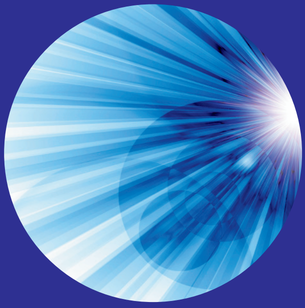
RONALD G. CAPELLE

OPTIMIZING Organization Design



A PROVEN APPROACH TO ENHANCE Financial Performance, Customer Satisfaction, AND Employee Engagement

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CHAPTER 1

WHY ORGANIZATION DESIGN MATTERS

Organization design, as we define it, is one of the most powerful tools available for improving organization performance. Our Optimizing Organization Design® approach

- is related to better employee satisfaction
- is related to better customer satisfaction
- is related to better financial performance
- can give you a competitive advantage that is more sustainable than most
- provides a significant return on investment
- provides a foundation for strategy implementation
- provides a foundation for human resources management

We define organization design as the relationship of an organization to its environment and the interrelationships of its parts. This includes the alignment of positions, accountabilities and authorities, people, deliverables, and tasks.

Within organization design, there is one factor that is powerful enough to be directly related to improved outcomes. That factor is the manager–direct report alignment. Following on the work of Jaques and his colleagues (Jaques, 1996), the basic idea is that every employee should have a manager exactly one level or "stratum" (our technical term which will be discussed shortly) above. We believe that this precise stratification is a necessary but not sufficient condition for an optimal manager–direct report relationship. Buckingham and Coffman (1999) have conducted significant research showing the importance of relationship with manager and how it is related to productivity, profitability, retention, and customer satisfaction.

The important relationships among these factors have also been demonstrated by Heskett and his colleagues in their development of the service profit chain (Heskett et al., 1994; Heskett, Sasser & Schlesinger, 1997; Heskett, Sasser & Schlesinger, 2003; Heskett, Sasser & Wheeler, 2008). They have shown that there is a relationship between the employee (satisfaction and loyalty); the customer (value equation, satisfaction, and loyalty); and financial performance (revenue growth and profitability). This research is further discussed in Appendix B.

EMPLOYEE SATISFACTION

Productivity in the department has improved, and user satisfaction has increased remarkably while employee morale and team work have shown exceptional gains.

—John W. Young, Executive Vice President, Human Resources, Four Seasons Hotels and Resorts, April 2002

We would expect that better organization design would lead to better employee satisfaction. Organization design provides better manager–direct report alignment (as well as overall better position alignment), better clarity of accountabilities and authorities, better matching of people to positions, and better alignment of deliverables. Any one of these alone might have a positive impact on employee satisfaction. The combination of all or most of them would seem to significantly improve that probability.

The relationship between organization design and employee satisfaction is strongly supported by our research (see Appendix B).

While these outcomes would have been expected, we have also shown the power of the manager–direct report alignment. Manager–direct report alignment also is based on the work of Jaques (1996) and his colleagues. They developed a measure of the complexity of work called "time span." With it, one can determine how many layers or strata an organization should have and place every position in the correct layer or stratum. More specifically, one can develop optimal manager–direct report alignment. This is a situation in which a manager is exactly one layer or stratum above a direct report, in terms of both the complexity of work done and capability to work at that level.

While there is one optimal situation, there are two suboptimal situations. The first is when a manager and direct report are operating at the same level or stratum (called "compression"). We would expect that the manager in this situation would be micromanaging and not adding sufficient value and that the direct report could not use her full capability. The second situation arises when a manager and direct report are operating more than one level or stratum apart (called "gap"). We would expect that the manager in this situation could feel "pulled down into the weeds" and see the direct report as having no "initiative" while the direct report would see the manager as providing inappropriate direction.

This manager–direct report alignment would therefore appear to be fundamental to manager and employee satisfaction. One can see how it could be related also to customer satisfaction and financial performance. There are relationships among all of these factors. Quite frankly, we have been surprised at the robustness of manager–direct report alignment. While we would have expected that organization design would be related to these outcome measures, we would not have expected that any of the sub factors would be robust enough to have a similar effect. Our experience with manager–direct report alignment has proved us wrong.

