Nine tests of **organisation design**

The weight of research and insight into organisational design is heavy and growing. Michael Goold and Andrew Campbell cut through the complexity and emerge with a new approach to organisation design which includes a rigorous framework for design choices based on nine key tests of organisational effectiveness.

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What are the factors that should guide the choice of organisation design? There are many managerial rules of thumb about things such as spans of control and reporting relationships. In addition, academics and consultants have produced a huge amount of work on organisation design. But our research told us that managers still lack a practical and systematic framework to guide their organisation choices. An important purpose of our work has been to condense previous ideas on organisation design into a few core principles, on which to base a usable framework.

Less an intellectual triumph than a practical checklist for addressing the most important issues,

FIGURE 1: FRAMEWORK FOR ORGANISATION DESIGN

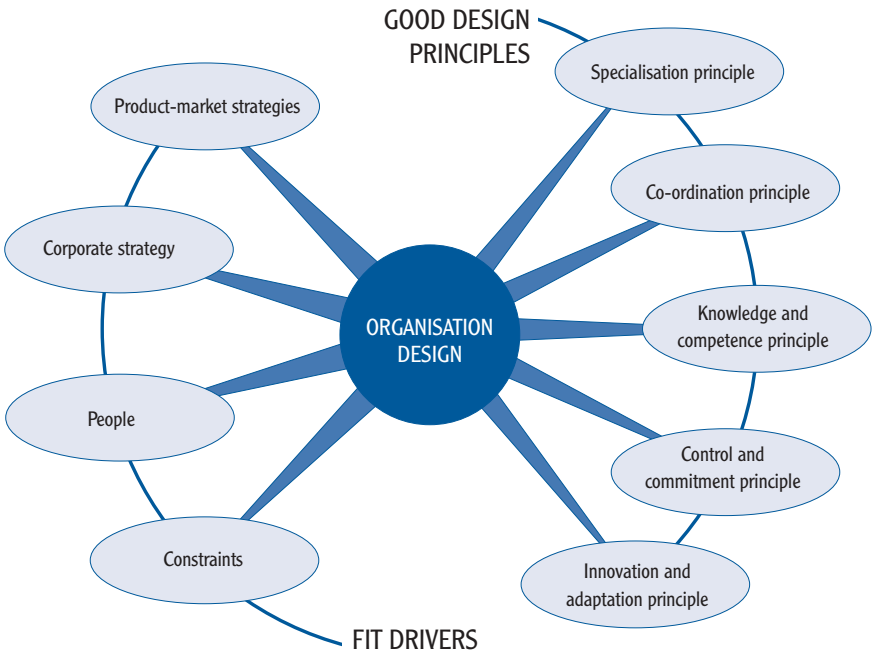

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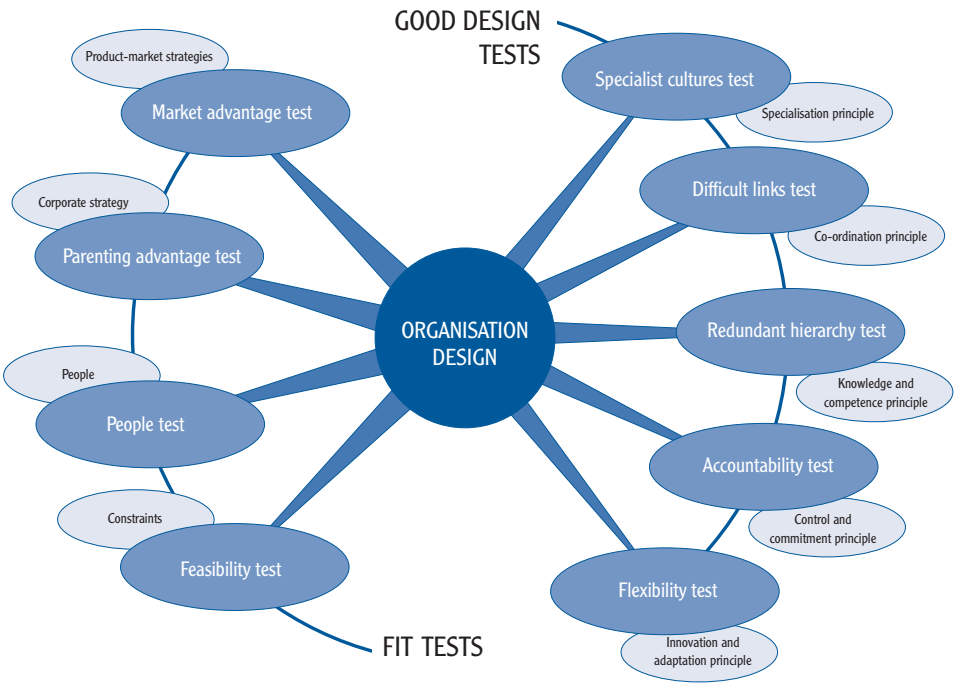
FIGURE 2: NINE TESTS FOR ORGANISATIONAL DESIGN



our framework is grounded on some basic principles. The first and most important, the fit principle, embraces four drivers of fit – product-market strategies, corporate strategies, people and constraints. The other good design principles are the specialisation principle, the co-ordination principle, the knowledge and competence principle, the control and commitment principle, and the innovation and adaptation principle (Figure 1).

