ALIGNING THE ORGANIZATION WITH THE MARKET

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Firms are being pulled by their strategies and pushed by increasingly assertive customers to organize around customer groups.[1] The inevitable upheaval is further justified by visible success stories such as Fidelity Investments, IBM, Cummins India, and Imation, and endorsed by organizational specialists who applaud smaller, market-responsive units.[2]

A new strategy was behind the January 2005 announcement that Intel would re-organize into five market-focused units: corporate computing, the digital home, mobile computing, health care, and channel products.[3] No longer would the firm rely on the design of discrete chips and expect customers to adopt them. Instead, the focus would be on the bundling of processes, ancillary chips, and integrating software into platforms tailored to each customer segment. Although the market logic of this strategy was compelling, there were no illusions that imposing such a management structure across the company would be easy in the face of a successful but engrained product-centered culture.

There has been a seemingly steady evolution of organizations toward closer alignment with their markets. The first stage of this evolution is the emergence of informal coordination to overcome the familiar deficiencies of product or functional silos. If this isn't sufficient, then integrating functions such as key account managers and segment taskforces are added. Fuller structural alignment is achieved by strengthening the customer dimension of the organization matrix with segment managers or customer-based front-end units.[4]

Each stage of this evolution is disruptive in the short-run, and adds coordination costs in the long-run. Is it worth doing? The findings from our study of 347 medium to large firms were mixed (see Appendix A for the details). Accountability for customer relationships sharply improved, and information sharing was better. Firms organized by customers were also easier to do business with, and better at dealing with problems and queries. But these benefits didn't translate into superior performance.

As we looked more closely at 15 high-profile reorganizations around customers, the reasons for these mixed results became clearer. There were some real successes, one disastrous failure, and a lot of work-in-progress. Some firms were over-aligned and several were returning to a product-focused structure. Thus one of Mark Hurd's first moves as CEO of HP was to undo Carly Fiorina's efforts to create an integrated sales force to sell bundles of products, and return to a more product-specific focus.[5]

From these stories of success, failure, and back-tracking, we have drawn three implementation lessons:

1. Keep everyone focused on the customer's total experience,
2. Adjust the pace of the alignment process to the anticipated obstacles, and
3. Keep realigning to stay ahead of market changes.

Many organizations cannot, should not, and will not aim for complete organizational alignment with their markets. Many successful companies like Samsung, Toyota, and Unilever remain resolutely product-focused and are not disposed to move beyond modest coordinating mechanisms. Those firms aiming for a very tight alignment should not embark on a multi-year journey to implement this design unless there is substantial leadership commitment.

TOWARDS A CUSTOMER-FOCUSED ORGANIZATION

Organization structures – comprising the formal structure and the coordinating mechanisms – are continually seeking an equilibrium. They never reach this state because any structure is the outcome of many compromises and takes longer to adjust than do changes in strategy or market requirements. Underlying this dynamic equilibrium is a steady progression toward more customer-focused structures. This evolution is shown in the four stages of Figure One, starting with Stage One as the familiar product or functional silo. For smaller and/or highly-focused firms, this clean and simple structure usually suffices. Problems arise as competitive pressures, fragmenting customer requirements, and proliferating channels create performance-sapping conflict. Silo structures are seldom a comfortable steady-state solution, leading to the next stage.

Stage Two: Informal Lateral Coordination

An early sign of difficulty is mounting tension between the sales and marketing functions. Both groups should be working in parallel toward short and long-term goals. Problems first surface when each function blames the other for its own failings, and are exacerbated by a lack of respect for the other's role. Sales may think of marketing as short-run sales prospecting and program support. Marketing thinks of itself as identifying attractive groups of prospective customers and finding ways to attract and keep them over the long-run. The view that prevails depends on which function has the most power and the most credible advocates.

There are various ways to defuse and channel these conflicts and misunderstandings toward more productive ends. Well-trained and properly incented product managers can serve informally as bridges and coordinators. It also helps if there is conscious cross-pollination by rotating people through each function to gain shared understanding and create spanning networks. Joint participation in planning meetings is essential. The introduction of company-wide customer relationship management (CRM) systems is sometimes useful, by requiring standardized communications and shared access to customer information. However, these moves are much more successful when done in tandem with the next stage of evolution.

Stage Three: Partial Alignment via Integrating Functions

The most significant and enduring shift in the organization of marketing has been the introduction of the boundary-spanning role of market segment and/or key account managers.[6] These are installed to overcome a functionally partitioned view of the customer, thereby helping to identify unmet or emerging needs and improve the coordination of marketing and sales. These internal customer advocates use their knowledge and persuasive ability to gain influence since they rarely have direct control over resources or incentives. The aim is to improve the coordination of all customer-contact activities. Thus, key account managers are often responsible for large multifunctional teams with many points of contact to different functions and levels within each large customer.

In the wake of these shifts marketing activities are increasingly dispersed and assigned to teams led by sales, or to cross-functional process teams responsible for customer service or logistics. Sometimes separate organizational units are formed to deal with customer relationship management, customer service, or world-wide branding issues that were once the sole province of the marketing function.

Stage Four: Fuller Structural Alignment

The traditional way to achieve structural alignment was to design a family of autonomous SBUs, each with full accountability for performance within a distinct industry or customer segment.[7] When all SBU resources are optimized to grow customer segment revenue and profits, then customer needs and preferences and opportunities for competitive advantage take priority in decision making. Thus, a U.K. publishing company with a portfolio of lifestyle magazines set up a number of small, decentralized SBUs, each addressing a different reader segment. There was little sharing of services between these SBUs.

