RETHINKING OPERATIONAL GOVERNANCE

THE NERVOUS SYSTEM THAT ENSURES THE COMPANY IS BOTH FLEXIBLE AND RESILIENT

AUTHORS
Sebastien Maire, Partner
Jérôme Bouchard, Partner
ORGANIZATIONS SUFFER DEFICIENCIES IN DECISION MAKING

A recent Oliver Wyman survey shows that more than nine out of ten companies make significant changes to their organization at least once every five years and that two out of three do so every three years.

Such changes inevitably cause disruption and cost time and money, so why do companies make them so often? Executives we talk to say that the reason they do so is that it is essential to have the right organization in place if they are to drive their desired strategy. They believe that company performance not only depends upon having the right strategy and technologies in place, but also on ensuring that the organization is efficient. Even with the best talent, organizational effectiveness requires good decision making and this, in turn, is a function of the way roles are distributed, processes are organized and tasks are conducted.

Modern companies are large and complex organizations that make many thousands of decisions every day, both large and small. The sheer volume of this activity can quickly lead to ossification and degraded outcomes. Our research and experience shows that the quality of decision-making and execution is determined by the quality of operational governance. This is the single most important factor for ensuring the quality, consistency, efficiency and speed in decision making and implementation.

The most frequent signs of deficient operational governance include:

- Costly and cumbersome bureaucratic processes resulting from the historical accumulation of rules and procedures (too many meetings, too much paperwork, great hierarchical complexity, etc.)
- Over-centralized decision making that all too often short-circuits established processes and responsibilities and shuts people out of the loop, thus sapping motivation and enthusiasm
- Informal processes dominate formal ones, creating a culture where ambiguity is king and decisions are the outcome of informal connections, resulting in low visibility about what drives such decisions
- Firefighting and crisis management as the norm, because this is the only way the organization can derive the energy to drive things forward
- Organizational silos: though people appear to do their job perfectly well and are even world class in their respective domains, overall company performance remains incredibly poor
Such symptoms are familiar to many an organization. Though organizational improvement programs are intended to identify and erase such problems, unfortunately they often seem to reoccur almost as soon as the program is over. There are many reasons why these problems so quickly reassert themselves – and it would be wrong to suggest that there is a silver bullet for eliminating them. Nonetheless, more times than not these problems can be traced back to the neglect of one critical though often overlooked aspect of organizational functioning – the organization’s central nervous system.

THE NERVOUS SYSTEM DRIVES DECISION MAKING

The analysis of the traditional organization chart fails to capture what is happening in terms of decision making and information flows. The problem is not just that this analysis focuses solely on the structure of the organization, but that it misses a vital element of the picture: the organization’s central nervous system, the highway along which the information and communication vital to decision making travels.

Operational governance focuses on all the critical aspects of the nervous system that links together the various parts of the organization (the parts shown in traditional organization charts) and that integrates these to the processes, culture and leadership style of the organization. Without a well-functioning nervous system the organization will quickly ossify.

DESIGNING THE ORGANIZATION’S NERVOUS SYSTEM

When executives set about adapting their organization to the changing environment, frequently the aspect that first attracts their attention is the task of revising the allocation of tasks and responsibilities. Their objective is to ensure that authority is distributed within the organization in a manner that reflects its strategic focus as closely as possible. Subsequently, their attention will shift to redesigning management and business processes so as to ensure their alignment with the new allocation of responsibilities. Finally, they may sometimes also address those aspects of the business’s culture, behavior and leadership style that underpin organizational collaboration and cohesion. What is missing from this agenda is a focus on operational governance, namely, on the corporate act of making and executing decisions.
All too often a company’s operational governance is not well adapted to the actual needs of the organization: rather than acting as the organization’s nervous system, facilitating the smooth flow and functioning of information and decisions, it is rigid, suffering from years of neglect. In addition to ensuring that the roles and responsibilities are aligned to the leadership style of the executive team and, in particular, with that of the CEO, the governance model also needs to fit well with the company’s organizational structure (its corporate structure, business lines, regions, etc.), its management style (whether centralized or delegated, etc.), the levels of autonomy and decentralization within the operational units, as well as the organizational needs of the people that work within it. Without the alignment resulting from a well-functioning nervous system, the structure of the organization, its culture and informal networks may actively obstruct effective decision-making.

Exhibit 1: The congruence model

Organizational effectiveness is achieved through the alignment and fit of the components
This begs the question, what does a well-functioning nervous system look like? To answer this, we need to look at three aspects that directly impact operational governance: the organization structure, its culture and the nervous system itself.