The relationship between manager–direct report alignment and employee satisfaction is shown in our survey of top 2000 Canadian companies (Capelle Associates Research Paper #9, 2003b). Nine other studies reinforce these findings. The first six are organization design assessment and implementation projects (Capelle Associates Research Paper #1, 1999; Capelle Associates Research Paper #3, 2000b; Capelle Associates Research Paper #4, 2000c; Capelle Associates Research Paper #5, 2000d; Capelle Associates Research Paper #13, 2005b; Capelle Associates Research Paper #15, 2011). In each of the studies both the manager–direct report relationship and employee satisfaction improved following the organization design intervention. Three more studies focus on situations where there was no organization design intervention. Capelle Associates Research Paper #14 (2005c) shows a significant relationship between manager–direct report alignment and employee satisfaction. Capelle Associates Research Paper #21 (2012f) looks at one role (analyst). It shows that individuals in analyst positions, who have requisite or optimal alignment with their managers (exactly one stratum below), have higher satisfaction than those who are in gap or compression situations. Finally, Capelle Associates Research Paper #22 (2012g) shows a significant relationship between manager–direct report alignment and employee satisfaction in three interrelated organizations.

It is clear that organization design in general, and the manager–direct report alignment in particular, are both directly related to employee satisfaction. We believe that better organization design and better manager–direct report alignment both lead to better employee satisfaction.

CUSTOMER SATISFACTION

We found that better aligning positions, clarifying accountabilities and authorities, matching people to positions, and developing business plans has resulted in improved employee performance and customer satisfaction.

—Naseem Somani, President and CEO, Gamma-Dynacare Medical Laboratories, October 2011

We would expect that better organization design would lead to better customer satisfaction. Improvements in alignment of positions, accountabilities and authorities, people, and deliverables should provide better clarity and a foundation to focus on customers. Our research supports the relationship between organization design and customer satisfaction. This is shown in our survey of top 2000 Canadian companies (Capelle Associates Research Paper #9, 2003b), as well as one additional study (Capelle Associates Research Paper #3, 2000b). We also find that there is a relationship between manager–direct report alignment and customer satisfaction (Capelle Associates Research Paper #9, 2003b; Capelle Associates Research Paper #3, June 23, 2000b; Capelle Associates Research Paper #14, 2005c).

In addition to our research studies, Heskett and his colleagues have developed the service profit chain (Heskett et al., 1994; Heskett, Sasser & Schlesinger, 1997; Heskett, Sasser & Schlesinger, 2003; Heskett, Sasser & Wheeler, 2008). They have shown that there is a relationship between the employee (satisfaction and loyalty), the customer (value equation, satisfaction, and loyalty), and financial performance (revenue growth and profitability). We believe that this adds further credence to the impact of better organization design and better manager–direct report alignment on both employee satisfaction and customer satisfaction.

FINANCIAL PERFORMANCE

We were indeed able to establish a statistically positive relationship between organization design and performance using our performance data and your organization design framework. We found that Capelle Associates' approach to better organization design is related to better financial performance in the global pension fund industry. This includes governance, layering, and delegation.

—*Keith P. Ambachtsheer, President, K.P.A. Advisory Services, and co-author,* Pension Fund Excellence: Creating Value for Stakeholders, *October 1999*

We would expect better organization design in general, and better manager–direct report alignment in particular, would lead to better financial performance. There are three factors related to this.

First, it seems logical and reasonable that improvements in the alignment of positions, accountabilities and authorities, people, and deliverables should lead to better financial performance. As well, the absence of optimal or requisite manager–direct report alignment leads to problems such as gaps or compression. These elements are fundamental to the operation of an organization. Our research supports this expectation. It is shown in our survey of top 2000 Canadian companies (Capelle Associates Research Paper #9, May 12, 2003b). It is also shown in a longitudinal study (Capelle Associates Research Paper #1, 1999) and a previously published study of financial performance in the global pension fund industry (Ambachtsheer, Capelle & Scheibelhut, 1998).