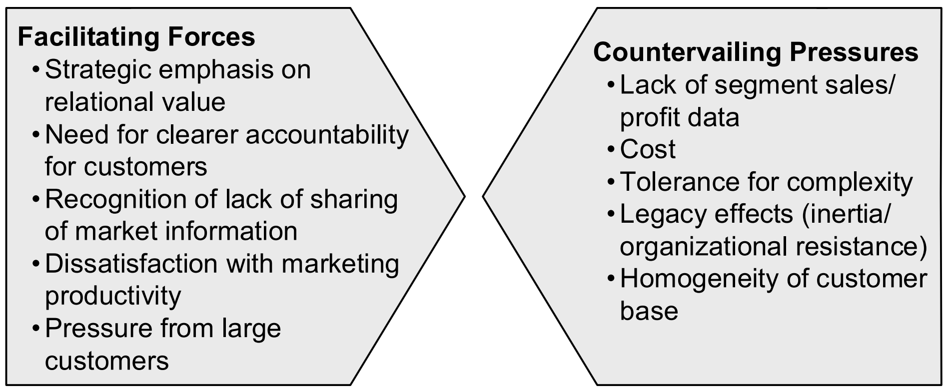
The stand-alone SBU design requires stable market segments that overlap minimally with the markets of other SBUs. If the SBUs share products, services, or capabilities, then coordination becomes difficult, the understanding of the customer becomes fragmented, and resources for serving customers are inefficiently allocated. In response to these problems, organization designers are evolving toward front/back hybrid models or matrices that add a customer segment dimension.

The front/back hybrid design has strong customer-focused "front end" units that offer integrated solutions (see Figure Two) and product business units that provide the modular elements to combine into solutions.[8] Within IBM, the original business units for personal computers, servers, software, and technical service are internal "back end" suppliers to the solution units—while also selling directly to customers. This design flourishes when customers want solutions that are customized to their individualized needs, and delivered through a single customer contact point. The other requisites for success are a strong corporate center to mediate the conflicting demands of the two units, and a strategy with solutions as the central thrust.

Fidelity Investments has evolved to the front/back hybrid model to meet the challenge of discount brokers on one side and independent financial advisors on the other. Their organizational transformation from a solely product-focused company began with a strategy that emphasized credible advice and investment solutions tailored to the individual investor's situation. This meant picking the customer segments to nurture, and creating dedicated groups to serve each of these segments with personalized guidance and service levels appropriate to the profit potential of the segment members. The product groups continued to develop and manage a broadened array of funds and financial services that could be readily bundled. See Figure Three for further details.

The Evolution of Organizational Alignment

How far a business proceeds through these progressive stages of alignment depends on the balance of facilitating and countervailing pressures summarized below:



The main driver is the emphasis of the strategy on relational value; as in solution strategies such as IBM's Global Services or General Electric's Power Systems. These strategies prevail when there is a wide diversity in the requirements and attractiveness of the customer base, and some of the best customers see value from buying an integrated bundle of products and services from one source. This requires engaging in close interactions far beyond the traditional buy-sell relationship. Conversely, a price value strategy that emphasizes leveraging economies of scale and scope, to compete in a reasonably homogeneous market with a standardized offering, does not usually require more than a Stage Two structure.

Tempering the decision to proceed all the way to a Stage Four structure with fuller structural alignment are: (1) a lack of information on the purchase behavior and profitability of individual customers or segments, (2) a low tolerance for the complexities of transfer pricing mechanisms and activity-based costing, and (3) the difficulty of overcoming inertia and reforming legacy systems. These countervailing pressures are a warning that while the evolution toward closer alignment is directionally correct, it is not sufficient to support robust prescriptions. The appropriate structure is guided as much by implementation realities as the strategic imperative to get closer to the customer.

GETTING CLOSER TO CUSTOMERS

> *"... (The) integration of "front office" functions that touch the marketplace ... can produce significant benefits, but the integration must be executed superbly or the benefits will be decimated by the parochial interests of individual units."*[9]

This quotation from Lou Gerstner, drawing on his experience with the turnaround of IBM, captures the stakes and risks of implementing a customer-based front-end design. To identify the main benefits and pitfalls, we interviewed senior managers of fifteen firms that had undertaken a large-scale redesign in an effort to gain a closer alignment with their markets.

Our method was to follow up on previously publicized reports or announcements of a firm realigning its organization around market segments, and ask the following questions:

1. Why was the organizational change undertaken? What were the triggers?
2. How was the design chosen? What alternatives were considered?
3. What were the biggest implementation challenges? How did the organization get behind the change and commit to making it happen?
4. What were the performance results? Was the redesign considered a success?

The fifteen firms in our study were classified by degree of success (see Exhibit One), using the judgments of those who were familiar with the history of the realignment process. Only four were unqualified, sustained successes. Two more were judged to be successes within one region, but their approach had not been adopted by their parent in other markets. In two cases, firms had retreated from a strong alignment with their market.

Most respondents were reluctant to attribute a numerical improvement in their profit or revenue performance to the organization change, on the grounds that it was embedded in concurrent changes in their strategy, systems and capabilities. A further six firms were in the midst of their realignment, and judged it was too early to announce success. But even these firms could point to promising early indications of success using intermediate metrics such as customer satisfaction and customer perceptions of responsiveness, as well as better utilization of marketing resources.

Rationales for Reorganization

The reason given for a major re-organization of Motorola, launched by the new CEO, Edward J. Zander, in late 2004, would have resonated with each of the firms in our study.[10] The intent was to dismantle Motorola's debilitating bureaucracy and end a culture of rivalry among product divisions who behaved like "warring tribes."

