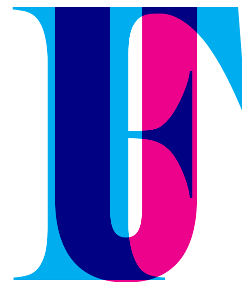
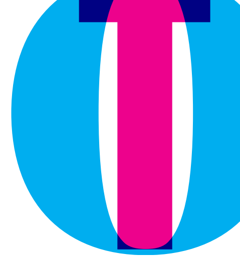
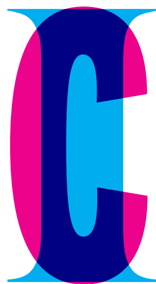
RESTRUCTURE OR RECONFIGURE?



DESIGNING THE REORG THAT WORKS FOR YOU

BY STÉPHANE J.G. GIROD AND SAMINA KARIM





To cope with ever-changing market conditions, companies often have to reorganize. But leaders tend to get conflicting advice about when and how to do so. Does the company need a new structure, or should it tweak the existing one? Will the benefits of a reorg outweigh the costs? Can the work be accomplished before conditions change again? How far should the changes go?

IN BRIEF

THE PROBLEM
Companies must reorganize periodically to keep pace with changes in market conditions. But executives grapple with conflicting advice about whether, when, and how to do so.

THE RESEARCH
The term "reorganization" encompasses two distinct change processes: *restructuring* and *reconfiguration*. Each delivers value if pursued in the right way. Over the past three decades, the authors have examined how each type affects organizational processes and performance.

THE RECOMMENDATION
To choose the right reorganization at the right time, follow these guidelines: Tailor the reorg to your circumstances, change at the right pace, play to your strengths, and determine what other systems need to change, too.

Over the past three decades, we've endeavored to help executives answer those questions with qualitative and quantitative research on the two main types of reorganization. *Restructuring* involves changing the structural archetype around which resources and activities are grouped and coordinated. Companies commonly organize around function, business line, customer segment, technology platform, geography, or a matrixed combination of these. Microsoft's shift, in 2013, from a business-line-focused org chart to one that revolves around functions, including Engineering, Marketing, Business Development and Evangelism, and Advanced Strategy and Research, is a good example. *Reconfiguration* involves adding, splitting, transferring, combining, or dissolving business units without modifying the company's underlying structure. Novartis reconfigured four global businesses into five in 2016 by splitting the Pharmaceuticals division into Oncology and Pharmaceuticals.

The goals for both types of reorg tend to be the same: to boost innovation and, ultimately, financial performance. But our research shows that success is almost always situational. Companies need to periodically shake up their structures to reduce "organizational cholesterol"—that is, the inertia, sticky routines, and fiefdoms that progressively undermine growth—or to change strategic direction in the face of major industry transformation. And in an era of transitory competitive advantage, they must also continually adapt to market changes with smaller-scale reconfigurations. Executives shouldn't choose between evolution and revolution. They should do both—in the right way, at the right time.

How can executives use each type of reorganization more effectively? Based on our analysis of the antecedents, processes, and performance outcomes of hundreds of restructurings and reconfigurations, we have developed a four-part framework.

CONSIDER YOUR CIRCUMSTANCES

In determining whether you need to scrap your existing organizational structure or modify it, two factors matter: the level of dynamism or turbulence of your industry and the urgency of your need for a strategic reorientation.

Our research indicates that in fast-moving markets—that is, those that fluctuate in size and are open to new and diverse entrants—reconfigurations involving quick, smaller-scale changes better position companies to seize fleeting opportunities; restructurings are too slow and cumbersome in such environments. Our research across a range of small firms, large European companies, and the U.S. *Fortune* 50 firms bears this out: Restructurings decreased profits by 2.6%, on average (a $57.1 million dent for the largest firms we studied), while reconfigurations yielded a small profit increase of 0.4%, on average ($9.6 million for the largest firms). In dynamic industries such as retail, banking, and technology, companies tend to reconfigure more than those in stable ones and develop effective routines to manage this type of change.