Second, organization design assessments can produce cost savings. These are all directly related to the manager–direct report alignment. The Capelle Associates Benchmarking Database shows average potential annual cost savings of $2,505 per position (Capelle Associates Research Paper #23, 2012h). The total in each case would be found by multiplying this number by the number of positions in the review (e.g., in a 1,000-employee organization, the average potential annual cost savings would be $2,505,000).

The third factor comes from related research. Buckingham and Coffman 1999 show a relationship between the manager–direct report relationship and profitability. Heskett and his colleagues (Heskett et al., 1997) have developed the service profit chain showing the relationship between employee satisfaction, customer satisfaction, and financial performance (revenue growth and profitability). So, not only do we show a direct relationship between organization design and financial performance, we would also expect that improvements in relationship with manager, employee satisfaction, and customer satisfaction would further drive financial performance. This hypothesis is further supported by the statistically significant relationships found in our survey of top 2000 Canadian companies (Capelle Associates Research Paper #9, 2003b).

In conclusion, we have three streams of support for the relationships between both organization design and manager–direct report alignment with financial performance: three studies showing direct relationships; one study showing cost savings; and a number of related studies showing that the relationships between manager, employee, and customer satisfaction align with financial performance.

COMPETITIVE ADVANTAGE

The advice came at significant turning points in our history and helped to keep the fund competitive and focused on identifying unexpected risks while remaining at the top of our game.

—Bob Bertram, Executive Vice President, Investments, Ontario Teachers' Pension Plan, November 2007

Better organization design, as we define it, can provide a competitive advantage. It is clearly related to better organization performance, as shown by employee satisfaction, customer satisfaction, and financial performance. However, there is more to the story. This Optimizing Organization Design® approach can and should be done in such a way as to be sustainable. Much of my focus in this book is on how to accomplish this. Further, because this approach requires both skill and commitment, I contend that it can be a more sustainable competitive advantage than many that can be more easily copied.

SIGNIFICANT RETURN ON INVESTMENT

The icing on the cake is that, although organization design did not start for us as a cost cutting exercise, it ended up paying for itself within the first year of implementation and that's a recurring benefit.

—Gerry Savaria, President and CEO, LS Travel Retail North America, July 2011

Improvements in organizations generally require some forms of investment. The critical question then becomes, "What is the return on investment?"

We track this information in our consulting work. We have information on 19 organizations. There were significant potential annual cost savings, mainly resulting from the elimination of redundant managerial positions (i.e., positions that are in the same stratum as their immediate manager). The average potential annual cost savings was $2,994,298 per organization. The average investment in the assessment was significantly lower at $454,779. The average potential annual return on investment (ROI) was 589 percent. It should be noted that while the investment is one time, the savings recur on an annual basis (e.g., if there are savings because a position is eliminated, those savings recur each year). The average potential annual cost savings per employee was $2,505.

This number is calculated by dividing the annual cost savings by the number of employees in the organization.

Two of the 19 organizations we tracked had no potential annual cost savings. It is important that these numbers have integrity, and be based on the best interest of the organization. In these two cases, the organizations were in a significant growth mode. Not only were there no redundant positions, but there were requirements to add positions. We have included these numbers in our averages because these are actual situations that one might also encounter.

We believe that the number of redundant positions that we identify is quite conservative (i.e., quite low). The average percentage of compressed situations in this study was 37.1 percent while the average number of redundant positions was only 2.2 percent per organization. If more aggressive criteria were employed, it would be possible to further elevate this number.

FOUNDATION OF STRATEGY IMPLEMENTATION

We have accomplished much over the years. Accountabilities are clearer. Administration is appropriately centralized. We created a new Product Development function to deal with the increasing complexity of this area. This separate focus helped us to accomplish much more than would otherwise have been the case. Similarly, we created a new function to deal with our fastest growing business line, which further enhanced its growth. In summary, we designed our organization to better achieve our strategy. In fact, I believe that organization is part of strategy, and is divorced from it to the peril of both.