This was necessary to help execute a strategy of "seamless mobility," and make it easy for consumers to transport any digital information – music, video, e-mail, phone calls – from the house to the car to the workplace. Zander planned to abandon a divisional structure based on products, such as mobile phones and broadband gear, and reorganize around customer markets such as the digital home and large enterprises. To overcome resistance, Zander has made cooperation a key factor in determining raises and bonuses.

The primacy of strategy. The managers we talked with consistently said there had to be a compelling strategic rationale for a re-alignment around markets before the organization could summon the energy to carry out the process. There was a clear path to competitive advantage, the reasons (or triggers) were obvious, and each implementer could see where they could contribute.

Numerous combinations of strategic rationales were behind the re-alignments we studied:

	Strategic Rationales	
	Primary Reason	**Supportive Reason**
Implement a solutions strategy	8	3
Get closer to the market (improve retention rate)	3	7
Find and exploit segment growth opportunities	3	1
Improve marketing productivity	0	4
Response to Competitive Pressure	1	2
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Number of Companies giving reasons (Two companies gave two supporting reasons)	**15**	**17**

Implementing a solutions strategy. This was the most frequently cited strategic rationale. These strategies require that the solution be co-created with the customers, be tailored to each customer or segment , require integration of products and services , and entail some degree of risk sharing.[11]

Cummins India began their evolution to a Stage Four solutions strategy with a ungainly group of separate joint ventures for making and selling engines, generator sets and related equipment, along with a separate service entity. The triggers for change were the threat of loss of their dominant share, plus deteriorating margins as the Indian economy opened to competition, and the consolidation of control over the joint ventures so they could be operated as one entity. Having a service business was viewed as "good fortune" because it helped Cummins learn about the on-going needs of their customers, and showed that the margins on custom service bundles were much superior to products.

The new head of Cummins India was the obvious owner of the solutions strategy, which was implemented through three "front-end" subsidiaries each focusing on a particular solution.

As subsidiaries they were shielded from the existing systems and culture of the “back-end” units that made the engines and generators. A key move was to make the three subsidiaries “product agnostic,” so they could offer competitor’s products when they were better suited to the solution. Initially there was internal skepticism, compounded by lack of knowledge of the needs of the end user buying the solution. The need of power system customers for uninterrupted power depended on much more than a reliable diesel engine. To meet that need Cummins had to source new components from outside the company, analyze the customer economics in depth to tailor their offering, and provide extensive maintenance and testing programs. Overall the realignment is viewed as a success, with market share and revenue slightly increased. Meanwhile sales of the core product business of engines and generators dropped by 30 percent.

Solutions strategies are most suitable for service companies such as Fidelity Investments or systems manufacturers like IBM able to provide a significant service “wrapper” to augment their product or firms in convergence markets. Thus Thermo-Electron, the global leader in analytical instrumentation, has been moving to a Stage Three realignment with key account managers to represent their whole line of bundled lab instruments, augmented with financial and maintenance services, and lab information systems using integrated software platforms. They are fixing a deeply flawed and fragmented business model in which 24 subsidiaries sold their individual products to the same customer as other subsidiaries – with much duplication of effort and aggravation of customers. One of the legacies of this balkanized structure was that key account managers from product divisions preferred selling the products they knew, and were less interested in selling solutions. To overcome this problem, Thermo-Electron began hiring people from their customers for this integrated selling job. As part of their journey to closer alignment with markets they have added market segment managers for each type of laboratory. It is their job to know everything about their segment and support the sales force by pulling resources from the product groups.

Getting closer to the market. While this was seldom the main reason for realigning around markets the advantages of, "getting closer to customers", gaining "deeper insights into segments," or "breaking away from product orientation," were seen as strong supporting reasons. Further impetus came when the customers tired of having multiple sales people from the same company visiting, and demanded a single point of contact to coordinate sales activities across all businesses.

A strong proponent of the strategic value of a market orientation was William Monahan, the Chairman and CEO of Imation who said, "If what you do does not lead to customers, then you should be doing something else." Imation was spun out from 3M in the mid-nineties as a collection of seven product-focused businesses in rapidly commoditizing markets. The first move was to divest five non-core businesses and concentrate on data storage media and devices. Even though Imation does not sell directly, they chose to realign their organization around four end-user segments: personal storage, entry level, mid range (high level of networking) and enterprise.

For each end-user segment Imation created a business team, led by product management, who are experts in assessing customer requirements and designing the Imation offering. This is a standard matrix design with a product dimension responsible for data storage products that can be used by multiple segments, and a market segment dimension housing the business teams responsible for the segments. Sales are made by key account managers who call on large retailers such as Best Buy, and large OEM accounts. Each account manager is also a member of a business team. Imation is not selling solutions; their advantage comes from deeper customer knowledge that strengthens their ties with their distributors and retailers. Other benefits are a much more “aggressive” culture (their term) with a stronger productivity mentality. By setting clearer strategic priorities Imation reduced their SG & A costs by two percent.

Pursuing segment growth opportunities. Both Sony North America and Nokia realigned themselves around market segments because their uncoordinated and product-centered organizations were missing growth opportunities, and marketing efforts were being diluted across too many categories. By bundling products to meet segment needs they were following Jack Welch’s notion, “If you have dominant share in the market, make the sandbox bigger.”

Sony Electronics, North America had mirrored the parent’s organization with five autonomous product divisions (e.g. home entertainment, digital imaging, personal mobile and so on) with separate profit-and-loss statements.[12] Because each product line had its own target customers, with Walkman focusing on the youth market for example, other segments such as active matures were underserved or overlooked. Independent marketing programs also meant that customers were on their own when bundling or linking Sony products. In an era of convergence, the lack of coordination meant missed opportunities.

