Designing High Performance Organizations

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Abstract

The importance of building high performance organizations is stressed. Human Capital and the development of organizational capabilities and core competencies are fundamental to creating high performance organizations in today's highly competitive business environment. In order to develop high performance organizations many of the traditional bureaucratic approaches to management need to be discarded and replaced by approaches which move information, knowledge, power and rewards to employees.

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If organizations need evidence that it is time for them to create a new approach to organizing and managing their businesses, they need only look around them to see how the business environment has changed. Simply stated, the level of competition today requires high levels and continuous improvement of organizational performance in four critical areas:

- The quality of goods and services
- The cost of producing goods and services
- The speed with which products and services are brought to market
- Innovation in the development of new products and services

In the past, companies had some slack in one or more of these four performance areas. If an organization could get a product out quickly, customers would pay more for it and would tolerate defects. Or, if the price was low enough, customers would accept poor quality, some slowness in delivery or service, or both. Today, however, there is little tolerance for substandard performance in any area. Customers want value, and that means speed, cost, quality, and innovation. Even more significantly, they do not have to tolerate shortfalls in performance; they can readily turn to alternative sources that offer faster, cheaper, better, more innovative products and services.

To avoid losing out in this new competitive business world that asks companies to simultaneously improve quality, lower costs, bring new products to market faster, and be innovative, organizations must respond by dramatically improving performance. And they must achieve that improvement in a business environment that is rapidly changing.

Why It Is So Tough: The New Environment

Why is business competition so different today? Why does it take ever higher performance levels to be successful? The explanation rests in four major changes in the business environment: a boundaryless economy, worldwide labor markets, instantly linked information and communications, and agile new companies.

1. *A boundary less economy* and the globalization of business have brought new competitors with both new and different management styles and powerful competitive advantages (for example, strong government support and relatively cheap skilled labor) into many markets. Japanese organizations such as Toyota and Honda have succeeded in large measure because they have a very different way of thinking about management, organizing work, relating to suppliers, and managing employees. Previously the importance of management and organization in building a competitive advantage was not evident to many in the industrialized democracies or the world because U .S. and western European companies all used the same management style and competed only with each other. Now that we see others using management and organization as a source of competitive advantage, it is clear that they can be powerful sources of advantage.

2. *Worldwide labor markets.* Because work forces in different countries have different skills and wages, organizations can now draw on a wider variety of workers and working conditions. This has led to the creation of organizational structures and business

strategies that are global in their reach. Because of the increasing ease of moving information and, in some cases, production around the world, work is moving to wherever needed skills exist at the best price. For example, a significant amount of electrical engineering work has already moved to Israel, and software development is increasingly being done in India and the former Soviet Union. Low-skilled jobs are moving to less developed countries where individuals are willing to work for low wages. Ultimately, this is likely to mean that the only work that will remain in more developed countries will require relatively high levels of skills or involve face-to-face contact for service delivery.

3. *Instantly linked information and communication.* Information technology is enabling organizations to be designed and managed in dramatically different ways. Personal computers, company networks, the Internet, World Wide Web, expert systems, and a host of voice and video communication devices make it possible for more people in complex organizations to have more information. Individuals and teams can easily and quickly gain access to large databases concerning particular products, processes, and customers. Net- works can help workers and managers form a consensus for action, produce innovative decision-making models, make it easier for individuals to work together on products and services, and reduce the time to respond to customer requests. This is in sharp contrast to the conditions that shaped traditional organizations: information was expensive to obtain and difficult to move around. Thus organizations sought ways to create efficient chains of command to move information up the line for centralized decision making, and they created specialized functions that could operate independently to perform single steps in production and service processes.

4. *Agile new companies.* Many newly formed companies find it easy to adopt new organizational approaches and to reach high levels of performance. Simply put, when it comes to

adopting new approaches to organizing and managing complex organizations, creation is easier than resurrection. New organizations do not have to unlearn and bury old habits or ways of doing business in order to create new ones. They do not have to dismantle existing systems, deal with individuals who stand to lose out because of change, or even change the psychological contract between employees and the organization. They also do not suffer from an "experience handicap that is based on what has worked in the past. They just have to learn the new. For example, instead of having to unlearn the behaviors associated with the belief that quality can be inspected in, they can start from the principle that it has to be built in by high-performance teams.