The principles are broad in nature and not always easy to convert into prescriptive guidance. They are more valuable in orienting managers than in resolving particular organisational dilemmas. However, as we worked with the principles, we found ways to convert them into some practical tests. Perhaps the most important contribution of this lies in the insights and understandings that the tests produce. The tests match the fit drivers and the good design principles. (See Figure 2).

The fit tests

One almost universally agreed proposition is that organisations need to be fit for purpose. Strategy,

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therefore, should be a key driver of organisation design, and we have found it useful to distinguish between product-market strategies and corporate-level strategy. But strategy is not the only driver of organisational design. At least as important are people. Many authorities counsel against designing an organisation around people, preferring to build around the strategy and change the people if necessary. However, people cannot always be changed and new ones with the required attitudes may be hard to find. So designs should take account of the people available to lead and work in them. Finally, organisation design is subject to various constraints, ranging from laws laid down by governments to organisational capabilities or resources that are deeply embedded.

> All too often, organisations evolve in ways that are not sufficiently related to the strategy of the company, or else pay scant attention to the limitations of managers who will fill key positions.

The fit drivers lead to four fit tests:

The market advantage test: "Does the design allocate sufficient management attention to the operating priorities and intended sources of advantage in each product-market area?"

The parenting advantage test: "Does the design allocate sufficient attention to the intended sources of added-value and strategic initiatives of the corporate parent?"

The people test: "Does the design adequately reflect the motivations, strengths and weaknesses of the available people?"

The feasibility test: "Does the design take account of the constraints that may make the proposal unworkable?"

The fit tests bring out the most important inputs that should guide organisation design choices. Provided the design has been selected with these inputs in mind, there should be no problem in passing the fit tests. However, organisation design choices are not always so rational. All too often, organisations evolve in ways that are not sufficiently related to the strategy of the company, or else pay scant attention to the limitations of managers who will fill key positions. In one company, we were told that the structure had always been primarily driven by the balance of power between the four barons who ran the main divisions, resulting in business unit groupings that had little to do with the opportunities in the markets being served. Under these circumstances, the organisation will be a barrier to successful strategy implementation and will damage competitiveness. The fit tests ensure that organisations that are evidently not fit for purpose will be exposed, and that more suitable alternatives will be adopted.

The good design tests

While the four drivers of the fit principle are recognised by most managers, we believe the good design principles and tests represent more of an advance. They synthesise the vast quantity of academic research and managerial experience about what makes an organisation work well into a few basic tests that should guide any organisation designer.

The specialisation principle and co-ordination principle both concern the boundaries between

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units. The specialisation principle states that boundaries should exist to encourage the development of specialist skills, whereas the co-ordination principle emphasises that activities that need to be co-ordinated should be located within the boundaries of a single unit.

Although these basic principles are clear, there are unfortunately often trade-offs between specialisation and co-ordination. A broadly-based product structure may give economies in purchasing and manufacturing, but be detrimental to the development of specialist products for particular markets. A disaggregated geographical structure with many local units may support the special skills needed for different regions, but prevent effective co-ordination in product development or IT infrastructure. The difficult organisational problems arise when there are trade-offs between different ways of grouping responsibilities. In order to help with these trade-offs, we have developed two tests, which give more precision to the basic principles and make them more practically useful.

> *The specialist cultures test:* "Do any 'specialist cultures', units with cultures that need to be different from sister units and the layers above, have sufficient protection from the influence of the dominant culture?"

> *The difficult links test:* "Does the organisation design call for any 'difficult links', co-ordination benefits that will be hard to achieve on a networking basis, and does it include 'solutions' that will ease the difficulty?"

The specialist cultures test questions whether the required specialist skills will thrive only if the managers concerned are insulated from the influence of other parts of the organisation. For example, sometimes the best way to develop and market a new product is to set it up as a separate business unit, with little or no contact with the rest of the company. Alternatively, instead of setting up a separate unit, it may be possible for the corporate parent to ensure that the specialist culture receives sufficient protection by flexing corporate policies and procedures or by giving it certain powers. The test focuses attention on the dangers of suppressing or damaging activities that fall outside the mainstream corporate culture, dangers which are easy to overlook.

The difficult links test recognises that many co-ordination benefits can be achieved through spontaneous networking between units, but that others will be more difficult. For example, best practice sharing can often be left to networking between units, whereas the establishment of common technical standards is unlikely without a corporate policy which makes them mandatory. Organisation designers should focus only on the few co-ordination benefits that will be difficult: where networking will not deliver the benefits. For these difficult links, it is necessary to develop appropriate co-ordination mechanisms or interventions to overcome the difficulty, or to readjust the design so that the co-ordination lies within the responsibilities of a single unit. This test makes managers assess which co-ordination benefits will be difficult to achieve if left to the network, and to think through whether and how the difficulty can be overcome.