MANAGING THE IMPLEMENTATION PITFALLS

A successful plan for a reorganization around customers has to consider many potential pitfalls. Some are built into the contradictions and compromises of the original design. Thus the pressure to contain overhead costs may conflict with the desire to improve coordination and information sharing across the organization.[13] Each new job function adds a bit more bureaucracy and cost, and disperses market knowledge more widely.[14] Also, it is hard to nurture deep functional expertise while subordinating these functions within process teams. The inevitable frictions are then seized on by those who preferred the status quo, or stand to lose something in the new structure. Inadequate systems are a major source of delay and frustration;

how can an organization be aligned to its markets if customer data is dispersed, segment profitability can't be estimated, and customer defections aren't visible?

As with any changed program, there must be senior management commitment, persistence, and intense communication to overcome the resistance to change.[15] But the odds of success are much improved if there is a compelling strategic rationale and our three implementation lessons are followed.

Lesson One: Keep Everyone Focused on the Customer's Total Experience

The benefits of a more customer-focused organization are first realized through clearer accountability for the relationships with the best customers. Functional and product-dominant structures are notably poorer at comprehending the total experience of the customers with the company and solving cross-functional problems. No one is looking at the company through the customer's eyes and asking how processes can be improved to reduce their frustration, how products can be integrated across units, or what new requirements could be satisfied with an augmented offering. Without clear accountability no one may be responsible for tracking customer defections and launching "win back" initiatives.

A corollary of a balkanized view of the customer is that systems and controls designed for measuring product profitability can't measure the profitability of individual customers or segments. Yet the ability to treat different customers differently according to their life-time value is at the heart of customer relationship management. Improving accountability requires a combination of system changes, customer-focused metrics, and incentives tied to customer segment performance.

A necessary early step is unified *customer information* that is filtered through linked databases, and delivered in a coordinated and meaningful way to customers. Then the company presents a single face to the customer. When individual product and geographic groups have their own information systems, including ordering and fulfilment, the firm is unable to coordinate its offering.[16] The consolidation of information at the point of customer contact also makes it easier to separate the front-end customer solution units from the back-end product infrastructure.

Further reinforcement of a customer-focused structure comes from the judicious choice of *performance metrics*. This choice should be guided by both strategy and objectives. Most firms we talked with held their customer-facing units accountable for segment revenue and profitability. But these measures are short on diagnostic value, and are usually not in the direct line of sight of individual contributors or teams. They need to be augmented with a dashboard or scorecard using metrics that illuminate the strategy and have a tested connection with financial performance. These differ by firm and industry. While customer retention is often a driver of growth and profits it is suspect as a measure when there are high switching costs. Similarly, customer satisfaction can be a useful diagnostic measure when it is asked about the components of the offer (service versus product for example), but it is also cumbersome and unreliable.

The best metrics support the strategy, are meaningful to employees, and are leading indicators of performance. Enterprise Rent-A-Car can rank their 5000 branches with two customer survey questions, one about its quality of their rental experience and the other about the likelihood they would rent from the company again. A more generalized version of these questions[17] is "How likely is it that you would recommend [company X] to a friend or colleague?"

Tailored performance metrics are also grounded in a deep understanding of customer needs and priorities. Thus, GE Plastics found that on-time delivery was most important to their customers, and that poor performance was caused by variability in meeting delivery promises. Both early and late delivery caused problems. They used their well-honed Six Sigma discipline to measure and manage delivery "span." This was the variation in delivery date around the promised date. By tying incentives to progress in narrowing this "span," and following this progress closely, they assured accountability where it mattered.

The clearest signal that accountability for segment performance matters is when *incentives* and *performance reviews* are directly linked to the segment metrics. Thus, Square D altered its incentive system so that the new market segment units were measured and rewarded for the number of customers acquired and kept, rather than number of units sold, and on the operating profit margin. Incentives are also useful for signaling desired behaviour. Thus, Thermo-Electron rewarded sales people for sharing customer leads with other market segment groups.

Implementation caveats. A good general rule is that employees only willingly accept a new accountability when they feel they can trust the metric and it with their actions. This rule is often violated. The first problem is that employees often lack confidence in the measures. For example, segment-level sales data is often hard to obtain. Proxy measures of revenue based on surveys may be "good enough" for decision-making, but not for incentive compensation. Also, accounting systems configured for product costing are generally clueless when it comes to measuring the costs of serving customers. Complex estimates of these costs are likely to arouse suspicion. Measures of customer satisfaction and retention are similarly vulnerable.

Another problem arises when employees learn they can game the metrics. The well-known manipulation[18] of customer satisfaction scores by auto dealers certainly compromises the value of this metric.

A third problem is that employees don't see how they can impact a measure because it is too far removed from anything they can control. Profit and loss measures at the segment level are essential for control and diagnosis, but few employees can personally relate to them. By contrast the GE Plastics measure of "span" of delivery performance is meaningful to all functions, including procurement and manufacturing, that would not normally consider the impact of their activities on customers. By focusing on the attribute of greatest importance to the customer they improved the overall alignment to the market.

Lesson Two: Adjust Pace of Alignment Process to Anticipated Obstacles

Reorganizations invariably take longer than expected. Sometimes a change in leadership undercuts the energy and commitment to the change. Because it takes longer to reorganize than to plan a change in strategy, there is an unrealistic expectation about how quickly it can be accomplished. Systems changes and upgrades are often a rate limiting stop in the process. Fidelity Investments managers estimate that it took them at least three years to accomplish 60 percent of their reorganization goals; mainly because of systems constraints.

