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Included with this full-text *Harvard Business Review* article:

- 1 Article Summary
Idea in Brief—*the core idea*
- 2 Change for Change's Sake

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Idea in Brief

A seemingly healthy, well-performing company can be more vulnerable than you might think because of a buildup of corporate cholesterol: natural human dynamics that limit communication, creativity, and efficient resource allocation.

Rather than wait for the heart attack to strike, executives should consider changing their firm's structures, rewards, and processes while performance is still good.

Surveying the workforce can help executives determine how urgent the need is for change and what kind of changes to contemplate. Companies that take charge of change in this way are high performers and popular places to work.

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SPOTLIGHT ON STRATEGIES FOR A CHANGING WORLD

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No one disputes that firms have to make organizational changes when the business environment demands them. But the idea that a firm might want change for its own sake often provokes skepticism. Why inflict all that pain if you don't have to?

That is a dangerous attitude. A company periodically needs to shake itself up, regardless of the competitive landscape. Even if the external environment is not changing in ways that demand a response, the internal environment probably is. The human dynamics within an organization are constantly shifting—and require the organization to change along with them. Over time, informal networks mirror the formal structure, which is how silos develop. Restructuring gets people to start forming new networks, making the organization as a whole more creative. It also disrupts all the routines in an organization that collectively stifle innovation and adaptability. Finally, restructuring breaks up the outdated power structures that may be quietly misdirecting a company's resource allocation.

All these processes—silo formation, the accretion of deadening routines, and the emergence of corporate baronies—take place all the time. But when everything is going well, you tend not to notice them, just as many seemingly fit people don't realize that their arteries are dangerously clogged. We present here a simple questionnaire that can serve as a kind of cholesterol test for your company, enabling you to see if your regimen needs minor or major adjustments. We begin, though, by looking at the ways that unhealthy structures and patterns can build up, threatening your firm's health.

The Formation of Silos

Most companies and business units are organized around a single criterion—be it function, product, geography, or market. The problem with this is that communication and collaboration tend to become trapped in functional, product, geographic, or other silos. As a result, a functionally organized firm, for instance, may be slow to recognize product op-

portunities, while a product-oriented firm may find itself duplicating work.

In theory, the solution is to organize as a matrix in order to force interaction across dimensions. But matrix organizations are notoriously difficult to manage because they blur accountability and slow down decision making. A better solution, we submit, is to periodically reorient the organization around a different criterion. When a firm reorganizes in this way, the old networks and culture do not suddenly vanish; employees often maintain their old patterns of interaction for quite a while, as first observed by professors Jackson Nickerson and Todd Zenger of Washington University. So, at least for the near term, employees cooperate along both informal and formal networks. As a consequence, the firm gets the best of both worlds.

Cisco Systems is a case in point. From 1997 to 2001, Cisco was organized into three units, representing three lines of business, each focused on a distinct customer type. Each unit had its own marketing, sales, and R&D organizations. Employees typically worked and had most of their interactions within their units.

In a major reshuffle following the company's first ever loss, in 2001, Cisco was reorganized by function. This included the creation of a centralized R&D group and 11 subgroups to promote more rapid and cost-effective technical innovation. In this new structure, engineers who had worked in one of the three units could exchange ideas and collaborate on product development with their peers across the company. Cisco undertook these changes to foster economies of scale and to streamline an increasingly overlapping product offering. Many feared, however, that the centralized R&D group would lose touch with customers. The fear proved unfounded—in large part, we believe, because of the strength of the old networks and of Cisco's customer-oriented culture. When it came to developing services and products for customers, it seemed that people still picked up the phone or met with former colleagues to develop optimal, cross-technology solutions.

Of course, formal structure and informal networks and culture eventually realign. Over time, people have fewer interactions with their old contacts, and once again their primary interactions occur in a silo. The firm's management may decide to revisit its organizational structure again. That is precisely what Cisco

seemed to be doing in 2004, with the creation of three Business Councils: cross-functional and cross-technology senior management groups that were meant to be, as one of the chairs put it, "the voice of the customer," providing feedback on Cisco's strategy, products, and services. They also represented a partial reversion to the old structure—each council focused on a particular customer type.

The Deadening Impact of Routine

Communication and collaboration are not the only victims of organizational stability. The longer things are done a particular way, the harder it is to adapt when markets shift. Worse, the less people in organizations explore and search for new opportunities, the less capable they are of doing so. As James March of Stanford University famously explained: Exploitation (doing what works today) drives out exploration (seeking out risky but potentially valuable new ways of doing things).

Clearly, breaking up silos in the ways we've just described will help an organization avoid getting trapped in its routines. But there's a danger to relying on just one kind of change—which itself can become routine. For years Hewlett-Packard oscillated between the centralization of functions, such as sales and marketing and product development, and their subsequent decentralization into product groups. These periodic alterations initially yielded benefits but eventually became a familiar process; executives got used to simply switching from one set of routines (what they were just doing) to another (what they had been doing five years ago). They ended up exchanging one set of deficiencies for another. Ultimately, the company's performance suffered.