Together, the specialist cultures test and difficult links test give managers a powerful means of assessing the trade-offs between the benefits that can be gained from co-ordination and from specialisation. In the 1980s, IBM decided to set up its PC division as a very separate unit, free from the influence of the IBM corporate culture and policies. This promoted a specialist PC culture that was highly successful in bringing the new product to market rapidly. Using a similar logic, many commentators argued that, when faced with performance problems in the early 1990s, IBM should break up the whole company into separate,

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independent units. Lou Gerstner, however, believed that the opportunity for IBM lay in providing integrated customer solutions. He therefore kept the company together. But he recognised that co-ordination between separate product divisions was not proving a satisfactory means of offering integrated solutions, due to conflicting divisional priorities and incompatible technologies. He therefore gave authority to IBM Sales and Distribution division and to a new unit, the Global Services division, to concentrate, respectively, on customer solutions and services, using both IBM and competitor products. These divisions have the power to offer a unified approach to customers and have dealt well with the previously difficult links between IBM divisions. At the same time, Gerstner has encouraged new business activities, such as Business Innovation Services, IBM's e-business initiative, not to be bound by IBM's traditional policies and ways of doing things. IBM's structure now takes account of both the difficult links and the specialist cultures tests.

The difficult links and specialist cultures tests help managers to address the organisation design issues faced by companies such as IBM, where there are evident advantages both from specialisation and co-ordination. The tests identify the real trade-offs between co-ordination and specialisation and help managers to find ways of gaining the benefits of co-ordination without undermining the development of specialist skills.

The knowledge and competence principle is mainly concerned with delegation. It states that responsibilities should be allocated to the person or team best placed to assemble the relevant knowledge and competence at reasonable cost. The practical test that follows from the principle is:

> *The redundant hierarchy test:* "Are all levels in the hierarchy and all responsibilities retained by higher levels based on a knowledge and competence advantage?"

This test is based on the premise that the default option should be to decentralise to operating units, only retaining responsibilities at higher levels if there is a knowledge and competence rationale. As we have argued in previous work, hierarchy can only be justified if it adds some value to the functioning of the organisation.[1] Questions about whether and how the hierarchy adds value have helped numerous companies to sharpen their thinking about the design of their headquarters, group and division levels. The redundant hierarchy test is a way of formalising these questions.

The control and commitment principle concerns two challenges that arise in any decentralised organisation: how to maintain appropriate control and how to ensure high levels of motivation. Units should feel strong pressures to self-correct if they are failing to deliver, and parent-level managers to whom the units report should be able to identify problems easily and promptly. This leads to a further test:

> *The accountability test:* "Does the design facilitate the creation of a control process for each unit that is appropriate to the unit's responsibilities, economical to implement, and motivating for the managers in the unit?"

The accountability test focuses managers on the pressures that exist for a unit to self-correct. These depend on the relationships the unit has with its internal and external customers, the performance measures for the unit, and the unit's reporting relationship. Market-facing business units with arms-length customer relationships and bottom-line performance measures are relatively easy to control and motivate. Corporate functions with no external customers, tied internal relationships and subjective performance measures present more accountability problems. In a complex structure, it is all too easy to create a design that looks good on paper, but leaves unit managers de-motivated and unclear about their performance objectives, and

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parent managers unable to control those who report to them. The accountability test helps managers design units and establish performance measures that produce effective, low-cost controls that are highly motivating.

The innovation and adaptation principle states that structures should be designed to innovate and adapt as uncertainties become clarified and environments change. An organisation design that is perfect for today is of little use if it cannot adapt to cope with the conditions of tomorrow. The principle yields our last test.

> *The flexibility test:* "Will the design help the development of new strategies and be flexible enough to adapt to future changes?"

The test recognises that some structures allow for evolution and adaptation, whereas others build in rigidity and power bases that resist change. It ensures that the designer considers the changes which may be needed and whether the design will be flexible enough to make them.

Using the tests

The purpose of the tests is to raise issues. Some can be addressed by refining the structure, by designing process solutions, or by appointing different managers. A key benefit from using the tests comes from the ideas for design improvements that they suggest. For example, a common problem is the creation of a layer of management, say a geographic region or a product group, without specifying what responsibilities should be retained by this layer and why. The redundant hierarchy test helps point out this design weakness, alerting managers to the need either to eliminate the layer or to define the responsibilities, skills, management processes and leadership style that is needed to make the layer a positive influence on performance.

Some issues raised by the tests point to unavoidable trade-offs: "do we lose more from under-attending to product or from under-attending to geography?" Often there is no clear answer to these trade-offs, but making sure that the question is asked helps managers to find a reasonable balance between competing interests. By pointing out the trade-offs and weak points in a chosen design, the tests help managers to be more thoughtful about problems that may occur and future changes that may be needed. The tests also help managers weigh the advantages and disadvantages of different designs and provide a rigorous analytical structure for making design choices.

The nine tests are the core around which we have built our new approach to organisation design.

An organisation design that is perfect for today is of little use if it cannot adapt to cope with the conditions of tomorrow.

This article is drawn from Michael Goold and Andrew Campbell's new book, *Designing Effective Organizations* (John Wiley & Sons, 2002).

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