Overall, we found the biggest impediment to the timely completion of a reorganization was an inability to anticipate and overcome obstacles. Few firms violated this imperative to worse effect than Xerox. There was a clear strategic rationale for a proposed front-end alignment around customers. As early as 1992 the then CEO, Paul Allaire,[19] saw that a shift of the Xerox strategy to focus on "the document" would have the greatest impact on customer relationships, "In the future Xerox won't just sell copiers. It will sell innovative approaches for performing work and enhancing productivity…But that means our salespeople need to understand the customer's business, what the customer's real needs are and how the customer is going to use our products."

To overcome the rigidity of an extremely functional organization, and present a single face to the customer, the sales and serves people were first organized into geographic customer operations divisions. This structure served the company well through the Nineties. Then growth slowed and an “outsider” Rick Thoman came from IBM to take over as CEO. He soon concluded that the next logical step was to assign the sales force away from their geographic responsibilities to industry groups to sell document solutions. This would seem to reinforce the direction set by Allaire and meet intensifying competition from HP and Canon. Because the change was so badly botched, none of its benefits were realized and Xerox was seriously damaged. Soon after, Thoman lost his job.

Our interviews and other autopsies found a mix of strategic misjudgments and serious implementation mis-steps by Xerox. In retrospect not all industry segments wanted a “document solution.” A hybrid model would have served them better with the solution approach limited to industry vertical markets like Law Offices or Pharmaceuticals where document management was crucial. Then there were unrealistic expectations about the abilities of the sales force. While they were very good at selling boxes to office administrators and purchasing agents with large contracts, it became painfully obvious when they called on systems or IT people that they didn’t know enough about networking or their assigned industry.

Xerox management didn’t properly train the sales force in their new assignments; nor were their customers adequately prepared to understand the changes. Sales people complained about losing long-standing client relationships, and being pulled into time consuming meeting and task teams while still being judged on customer calls and sales results. The fall-out was very damaging; the sales cycle lengthened, aggrieved customers slowed their payments, and a third of the sales force left the company.

The cultural imperative. A firm's culture can either give or deny permission to proceed with a realignment around markets. Both Nokia and Capital One benefited from supportive cultures. Nokia grew up with a flexible culture that encouraged informal networking and cross-business task-forces. This made it easier for small project teams to evolve into separate businesses serving distinct markets.

Capital One also leveraged its culture to move from a conventional functional organization that took a centralized "credit view" of their customers, to business teams organized around markets such as super-prime or sub-prime customers. Each team had all marketing and customer acquisition and retention activities, and was responsible for credit analysis and rating. This was a big departure from practice, that begun with the highly visible success of a credit card for college students without credit histories. An analytical culture of "show me the NPV" could see the possibilities of this early win, and with an average employee age of less than 30 years, most people were not strongly wedded to the traditional organization.

Obstacles arise when this culture is mature and has absorbed dysfunctional beliefs such as: the sales force "owns" the customers, or "we'll sell to whoever will buy," or "customers don't know what they want." This was the environment that Lou Gestner forced when he joined IBM, and contributed to Xerox's plight.

Cultural obstacles are among the most different to anticipate and may only surface later as subtle resistance; or an unwillingness to share information. One proven way to deal with them is through success stories. This, Square D was divided into core and non-core markets (the latter were mostly about new opportunities). Market –segment management began in the non-core markets because they didn't have strong legacy cultures to overcome. Once the leaders of the non-core markets demonstrated the pay-off from their realignment, they were transferred into the core markets as change agents.

*Implementation Caveats***.** Mismatched capabilities, fragmented information systems and inadequate execution can all undermine the realignment process. For the most part the firms we studied anticipated and dealt with these obstacles, because they are a familiar feature of all organizations. They were more likely to miss two less familiar obstacles to realignments around markets that stem from customer resistance and exacerbation of long-simmering functional tensions.

A common economic rationale for realignments around customers is that different customers are treated differently according to their cost-to-serve and life-time value. But long-standing and loyal customers usually resent being relegated to a lower status, such as being served by distributors, when they had always been served directly. These customers will have friends and advocates within senior management and the sales force who may take their side. A careful migration path for these customers has to be designed in anticipation of this obstacle to avoid jeopardizing the whole program.

Finally, an organizational realignment often exacerbates long-standing conflicts, notably between marketing and sales. When field sales, telesales, retailers, and customer service all interact directly with the same account, and market managers devise strategies for these accounts that are not closely coordinated with sales, the objective is seamless execution, but the results are often expensive duplications, infighting and a poor customer experience. These adverse results constitute a very sizeable transition cost of the new organization – and a deterrent to ambitious reorganization plans.

Lesson Three: Keep Realigning to Keep Ahead of Market Changes

Organizations continually slip out of alignment with their markets because markets are increasingly dynamic and strategies must keep pace. Indeed managers must brace themselves for an accelerating pace of realignment. They can only hope the rate of change is slower than their ability to complete the previous change. This is far from a sure thing because of the inherent drag of system legacies, culture and other obstacles.

One reason for continuous change is that any organization that highlights the customer dimension confronts the question of which customer to serve. The strategic logic does not permit the luxury of serving all segments equally well. Do we want a high share of a few accounts, or a smaller share of a large number of accounts? But the roster of high value accounts keeps changing, so teams must be able to continuously form and reform as new segment opportunities emerge.

Second, there is the pendulum phenomenon. An organization in transition only stops at the top of a pendulum swing and then moves most quickly when it reaches the bottom of the swing, which was the intended destination. Because of this momentum it is easy to overshoot and overalign, so savvy manager's expect to adjust and correct their course. This is all part of the learning process. When Philips Semiconductors shifted entirely to global account teams, as part of a tighter collaboration with customers on technology, service, and logistics with their biggest global accounts, they encountered a number of problems. Some were the natural fall-out of managing teams across many time zones, and the resistance of some country cultures to not having a local as their boss. They also found they couldn't fully customize their entire service organization. Nor did all accounts want a highly linked collaborative relationship, that looked like a virtual joint venture. Now they are moving to a hybrid organization with global teams for the top 70 percent of their customers. The others will be served with regional teams.