For that reason, we advise companies to vary the types of change they make and the details of their change efforts, as summarized in the exhibit "A Regimen for Change." One year, for example, you might want to emphasize individual rather than group performance in the compensation system. Another year you might rearrange office space so that people in a business unit are grouped by function instead of customer segment, and then change back a few years later.

Jeffrey Immelt and his successor, Joe Hogan, took just such an approach to change during

Freek Vermeulen (fvermeulen@london.edu) is an associate professor at London Business School. **Phanish Puranam** (ppuranam@london.edu) is a professor at London Business School, where he codirects the Aditya Birla India Centre. **Ranjay Gulati** (rgulati@hbs.edu) is the Jaime and Josefina Chua Tiampo Professor at Harvard Business School.

their respective spells as CEO of GE Healthcare (formerly GE Medical Systems). Following Jack Welch's decision to increase the company's focus on services and customers, Immelt embarked on a series of changes aimed at furthering those goals.

In 1997, Immelt restructured GE Healthcare around three geographic centers, a move that combined equipment and service. When Hogan took over, he restructured GEH again almost immediately, moving service to a new global organization, GE Healthcare Services. Subsequently, the president of Healthcare Services, Paul Mirabella, initiated several other changes to reconnect equipment and service. This included the creation of two positions: Enterprise General Managers (EGMs), who looked after major accounts, and Enterprise Development Executives (EDEs), who were tasked with building customer partnerships. Mirabella also altered reporting lines and shifted the incentive system from a focus on past performance toward a forward-looking mix of indicators.

You might think that all this turmoil and variation would cause problems. In fact, the

changes enabled GEH to develop its service business with great success. In 2004, the new sales organization secured enterprise contracts with a total value of \$1.1 billion. In the following year, the new EDEs won partnership opportunities with a total contract value of \$1.2 billion.

The Emergence of Entrenched Interests

If you avoid making changes for too long, a third problem emerges: Companies gradually become seriously inefficient at allocating resources. The more resources a particular unit acquires, the more it can acquire. At first, a unit's power may accurately reflect its importance, but over time that power may no longer be justified. The company may be better off assigning a larger proportion of its resources elsewhere.

Most companies faced with that problem tinker at the edges, perhaps establishing cross-unit teams, initiating a centralized corporate "fund" to subsidize cross-unit collaborative projects, or creating specific integrator functions (which invariably turn out to be very frustrating jobs). But executives at a powerful business unit who are judged primarily by that unit's performance may not turn up for meetings with other units and may be late providing information and other resources to them. By the time they do anything, the opportunity to strengthen the weaker unit might well have passed. And as long as the powerful executives deliver on their primary obligations, it's unlikely anyone assessing them will really care.

If groups have become this strong, you are going to have to initiate fairly dramatic organizational changes to improve matters. You may even need to disband the groups entirely. As long as they exist, even if they have been stripped of some authority, their influence will hamper progress and renewal. Given the magnitude of change required, the firm should be prepared for the possibility that some individuals will leave. Yet this may be necessary—or even desirable—to enable the creation of a new balance within the firm.

Consider Jones Lang LaSalle, a global commercial real estate management company. JLL was organized into three divisions: the Tenant Representation Group, Corporate Property Services, and Project and Development Services, aimed respectively at leasing, commer-

When and How to Change

Fostering Communication

Problem

Collaboration across units has all but disappeared

Solution

Use informal networks to compensate for the limits of the formal structure
Be prepared to repeat the process again and again

Building Agility

Problem

There's a persistent failure to spot new developments and opportunities in the market; innovativeness has declined

Solution

Expose people to new aspects of their tasks and opportunities for collaboration
Be prepared to accept a constant state of mild disruption

Breaking Up Entrenched Interests

Problem

Some groups doing critical work have trouble getting the resources they need; resources are concentrated in a few powerful groups

Solution

Change the dimension along which resources are allocated
Be prepared to disenfranchise and even lose certain people

cial property management, and the provision of services related to the development of new buildings. The entire company revolved around the three divisions, employees generally spent their entire careers within one of them, and all company metrics focused on unit measures. The most influential individuals in the company were the three unit heads, who made important decisions on their own.

The trouble was that the units were not equally strong in specific geographic markets. When one unit was weak in a particular market, the other two sometimes had trouble serving corporate clients who wanted all three services within it. Top management had long recognized the shortcomings of the entrenched power structure, but the autonomy of the units was so firmly established that each had limited success in persuading the others to invest in certain geographies. It was difficult to get them to collaborate to develop the fast-growing and profitable market for the provision of integrated services to large multinational firms. Each unit viewed the others as an intrusion and typically collaborated only when it was in the unit's own best interest.

The scale of the missed opportunities be-

came apparent in 2002, when top management created a local organization, separate from the units, aimed solely at New York City. Within a year, the commercial real estate managed by JLL in New York City had grown nearly 25%, to more than 30 million square feet, making it the third-largest commercial property manager in the metropolitan area. In response to the success of this experiment and to the gaps in local expertise elsewhere, the company's incoming CEO in 2005, Colin Dyer, decided to replace the three units with a new structure organized around clients and markets: The former handled relationships with large clients, and the latter handled one-off transactions in large metropolitan areas. In the subsequent two years, JLL's share price tripled.

