

## CHAPTER

# 6

## Reinforcing New Behaviors

**A**s we have seen, effective change implementation proceeds in a logical sequence of interventions. A dynamic competitive environment triggers the requirement for change.

Diagnosis sets the stage for effective change implementation by surfacing any misalignment that may exist between patterns of internal behavior and a desired new strategy.

In Step 1, redesign considers alternative patterns of behavior that will help the organization create and sustain outstanding performance. Out of the diagnostic process comes a shared understanding of the roles and responsibilities that employees must enact and the relationships that employees must create both among themselves and with key external stakeholders.

In Step 2, training and development helps employees acquire the required new skills and behaviors.

In Step 3, people change decisions ensure that the organization has employees with the needed competencies and behaviors.

Now, at Step 4, organizational leaders reinforce the new behaviors through what might be thought of as the “hardwiring” of the organization: structures, systems, and technologies. This chapter will explore the choices available in terms of hardwiring and analyze the importance of placing structural, system, and technology changes at the back end of a change process rather than leading with those interventions.

In particular, this chapter will:

- Identify the major structural choices faced by organizational leaders and the behavioral implications of those choices
- Consider the role of compensation in shaping desired behaviors
- Analyze the role of information technology (IT) in impacting employee behaviors

Before doing so, we will examine an attempt by a large national retail chain to restructure in order to revive their market during a recession. As you read this short case, ask yourself:

- How would you evaluate Macy's response to the recession?
- Is it really feasible to do both turnaround (layoffs) and transformation (restructuring) simultaneously?
- What and whose behaviors is Macy's attempting to change?

### **LOCALIZING A RETAIL GIANT CHAIN**

Macy's is the largest division of the retail giant Macy's Inc. (which also operates macys.com, Bloomingdale's, and bloomingdales.com). The department store chain sells clothing and accessories for men, women, and children, as well as a wide assortment of home furnishings. The chain operates in 45 states and, until the 2009 construction of Shinsegae Centum City in Busan, South Korea, boasted the largest single department store in the world (in New York City).

In the 1990s, the department store industry in the United States experienced considerable restructuring. Federated Department Stores purchased the Macy's chain and soon consolidated many of the other brands it had recently acquired—Jordon Marsh, Filene's, Rich's, Marshall Field's, Famous-Barr among them—under the Macy's banner. In 2007, Federated itself changed its corporate name to Macy's.\*

Like other retailers, Macy's executives understood that while all of these consolidations offered many advantages associated with the economies of scale and scope, they also tended to deprive the stores of local focus or flavor.<sup>†</sup> Decisions about what merchandise to carry and how to market and display that merchandise were made in corporate headquarters. Macy's relied on sophisticated market research, of course. But still, each store tended to resemble every other one. They had all become more or less generic.

The recession of 2008 led to cost cutting—4 percent of Macy's jobs were eliminated—but Macy's executives also wanted to increase revenues. Their strategy for doing that, labeled My Macy's, would move away from the cookie-cutter image of the chain by emphasizing local appeal and regional differentiation. The company experimented with six stores, allowing local managers greater say over what merchandise to carry and how to market it. Product mix could vary by region. Even the same products could be packaged and marketed according to local tastes. Decisions would now be made by local managers. This was an advantage over corporate market research, explained CEO Terry Lundgren. "It is much more accurate to have people living in the marketplace tell you, 'This is who is shopping in my store.'"

With the success of these half-dozen pilots, Lundgren decided to roll out My Macy's to the chain's 800-plus stores. To do that, he knew that he would have

\*So, Macy's is the name of both the corporate umbrella and its largest single business unit. This case focuses on the Macy's business unit.

<sup>†</sup>Economies of scale allow an organization to become more efficient by increasing the number of times it performs a single activity, while economies of scope allow a company to gain efficiencies by performing more than one activity with spare capacity.

to change the company's highly centralized structure. The businesses would now be subdivided into 69 "geographic districts" (approximately 12 stores per district). Results proved promising, helping Macy's recover from the recession. "We see the power in the local input from our experience over the past year," said vice chairman Tom Cody. "We know that the critical piece comes from the intelligence of the local market."

## SELECTING THE APPROPRIATE ORGANIZATIONAL FOCUS

Macy's new strategy called for regional differentiation, while its formal structure made such differentiation difficult, if not impossible. So, in order to achieve that strategy, Macy's changed its structure. After running six pilots, the company moved to a focus on regional markets.

In all organizations, the activities of employees need to be focused on two separate issues:

1. The *functional* or technical activities required to achieve the desired outcomes of the organization.
2. Responsiveness to the external *marketplace* (customers, suppliers, competitors, regulators, and so on) in which the organization has elected to compete.

No organization can select one focus to the exclusion of the other; the focus of employees must be simultaneous. Nonetheless, organizational leaders may choose to emphasize one over the other, and that emphasis is likely to change over time in response to the dynamism of the competitive environment and the strategic choices of the organization. It is therefore important that leaders understand the impact that various structural choices will have on the focus of employees and, consequently, on their behavior. Organization structure is a mechanism for helping to achieve the desired focus. Therefore, when a new strategy calls for a new focus, it is likely that the structure of the organization will need to change.

## Choices of Organizational Structure

**Organizational structure** refers to the formal manner in which employees are subdivided into units and divisions as a way of focusing their efforts on the required tasks of the company.

Structures impact behaviors by defining the context for work. The change implementation question, therefore, becomes two fold:

1. *What* structures to use?
2. *How* and *when* do we change structures?

Let's examine the *what* question first: what are the structural options available to leaders?

A quick look at an organizational chart reveals the choices that leaders have made concerning structure. A chart may show, for instance, functional units such as manufacturing, marketing, and engineering. Another chart might

### Building a Vocabulary of Change

*Organizational structure* the formal manner in which employees are subdivided into units and divisions as a way of focusing efforts on the required activities of the company.

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

## 128 Chapter 6

include product-oriented divisions, such as Macy's regional divisions. Far more complex charts might find lines of responsibility crisscrossing both horizontally and vertically, linking functions with product lines and perhaps even geographic regions.

