ORGANIZATION IS NOT STRUCTURE, BUT CAPABILITY

Prepared for Organization of the Future 2

Dave Ulrich -
Professor, Stephen M. Ross School of Business,
University of Michigan, and Partner, the RBL Group

Norm Smallwood -
Partner, the RBL Group
The organization of the future exists today, but not in the traditional sense. When thinking about an organization, one generally turns to morphology and defines an organization by roles, rules, and routines. Roles define the hierarchy of who reports to whom and who has accountability for work. Rules represent policies and prescriptions for how work is done. Routines reflect processes or cultures within the workplace. Combined, these three traditional factors capture an organization's structure or shape. In the last decade, much restructuring of organizations has been done to resize, reshape, reengineer, redesign, delayer, and rebuild organizations based on these three factors. While this restructuring work encapsulates organization design, it is only a small part of the complete organization of the future.

When we work with executives to define the organization of the future, we ask them to name a company they admire. The list of admired companies varies, but often includes well-known firms such as General Electric Co., Apple Inc., The Walt Disney Co., Google Inc., or Microsoft Corp. We then ask the executives, “How many levels of management are in the admired firm?” almost no one knows. More importantly, no one really cares. We do not admire an organization because of its roles, rules, or routines. We admire General Electric Co. because of its capacity to build leaders in diverse industries; Apple Inc. because it seems to continually design easy-to-use products; The Walt Disney Co. for the service we experience; and Google Inc. and Microsoft Corp. for their ability to innovate and shape their industry. Organizations are not known for their structure, but for their capabilities.

Capabilities represent what an organization is known for, what it is good at doing, and how it patterns activities to deliver value. The capabilities define many of the intangibles that investors pay attention to, the brand to which customers can relate, and the culture that shapes employee behavior. These capabilities also become the identity of the firm, the deliverables of HR practices, and the key to implementing business strategy.

Elsewhere we have chronicled a menu of capabilities an organization might require to succeed. In this chapter, we specify five key capabilities that organizations of the future must demonstrate (talent, leadership, agility, outside-in, and purpose). We select these five because they are the capabilities required to cope in the business world of tomorrow. We also highlight new business realities, review these five capabilities, and then discuss their implications for creating the organization of the future — today.

New Business Realities

Globalization has made the world a global village, with new markets offering new challenges and opportunities, especially in China, India, Brazil, and Russia. Global issues like trade barriers, exchange rates, tariffs, and distribution become important elements of managerial choice. Technology has increased accessibility, visibility, and connection. The connected world is smaller, rapidly changing, and has open information. Employees represent increasingly diverse demographic backgrounds, including not only race and gender, but personal preferences, global or cultural backgrounds, and orientation to work. Employees are aging more in some parts of the world than in others. Employee expectations rise constantly as they gain education and skills. Customers are increasingly segmented and demanding. With more choices, they are more selective with whom they work. Investors are increasingly attuned to and concerned about not only financial results, but also intangibles. Competitors come from both traditional global players and smaller innovators.

Many spend enormous amounts of time specifying these trends and their implications on business in general. Most of these trends are outside the control of any individual or any company. They occur in predictable and unpredictable ways. They affect all aspects of business, including how to fund a firm, how to position the firm in customers’ minds, and how to engineer and deliver products. They also affect what capabilities the organization of the future should master. In recent decades, leaders have built organizations to succeed by being efficient, accountable, and innovative. We don't deny these are critical capabilities, but they are table stakes for the world ahead.
We propose five capabilities for dealing with the global trends of the future:

I. Talent

II. Leadership

III. Agility

IV. Outside-in Connection

V. Strategic Unity

I. Talent: the ability to attract, retain, and deploy human capital demonstrating competence and knowledge of the workforce

An organization with talent as a capability is good at attracting, motivating, and retaining competent and committed people. With these strengths in place, “talent” means going beyond platitudes such as, “people are our most important asset,” and “strategy follows people.” It means investing time and resources to source, secure, and engage superior talent. We believe there is a formula for talent: competence, commitment, and contribution.

Competence means that individuals have the knowledge, skills, and values required for today’s and tomorrow’s jobs. One company clarified competence as right skills, right place, and right job. Committed or engaged employees work hard, put in their time, and do what they are asked to do. In the last decade, commitment and competence have been the bailiwicks for talent. However, we have found the next generation of employees may be competent (able to do the work) and committed (willing to do the work), but unless they are making a real contribution through the work (finding meaning and purpose in their work), their interest in what they are doing will diminish and their talent will wane. Contribution occurs when employees feel that their personal needs are being met through their participation in the organization. Organizations are the universal setting in which individuals find abundance in their lives through their work; naturally, they want this investment of their time to be meaningful. Simply stated, competence deals with the head (being able), commitment with the hands and feet (being present), and contribution with the heart (simply being).

