How Boards Can Support Organizational Transformation

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Change need not be as risky and wrenching—if directors understand key issues involved.

Competitive realities in today's business world are forcing the need for large-scale transformations of organizations, even in successful companies. While in some cases transformation initiatives can lead to dramatic business improvements, in other cases the transformation may stall or even backfire.

The board of directors can play an important role in smoothing the transformation process by understanding some of the common pitfalls an organization may encounter, and by ensuring that executive teams are adopting a focused, systematic approach to change initiatives. Directors can also play a major role in managing shareholder expectations during the transformation to give this reasoned approach a chance to take effect without damaging shareholder confidence.

Contrasting Change

Even successful companies can benefit from organizational transformation. Take Microsoft Corp., for example, currently undergoing a sweeping overhaul of its philosophy and structure despite incredible prosperity. While its financial performance has been astounding, there had been growing discontent at Microsoft—layers upon layers of red tape caused lags in decision-making and product development, key talent had been leaving, and the company faced more challenges to its product dominance than ever before.

The transformation, dubbed "Vision, Version 2" by Microsoft chairman Bill Gates, aims to streamline decision-making and reinvigorate employees, and industry analysts seem to think it's a step in the right direction.

All too frequently, however, apparently rational but ambitious organizational transformations such as "Vision, Version 2" stall or derail, delaying anticipated benefits and shaking shareholder confidence.

Witness the situation at Sunbeam Corp., the appliance manufacturer that was losing market share and definitely in need of a transformation when Albert J. Dunlap was hired as CEO in 1996. Known as "Chainsaw Al," Dunlap had made a name for himself at Scott Paper and Lily-Tulip, where he had slashed jobs and upped corporate profits. Upon being hired at Sunbeam, Dunlap wasted no time in using his well-publicized approach to corporate transformation: He quickly picked up his chainsaw and cut Sunbeam's work force in half and introduced other major initiatives designed to cut costs and boost profits. While hopes for a transformed Sunbeam were high, initially driving its stock from $12 to $50 a share, after nearly two years, things started to crumble.

Despite all the cost-cutting moves, Sunbeam posted a first-quarter loss in 1998, and allegations were made about artificially inflated profits in previous quarters. Shortly thereafter, Sunbeam's board fired Dunlap.

Why did Sunbeam fail to achieve successful change? How can Microsoft prevent such failure? The answer lies in understanding and avoiding common pitfalls of organizational change.

Transformational Pitfalls

There are four common pitfalls that can stall or derail even the best corporate initiatives or transformations.

Pitfall 1: One-Size-Fits-All

The first, illustrated by the example of Sunbeam Corp., is expecting staff changes to produce quick results with a "one-size-fits-all" solution. While sometimes the existing leader is no longer a match for the job, it is not always safe to assume that an individual who is a star in one organization can simply impose his or her solutions on another organization, as Al Dunlap tried to do at Sunbeam. A warning sign: If transformational progress is stalled or regresses even after new leaders are brought in, the organization may be experiencing this pitfall.

Pitfall 2: Covert Resistance

While replacing leaders of an organization will guarantee change, it may not guarantee progress, as the problems may go well beyond any one person or group. The new leader frequently faces covert resistance, the second pitfall. Many

DIRECTOR SUMMARY

Large-scale corporate change initiatives often backfire, creating more problems than they solve. Directors can ensure successful transformation efforts by understanding common pitfalls, by understanding culture—both formal and informal—and by asking the right questions. ◗

Formal corporate culture involves everything that's official—the corporation's mission and value statement, the policy manual, the operating procedures, the performance review system, the organization chart, and so forth.

times, transformation initiatives will be mandated from the top down without the proper support or planning. The CEO and/or executives will insist on the change, and the organization will respond back with lip service agreement, but in reality, everything keeps on happening the way it did before the initiative was put into place.

For example, executives of a company I was called in to help had decided to introduce Lotus Notes in its workplace to improve information sharing and cross-group communication. Managers had explained the benefits of the new system, provided training, and encouraged its employees to use the system. However, the team charged with planning and implementing the Lotus Notes initiative did not take into account the natural tendency of organizations to "push back."

While the new system was well supported in one sense, management maintained many formal and informal incentives for the work force to value short-term speed and immediate results. Therefore, employees were reluctant to take the time to fully familiarize themselves with the new system, citing that it was "too much work" to use.

While the employees did not openly rebel, and outwardly voiced a willingness to use the new technology, their covert resistance resulted in wasted time and resources along with missed opportunities by underutilizing this potentially powerful technology.

Pitfall 3: Lack of Preparation

While forcing major changes creates one set of problems, premature introduction of major changes leads to the third common transformational pitfall: lack of preparation. Executives can get everyone charged up for a key initiative, and get all the employees enrolled and excited, but lo and behold, for a variety of reasons the organization isn't able to absorb the magnitude of the change, and the initiative crashes and burns—until the next major initiative is introduced. Not only does this lead to a "flavor of the month" cynicism, but the unfortunate lingering effect is a reluctance in the organization to innovate and try new approaches. The truth is that the same initiative would have had a greater chance of success if it had been introduced in an incremental manner.