The structural changes weren't costless. Some senior executives left when their authority, budgets, and number of direct reports declined sharply. Moreover, the transition, like most changes, was time consuming and took the best part of a year of top management attention. Yet, as one senior executive, who saw his number of direct reports reduced from 1,800 to two, commented at the time, "What's really good is, we operate better as a division. There is more of a sense of team. There were always bottlenecks, and now there are fewer. The restructuring never would have happened in the past because I wouldn't have let it. Everybody was preserving the silos, right?" He remains with JLL and has watched the company's performance soar.

A Regimen for Change

Companies that change before they have to don't undergo the painful, wholesale reorganization and restructuring that characterize many large firms. In undertaking periodic change initiatives, it's important to vary the focus by choosing a different category—structure, rewards, or processes—and zeroing in on a different aspect for each round of change.

Structure

How is your business organized?

- Function
- Geography
- Customer type
- Product

Rewards

What is emphasized in performance reviews and compensation?

- Individual, team, or companywide incentives
- Open versus confidential appraisals
- Short-term performance versus long-term development
- Revenues versus value-added

Processes

How do you carry out your work?

- Decision rights (who decides what, reporting lines)
- Distribution (centralized or decentralized)
- Location (which processes sit next to each other)
- Focus (customer or product)

Knowing When to Change

Let's suppose that your company is performing well; there's nothing obviously wrong with your business model, and Wall Street seems to be happy. Should you continue with your existing diet and exercise regimen, or do you need to contemplate some lifestyle changes?

To help you make that determination, we've developed a simple questionnaire, intended for all senior managers, that can help you get a handle on whether your company's networks have become too stable, whether your employees are falling into unquestioned routines, or, worse, whether powerful executives are channeling investment resources into yesterday's business activities.

The questionnaire, which we present in the exhibit "A Corporate Cholesterol Test," helps you decide whether it is time to redesign the

Assessment: A Corporate Cholesterol Test

Distribute this questionnaire to all your company's managers from time to time. Respondents should answer with a simple yes or no. To ensure honest answers, take steps to preserve respondents' anonymity.

1. The quality of communication and collaboration

- Do employees interact only with people from their own group? Y/N
 Are there strong subcultures that align with business groups or divisions? Y/N
 Are there breakdowns in communication caused by the formation of silos? Y/N
 Has collaboration between groups decreased over the past five years? Y/N

Total Yes Answers ____

2. The capacity to adapt

- Are many people uncomfortable with change? Y/N
 Do people and groups operate according to well-established routines? Y/N
 Has it been a long time since your firm developed a significant new revenue stream? Y/N
 Has the percentage of revenue from new streams decreased over the past five years? Y/N

Total Yes Answers ____

3. The balance of power among groups

- Do influential groups or individuals use most of the company's resources? Y/N
 Is it difficult for people outside the company's central group to obtain resources? Y/N
 Do influential groups or individuals impede decision making? Y/N
 Have the groups or individuals that were influential five years ago extended their influence? Y/N

Total Yes Answers ____

Final Score

0-2 yes answers

There's no need for change just yet.

3-7 yes answers

It's the perfect time for a change.

8-12 yes answers

You're late already; your company needs substantial change.

of changes you need to make, look at your total in each category. If your highest score is in the first section, then you need to contemplate changing the basis on which the company is organized (such as product or function). If you score most in the second section, you need to make sure that your next change is different from your last one. If you score high in the final section, then you need to make multiple changes all at once in order to shake up the organization.

You can refine this questionnaire by, for example, translating the questions into a set of propositions, to which respondents indicate their level of agreement on a scale of, say, one to five. The broader point is that your employees' perceptions and observations are generally a good leading indicator of whether corporate cholesterol is building up in the organization. Complaints about lack of cooperation and powerful executives and units are staple water-cooler topics. There isn't a company in existence whose employees aren't quick to complain when structures, rewards, and processes start getting in the way of doing a good job.

Companies that take the initiative with change in the ways we've described will, on the whole, avoid the coronary-inducing bursts of massive reorganization and restructuring that characterize many large firms. Even if they do have to undergo radical change, they will be better prepared to survive it. As Alfred West, founder and chief executive of the asset management company SEI, puts it: "Change is not easy, [but] you can't dodge it. It is with you. And you'd better embrace it." West is a serial changer, constantly tweaking SEI's structure, rewards, and business processes. Yet despite the organizational uncertainty and disruption this entails, SEI has consistently posted earnings growth of 40% per year and an annual average return of 28%, while featuring repeatedly on *Fortune's* list of Best Companies to Work for in America.

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organization, what kind of change to make, and what the scale of that change should be.

Each "yes" answer is worth one point. If you score less than three points, your organization doesn't need to change right now. If you score from three to seven, you need to contemplate at least one change soon. And if you score more than seven, your need is urgent and probably large scale. To determine what kind