Although structure is often thought of in terms of boxes and lines—who holds what title and who reports to whom—the key question is really one of focus

### THEORY INTO PRACTICE

---

*Organization structure is more than just boxes and lines; it is a way to focus the activities of employees.*

---

**FOCUS ON FUNCTIONAL EXCELLENCE** In their earliest founding stages, organizations typically exist in a prestructural state. When Open Markets, Inc. (OMI), a software tools and development business started, for instance, 12 employees shared office space in a Cambridge, Massachusetts, basement. They had no job titles but only the most general definition of individual responsibilities. The tasks that needed to be accomplished were simply shared.<sup>1</sup>

At some point, as organizations evolve, leaders adopted a more formal structure to add greater order, stability, and focus. "As we've grown," noted an OMI employee, "some people feel it is difficult not knowing who your boss is, who will evaluate your performance, where to go for help. As we get larger, we need a little more structure."<sup>2</sup> At OMI, employees naturally assumed responsibilities for the various functional activities of their organization: software development, of course, but also marketing, sales, vendor relationships, finance, and administration.

### THEORY INTO PRACTICE

---

*As organizations move beyond the small, start-up stage, they are likely to adopt a simple functional structure: people with similar skills performing related activities are placed in functional departments.*

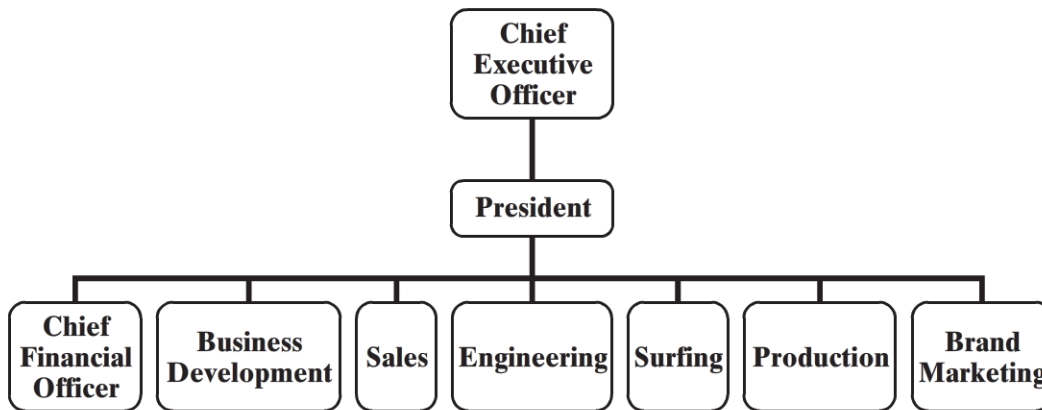
---

#### Building a Vocabulary of Change

*Functional structure a formal design choice that groups people together in units based on common tasks and specialized skills.*

Over time, as an organization continues to grow, individuals with like-minded interests, inclinations, and competencies find a home among one or another of these functional activities. In doing so, an organization can change by adopting a **functional structure**: a structure meant to focus activities on the functional or technical tasks of the organization. Exhibit 6-1 depicts a prototypical functional organization chart for an Internet portal provider.

By changing to a functional structure, organizations seek to bring discipline and efficiency to an operation. Functional structures help the organization achieve efficiencies of operation and standardization of offerings. Functionally structured organizations are in a position to fine-tune the product and service offerings, making sure the customer, "gets the most for the least."<sup>3</sup>



**EXHIBIT 6-1**  
Functional  
Organizational  
Chart.

## THEORY INTO PRACTICE

---

*Use functional structures to shape the development of technical skills and expert knowledge on the part of employees.*

---

No matter how functionally oriented an organization might be, there must also be some simultaneous capacity to respond to the marketplace. Functional structures attempt to achieve that responsiveness through a well-ordered sequential process.

In a functionally structured manufacturing firm, for example, we can follow the sequence:

1. Ideas from the marketplace enter the organization through the marketing department.
2. Engineers translate those ideas into designs.
3. Production transforms designs from concept to reality.
4. Products are delivered to customers via the sales department.
5. The financial department attends to such matters as profit margin and return on investment.

It is the responsibility of the general manager who sits atop the functional structure—sometimes a CEO, a senior vice president, or a managing director—to assure that the appropriate level of coordination among these sequential functional activities is achieved.

Because leaders call upon structures to focus employee behaviors, it is important to ask: Just what kind of employee behaviors can functional structures be expected to reinforce?

Let's start with the rigorous development of in-depth technical expertise. This development is enhanced by a functional career path that typically moves employees upward through a specific department. The organization hires individuals who enter at a low level of a function, then move vertically upward

## 130 Chapter 6

through that function as performance warrants. The organization gains from functional career path by developing and retaining their employees' expertise and knowledge. The individual gains clear career expectations, speedy upward mobility, and rapid salary escalation. Organizations whose success depends heavily on the depth of their technical competencies—accounting firms, hospitals, law partnerships, and universities, for instance—typically adhere to this functional pattern.

Organizational leaders may find that by moving to functional structures they inadvertently prompt behavioral patterns that can prove problematic. If an organization seeks enhanced innovation and speedier responsiveness to the marketplace, leaders may find a functional structure to be limiting and inhibiting. By focusing employees on achieving efficiencies and incremental improvements in existing products and services, functional structures may render employees less likely to be able to respond quickly with new and innovative offerings.

Much of the behavioral problem inherent in functional structures relates to low levels of coordination among employees, especially employees across different functional units. Functionally trained and developed individuals may find coordinated efforts with individuals from other departments to be difficult. Over time, insulated units tend to develop their own ways of thinking, unique patterns of working, speaking, conceptualizing time, and even defining effectiveness.<sup>4</sup>

In functional structures, employees have little opportunity to develop the competencies required of working together across departmental boundaries. At its worst, a kind of "us against them" mentality can evolve as employees battle each other across functions rather than uniting against common (external) competitors. The skills of the general manager may not be sufficient to overcome these structural barriers and achieve the required coordination.

