow the herd, this does not mean that managers can let up in their pursuit of increased productivity and decreasing costs.

Instead of looking exclusively at structural cost cutting opportunities, the implication is that by focusing more on intangibles such as people, engagement, culture and communication, organisations will be able to get to the root of their problems far more effectively. The difficulty here is that historically, these issues have been tricky to quantify and they will often be hidden to traditional data gathering and management tools.

Ironically, restructuring is attractive because it is clearly visible and deals with aspects of the organisation which are easily measurable or quantifiable, this then makes targeting intangibles seem a much less attractive or obvious option. That said, it is estimated that 20% of productivity is lost to poor communications and unproductive behaviours. A focus on this area requires an approach that can enhance productivity via intangible factors while maximising efficiency and reducing costs.

Why are these areas valuable?

At its core, any move to cut costs and improve efficiency should enable managers to focus on the highest margin activities. By definition, this requires that managers are provided with sufficient information to identify and fully understand their operations and activities. On a practical level, this means that companies benefit from investing in understanding the intangible areas of their operations. This requires a focus on generating new insights around activities such as;

- Change management
- Collaboration
- Culture
- Informal networks
- Internal communication
- Levels of innovation

Although these areas are by definition harder to measure than the explicitly tangible costs of the business, greater control and understanding of these areas lie at the heart of improved effi-

ciency.

Undoubtedly and given different industries, such intangibles are likely to play a greater or lesser role, depending on the circumstances in question. For example, in industries such as software and biotechnology, intangibles are likely to be far more significant in driving performance than industries which are more commodity focused. Still, this does not mean that organisations in industries such as food or construction can afford to ignore them.

Making the intangible tangible

Any initiative for improved efficiency requires changes in behaviour from those involved. Whilst it may be possible to impose new systems and structures on people, without people's explicit co-operation and acceptance of new ways of working, any gains from these structural changes will not be realised. Only by aligning behaviours and culture to systems and processes is it possible to combine short term cost savings with longer term improvements in efficiency.

As a means to facilitate this, Four Groups have developed a series of tools which provide managers with the insight and understanding around these traditionally intangible areas. By providing information about how to best engage staff, improve interaction and better understand and predict behaviours, relationships and culture, it is possible to show the interdependence between an organisation's tangible and intangible resources.

Four Groups helps by presenting information around intangibles in a systematic and comparable way, making it possible to address the fundamental issues of efficiency.

The benefits of focusing on the intangibles has long term implications and benefits. Concentrating on and systematically managing these areas means that organisations are able to become more flexible, consistent and productive. Change is a constant process and by building this into the organisational culture, it is possible to become more proactive and agile.

Beyond change

Any restructuring effort should be seen as part of a wider change management programme where it is necessary to engage hearts and minds. Given the availability of more sophisticated and precise information, organisations can create an ongoing flexibility and responsiveness which will enable a more focused and targeted approach to their operations. By implanting change into the DNA of the organisation, it is possible to nip any problems or difficulties in the bud before they have any noticeable impact on performance. Furthermore, an organisation which is constantly innovating and identifying the most efficient methods of working is likely to create key performance differentiators as a natural by-product of such activities.

Calls for restructuring are often prompted by external factors or events beyond the control of management. However, the real drive for change must ultimately come from within and equipping an organisation and its people with the information and imperative to naturally seek out and adapt to more efficient ways of working is likely to minimise the negative impact of any external pressures.

An organisation's structure is only part of the wider operational and industry dynamic and as with other competitive pressures, the most effective structure for a particular industry is likely to coalesce around industry best practice. By extension, an efficient, optimised structure can only be viewed as a short term competitive advantage at best and something that becomes a commodity over time at worst. In contrast, what is likely to drive long term performance are the intangibles and other areas where an organisation is able to differentiate itself. Even in industries where the intangibles seem to be less important, their measurement and understanding is vital to achieving the highest possible performance levels.

Conclusion

Given readily available information, it is not surprising that companies focus on cost cutting when reacting to external events. In the short term, this approach seems to be a route to quick and tangible results. However, the singular cutting of costs is unlikely to yield long term benefits and by extension, organisational structure seems to have a marginal effect on long term performance. To achieve that goal, a far more granular understanding of an organisation's tangible and intangible elements is required.

By addressing intangible issues alongside more formal, structural elements, it is possible to not only react to and take advantage of external market pressures but to also create an ongoing

culture which is naturally adaptable and capable of working in a flexible and responsive manner.

Footnotes and references

1. http://tinyurl.com/56eje5

2. When organization isn't enough, McKinsey Quarterly, February 2006, http://tinyurl.com/6fcoy5

3. http://tinyurl.com/5t2b3p

Four Groups Ltd
5 St. Johns Lane
London
EC1M 4BH, United Kingdom

Tel: +44 (0) 20 7250 4779
Email: contact@fourgroups.com
www.fourgroups.com

© 2008 Four Groups Ltd, 5 St. Johns Lane London EC1M 4BH, United Kingdom.

All rights reserved. No part of this document may be reproduced without express written permission from Four Groups Ltd.

Company Number: 4650494
VAT Number: 817 7962 85
Registered in England and Wales