Competitive Realities. Alignment with a market means being responsive to both customer opportunities and competitive cost pressures. In tough economic times the customer dimension may be subordinated, as we found with two firms that reemphasized the product dimension.

Until 1993, Square D, the maker of industrial control and electronic distribution systems, was organized around three main products, and couldn't seem to grow any faster than the underlying markets. At the same time their large manufacturing customers, such as the Big Three automakers, were globalizing and wanted integrated solutions. To get closer to these customers they reorganized around four main markets; industrial, residential, construction, and original equipment manufacturing. The remaining functions were then reorganized to support these divisions with centralized manufacturing.

This customer-focused model was just right for the Nineties, but struggled when the economy slowed and customers started moving production overseas in search of lower costs. As the head of sales and marketing noted, "Our customer-focused organizations, with product and customer segment sides of the matrix equally balanced, served us well throughout the 1994-2000 period.... If I rate our performance then at A-, the last two years would a much lower rating. As a result we are now strengthening the product side of the matrix…. Within the cross-functional teams that serve segments, the product organization is being made more accountable – their role is being evaluated, their compensation plans are being changed … the product side will be mainly responsible for the P&L, and the trade-offs that are necessary between revenues and costs." They found it was easier to implement cost measurements and cost allocations to the product side and hold them accountable for cost savings. In this way they have converged to the familiar hybrid structure where the front-end is aligned around markets and the rest of the organization is structured around products.

There are many parallels between Square D and Cisco Systems. Until August 2001 Cisco had an advanced version of the Stage Four design, with three separate semi-autonomous lines of business.[20] Each LOB independently developed, manufactured, and sol customized networking solutions to distinct customer segments: internet service providers, enterprises, and small to medium-sized businesses. With this structure they rode the explosive growth of the industry to sales of $22.3 Billion in 2001 from $6.4 Billion in 1997.

The 2001 technology slump exposed the fault lines of this structure. Because each segment-facing LOB developed and built their own products, there was a great deal of redundancy in engineering and innovation. Concurrently, the customer segments were converging in their technological sophistication and requirements, low-cost competitors like Huawei from China were selling lower-priced versions of Cicsco's equipment, and overall demand was falling quickly. Under this burden, net income collapsed from $2.7 Billion in 2000 to a $1 Billion loss in 2001.

To squeeze out the costly redundancies, all related technologies were centralized into eleven technology groups under a Chief Development Officer. A central marketing organization housed solutions engineering teams that could mix and match these technologies. The risks of building technology silos was well recognized. "We moved the inflection point back towards engineering. This allows the technology to be used in multiple customer segments, but it does put engineers further away from the customers …" Amazingly, this entire realignment was implemented within three months, without layoffs or physical relocation for most engineers, which made it easier to them to keep connected with other technology groups. By the end of 2003 they were seeing the benefits of the cost efficiencies, without apparent deterioration in customer satisfaction, and net income was $3.6 Billion.

Finding the Structural Sweet Spot

Organization structures are destined to stay in flux because they are just a means to an end, which is the realization of a competitive strategy. A rethinking or redirection of this strategy is tantamount to a redesign of the enabling structure and supporting elements. Both Square D and Cisco Systems had ridden their full customer-focused organizations to rapid growth during the nineties, but found they were overaligned when market growth slowed and low cost competitors challenged their cost base. Both settled on a hybrid front-back design. Perhaps this is the sweet spot for pursuing a solution strategy.

In both cases the realignment was eased by their strongly market-driven cultures. Close observers of the Cisco reorganization concluded that the high value placed on customer advocacy was so embedded in the cultural DNA that it was unaffected by the changes to the formal structure. In summary, organizations are about more than boxes, arrows, and lines, but structure does signal strategic intent. Although the balance of accountability and power of each dimension will stay in flux, there is no doubt that some form of alignment with markets has value even in the most cost constrained and demanding markets.

Appendix A
About the Research

A representative sample of senior marketing, sales, and MIS managers and executives was drawn using a database combining information from Dun & Bradstreet and Market Place. SIC codes were selected from the manufacturing, transportation, public utilities, wholesale and retail trade, finance, insurance, and real estate sectors. Companies located in all 50 states with more than 500 employees were included in the sample.

The questionnaire was mailed to the most senior person who was knowledgeable about the competitive strategy performance of the firm. Two weeks after the mailing, follow-up telephone calls were used to remind people to complete the survey, and surveys were remailed if requested. 1,100 surveys were sent out in the first mailing, and a second wave was sent out about four weeks later to 900 new contacts. The two mailings had similar response rates and the final response rate was 17 percent. Data collection was completed in March 2002.

There were no significant differences between the firms that responded compared to the sample frame in terms of their industry, number of employees, and geographic location. Early respondents did not differ significantly from later respondents, which further confirms that representativeness of the data.

Respondents were asked: "How are you organized now?" and "How do you think you will be organized in 3 years?" to establish the prevalence of the five major organizational dimensions:

	How are you organized now?	… in 3 years?
Product-service lines	.61	.50
Customer groups	.32	.52
Process teams	.22	.33
Functions	.50	.26
Geographics	.48	.36
	2.13	2.37

The first analysis treated organization by customer groups as a binary independent variable and used logistic regression to seek potential antecedents. An equation with 8 market characteristics, 2 company demographics, and 6 strategic choices failed to find a variable that was significant at the .05 level.