When your company is facing major industry disruption, however, piecemeal reconfigurations are not sufficient, and restructuring is necessary. As John Chambers, the executive chairman of Cisco, has said, true transformation can't happen without radical, holistic change. IBM followed this principle for many years, lost sight of it for a while, and recently returned to it. In 1995, when the company was struggling to adjust to the end of the mainframe era, then-CEO Lou Gerstner and his team responded with a new service-and-solutions strategy bolstered by a "front-back" matrix. In this new structure, the back end of the organization (Technology, Personal Systems, Server, and Software Technology Platforms) would develop solutions that the front, customer-facing part of the company (a new Worldwide Sales and Services group) would market. The goal was to break down silos and better meet customer needs, and the reorg was a huge success.

Throughout the 2000s, however, IBM tried to navigate the dynamism of its industry by relying on reconfigurations. It downscaled its lower-margin hardware business through a wave of unit closures and divestitures and ramped up its digital efforts by adding new units such as commerce, security, analytics, Watson, cloud, and health care. Though the company still aspired to be a cutting-edge technology icon, its strategy of modest changes caused it to fall short of that goal, and its performance languished. Today, CEO Ginni Rometty is pursuing a major restructuring to support a strategic reorientation toward cognitive computing technologies that enable the "internet of things." The company has begun to dismantle technology platforms and replace them with integrated business units focused on specific industries.

PACE YOURSELF

Given the turmoil and tension that major restructurings cause, they shouldn't happen too often. Moreover, restructurings take time to bear fruit: Our research indicates that even the most successful ones take three to four years to have a

positive impact on profits. We recommend waiting at least five years between them—or longer if your strategy needs only tweaking, not radical transformation. When organizations try out too many structures too fast or continually bounce back and forth between old archetypes and new ones, confusion reigns and engagement, innovation, and performance falter.

When it comes to reconfigurations, the rhythm is more of a balancing act. Engage in too few, and you won't get enough practice to do them well. Undertake too many, and you'll end up with hasty or flawed measurement of outcomes, a dangerously inward focus, and change fatigue. In some cases, multiple reconfigurations can snowball into an unintended restructuring that hurts performance. We found that when firms suddenly double the amount of reconfigurations they pursue in a given year, the result is a dip in profits of 1%, on average (a decline of about $22 million for our largest firms). Some companies engaged in such elongated, persistent change cycles that they reconfigured themselves out of existence. Think Texaco, Digital Equipment Corporation, and McDonnell Douglas.

One organization that seems to have found the right balance and pace of restructurings and reconfigurations over the years is Dow Chemical. Following successful restructurings in 1985, 1995, and 2000, the company embarked on another in 2009 to reflect a new strategic direction following its acquisition of specialty chemicals manufacturer Rohm and Haas. It adopted a matrix structure, with five business divisions and geographic regions supported by a common Business Services Group and stronger central functions (such as Engineering and Manufacturing). The company has meanwhile executed a variety of reconfigurations. Since 2009, it has dissolved at least two units per year to focus on specialty and advanced chemicals. And at least once a year, it has split businesses to form market-focused stand-alone units (such as the new Infrastructure Solutions group) and combined units (for example, merging the Chemicals and Energy divisions into one group). By 2013, Dow's profits had nearly doubled.

EVEN THE MOST SUCCESSFUL RESTRUCTURINGS TAKE THREE TO FOUR YEARS TO BEAR FRUIT.

PLAY TO YOUR STRENGTHS AND DIFFERENTIATE

Whether you are restructuring or reconfiguring, the way you group and allocate activities and resources must play to your strengths and differentiate your company from competitors. That might seem obvious, but not all firms have the discipline to follow this guideline—or even understand which practices are most suited to their situation.

Structural change works best when it reinforces a company's unique points of differentiation rather than attempts to mimic competitors' strategies. Consider Citi and HSBC, the only two universal and global banks. Whereas Citi organizes its activities by business lines, HSBC relies on a three-dimensional (business-geography-functional shared services) matrix. HSBC's structure, rolled out in 2011, is more complicated and expensive to maintain, but because the bank's strategy is to offer customers seamless cross-border financial services—and to charge a premium for doing so—management believes the benefits outweigh the costs.

Consider also the professional services firm Accenture. Instead of grouping countries by region, as many consultancies do, Accenture is organized around more-strategic geographic distinctions. Its "core market" structure focuses on developed economies, promoting cross-border efficiencies and standardization, and its "growth markets" structure focuses on emerging economies, allowing more local adaptation and autonomy. Procter & Gamble used its "Organization 2005" restructuring to set itself apart from competitors in a different way, centralizing its resources and activities to a much greater extent than industry observers thought possible.