—Derek Fry, President, Visa Canada Association, March 2006

Often we find that there is often a focus on strategy (e.g., front-end analysis and planning), but less on strategy implementation.

One without the other is meaningless. I was a founding member of the Strategic Management Society in 1980. The society is dedicated to the principle that overall strategic management is important, and that strategic planning is a necessary but not sufficient condition for good performance: strong implementation is critical.

An organization has to be capable of delivering its strategy. This entails the optimal alignment of positions, accountabilities and authorities, people, deliverables, and tasks. If these are not well aligned, performance will be suboptimal. Our research shows that only about 50 percent of manager–direct report relationships are optimally aligned, so it seems unlikely that most organizations are best positioned to deliver their strategies. Further, I would hypothesize that most organizations do not even have the information necessary to know whether or not this is the case.

Our approach provides the foundation for an integrated organization planning and review system. This ensures that deliverables at each level are integrated and at the requisite level of complexity. Without this foundation, more complex, higher-level work is often not done well, or at all. Our approach also makes it possible to integrate strategic planning, business planning, and performance management systems into one more effective and better aligned system. This adds more power by aligning and integrating all work to the necessary outcomes.

FOUNDATION OF HUMAN RESOURCES MANAGEMENT

We have been able to utilize these principles to strategically realign several critical Human Resources systems and practices. Of greatest significance is the impact they have had in the areas of Talent Management, Talent Pool Assessment, Compensation and Job Evaluation.

—Eric Pickering, Vice President, Human Resources, Allstate Canada Group, February 2006

Key questions to consider in human resources management include "How effective are our human resources policies and practices?" "How well are our human resources policies aligned to strategic requirements?" and "Are they changing for better or for worse?" While managers throughout an organization are accountable for their human resources (i.e., managers are accountable for their direct reports), the human resources function should ensure that the human resources systems and practices are optimal.

The foundation for answering these questions, and for improving systems and practices, can be found in this Optimizing Organization Design® approach. This would include the alignment of positions, accountabilities and authorities, people, deliverables, and tasks. This organization framework provides unique added value to human resources management. It can be used to

- Provide more strategic value to the organization, and have a broader impact on its outcomes.
- Determine how many strata an organization should have and place each position in the correct stratum. Each stratum is different in the nature of work, the complexity of work, and the information processing capability that is required for an individual to be successful.
- Organize each stratum into three parts (low, medium, and high), that provides a framework for job evaluation, career progression, and compensation.
- Better clarify accountabilities and authorities. Most organizations complain about having silos. This approach provides a solution by addressing cross functional accountabilities and authorities.
- Develop more powerful managerial leadership training.
- Better develop the talent pool. Matching people to positions requires that they have the appropriate knowledge, application, and (unique to this approach) information processing capability. With this information the organization can make better

recruiting, selection, promotion, and talent development decisions.

- Increase employee retention. We have found that the manager–direct report relationship is fundamental to maintaining employee loyalty. Our approach can measure and improve this relationship.
- Ensure that employees are delivering the outcomes that are required for their strata. Too often, the deliverables produced by employees are at a stratum lower than their level of compensation.
- Ensure that employees are doing appropriate tasks for their stratum. Our research shows that professionals spend about 50 percent of their time doing lower-level tasks than someone at a lower level could be paid less money to do as well. This situation is not only a waste of money, but also results in lower employee satisfaction because it means that some individuals are working below their capability. This design approach ensures that the right work is done by the right positions at the appropriate level of compensation.

CLIENT EXPERIENCE

Numerous executives have experienced success in using our approach to organization design to improve organization performance. This is probably the best test of an approach—does it work in real life?

In Appendix A, we have comments from more than 30 executives about their experience in utilizing our organization design approach to improving organization performance. These comments are all dated and go back almost 20 years. While we are grateful for the expressions of thanks we received in these commentaries for the support that our firm provided, that is not why we added them to the book. The most important point is that executives are accountable for improving the performance of their organizations. They are the ones who have to ensure that improvement takes place and is sustained. A consultant doesn't improve an organization—an executive does. These executives have been able to utilize our support and make something happen.