The second analysis sought the consequences of being organized by customer groups. The significant correlations were:

- Employees' freedom to take actions to satisfy individual customers (Pr > .06)
- Openness to sharing information about customers (Pr > .13)

- Accountability for overall quality of relationships with best customers (Pr > .0003)
- Number of companies a customer sees (Pr > .01)

The correlations in separate equations with relative retention and relative profits as dependent variables were not significant.

FOOTNOTES

[1] See J. R. Galbraith, *Designing Organizations: An Executive Guide to Strategy, Structure and Process,* San Francisco: Jossey-Bass, 2002, Chapter Seven; N. W. Foote, J. Galbraith, Q. Hope and D. Miller, "Making Solutions the Answer," *The McKinsey Quarterly*, 3, 2001, 8-93; D. K. Rigby, F. F. Reichheld and P. Schefter, "Avoid the Four Perils of CRM," *Harvard Business Review*, February 2002, 101-109; and G. S. Day, "Creating a Superior Customer Relating Capability," *Sloan Management Review*, 44 (Spring), 2003), 77-83.

[2] H. E. Aldrich, *Organizations Evolving*, Thousand Oaks, CA: Sage, 1999, and J. Child and R. G. McGrath, "Organizations Unfettered: Organizational Form in an Information-Intensive Economy," *Academy of Management Journal*, 44, 2001, 1135-1148.

[3] For background on Intel's re-organization, see C. Edwards, "Shaking up Intel's Insides," *Business Week* (January 21, 2005), p. 35; "Intel's Right-Hand Turn," *The Economist* (May 14, 2005), pp. 65-66, and A. Lashinsky, "Is This the Right Man for Intel?" *Fortune* (April 18, 2005), pp. 110-120.

[4] D. Miller, R. Eisenstat and N. Foote, "Strategy from the Inside Out: Building Capability-Creating Organizations," *California Management Review*, 44 (Spring), 2002, 37-54, and R. Eisenstat, N. Foote, J. Galbraith and D. Miller, "Beyond the Business Unit," *McKinsey Quarterly*, 1, 2001, 54-63.

[5] P. Burrows, "The Un-Carly Unveils His Game Plan," *Business Week* (June 27, 2005), p. 36.

[6] These shifts were identified and documented in C. Homburg, J. P. Workman Jr. and O. Jensen, "Fundamental Changes in Marketing Organization: The Movement Toward a Customer-Focused Organizational Structure," *Journal of the Academy of Marketing Science*, 28 (Fall), 2000, 459-478.

[7] M. Gould and A. Campbell, *Designing Effective Organizations: How to Create Structured Networks*. San Francisco, CA: Jossey-Bass, 2002.

[8] This description draws heavily from Galbraith (2002), *op. cit.,* Chapter Eight and from Foote, Galbraith, Hope and Miller (2001), *op. cit.* The stream of research described in this chapter also confirms the evolution toward customer-focused organizations.

[9] Louis V. Gerstner, *Who Says Elephants Can't Dance? Inside IBM's Historic Turnaround*. New York: Harper Business, 2002, p. 248.

[10] R. O. Crockett, "Reinventing Motorola," *Business Week,* August 2, 2004, 82-83.

[11] D. Sharma, C. Lucier and R. Molloy, "From Solutions to Symbolism: Blending with your Customers," *Strategy and Business,* 27, 39-48.

[12] D. Sharma, C. Lucier and R. Molloy, "From Solutions to Symbolism: Blending with your Customers," *Strategy and Business,* 27, 39-48.

[13] The trade-off between specialization and coordination was first identified by P. Lawrence and J. Lorsch, *Organization and the Environment*, Cambridge, MA: Harvard University Press, 1967.

[14] S. Ghoshal and NiFin Nohria, "Horses for Courses: Organizational Forms for Multinational Corporations," *Sloan Management Review.* (Winter 1993), 23-35.

[15] J.K. Kotter, *Leading Change,* Cambridge MA, Harvard Business School Press, 1996.

[16] M. Sawhney presents a similar notion in "Don't Homogenize, Synchronize." *Harvard Business Review,* (July-August 2001), 101-108. He notes the most difficult challenge is getting the back-end product groups to view the internal customer-facing units as their primary customer, rather than the external end-users.

[17] M. Sawhney presents a similar notion in "Don't Homogenize, Synchronize." *Harvard Business Review,* (July-August 2001), 101-108. He notes the most difficult challenge is getting the back-end product groups to view the internal customer-facing units as their primary customer, rather than the external end-users.

[18] F. Reichheld, "The One Number You need to Grow," *Harvard Business Review,* (December 2003), 46-54.

[19] Reichheld, *op.cit*, page 49.

[20] This description of the Cisco reorganization is based on Ranjay Gulati and Phanish Puranam, "Organizational Inconsistencies After Reorganization: Good for Performance?" London Business School, unpublished working paper, 2005.

Exhibit One
Classification of Companies Interviewed
(Success is based on management judgment plus objective measures of performance improvement.)

Sustained success	Regional success – not global	Redesign in progress	Initial success followed by shifting emphasis back to product dimension	Damaging retreat
1. IBM[1] (interviews in depth with Systems Group) 2. Fidelity Investments 3. Capital One[2] 4. Imation	5. Cummins India 6. Astra-Merck[3]	7. Nokia 8. IntelSat 9. Qwest Communication 10. Thermo-Electron[4] 11. Sony USA[5] 12. Philips Semiconductors	13. Square D 14. Cisco	15. Xerox

[1] Louis V. Gerstner, *Who Says Elephants Can't Dance? Inside IBM's Historic Turnaround*. New York: Harper Business, 2002, p. 248. Gerstner was an important source of insight into the strategic logic of aligning the IBM company Forward solutions.