Gaining Competitive Advantage

What are the sources of competitive advantage that can produce winning organizations in today's highly competitive environment? I see three major sources that when combined can produce organizations that are likely to be winners. The three are all concerned with the human side of business: human capital, organizational capabilities, and core competencies. These three go together in the sense that organizational capabilities and core competencies require the right kind of human capital in order to be created and sustained by corporations. Organizational capabilities and core competencies require more then simply talented labor. They require the right organizational systems and management styles, but they clearly rest on the talent of the individuals in an organization. Given this, it is hardly surprising that there is an increasing emphasis on human capital and a dramatic increase in the degree which organizations compete for talented human capital.

Organizational Capabilities and Organizational Effectiveness

In order to be successful, organizations must have capabilities that allow them to coordinate and focus behavior in ways that are tuned to the marketplace and produce high levels of performance – ways that differentiate them from their competitors. Every organization must understand what capabilities it needs to compete in its market and then develop them by creating the appropriate organizational designs and management systems.

What are some key organizational capabilities? They include the ability to focus on quality or customers, operate on a global basis, be a low-cost operator, learn, respond quickly to the business environment, speed products to market, and a host of other capabilities that we will discuss throughout this book.

Organizational capabilities don't exist in one place, in the heads of a few technology gurus, or in a set of patents. They rest in the systems, culture, relationships, and overall design of an organization and typically require the coordination of many individuals and systems in an organization.

In some respects, the ability to change rapidly is the ultimate competitive advantage. It is the ultimate competitive advantage because it potentially enables an organization to stay ahead of its competitors and meet the increasingly higher performance standards that the environment presents. It is also a very difficult capability to develop because it requires changes in the human capital of an organization. Simply stated people need to change their skills and behavior in order for an organization to change.

Today, organizational success frequently requires not just a single world-class organizational capability but the right combination of several. It may take two or three that are exceptional and a number of others that are at least at a world-class level. For example, successful U.S. corporations such as Motorola, Hewlett-Packard, Cisco and Home Depot are able to both innovate and focus on other capabilities.

Core Competencies and Organizational Effectiveness

It is important to note that organizational capabilities are not the same thing as core competencies. Core competencies, also a possible source of competitive advantage, are technical areas of expertise such as 3M's knowledge of chemical processes, Intel's expertise in micro-electronics, Honda's competency in making gasoline engines, and Sony's ability to miniaturize products.

The longevity of the competitive advantage that an organization gains from its core competencies depends on how easy they are to copy. There is always the risk that others can duplicate an organization's core competencies when they rest in the minds and skills of a small number of employees.

For example, other organizations can gain the same competencies by hiring key employees away from the organization that has developed them. Apple did just this when it started. It hired two people from Xerox's Palo Alto, California, research facility who had developed the software operating system for Xerox's innovative personal computer, Star. They went on to develop the Apple operating system, which provided Apple with a significant competitive advantage.

Employees may also leave on their won and take core competencies with them to create new, competing organizations. One of the most dramatic examples: during the 1970's, Fairchild Electronics – which pioneered the development and production of semiconductors – combined a high level of technological competence with a well-deserved bad reputation for the way it managed and treated employees. This combination made it difficult for Fairchild to maintain a technological advantage despite the pioneering development work it did on semiconductors. Employee after employee simple took knowledge of Fairchild's core competency in semiconductors with them and used it to start competing businesses that were better managed. While its break aways Intel, AMD, and others among the most successful semiconductor firms in the world today, Fairchild is now out of business.

While it is important to acquire, develop, and protect core technological competencies, it is clear that they are neither enough by themselves for success nor necessarily the best source of a sustainable competitive advantage. Organizational capabilities oriented toward understanding customers and speeding technology to market with the best possible quality and at a reasonable cost are often more important.

The Xerox personal computer experience provides a good example of this point. Xerox once had a significant technological lead in the personal computer business. It developed the first PC for office use as well as the software that proved so important to the early success of Apple. However, it lacked the organizational capabilities to capitalize on its technological core competencies and, as a result, is not in the computer business today.

Finding Competitive Advantage

Organizations need a strategy that identifies the kind of performance that is needed, to communicate the need for that performance through mission and values statements. They can only do this well if they have a good understanding of the environment the organization faces and how business strategies and performance are related to competencies and capabilities. This relationship is shown in the Diamond Model (see Figure 1), which shows that organizational effectiveness results when there is a fit among four points: (1) strategy, (2) competencies, (3) capabilities, and (4) the environment.