### THEORY INTO PRACTICE

---

*Organizations seeking to create seamless coordination across functions may find that the silos erected through functional structures get in the way.*

---

Organizational change efforts may seek to deal with the challenges raised by a functional structure. The particular challenge is to enhance marketplace responsiveness. One of the most common ways of achieving that focus is to adopt a divisional structure.

#### Building a Vocabulary of Change

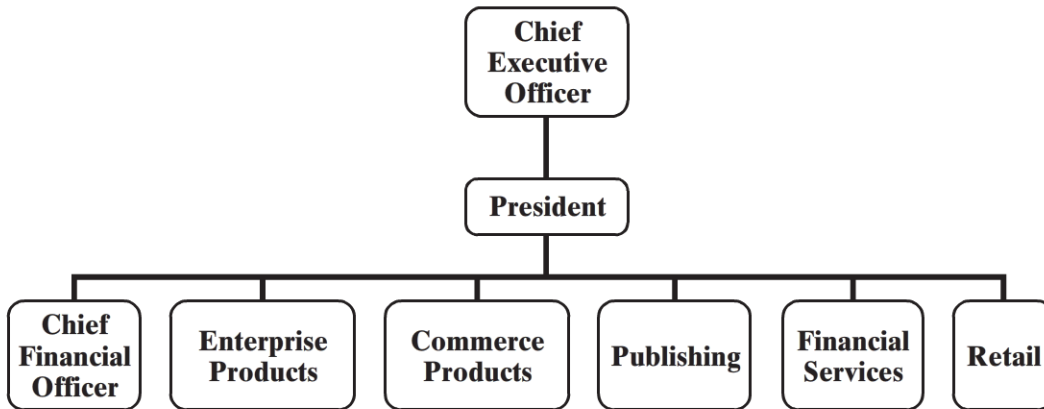
*Divisional structure* a formal design choice that groups people together in units based on common products, services, or customers.

**FOCUS ON MARKETPLACE RESPONSIVENESS** As organizations grow in both size and complexity, they often seek greater external focus. Most typically, they turn to a **divisional structure** as a way of reinforcing behaviors that respond to the marketplace.

All activities associated with a particular product or families of products are brought together in a divisional unit. A general manager, often a senior vice president, divisional president, or managing director, sits atop each unit. That structure is depicted in Exhibit 6-2 for a prototypical software developer.

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

**EXHIBIT 6-2**  
Divisional  
Organization Chart.



Another divisional option is to adopt a geographically focused structure. To reinforce geographic responsiveness, a fast-food chain, which is essentially a single-product operation, can create separate geographic divisions. McDonald's non-U.S. operations are subdivided into four regions: Asia/Pacific/Middle East/Africa, Canada, Europe, and Latin America. The company does so because executives believe that important differences exist in these multiple regions—in customer tastes and expectations, in supplier relationships, in government regulations, and in financial and labor markets—that require a differentiated response.

As we saw in the case of Macy's, regional structures may also be called upon to bring greater focus on local markets even within the same country. Differences in taste, style, and customer preferences do exist across regions. By creating 69 geographic districts, Macy's enhanced local autonomy which allowed for local responsiveness. The districts were not entirely autonomous, however, with corporate headquarters in Cincinnati still providing some centralized support functions.

### THEORY INTO PRACTICE

---

*Divisional structures enhance coordinated focus on the marketplace but make integration across highly autonomous divisional units difficult to achieve.*

---

The object of the divisional structure, whether it is based on products, customer groups, or geographic locations, is to reinforce a market focus. Product divisions pay close attention to the expectations and needs of customers for their particular offerings, while geographic divisions can attend to the special requirements and habits of the customers in their regions.

It is precisely that focused attention on the external marketplace that, it is hoped, allows companies organized divisionally to meet the challenge of coordination faced by functionally structured companies. By concentrating on a clearly defined and understood market segment, divisions seek to win by offering new products and services. Rapid responsiveness to shifting market realities is the goal.

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

132 Chapter 6

Changing from a functional to a divisional structure is not cost-free. Functional organizations seek the economies of scale; divisional organizations can be thought of as doing the opposite. In pure form, each functional activity is repeated in each division.

Adopting a divisional structure is meant to shape market-focused behaviors. It is not, in and of itself, any guarantee of true responsiveness. Remember, each product division is a self-contained functional organization. The problems often associated with functional organizations—internal focus, poor coordination, sluggish response time—can accrue over time in a product division. In multidivisional organizations, problems of coordination may arise across and between divisions. In order to respond to such problems, organizational leaders may now seek a kind of collaborative balance between functional and product divisions.

**THEORY INTO PRACTICE**

*Functional silos can exist within divisional structures.*

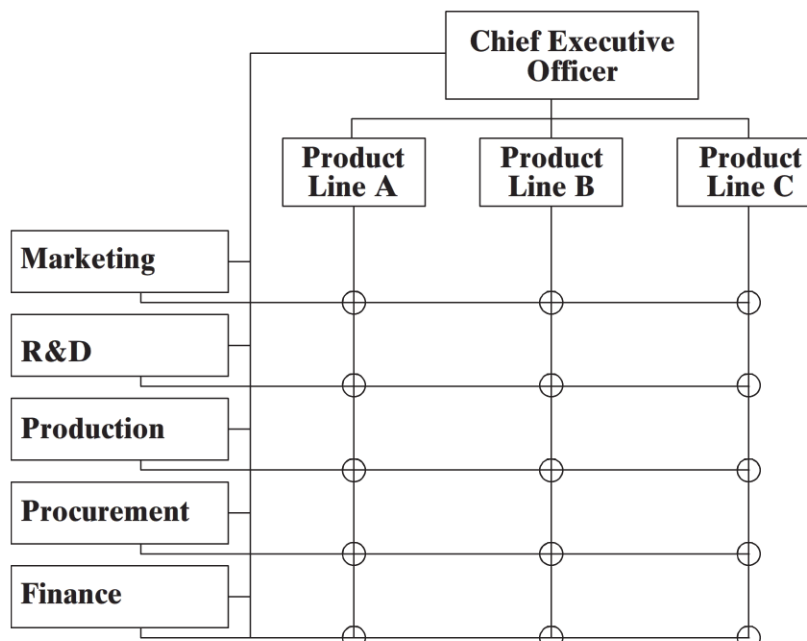
**Building a Vocabulary of Change**

*Matrix structure* a formal design choice that groups people by both function and product or product and geographical region.