In this talent equation, the three terms are multiplicative, not additive. If any one is missing, the other two will not replace it. A low result in competence will not ensure talent even when the employee is engaged and contributing. Talented employees must have skills, will, and purpose; they must be capable, committed, and contributing. Leaders need to improve each of these three dimensions to respond to the talent clarion call.

II. Leadership: the ability to build leadership as an organizational capability in order to turn customer expectations into employee actions and increase leadership brand

An organization with leadership capability is good at embedding leaders throughout the organization who deliver the right results in the right way by crafting and carrying a leadership brand. A leadership brand exists when leaders from the top to bottom of an organization have a unique identity. These leaders are identifiable. They are focused. This identity and focus begins from the outside in, when the criteria for leadership actions are based on customer expectations. When organizations have a leadership brand, they deliver results. We have identified five steps to building a leadership brand:

A. Nail the fundamentals.

Any brand takes a long time to build and includes two major elements: the fundamentals and the differentiators. A quality product like a Rolex watch has the fundamentals of any watch: a watch face, minute hand, second hand, and a crystal. It also has brand differentiators – its look and feel and the accuracy of its timekeeping – that bespeak high quality. Both the fundamentals and the differentiators must be carefully crafted, but the fundamentals must be in place first. We call leadership fundamentals the “Leadership Code,” which consists of a leader’s ability to demonstrate competence as:

• Strategists: they need to be able to position the firm for continued success with internal and external stakeholders

• Executors: they must be able to implement systems that deliver results and make change happen

• Talent Developers: they must be able to get the most out of people in the short term by motivating and engaging them

• Human Capital Developers: they find ways to develop tomorrow’s talent and groom employees for future opportunities.

• Personal Proficiency: they demonstrate the ability to learn, act with integrity, exercise emotional intelligence, make bold decisions, and engender trust

A successful leadership development model should incorporate all elements of the Leadership Code. An individual leader may have a predisposition in some areas, but should be strong in at least one of the leadership fundamentals. Once these fundamentals are established, companies can begin shaping their organization’s leadership brand.

B. Connect leadership behaviors to the firm reputation you’re trying to establish.

Building a leadership brand begins with a clear statement, somewhat similar to a mission statement, that connects what the firm wants to be known for by its best customers with specific leadership skills and behavior. Apple Inc., for example, wants to be known for its outstanding ability to innovate and design user-
friendly technology; to that end, it hires the best technologists and designers and encourages them to innovate. Wal-Mart Stores Inc. wants to be known for its everyday low prices, so it hires managers who are frugal and unassuming themselves, who can drive a hard bargain, and so on.

C. Assess leaders using the statement of the firm’s leadership brand. Once a company has crafted a statement of its leadership brand, it needs to evaluate individuals against the statement to make sure they are living up to it. Firms must ensure that executives continue to embody the brand values as people develop over time and progress through the leadership pipeline. This requires firms to assess leaders from the customers’ point of view, measuring results less by what the individual manager — or the company — produces than by how customers perceive and value the company and its offerings. Instead of worrying about goods shipped on time, customers care about whether they receive their goods on time. Instead of concerning themselves about the firm’s product error rates, customers notice when the products they receive aren’t fully operational upon arrival. Rather than measuring employee commitment to the firm, a company should try to assess the impact of employee commitment on customers.

D. Invite your customers and investors to participate in designing and delivering management practices consistent with your leadership brand. If your best customers or investors could observe or participate in the training you offer your leaders, how would they respond? Likewise, to what extent do your company’s hiring, performance management, communication, and other management practices reflect customer expectations?

E. Track your leadership brand efforts. The result of a leadership brand focus is good management that is unmoored by individualism, yet lasts over time. As companies begin to develop as “leader-feeder firms” and “graduate” excellent leaders, they engender a reputation for very high quality management — the essence of a leadership brand. Such leadership bench strength can easily be measured by the number of leaders who leave the firm and go on to top positions in other corporations.

III. Agility: the ability to respond quickly, change, be flexible, learn, and transform

An organization with agility is good at making important changes happen fast. Gaining speed goes beyond change to fast change. Speed means that the organization has an ability to identify and move quickly into new markets, new products, new employee contracts and new business processes. Leaders embed this capability into the organization by being focused on making decisions rigorously, by implementing change processes throughout their organization, by removing bureaucratic barriers to change, and by eliminating organizational viruses. Building agility takes time because the laws of inertia keep change from happening; however, when large firms can act like small, nimble firms, they have mastered the speed capability. We see five main issues that leaders need to address in the pursuit of speed:

A. Emphasize smart agility. Speed matters, but it must be related to relevant and important issues, not trivial ones. Being faster at a bad idea or an incorrect solution only gets wrong things done sooner. Leaders leverage speed carefully when they exercise it to help accomplish business goals rather than serve as an end in and of itself. It should also be noted that agility should vary by business issue.