[2] This case is described in G. S. Day, *The Market-Driven Organization*. New York: Free Press, 1999, and the findings were confirmed in follow-up interviews two years later.

[3] This case is described in G. S. Day, *op.cit*.

[4] Based on a speech and discussion by Dr. Maryn Dekkers, CEO of Thermo-Electron Corp. at the *CMO Summit* at the Harvard Business School in October 2004.

[5] A description of the Sony USA organizational redesign can be found in the Marketing Leadership Council, *Driving Customer-Focused Decisioin Making*, Washington, D.C., 2002, p. 248.

Figure One
Stages of Evolution Forward Customer-Focused Organizations

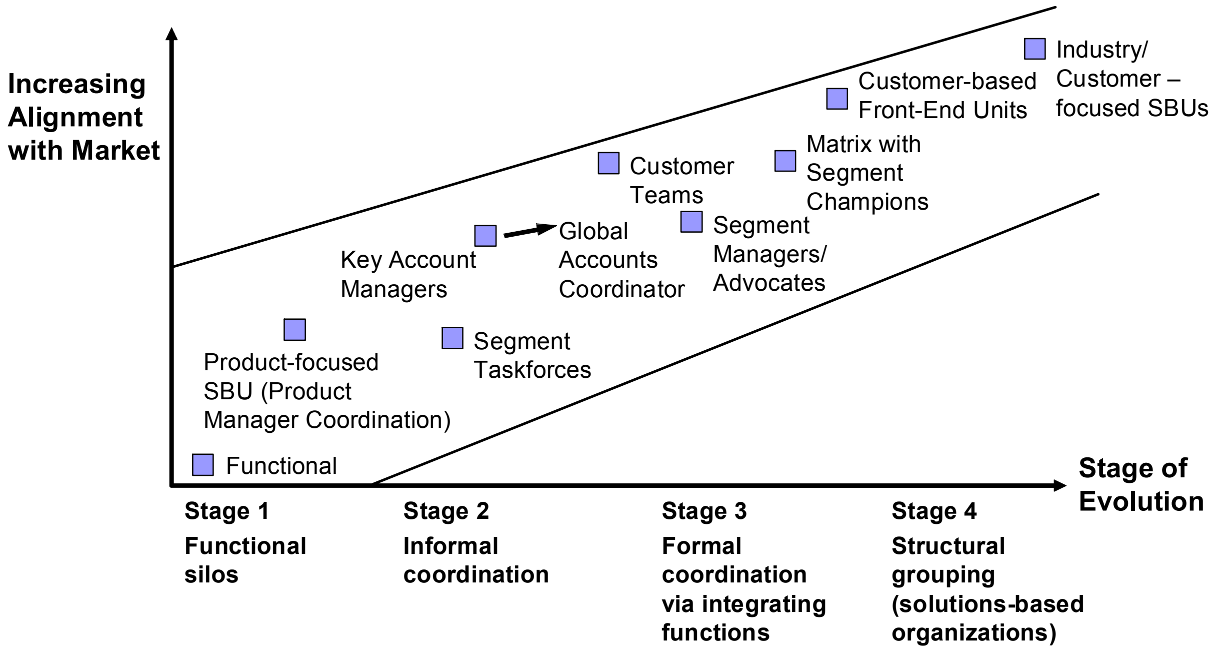
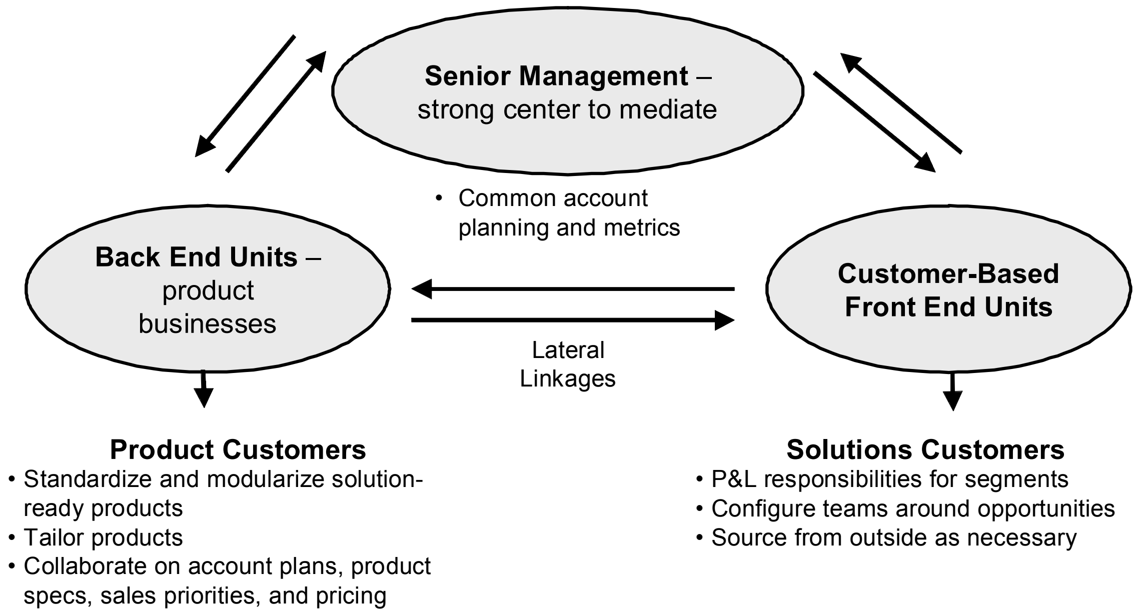


Figure Two
Customer-Based Front-End Units



Source: Adapted from Foote, Galbraith, Hope and Miller (2001)

Figure Three
Transforming Fidelity Investments