**DUAL FOCUS** Leaders opt for a functional structure in order to emphasize efficiencies and depth of technical know-how and experience. A shift to divisional structures helps reinforce external focus on the marketplace. However, many organizations cannot make an either/or choice between internal and external focus. As the external environment becomes increasingly complex, organizational leaders need to consider increasing the complexity of their internal structures.

One choice available to organizations is the **matrix structure**. Exhibit 6-3 depicts one type of matrix structure. In that organization, both divisional and functional structures exist in an overlapping fashion, allowing for dual focus.

**EXHIBIT 6-3**  
**Matrix Organizational Chart.**



The requirement for dual focus might also arise from geographic demands. ABB built a geographic matrix through three regional groupings—Europe/Middle East/Africa, the Americas, and Asia—while simultaneously seeking segment focus through power, transmission and distribution, and industry and building systems divisions. Strategic focus again lies at the heart of the organization's challenge. While functional and product divisions prioritize their focus, matrix structures seek dual focus, attempting to move both quickly and efficiently.

### **THEORY INTO PRACTICE**

---

*Organizations can move to a matrix structure to help support dual focus—on technical expertise and marketplace responsiveness.*

---

The most striking—and for many people the most troubling—feature of the matrix is the lack of a single reporting relationship. Consider the matrix structure depicted in Exhibit 6-3. Assume you are a market analyst housed in product line C. Who is your boss: the manager of product line C or the head of marketing? The answer, of course, is: both. In order to achieve the desired complexity of focus, you will be reporting to and expected to be responsive to both simultaneously.

The notion of dual reporting relationships violates one of people's most deeply held assumptions about the desirability of a clear and unified chain of command in organizations. By breaking that clear chain of command, matrix structures require employees to deal with competing, even conflicting directions from multiple bosses. Ambiguity, tension, even conflict—these are all likely outcomes of a matrix. That likelihood undoubtedly accounts for the high failure rate—perhaps as high as 70 percent—reported by organizations who have attempted to implement a matrix.<sup>5</sup>

Despite their obvious complexities and ambiguities, when matrix organizations reflect the complexities and ambiguities in their external environment, they can enable greater responsiveness. Because most organizations “have to do business with multiple customers, multiple partners, multiple suppliers, and compete against multiple rivals can multiple areas of the world,” writes Jay Galbraith, they will need a structure that allows them to deal with multiple constituencies.<sup>6</sup> In order to respond to multiple constituencies, IBM currently maintains not two but *three* overlapping structures: products (hardware, software, and business solutions), customer groups (large corporations, governments, health care facilities, etc.), and geographic regions.

### **THEORY INTO PRACTICE**

---

*Matrix structures will be most effective in organizations that can manage ambiguity, tension, and conflict well.*

---

Despite the difficulties inherent in managing a matrix, it is often necessary in order to compete effectively in today's highly fragmented competitive environment. Organizations that are able to make a matrix function effectively will enjoy a great competitive advantage.

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

134 Chapter 6

**Building a Vocabulary of Change**

*Supply Chain* activities called upon by the organization to produce and deliver products and services to the customer.

**Building a Vocabulary of Change**

*Horizontally linked structure* a formal design choice that groups people along the supply chain activities and processes that produce, market, deliver, and service the firm's offerings.

**FOCUS ON THE SUPPLY CHAIN** The advent of sophisticated information technology and the geographic dispersion of technological excellence and knowledge have encouraged organizations to focus on their supply chain. Organizations develop competitive advantage and create shareholder wealth through an interdependent sequence of activities known as the **supply chain**.

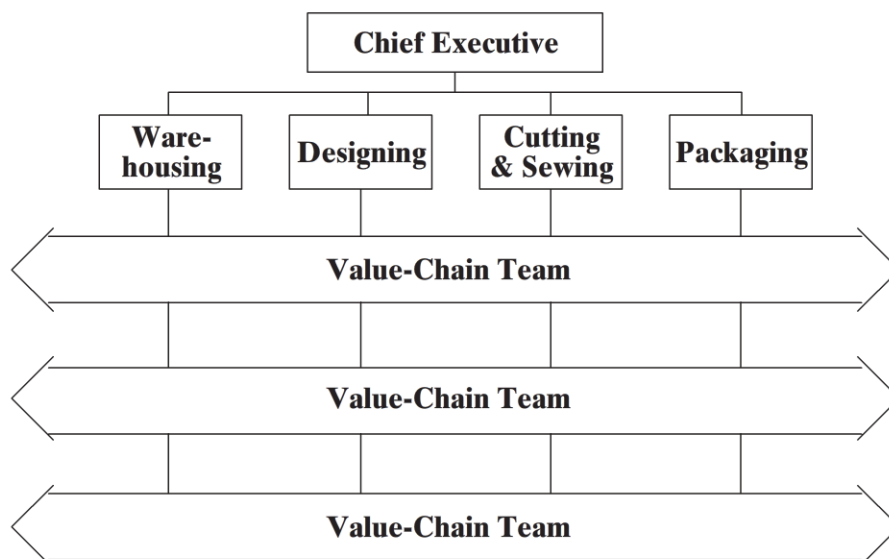
The supply chain can be defined as "the separate activities, functions, and business processes that are performed in designing, producing, marketing, delivering, and supporting a product or service."<sup>7</sup> **Horizontally linked structures** focus employees on the interrelated activities of the supply chain.

Horizontally linked structures usually supplement rather than replace existing functional or product structure in an organization. Dell Computers, a pioneer in supply chain linkages, relies on what founder Michael Dell calls "virtual integration." Dell focuses its attention on "how we can coordinate our activities to create the most value for customers."<sup>8</sup> Companies as varied as Zara, Wal-Mart, Southwest Airlines, and Shouldice Hospital call upon horizontally linked structures to coordinate supply chain activities in order to provide customers with a unique experience and their companies with a unique competitive advantage.