B. Start small. For leaders working to increase agility, this means turning large, complex problems into small, daily, and doable actions — and then being consistent and persistent about pursuing those actions until a tipping point is reached and the impact begins to occur quickly.

C. Recognize capacity. Capacity deals with how much change an institution or individual can handle and absorb. Leaders need to ensure that change aspirations exceed resources, but not by too much. Managing capacity begins with answering the questions, “What do we most want to do?” and “What are we doing that we don’t need to do?” Separating high- and low-priority issues — and being explicit about what will and will not be done — frees institutional and individual time and energy. It also helps prioritize the workload, ensuring that resources and energy may be directed toward the things that matter most.

D. Identify agility targets. Leaders may create a number of key initiatives to accomplish business goals. Speed occurs when these initiatives (e-commerce, quality, customer service, and so on) are done faster with similar or better quality. An indicator of institutional speed would be a 20- to 30-percent cycle time reduction for any and all key initiatives, not just trivial ones. Being faster at a bad idea or an incorrect solution only gets wrong things done sooner. Leaders leverage speed carefully when they exercise it to help accomplish business goals rather than serve as an end in and of itself. It should also be noted that agility should vary by business issue.

E. Recognize that agility also affects individuals. It’s useful to calculate a return on time invested (ROTI) index to track trends in employee productivity, commitment, and engagement in their work. Individuals experience agility and speed when they are able to focus on work that matters most, when they feel they have control over their work, and when they see how their work aligns with the overall goals of the company. Individual speed would result in employees taking appropriate risks, feeling more responsibility for their actions, being able to appropriate
An organization with strategic unity has the ability to articulate a shared point of view and common behaviors in an increasingly diverse work setting. An organization is not structure, but capability. Agility must be both institutional and individual. If institutional agility occurs, processes may be improved, but if individuals are not feeling engaged in the effort, they may not be committed and productive, and over time, the speed will slow. If individual behaviors are carried out with more agility but the institutional processes remain slow, people will become frustrated and the institutional changes won’t be sustained.

IV. Outside-in Connection: the ability to turn outside expectations from customers, investors, and communities into internal organization actions

An outside-in organization is good at building enduring relationships of trust with targeted external stakeholders. An outside-in connection produces value when it turns expectations from customers, investors, or communities into employee and organization actions.

Customer connection means the identity in the customer's mind becomes the basis for creating an organization’s culture. When a firm develops an external reputation for quality, service, or price, customers rely on this identity and do business with the firm based upon it. The identity of the firm in the mind of its best customers should also translate to employee behavior. When employees inside behave congruently with customers’ expectations outside, a unique bond and connection is forged. An organization’s culture begins from the outside in when it gains clarity about its external brand.

Investor connection means that those who directly invest in the firm (and those who analyze its performance) examine both tangible and intangible results. Investors may gravitate toward firms with favorable intangibles, such as meeting expectations, strategic clarity, functional competence, and leadership depth. When these external investor intangibles show up as management initiatives and actions, a connection is made.

Community connection means the organization’s policies and practices are congruent with sustainable, socially responsible, and ethical standards. Increasingly, Generation Y employees want to work for companies who demonstrate social conscience and good citizenship through their policies and practices. Managing energy, working on environmental issues, and serving a broader humanity become parts of an organization’s social identity.

V. Strategic Unity: the ability to create a shared point of view and common behaviors in an increasingly diverse work setting

An organization with strategic unity has the ability to articulate a shared point of view about the future. More organizations have strategies than accomplish them. Often, this is because there is not a unity or shared understanding of the desired strategy. Three agendas go into creating strategic unity: first, an intellectual agenda ensures that employees from top to bottom share both what the strategy is and why it is important; second, the agenda is delivered through simple messages repeated constantly; and finally, the behavioral agenda ensures that the strategy shapes how employees behave by telling employees what to do (and by asking employees what they will do based on the strategy). By allowing employees to define their behaviors relative to strategy, they become committed to it. A process agenda ensures the organization’s processes—such as budgeting, hiring, and decision making—align with its strategy. These processes may be reengineered to ensure they create unity. When all three agendas are in place, strategic unity follows.

We are surprised to discover the way many leaders answer the simple question, “What is your business about?” They respond with an industry affiliation: “We’re in the chemicals business.” Or, they come up with a high-level activity report: “We make and sell vacuum cleaners.” What they don’t have is insight derived from paring the business down to the core of viability. Business focus describes what makes the organization tick at an elemental level; without it, it’s very difficult to attain strategic unity. Strategic unity can be seen when employees at all levels know what their organization is trying to do, what they are personally expected to contribute, and how they can make a difference.