The Diamond Model does not explicitly identify human capital as a critical determinant of organizational effectiveness. This may be a bit misleading because human capital is a critical element with respect to each of the four points of the diamond. Indeed, it might be better to show the Diamond Model with human capital as the center. I have already discussed how human capital is critical to the core competencies and organizational capabilities. I have not pointed out the critical role it needs to play with respect to strategy and the environment.

Human capital is critical with respect to two issues in the area of strategy. The first concerns strategy formulation. Formulating an effective business model for an organization is a complex, challenging, and knowledge intensive activity. It requires an organization to have or to obtain a particular kind of talent. There is every reason to believe that this kind of talent is scarce and therefore not easily attracted or retained. Typically strategy is formulated at the top of an organization but it does not have to be. In an organization that is committed to high levels of employee involvement, strategy ideas and formulation may take place throughout the organization. Further, in organizations that are committed to the use of employee involvement and organization structures, employees throughout the organization need to understand the business strategy and the implications of it for how they should perform in their jobs. Only if this exists is the hierarchical structure of a traditional organization likely to be unnecessary. In short, having human capital that understands and is committed to the strategy can be an effective substitute for a hierarchy.

Human capital needs to be a critical feature in formulating a strategy in a second respect. The strategy of an organization needs to take into account the availability of human capital both within the organization and in the external environment. It does no good to create a strategy if the human capital that is necessary to create the right mix of core competencies and organizational capabilities is not available. Thus, the strategy formulation process needs to realistically assess the current human capital in an organization and formulate reasonable expectations about what human capital can be attracted and retained.

Although it sounds like an obvious point, I have often seen organizations fail to take account of human capital constraints when they formulate their strategy. The most common error is when they decide to move into a new business area without taking into account their lack of core competencies in the area and perhaps more subtly, their ability to develop organizational capabilities that are needed. This has clearly happened to traditional companies that have tried to move into the Internet space. They have struggled, in many cases because they don't have the right systems to attract the right talent to operate Internet businesses, and because they don't have the executional capabilities around quality or customer service that is needed. This is usually partly a result of their systems but also partly a result of their lack of the right human talent and their inability to attract it.

Finally, a critical aspect of the environment is the human capital that exists in it. Organizations can only attract particular kinds of human capital if it exists in the market where they are trying to attract it. Again, this seems like an obvious point but it is one that is often overlooked by organizations. For example, if schools are not turning out engineering graduates in a particular area it does like good for organizations to open up jobs for them. They need to proactively influence the environment to produce the kinds of human capital that is necessary for them to pursue their businesses.

Often universities are unaware or unprepared for shifts in demand for particular kinds of human capital and thus they need to be prodded and incented by organizations and governments to produce the appropriate types of human capital. Thus, organizations need not to look passively at the environment when it comes to human capital but try to shape the environment so that it creates the kind of human capital that organizations need to succeed. Good examples of this are those organizations that have moved to high performance organization strategy. In order for employees to work in this type of environment, they need problem solving skills and they need to understand the basic economics of the business, group process and a host of other skills. These are not necessarily features that are focused on in most educational settings. Thus, most companies need to and in some cases have encouraged schools to build more team skills training into their curriculum and more economic education. Governments that want to attract and effective businesses need to focus on the quality of the labor force their education systems produce. As has been proven by Ireland, India and a number of other countries work will go to wherever employees can be found that have the right combination of skills and wage rates.

In addition to needing human capital that has the knowledge, skills and ability to perform, organizations need individuals who are committed to the ultimate success of the organization. When I first studied psychology I was presented with the following equation: performance = ability x motivation. It nicely summarizes the issue of human performance in organizations, perhaps a bit too simply but it still makes the very important point that performance only occurs when you have people who can and want to perform. I am using the word *committed* here rather than the word *loyal* because I think the key issue is the commitment of individuals to the success of their activities in the organization. Another appropriate word here is certainly *motivation*. Organizations need individuals who are motivated to perform effectively. Historically, there has been an emphasis on having employees who are loyal to the organization but in today's business environment I am not sure that loyalty is necessary nor indeed achievable in many cases.