Zara, a fashion chain owned by Spain-based Inditex (which also owns and operates Pull & Bear, Massimo, and Dutti, among other retail formats), has succeeded by organizing activities around its supply chain. Starting with a clearly stated strategy—a focus on the ever-changing tastes of trendy young shoppers—Zara created raw material and design teams that could deliver their newly designed products into Zara retail stores within 3 to 15 days.<sup>9</sup> An organization chart for Zara is presented in Exhibit 6-4.

More traditionally structured apparel companies, where activities in the supply chain are separate and unlinked, often take up to a year to move from design to sale. Given the dynamic tastes of the rather fickle consumer base for fashion, slowness often leads to unused inventory, price-slashing sales, and waste.

**EXHIBIT 6-4**  
Horizontally Linked Structure at Zara.



## THEORY INTO PRACTICE

---

*Organizations can use cross-functional teams to achieve linkages across the various and interdependent activities of their supply chain.*

---

Organizations that have pioneered horizontally linked structures typically started with a clear strategic focus on their supply chain. It has been far more difficult for older, traditionally organized companies to respond. Delta's effort to create its own low-cost airline, Song, to compete with Southwest Airlines fell flat. Marks & Spencer tried and failed to compete with Zara for the young, fashion-trendy customer. Kmart has repeatedly slashed prices to compete with Wal-Mart while undermining its own profitability.

The difficulty seems to lie not in any formal structural change but in the organizational context that supports and reinforces the structure. Long-standing functional arrangements have cemented patterns of employee behavior that remain unchanged despite efforts to create horizontally linked activities.

No structure, whether it is horizontally linked, matrixed, or divided into divisions or functions can, in and of itself, provide an organization with distinctive competitive advantage for the simple reason that structures are not and cannot be distinctive.

### The Role of Structural Intervention in Implementing Change

When Lou Gerstner took the reins of an ailing IBM, he made a strategic decision: derive competitive advantage from the size and scope of his global operation.<sup>10</sup> Rejecting suggestions that he spin IBM off into a number of smaller companies, he sought instead to create an integrated global organization.

Gerstner's initial challenge in pursuit of that strategy was to integrate IBM's overseas operations with the base of the company. What was often known within IBM as a "religion of decentralization" had led to highly autonomous country general managers who reported to powerful regional executives. The head of IBM France, say, ran what amounted to a largely independent operation.

IBM's decentralized structure worked wonders for the company. Country managers could focus on their own regions and grow the business based on local responsiveness. But if local responsiveness was the benefit of decentralized structures, the cost was low collaboration. Employees in non-U.S. operations had come to think of themselves as working in and for their own home country company. *I work for IBM France, not IBM.* Little connection existed between the country-based operations and the corporate entity.

IBM customers provided the trigger for change. Global customers such as American Express complained about interacting with what seemed like different mini-IBMs in each country rather than one IBM with a global presence. Give us one face for IBM globally, they said, not many faces for each IBM national operation.

Gerstner agreed that the lack of global interaction posed a problem: "Each country had its own independent system. In Europe alone we had 142 different financial systems." The status quo simply did not allow for the seamless global

responsiveness that Gerstner's new strategy and IBM's global customers demanded. "Customer data could not be tracked across the company. Employees belonged to their geography first, while IBM took a distant second place." This, Gerstner believed, *had* to change and change fast if his strategy of global integration was to succeed.

As a former employee at the global consulting firm McKinsey & Company, Gerstner had experienced what he believed to have been an effective approach to globalization. Customer-focused global teams transcended national borders, allowing seamless responsiveness to global customers. To help IBM achieve that same global seamlessness, Gerstner turned to Ned Lautenbach, head of non-U.S. sales. Gerstner and Lautenbach would pursue their strategy with a globally focused, customer-centered organization.

Gerstner announced a new structure. Twelve customer groups (such as banking, government, and insurance) and one small and medium-sized company group would take over all IBM accounts, including responsibility for budgets and personnel. The restructuring reassigned most employees in non-U.S. operations to a specific group; they would now report to the global leaders of their industry group rather than to their country general managers.

The response from country general managers was overwhelmingly negative. *It will never work* and *You will destroy the company* were statements that expressed their resistance. Some country general managers responded by simply ignoring the new structure. One regional executive unilaterally decided to block all communications between Gerstner and the field.

It took three years of what Gerstner called a "painful and sometimes tumultuous process" before the new global strategy could be driven into IBM's multinational structure. "Regional heads clung to the old system," reflects Gerstner, "sometimes out of mutiny, but more often out of tradition." Only after "massive" shifts in resources, systems, and processes—not to mention the removal and replacement of numerous country managers who could not or would not make the transition—did the new structure take hold.

The fierce resistance that greeted Gerstner's attempt to realign IBM's global structure with its new strategy was, in part, a predictable response to his calling on the restructuring lever too early in the change process. After articulating a strategic focus and creating a supportive context, leaders can call upon structural interventions to reinforce new patterns of employee behavior. Organizations seeking greater customer responsiveness may move from a functional to a divisional function. If the firm's supply chain is failing to deliver competitive advantage, then the company may adopt a horizontally linked structure.

Just because structural interventions are useful in shaping employee behavior does not mean that changing structure is an effective opening tool for change. Effective change implementation, in fact, calls upon structural intervention not to *drive* change but to *reinforce* new patterns of behavior that have been created through earlier-stage interventions.

Returning to Lewin's theory of change (Chapter 2), adopting a new structure is part of the refreezing stage, not the unfreezing stage. For that reason, structural changes are most effective when used in Step 4.

## THEORY INTO PRACTICE

---

*Think of structural change in terms of Lewin's refreezing, not in terms of unfreezing.*

---

To understand the power of appropriate sequencing of interventions in impacting effective implementation, let's look at IBM. That company's highly decentralized divisional structure allowed responsiveness to multiple national markets served by this giant corporation. Global customers such as American Express now demanded greater coordination across national boundaries. *We're a global company, customers were telling IBM. We expect you to be a global supplier. We don't want to be dealing with multiple national mini-IBMs with little capacity to provide consistent and seamless service.*

Gerstner's new strategy for IBM counted on taking advantage of the company's depth and scope. He drove that renewed strategy by creating a global matrix structure: customer-based groups laid over a geographically divisionalized organization.