As I reread the commentaries I was struck both by the differences among the executives and by the variety of their insights. With respect to the first point, while we have a comprehensive approach, not all parts are implemented all the time. Even when they are, there are differences in the organization priorities and emphasis. Our approach is not, and cannot be, "one size fits all." While the underlying principles and systems and practices are the same, the actual application has to be tailored to the unique differences in each organization. As for the second point, I find that, as a consultant, I have certain views of the world. What I find is that the executives with whom I work often have different insights and perspectives. I think that there is much to be learned from them.

These executive comments account for about half of the approximately 100 comprehensive organization assessment and implementation projects that we have done over the past 20 years. I think that it would be fair to conclude that in these cases, executives have been able to improve organization design and achieve benefits that one would expect. It should be noted that in many of these situations we also have client research (that is covered later) demonstrating the changes and improvements.

RESEARCH SUPPORT

As is evident from the positive comments made by executives reprinted in this book, the experience of a great many organizations has proven the benefits of our program. A second important validation for our approach is the research support showing its effectiveness. We have been conducting research on organization design for almost 20 years. Some of this work has been alluded to already. It includes one published paper (Ambachtsheer, Capelle & Scheibelhut, 1998) and the 23 papers that can be found in Appendix B.

This body of work includes the following:

- nonequivalent control group design (there is a control group, but it is not assigned on a random basis)
- one group pretest posttest design (measurement before and after organization design)
- a survey of the top 2,000 companies in Canada
- a measurement and survey within the global pension fund industry
- analysis from the Capelle Associates Benchmarking Database of more than 59,000 manager–direct report relationships from 76 organizations, and more than 13,000 employee satisfaction responses from 38 organizations (this benchmarking database includes managers and their direct reports from the United States, Canada, and many other countries)
- numerous other studies showing relationships among variables

There is consistency in the outcomes from different approaches in different situations over many years. Our research supports the importance of organization design. The following points are important:

- Organization design is (statistically significantly) related to employee satisfaction, customer satisfaction, and financial performance.
- Manager–direct report alignment is (statistically significantly) related to employee satisfaction, employee satisfaction, and financial performance.
- Despite the importance of the manager–direct report alignment, we find that it is misaligned about 50 percent of the time. This is a horrendous waste of human capability—and a tremendous opportunity for improvement.
- Organization design assessments produce average potential annual cost savings of $2,505 per position (total savings are

found by multiplying this number by the number of positions in the review). For example, in an organization of 1,000 employees, this would be average potential annual cost savings of $2,505,000.
- Task alignment assessments can produce average potential annual cost savings of approximately $10,951 for each higher level position included in the review. This is because professionals spend about half of their time doing tasks that someone at a lower level could be paid less to do at least as well.

All of the research papers can be found in Appendix B. You may not be interested in reviewing all of them, but we recommend that you read the introduction and those studies that are of particular interest. It should be comforting for you to know that this approach is supported by both executives who have had success with it and a substantial body of research.

SPECIAL TOPICS

Three special topics need to be addressed as you begin to think about organization design. The first is to understand the strategy, which is an important early step in this Optimizing Organization Design® approach. The second is to understand the work, which is an oft-repeated refrain in organization design. The third is the mistaken belief found in some (often high tech) organizations that a clear organization design will make them bureaucratic.

Understand the Strategy

While we do not provide strategy consulting services, strategy and organization design are integrally linked. We believe that understanding the strategy of an organization is an important early step in enhancing organization design. However, we would have a few caveats.

The first is that strategy is often thought of as being relatively one dimensional and precise (e.g., we will get the strategy and then do the design). Our experience is that it is both complex and evolving. What's more, written documents often do not best describe strategy: it is better to derive it from discussions with senior executives.