The Competitive Organization

The most familiar approach to organizing is hierarchical organization. How to structure a hierarchical organization is well known, as is how to reward the individuals who work in it. The kinds of information a hierarchical organization needs, the measurement processes it requires, and the kinds of people it requires are also well known. In fact, just because the hierarchical approach is so well known, it is not an approach that is likely to provide a competitive advantage.

But this is the least of its problems. The most serious problem involved in the hierarchical approach is its inability to create an organization that can combine speed, cost effectiveness, product quality, and learning. In many respects, the search for the fast, flexible organization is a search to overcome the disadvantages of a hierarchical structure. These disadvantages result from the limited capacity at the top of the organization to coordinate the organization 's activities. All hierarchies get narrow at the top. No matter how intelligent the senior executives are, and no matter how effective their teamwork may be, there is a limit to their problem-solving capacity and their ability to respond quickly. In hypercompetitive industries, there are simply too many demands on management's time, too many decisions to be made, and too many constituencies to satisfy.

This situation calls for a new approach to how corporate boards are organized and staffed. It is also leading organizations to structure themselves differently. The new logic calls for replacing bureaucratic controls with the following four components of effective employee involvement:

- Information about business strategy, processes, quality, customer feedback, events, and business results
- Knowledge of the work, the business, and the total work system
- Power to act and make decisions about the work in all of its aspects
- Rewards tied to business results, individual growth, capability, and contribution

When these four elements are appropriately positioned, involvement can be an effective source of control and organized action.

Involvement requires that the amounts of information, knowledge, power, and rewards that individuals have be balanced and that all employees have significant amounts of them. This does not mean that those at the top have any less knowledge, information, power, and rewards; it does mean that the organization becomes flatter (that is, it has fewer levels) and that the information, power, knowledge, and rewards that were in the middle of the organization are pushed down so that they are spread throughout the organization. This is what makes effective decision making and involvement possible at lower levels in an organization. Figure 2 presents this thinking in graphic form.

It shows that involvement-oriented and traditional organizations position these four key elements very differently. In well designed, traditional, hierarchical organizations, individuals at the lowest levels have little information, power, knowledge, and rewards, while individuals at the top have large amounts of all four. In the involvement approach, individuals at the lowest levels have much larger amounts of these elements.

Balance among information, power, knowledge, and rewards is critical to effective involvement. In general, they are well managed and balanced when individuals are rewarded based on how effectively they exercise the power that is associated with their position and when they have the information and knowledge to exercise their power effectively. Individuals should not have more power than they can exercise effectively given the amount of information and knowledge they have, nor do they need significantly more knowledge than they can use given their power and information. Having more power than knowledge or information is particularly dangerous, since it can lead to poor decision making.

Finally, rewards must fit the kind of power individuals exercise, the type of knowledge they have, and the information they receive. Otherwise, individuals will not be correctly motivated, and there will be a lack of accountability for performance because there are no consequences attached to it.

In a well-designed, high-involvement organization:

- Individuals understand the business. They know its strategy, how it is doing, and who their customers and competitors are.
- Individuals are rewarded according to the success of the business. They are owners and share in its performance so that what is good for the business is good for them.
- Employees are able to influence important organizational decisions. They decide on work methods, participate in business strategy decisions, and work with each other in order to coordinate their work.

In summary, the new logic argues that the best control comes from the marketplace and the customer. Through involvement, it creates employees who act like owners and managers, who exercise self-control because they are involved in satisfying the customer and meeting market demands. It rejects the traditional approaches to control as too expensive, ineffective, and in many cases dysfunctional.

The new logic turns the traditional equation of who adds value to the organization 's products and services upside down. It constantly pushes for individuals throughout the organization to add more value by

- Doing more complicated tasks
- Managing and controlling themselves
- Coordinating their work with the work of other employees
- Suggesting ideas about better ways to do their work
- Developing new products and ways to serve customers

This is in sharp contrast to the traditional hierarchical organization where individuals at the lower levels carry out prescribed, routine, low-value-added tasks in a controlled manner while senior management adds major value through their work on organizational design, strategy, and the coordination of the work of different groups and functions. It challenges governments and societies to develop individuals who can operate effectively in these high performance organizations. Those that do will attract the world's best corporations and jobs and will benefit accordingly.

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