Gerstner's reasoning seemed solid: global responsiveness could be coordinated by global customer-group executives. That was the approach that Gerstner had experienced at McKinsey. It worked well there, so why not at IBM as well?

The problem Gerstner ran into had far less to do with the efficacy of the idea than the implementation process he called upon to introduce that idea. The structural change occurred early in the process of transforming IBM. Gerstner had failed to unfreeze attitudes by creating dissatisfaction with the status quo. Used to a high level of autonomy, country managers resisted. That resistance grew, in part, from their own habits, competencies, and preferences. It also grew from the process used to introduce change.

The country managers themselves had not been part of the diagnosis that led to the change, nor had the country and industry group managers worked collaboratively to develop well-defined roles, responsibilities, and relationships among the two groups; nor had IBM provided training on how to enact these new, complex roles. In essence, Gerstner jumped from a diagnosis formulated by a handful of corporate executives—mainly him and Ned Lautenbach—to a new structure.

Faced with fierce resistance on the part of country managers, he removed and replaced a number of them. Despite all his formal authority and the power of his vision for a truly global IBM, it took three years of what Gerstner himself called pain and tumult before the desired new behaviors began to take hold in the organization.

This is not to say that pain and tumult can be avoided entirely in implementation. The point, rather, is that the approach of using structural change as a driver rather than a reinforcer helps create heightened levels of resistance, some of which might have been avoided.

Structural change typically unfolds as a top-down intervention. It is the task of leadership, after all, to design the architecture of the organization in order to enable outstanding performance. However, if structural change takes place

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

## 138 Chapter 6

late in the change process, restructuring will not be experienced as a unilateral imposition from above.

Remember the old adage: People don't resist change; they resist being changed. If structural change occurs early in the process, it will be experienced by employees as being changed. If new structures are used to reinforce new behaviors, employees are more likely to support the change.

### THEORY INTO PRACTICE

---

*When structural change occurs early in a change process, employees can be confused by its purpose, unsure of what new competencies are being required, and unwilling—or unable—to make appropriate alterations in behavioral patterns.*

---

### USING INCENTIVES TO SUPPORT NEW BEHAVIORS

Compensation represents one of the strongest, perhaps most immediate tools that can be called upon to change patterns of employee behavior. Do we need a more performance-driven culture? Let's place employees on a pay-for-performance incentive. Need to attract young, highly skilled employees to our start-up business? Let's dangle huge stock offerings. Having trouble implementing activity chain process teams? Let's try team-based performance bonuses.

Organizations expend a huge amount of resources on pay—time, energy, not to mention money (anywhere from 40 percent to 70 percent of sales revenues). What value are they gaining in return for that expenditure? How successful are monetary incentives in shaping and altering employee behaviors?

The answer may seem obvious: *Of course* money can shape and alter behaviors. The real question, however, relates to long-term effectiveness. What role can compensation play in efforts to implement organizational change? To answer that question, we need to understand both the nature of pay's impact on behavior as well as the choices available to organizational leaders.

#### Focusing Pay on Performance

As the competitive business environment increasingly pressures organizations to achieve ever-improving performance, companies have rushed to adopt some sort of pay-for-performance plan. **Pay for performance** devotes at least some portion of an individual's pay (ranging anywhere from 3 percent to multiples of 100 percent) to measurable performance outcomes.

Pay for performance can take one of the two forms: *merit pay*, which raises base salary based on performance, and *incentive bonuses*, which offer regular but onetime payouts on the basis of performance. Bonuses do not alter base salary. They are considered onetime payments because they are not guaranteed. Substandard performance in the following year can reduce or eliminate the bonus.

Virtually every organization in the United States claims to have some kind of a merit pay system already in place. Incentive bonuses have become more

#### Building a Vocabulary of Change

*Pay for performance* pay that is tied to performance in the form of either a merit raise to base pay or an incentive bonus that does not increase base pay.

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

popular over the past two decades. As a percentage of total payroll costs, bonuses rose from 4 percent in 1991 to 9 percent in 2000.<sup>11</sup>

Most organizations select a mix of performance pay in order to shape employee behavior. GE, for example, calls for a blend of different bonuses to motivate executives, as indicated in the following company statement:

- **Salary and Bonus**—We pay salaries that are designed to attract and retain superior leaders, and we pay annual bonuses to reward exceptional performance.
- **Stock Options and Stock Appreciation Rights**—We award these to provide incentives for superior long-term performance and to retain top executives because the awards are fortified if the executive leaves before they become fully exercisable five years after grant.
- **Restricted Stock Units (RSUs)**—We grant RSUs to more closely align executives' interests with investors' long-term interests, to retain top executives because the awards are paid out only to executives who remain with the company for extended periods.
- **Long-Term Performance Awards**—We use these to provide a strong incentive for achieving specific performance measurements over multiyear periods.<sup>12</sup>

Organizations seek a mix of rewards in order to help ensure alignment between employee behaviors and their strategic goals.

One question to be raised in introducing or redesigning a pay-for-performance plan relates to level of aggregation: at what level of outcome should a pay-for-performance incentive be targeted—the individual, the group or team, or the organization? Pay for *individual* performance dominates the design of compensation in the United States. Exhibit 6-5 summarizes the various forms of individual pay-for-performance plans.

## THEORY INTO PRACTICE

---

*Individual incentives will be most effective in shaping behavior when the individual controls the outcomes being measured and rewarded, when the outcomes are tied to improved performance, when the evaluation of an employee's contribution is perceived as being valid, and when the difference between rewards for high and low performance is significant.*

---

Piece rate	Employee earns all or part of a wage based on number of units produced
Commission	Salesperson earns all or part of a wage based on number of units sold
Merit pay	Employee earns raise to base wage based on performance evaluation
Bonus	Employee earns extra payment based on performance

**EXHIBIT 6-5**  
**Forms of Individual**  
**Pay-for-Performance**  
**Plans.**

Although individual pay-for-performance incentives seem to hold great potential for shaping behavior, a number of challenges constrict that potential impact. The first question that can be raised about a pay-for-performance plan relates to the degree to which individuals have *control* over the outcomes that are being measured and rewarded. Without a significant and clear relationship between individual effort and outcome, a pay-for-performance incentive can drain the system of its full behavioral impact.