One client company learned this lesson the hard way when the new CEO chose to introduce a large-scale reorganization of his company into cross-functional teams. The initiative was introduced with great fanfare, and there was tremendous excitement about the potential for new results. However, the CEO didn't realize how deeply embedded the organization was in hierarchical "silos." Consequently, the move to cross-functional teams was derailed as teams were undermined by other priorities. While the initiative eventually got back on track, fixing the problem required extra time and resources that could have been applied elsewhere.

Pitfall 4: Incorrect Information

The last pitfall, but certainly not the least, is taking or failing to take action based on incorrect information or assumptions. In a widely publicized case, in February 1999, Sears, Roebuck and Co. paid a $60 million fine against a charge of bankruptcy fraud perpetrated by one of its subsidiaries. The problem, which went undetected by Sears executives for over a decade, was apparently driven in large part by pressure to meet aggressive business goals imposed during a transformation effort, along with a reluctance of front-line workers and middle management to send bad news to the top. The fatal assumption made by Sears executives was the belief that there was free-flowing communication within their organization.

The Importance of Corporate Culture

All of the transformational pitfalls have a common theme: the importance of fully considering existing corporate culture in planning and advancing the transformation. What exactly is corporate culture? It's defined by the formal and informal values, beliefs, and practices that exist within a corporation. Culture encompasses the way in which the organization presents itself to the outside world as well as the way in which internal operations are conducted.

Formal corporate culture involves everything that's official—the corporation's mission and value statement, the policy manual, the operating procedures, the performance review system, the organization chart, and so forth. Informal culture involves what really happens within a company—the real values, beliefs, and practices. While more weight is usually given to the formal culture in planning and communicating inside and outside the organization, the informal culture is more important in shaping what really happens.

When the formal and informal corporate cultures clash, as often occurs with transformations, gridlock can ensue, as in the pitfalls I've described. If a formal initiative is counter to the informal business culture, the informal culture will win every time. In order to avoid that gridlock, and the derailment of the transformation, it's important to understand both types of cultures and take them into consideration when developing initiatives.

To successfully lead an organization through a transformation, leaders need to adopt a focused, systematic approach.

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Too many managers have been pressured into an “act now, think later” mentality, especially when the transformation is to be accomplished under difficult circumstances, with boards and shareholders clamoring for immediate results. Managers and directors will be more effective when they launch a transformation by conducting an assessment of the existing corporate culture—a “snapshot”—and see how it might affect or interact with initiatives that need to be put into place. For example, Microsoft President Steven Ballmer conducted 100 in-depth employee interviews before coming up with the “Vision, Version 2” plan to reinvent that corporation.

Once the existing formal and informal corporate cultures are understood, executives need to address the underlying issues that can lead to resistance and performance problems. Of particular importance is how a gap between the informal and formal business cultures is inadvertently perpetuated through a wide range of rewards and punishments, such as: praise, criticism, promotions, “perks,” and terminations. Once the cultural issues have been addressed, realistic goals and priorities can be set, and the organization can be prepared for the changes to come.

A Successful Transformation

Greg Brenneman, president and Vice President of Global Services of Continental Airlines, knew how important culture issues would be in his effort to transform that troubled corporation in 1994. The “Go Forward Plan” to reinvent the airline and make it profitable included four cornerstones: “Fly to Win,” the market plan; “Fund the Future,” the financial plan; “Make Reliability a Reality,” the product plan; and “Working Together,” the people plan, designed to transform Continental’s culture.

The “Working Together” plan called for changing the culture from one where work groups were commonly pitted against one another, communication between management and employees was minimal and employee’s suggestions disappeared into a “black hole,” to one where employees had confidence in management, peace was maintained and promoted between work groups, and people were treated with dignity and respect. In other words, they established healthy culture traits that had been lacking in the old culture.

Needless to say, it worked, but the transformation required an incremental process. However, the payoff has been worth the investment. Huge reductions have taken place in turnover, sick leave, on-the-job injuries, and workers’ compensation claims. And even more important, Continental Airlines has achieved dramatic and profitable results in the past several years.

What Is the Board’s Role?

While corporate boards of directors usually don’t have day-in, day-out contact with their organizations undergoing transformation, they cannot be divorced from the goings on. Board members can ask questions of the CEO to make certain that the plan devised by executives is realistic and takes a focused, systematic approach.

Examples of questions that the board can ask include:

◗ What are the potential business culture obstacles that must be overcome for this transformation to be carried out within the estimated time frame?

◗ What assumptions about the existing business culture are being made by this transformation plan? (*e.g.*, speed of decision making, communication flow, etc.)

◗ What plans exist to deal with organizational anxiety and resistance?

◗ What is the plan for communicating with stakeholder groups to support and reassure them during the transformation period?

Continental understands the importance of this last point. Its recent large-scale transformation was carefully and consistently explained in person and in writing to each stakeholder group to ensure that there was a common understanding of the challenges that were being faced and the steps that were being taken in response to these challenges. This bolstered confidence considerably.

Understanding Essential

In summary, understanding both formal and informal elements of the existing corporate culture is an essential element of organizational transformation. Without taking culture into account, a transformation can easily succumb to pitfalls that can cause it to fail. If the board and management understand their formal and informal business culture, their transformation initiative has a greater chance for realization. The board’s involvement can help keep the process on track and give it time to succeed. ◗

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