The second is that strategy often refers to a plan. The strategy implementation system, which we would call "organization planning and review," is at least equally important, but often overlooked. Complicating matters further is that the term "strategy" can be vague: we prefer "strategic positioning." This is discussed in detail in a later section of the book on aligning deliverables.

The third caveat is that strategy and organization design are generally thought to be sequential: One first does strategy and then design. We find that these phases are more iterative (i.e., each informs the other). An organization design should be both robust and flexible so it can be modified as strategy evolves.

Despite these caveats, it remains true that strategy does inform organization design. This starts with position alignment. Strategy informs both vertical alignment (e.g., how many strata do we need and how do we place each position in the appropriate stratum) and functional alignment (e.g., do we need business units, and how do we make choices about organizing by functions, customers, products/services, geography, etc.).

Much has been written on strategy (far more than on organization design). We have found the following books to be particularly useful in understanding strategy: Ansoff (1979, 1988), Buzzell & Gale (1987), Kim & Mauborgne (2005), Mintzberg (1994), Mintzberg et al. (1998), Pearce & Robinson (1991), and Porter (1980, 1985).

Understand the Work

This could be our mantra. The starting point always is to understand the work. It forms the foundation on which other information gathering and analysis can take place.

In understanding the work of a larger organization, it is important to determine at an early stage the fundamental delivery unit or driver. This is the focal point around which one can design the rest of the organization. For example, in a banking network the delivery unit could be the branch manager. In a hospital, it might be a ward delivering patient care. In a railway, it could be the operational units that move the goods. In a government fisheries department the migratory patterns of fish species might be the unit that makes sense of the system. In each case there is a "key" that provides a fundamental design factor.

In assessing only a part of an organization, it is more difficult to start with a support function (e.g., Human Resources) than a core function (e.g., Production). There are two reasons for this. First, the support functions are designed to provide support to core functions. One has to have some understanding of these in order to properly align the support function. This is doable but complex. The second reason is that a support function is more interconnected with the rest of the organization than some core functions are, which also adds complexity to the analysis.

"A Clear Organization Design Will Make Us Bureaucratic"

Some organizations take the position that clarity of organization design is a problem. Specifically, they argue that it will increase bureaucracy and reduce innovation. These organizations are a small minority and generally found in the high tech sector, where innovation and speed to market are particularly important. We believe this view is extremely dysfunctional. It makes the mistake of confusing clarity with rigidity (i.e., "we can't move quickly enough"). We see it differently.

Some of these (often high tech) organizations often need to deal with developing and managing a complex set of relationships with suppliers, outsourcers, partners, customers (of many varieties), and competitors (who are sometimes partners). This complex set of relationships can include a substantive supply chain. Due to this complexity, there is often a requirement for a sophisticated set of systems, skills, and practices.

Einstein said that everything should be made as simple as possible—but no simpler. We would argue that an organization design must have the "requisite complexity" necessary to deliver its business requirements. If an organization does not have clarity internally, how can it provide clarity to its supply chain and related relationships? A clear organization design does not equate to rigidity and bureaucracy. The reality is quite the contrary. The approach we are describing is principle and research based. If one understands these factors, it is possible to make the necessary changes to the organization more quickly and accurately, and in a way that makes it possible for others to better appreciate where things are going and how they will get there.

A number of our clients are growing quickly, making acquisitions and operating in a turbulent environment. They require a design that is robust and flexible. Our approach supports their specific requirements.

CONCLUSION

You can use our approach to significantly improve your organization performance. In fact, it could be one of the most important methods in your toolkit. You can employ it to improve employee satisfaction, customer satisfaction, and financial performance. You can achieve a competitive advantage that is more sustainable than most. While organization improvements generally require a financial outlay, this one has a significant return on investment (ROI). Organization design also provides a foundation for both strategy implementation and human resources management.

Finally, you can know that this approach is solidly grounded in 25 years of experience. Our approach has demonstrated success in implementation and achieving expected benefits. Organization design tends to not be a central preoccupation for most executives. This constitutes a significant missed opportunity. We encourage you to take advantage of some of the unique opportunities that this book provides.