A second question relates to whether the incentive system has targeted appropriate *measures of performance* on which to base the reward. Failure to include *all* outcomes that are important for outstanding performance can lead to dysfunctional consequences. The more effectively the system impacts behavior, in fact, the more likely it will be that singling out one aspect of performance for measurement will give that aspect disproportionate attention.

For an individual pay-for-performance plan to impact behavior, the pay increment tied to outstanding performance must be perceived as being *significant*. To have a behavioral impact, the additional reward for that behavior should be 10 percent to 20 percent higher than the reward received absent the behavior. Raises, however, often amount to a relatively small amount of total compensation, making their potential to impact behavior weak. The “significance range” can be reduced considerably—down to 3 percent to 5 percent—if raises are accompanied by public recognition and praise.<sup>13</sup> Concerns over secrecy and confidentiality, however, often blunt an organization’s willingness and ability to accompany merit raises with public acknowledgment.

Finally, in order to be effective, pay for performance must be based on *valid judgments* about individual performance. Distortions often creep into the evaluation process, leading participants to question the validity of resulting assessments. That lack of trust in the evaluation process presents itself as one of the key reasons. U.S. employees report high levels of dissatisfaction with the implementation of their companies’ pay-for-performance plans. Less than one-third of surveyed U.S. employees believe a direct link exists between pay and performance, despite company claims of a merit pay plan.<sup>14</sup>

Despite the numerous questions that can be raised about the limitations of individual pay-for-performance incentives (summarized in Exhibit 6-6), such plans are nonetheless becoming more popular. Although there is evidence that managers in non-U.S. countries are far more skeptical of the positive arguments U.S. managers make concerning the performance benefits of discretionary bonuses, such bonuses are becoming increasingly popular around the world.<sup>15</sup>

*Team-based* pay-for-performance plans are becoming more popular in direct relationship to the rising reliance on team effort. Among performance incentives aimed at nonexecutive employees, in fact, team-based plans have become the most popular.<sup>16</sup> Under such a plan, teams can share a performance bonus equally or allocate to individual members based on an evaluation of their contribution. Team-based bonuses enhance team performance, although the effect is relatively weak.<sup>17</sup> A caveat is in order, however. Team-level bonuses can hurt collaboration *among* and *between* teams.

**Username:** Mohammad Aljahdari **Book:** Implementing Organizational Change: Theory into Practice, Third Edition. No part of any book may be reproduced or transmitted in any form by any means without the publisher's prior written permission. Use (other than pursuant to the qualified fair use privilege) in violation of the law or these Terms of Service is prohibited. Violators will be prosecuted to the full extent of the law.

---

Performance appraisals are inherently subjective, with supervisors evaluating subordinates according to their own preconceived biases

Emphasize individual rather than group goals that may lead to dysfunction conflict in the organization

Encourage a short-term orientation (the performance period being evaluated) at the expense of long-term goals

Merit pay raises become an annuity on which employees continue to draw regardless of future performance

The often lengthy time lag between actual performance and reward undermines perceived connection between the two

Many jobs cannot be individually isolated and precisely measured without taking into account complex interdependencies

Pay differentials between performance levels tend to be relatively small and therefore of questionable behavioral value

Actual payout of program often determined by organizational factors beyond the control of individual employees and only indirectly related to actual performance

---

**EXHIBIT 6-6**  
**Factors That May Undermine Effectiveness of Individual Pay-for-Performance Plans.**

Based on Luis R. Gomez-Mejia, David B. Balkin, and Robert L. Cardy, *Managing Human Resources* (Englewood Cliffs, NJ: Prentice-Hall, 1995), p. 404 and Edward E. Lawler III, "Pay Strategy: New Thinking for the New Millennium," *Compensation and Benefits Review* 32 (January–February 2000), pp. 7–12.

---

**THEORY INTO PRACTICE**

---

*Organizations call upon team-based performance bonuses to enhance the effectiveness of teams, but the bonus may undermine collaboration between teams.*

---

Because strategic renewal focuses on organizational performance, *organization-level* incentives often supplement or replace individual bonuses. Traditionally, organizations have offered organization-wide incentive bonuses only to executives and upper management on the assumption that their actions are more closely tied to overall organizational performance than employees at lower levels. However, some organizations have adopted a different perspective. Part of Archie Norman's strategic renewal at Asda was to offer an organization-level performance bonus to all employees, encouraging everyone to keep focused on the same measures of overall effectiveness.<sup>18</sup>

---

**THEORY INTO PRACTICE**

---

*Bonuses based on the overall performance of the organization make a symbolic statement recognizing the shared purpose and responsibility of all employees and organizational units.*

---

Stock options are intended to tie the total compensation package of individuals to the performance of their organization.<sup>19</sup> The goal, as articulated by the board of directors of eBay, is to "align the interests of directors and executives

## 142 Chapter 6

with the interests of stockholders.”<sup>20</sup> Favorable tax laws have made these plans more popular in the United States than elsewhere, although a number of multinational firms—PepsiCo, Bristol-Myers Squibb, DuPont, and Merck among them—have offered stock options to virtually all of their employees worldwide.<sup>21</sup>

The actual effectiveness of these various organization-level performance bonuses is unclear. Some sort of incentive tied to organization-level performance is a frequent characteristic of high-performance companies.<sup>22</sup> What is less certain is whether the organization-level performance bonus results *in* or *from* outstanding performance. The cause-and-effect relationship between specific behaviors and organizational outcomes may be far too vague, especially in large organizations, to create a powerful incentive on the part of individual employees.

Undoubtedly, the degree to which organization-wide bonuses are accompanied by communication and feedback on firm performance, as well as the empowerment of employees to impact performance, will enhance the plan's motivational impact. Tying all employees' pay packages in some significant way to the same organizational-level outcomes may help in both a symbolic and real way to communicate a mutuality of interests and concerns.