Implications for the New Organization

Leaders at all levels should focus on an organization’s capabilities rather than its structure. In board of director meetings, good governance is not just about fiscal responsibility, management succession, or corporate ethics; it’s about ensuring that management understands and builds the capabilities needed to execute strategy. As leaders work to define their strategic direction, they should also be disciplined about how they will get there. Focusing on organizational capabilities ensures that desired strategies are realized.

As we have worked with dozens of companies to do capability audits, we have learned some lessons. No two audits will look exactly the same, but our experience has shown us that, in general, there are good and bad ways to approach the process. You’ll be on the right track if you observe a few guidelines:

1. Get focused. It’s better to excel at a few targeted capabilities than to diffuse energy over many. Leaders should choose only a few on which to spend their time and attention. This means identifying which capabilities will have the most impact and will be easiest to implement, then prioritizing accordingly. The remaining capabilities identified in the audit should meet standards of industry parity. Investors seldom seek assurance that an organiza-
tion is average or slightly above average in every area; rather, they want the organization to have a distinct identity that aligns with its strategy.

2. Learn from the best. Compare your organization with companies that have world-class performance in your target capabilities. Quite possibly, these companies won’t be in the same industry as your organization. It’s often helpful, therefore, to look for analogous industries where companies may have developed extraordinary strength in the capability you desire. For example, lodging and airlines have many differences, but they’re comparable when it comes to several driving forces: stretching capital assets, pleasing travelers, employing direct-service workers, and so on. The advantage of looking outside your own industry for models is that you can emulate them without competing with them. They’re far more likely than your top competitors to share insights with you.

3. Create a virtuous cycle of assessment and investment. A rigorous assessment helps company executives figure out what capabilities will be required for success, which in turn helps them determine where to invest. Over time, repetitions of the assess-invest cycle result in a baseline for benchmarking.

4. Compare capability perceptions. Like 360-degree feedback in leadership assessments, organizational audits may reveal differing views of the organization. It’s instructive, for example, when top leaders perceive a shared mindset but employees or customers do not. Involve stakeholders in improvement plans. If investors rank the firm low on capability, for instance, the CEO or CFO may meet with the investors to discuss specific action plans for moving forward.

5. Match capability with delivery. Leaders need not only to talk about capability, but to demonstrate it in results; rhetoric shouldn’t exceed action. Outline expectations in a detailed plan. One approach is to bring together leaders for a half-day session to generate questions for the plan to address: What measurable outcome do we want to accomplish with this capability? Who is responsible for delivering on it? How will we monitor our progress in attaining or boosting this capability? What decisions can we make immediately to foster improvement? What actions can we as leaders take to promote this capability? Such actions may include developing education or training programs, designing new systems for performance management, and implementing structural changes to house the needed capabilities. The best capability plans specify actions and results that will occur within a 90-day window.

6. Avoid underinvestment in organization intangibles. Often, leaders fall into the trap of focusing on what is easy to measure instead of what is in most need of repair. They read balance sheets that report earnings, EVA, or other economic data, but miss the underlying organizational factors that may add value.

7. Don’t confuse capabilities with activities. An organizational capability is a bundle of activities, not any single pursuit. So leadership training, for instance, needs to be understood in terms of the capability to which it contributes, not just the activity that takes place. Instead of asking what percent of leaders received 40 hours of training, ask what capabilities the leadership training created. Attending to capabilities helps leaders avoid looking for single, simple solutions to complex business problems.

Conclusion

The organization of the future exists today when leaders shift their focus from the organization as a structure to the organization as a set of capabilities needed to execute a strategy. We see five critical capabilities that leaders can identify, implement, and track to help their organization be successful. Leaders who build these capabilities today will be able to respond to a variety of potential futures.

---

1 Our work on capabilities can be found in:

2 Those who have studied business trends include:
About the Authors

Dave Ulrich, PhD, is a professor of business administration at the University of Michigan Ross School of Business and cofounder of the RBL Group. He has consulted and done research with over half of the Fortune 200, and has published more than 200 articles and book chapters as well as 23 books. He served as the editor of the Human Resource Management Journal from 1990 to 1999, and is a fellow of the National Academy of Human Resources. HR Magazine has named him the number one thought leader in HR for the past four years.
dou@umich.edu

Norm Smallwood is a recognized authority in developing businesses and leaders to deliver results and increase value. His work relates to building organizations, leadership, and strategic HR capabilities that impact market value. He believes leadership brand occurs when leaders at every level connect employee actions to the desired customer experience. He co-founded the RBL Group with Dave Ulrich, and has co-authored six books, including Real-Time Strategy, Why The Bottom Line Isn’t!, and Results-Based Leadership. He has published more than 150 articles in leading journals and newspapers, and has contributed chapters to multiple books and periodicals, including the Harvard Business Review. For several years, Leadership Excellence Magazine has ranked Norm as one of the top 100 Global Voices in Leadership.
nsmallwood@rbl.net