Reconfigurations also deliver better outcomes when they're explicitly designed to build on a company's strategic strengths and leverage interdependencies. Consider Johnson & Johnson's decision to merge two of its units, Arbrook, Inc. and Jelco Laboratories, in the 1970s. Both were already market leaders in their segments of bandages, sterilizing equipment, syringes, needles, and blood collection equipment. But when combined, the group became even more innovative (and profitable), developing the first fluid-injection systems for surgical sterilization.

Another reconfiguration best practice is to put organically developed units together with acquired ones—ensuring that the combined unit has both institutional DNA and new blood. J&J had less success in the eight years it spent buying, combining, and splitting various acquired heart-valve businesses, because they were always managed separately from the existing organization, and it ultimately exited the field in 1986.

Companies undertaking either type of reorganization must remember that when activities are reassigned, the resources needed to support them must follow. At J&J, executives determine in advance which physical assets (for example, manufacturing plants and R&D facilities) and people (particularly executives with reorg experience) should move when units do. We found that firms that buttressed newly created or merged units with the facilities and support services they needed were more innovative (that is, they had 17% more patent citations) than firms that failed to do so.

DETERMINE WHAT OTHER SYSTEMS NEED TO CHANGE

When a company restructures, many other aspects of the organization must change too. These include management processes, IT systems, the culture, incentives and rewards, and leadership styles. This has to happen quickly, if not simultaneously—especially in fast-moving markets. Restructurings that are conducted in isolation often result in misalignment that can paralyze the company.

HSBC sought to avoid this pitfall when executives introduced the matrix structure tied to its new global account management strategy. They not only broke down existing country-based silos but also trained managers in how to stimulate a more collaborative culture. They introduced employees to two new core values—being open and connected—on which they would be evaluated, and realigned rewards, tying bonuses to cross-selling objectives and the company's overall performance rather than just division profits. The executives clarified roles and responsibilities under the new structure; for instance, global business units would set pricing guidelines, but local teams were empowered to adapt prices within those boundaries. And they moved quickly to integrate HSBC's multiple IT systems and to invest in digital tools that would promote information sharing. Perhaps most important, they communicated openly and transparently about the changes, explaining their thinking, laying out plans, and celebrating successful milestones along the way.

Reconfigurations, by contrast, are more likely to be successful when executives make sure that changes affect only the targeted units, maintaining continuity in other areas of the organization. That's because organization-wide practices and processes to which everyone has already become accustomed can create common ground when units are merged or transferred.

Consider again Accenture. In 2014 it reconfigured its three growth platforms into four (Strategy, Digital, Operations, and Technology) under its existing matrix structure. The changes were relatively seamless thanks to a host of established practices and processes: the standardized model that all consultants use to approach customers and deliver value; the firm's common performance appraisal, career development, knowledge management, intranet, and IT systems; and a similar office culture and environment around the world.

"REORGANIZATION" IS A catchall term that encompasses two distinct change processes—restructuring and reconfiguration. Each delivers value if pursued in the right way. To determine the best approach, first consider your company's circumstances: In dynamic industries, reconfiguration is best—unless industry disruption calls for a big strategy shift and a new structure to see it through. Remember to space your reorgs out: Restructure sparingly, and reconfigure more frequently but not so often that chaos reigns. Use your reorg as a means to build on your strengths and differentiate your businesses from the competition. And clearly define the scope of change. In restructurings, new culture, practices, processes, and systems are often needed; in reconfigurations, continuity and commonalities are preferable. These guidelines won't ensure a smooth reorganization. But they should improve your chances of a successful outcome.

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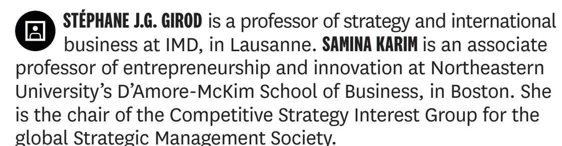

STÉPHANE J.G. GIROD is a professor of strategy and international business at IMD, in Lausanne. **SAMINA KARIM** is an associate professor of entrepreneurship and innovation at Northeastern University's D'Amore-McKim School of Business, in Boston. She is the chair of the Competitive Strategy Interest Group for the global Strategic Management Society.

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