### Building a Vocabulary of Change

*Extrinsic reward* rewards (pay, promotion, praise, and so forth) provided by the organization to employees.

### Intrinsic and Extrinsic Rewards

Incentive pay, regardless of the specific design, is an **extrinsic reward**: a reward external to the individual and provided by the organization. Money is the most obvious and prevalent example of an extrinsic reward. Motivational theory tells us that extrinsic rewards, although powerful, may not be terribly effective in driving long-term behavioral change.

### THEORY INTO PRACTICE

---

*By relying heavily on extrinsic rewards to shape employee behavior, organizations risk driving out the intrinsic rewards that might be associated with the work; as a result curiosity, creativity, and problem-solving behaviors may be lessened.*

---

### Building a Vocabulary of Change

*Intrinsic reward* rewards (feelings of pride, satisfaction, and self-esteem) that accrue to the individual based on the performance of a task.

Commitment to adopt new behaviors comes from *within* individuals. If the goal of change is to create motivation—as internalized desire on the part of employees—to adopt new behaviors, then organizational leaders need to consider intrinsic rewards as well. An **intrinsic reward** is a positive outcome naturally associated with a behavior.

Intrinsic rewards—a sense of accomplishment, learning, and growth, for example—are provided in a constant and ongoing way as individuals interact with their environments. Intrinsic rewards, according to Edward Deci, motivate exploration, play, curiosity, and puzzle solving.<sup>23</sup> For that reason, intrinsic rewards can be more helpful in building commitment to new behaviors, especially when the desired new behaviors are based on creativity and problem-solving activities.

No organization can rely solely on either extrinsic or intrinsic rewards to support new patterns of behavior. The challenge is that the two approaches to shaping behavior do not easily coexist. Overreliance on extrinsic rewards, pay in

particular, can actually *dampen* internal motivation.<sup>24</sup> Employees may, and often do, find themselves behaving in a certain way *because* of the money attached to the behavior rather than an internalized desire to undertake the behavior. And the more attractive the reward is to that employee, the more likely it is to drive out internal motivation.

Not all extrinsic rewards work against internal motivation and creativity. Praise, which is an extrinsic reward, can enhance motivation by helping individuals feel competent and self-determining. Even pay can be used in ways that do not drive out motivation: when pay is used to *attract* individuals to an organization, it does not have a negative impact on motivation.

Rewards such as bonuses that are *not* tied a priori to specific outcomes but are presented after the fact in recognition of particularly creative effort are likely to lead to higher creativity in the future. The creativity benefit of such after-the-fact bonuses is enhanced when those bonuses are coupled with constructive feedback and tied to creative outcomes rather than any particular or specific methodology for achieving those outcomes.<sup>25</sup> Even so, intrinsic rewards are the primary factors contributing to creativity; extrinsic rewards more typically encourage routine behavior.

## THEORY INTO PRACTICE

---

*Bonuses provided “after the fact”—without being announced or promised beforehand—can be used to reinforce desired new behaviors.*

---

The opportunity as well as the challenge for a manager is to provide motivation that is, in essence, internal to employees. Design decisions that allow employees to participate in decision making enhance the developmental opportunities of work, thus providing a key intrinsic motivation. Providing employees with autonomy and performance feedback enhances employees' sense of self-efficacy and ego satisfaction. In these cases, the organization is creating an environment where employees are more likely to find intrinsic motivation in their work.

**Pay equity** is also vital to the achievement of intrinsic motivation. Only employees who believe that their pay level is fair and equitable—compared to peers both inside and outside the organization, to subordinates, and to superiors—will be intrinsically motivated by the desire to learn, to develop, and to grow.<sup>26</sup> Job evaluation plans endeavor to create a sense of internal equity, and regular salary surveys can help achieve external equity. Just as importantly, organizations that provide employees with regular and candid feedback about performance and contribution can help ensure congruence between pay levels and perceptions of fairness.

### Building a Vocabulary of Change

*Pay equity* a perception by employees that their pay is fair and equitable in relationship to others: peers inside the organization and out as well as subordinates and superiors in the hierarchy.

## THEORY INTO PRACTICE

---

*Organizations will not be able to call on intrinsic motivation unless employees feel that they are being paid equitably.*

---

### Sequencing the Introduction of Incentives

The temptation to introduce a new incentive plan early in change implementation is powerful but potentially harmful. Some brief examples of unintended consequences include:

- A community bank introduces a sales bonus designed to encourage more aggressive revenue generation on the part of employees. Customer service representatives now ignore the complaints of, and even occasionally hang up on customers once those customers have expressed a lack of interest in purchasing additional bank services or product offerings.
  - After introducing a new executive bonus based on divisional performance, an organization finds its executives withdrawing shared resources from other divisions in order to maximize their own performance.
  - A Silicon Valley–based software developer, which had relied heavily on stock options to attract employees, reels when its stock price drops sharply; high turnover deteriorates performance, which leads to even lower stock prices and leaves management with little to offer new employees by way of attraction.
  - A plant manager halts a team-based incentive plan because of increasing rivalry among teams.
  - A school system finds its “Teacher of the Year” bonus award designed to enhance performance instead leads to dissension and distrust among its formerly collegial faculty.

When applied early, new pay incentives can either fail to alter long-standing patterns of behavior or, even more troubling, change patterns of behavior in an unintended, even unwelcome way.

In the above examples, new incentives were put into place before a thorough diagnosis of the existent patterns of behavior in the organization; before a carefully, strategically guided, and participative effort was made to redesign roles, responsibilities, and relationships among employees; and before human resource development worked to imbue the organization with required new competencies. Management turned to incentives as a quick fix: an intervention that would immediately shape employee behavior. That is exactly what they did, of course, but not in a desired way.

#### THEORY INTO PRACTICE

---

*Introducing new incentives early in a change implementation process risks negative consequences.*

---

When it comes to integrating new incentives into change implementation, leaders face two types of choices: *what* and *when*.

*What* choices relate to decisions concerning the design of their incentives:

- At what level of performance will incentives be set?
- How large will potential incentive earnings be in relationship to base salary?