**Organization:** It is commonly understood that large companies are highly complex systems. In today’s world, the simple, hierarchical structures of old are largely dispensed with. Modern companies frequently exhibit the following characteristics:

- Often organized as matrices
- Connected strategically to their environment in relationships that reach beyond company boundaries (the ‘extended enterprise’)
- Contain end-to-end operational processes that cut across the organization and involve many if not all company players

None of this should be taken for granted. Though the above description no doubt mirrors the organization typical of a multinational company in the present environment, executives might do well to ask whether this organizational model is consistent with their company’s current strategic issues and geographical challenges. Does it have a readily intelligible decision making process with clearly defined responsibilities and lines of authority? Is it effective in motivating management and in delegating decisions to the right level of authority? However challenging these questions might appear to be in their own right, in some senses they are the easy questions to answer, ones that executives are at least familiar with.

**Culture:** This is where the questions become more difficult to answer. Though all executives are aware that culture plays a major role in determining organization performance, frequently they do not give as much attention as they might to such issues.

Today’s companies, with their large geographical reach, history of M&A, and deep supplier relationships, are just as complex culturally as they are structurally, maybe more so. This legacy leads to many of the following characteristics:

- A lack of cultural homogeneity
- The coexistence of many different cultural structures and configurations (as a result of historical accumulations)
- Differences that apply at each of the different levels of the organization, in terms of the authorities and responsibilities (reporting), internal and external communities, programs and projects, etc.

Whereas the goal, in terms of organization design, is to produce clarity in terms of structure, processes and systems, the task in
ensuring cultural fit with the company’s operational governance is more complicated and subtler. As a number of companies have found to their cost, by eliminating all cultural differences you can, for instance, undermine the effectiveness of your R&D organization, damage customer relationships, or eliminate the very distinctiveness that gave your acquisition its value. The question that needs to be asked, therefore, is what is it about the culture of the company that is truly valuable? Likewise, what is it that is really adding value to the organization, giving it a competitive edge, making it truly distinctive?

### Exhibit 2: Common malfunctions in operational governance

<table>
<thead>
<tr>
<th>Observed symptoms</th>
<th>BUREAUCRATIC</th>
<th>ORGANIZATIONAL SILOS</th>
<th>FIRE-FIGHTING</th>
<th>OVER-CENTRALIZED</th>
<th>INFORMAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slow decision making processes</td>
<td>Lack of communication across operational units and functions</td>
<td>Much of the time, management is reacting to events rather than taking the initiative</td>
<td>All decisions delayed (awaiting blessing from the boss)</td>
<td>Alternative arrangements lead to decisions being made outside governance committees</td>
<td></td>
</tr>
<tr>
<td>Disproportional decision processing costs</td>
<td>Many tradeoffs made at the top of the company (priorities, resources)</td>
<td>What really happens diverges from the ideal model or plan and requires constant emergency measures</td>
<td>Little true accountability</td>
<td>Some individuals take important powers without any formal mandate</td>
<td></td>
</tr>
<tr>
<td>Meeting-itis</td>
<td>Insufficient transfer of knowledge and experience in the company</td>
<td>Operational problems solved by experts on an ad hoc basis rather than according to a structured process</td>
<td>Managers lack motivation, either becoming disengaged or looking for excitement outside their remit</td>
<td>Not clear what needs to be implemented; decisions are transformed into actions seemingly at random</td>
<td></td>
</tr>
<tr>
<td>Failure to execute decisions after they are made</td>
<td>Insufficient cross-company initiatives</td>
<td>Mid and long-term vision too distant in regard to the company environment and immediate challenges</td>
<td>Mythic leader</td>
<td>Cultural practices, related to local culture or legacy corporate culture determine outcomes</td>
<td></td>
</tr>
<tr>
<td>Contradictory instructions</td>
<td>Organizational interfaces disconnected from operational processes</td>
<td>Poor allocation of resources</td>
<td>Decision making thresholds not well defined, preventing local empowerment</td>
<td>Certain management teams appear to be fighting off the rest of the organization</td>
<td></td>
</tr>
<tr>
<td>Uncontrolled proliferation of cross-company initiatives</td>
<td>Distribution of authority misaligned with processes</td>
<td>Excess allocation to immediate problem solving</td>
<td>Lack of delegation to operational echelons</td>
<td>Leadership at the top too far from the business issues</td>
<td></td>
</tr>
</tbody>
</table>

### Proposed solutions

- Simplify the organizational structure, especially the number of management layers
- Align decision-making authority with operational processes
- Reduce the number of committees or the number of participants
- Establish cross-company, multifunctional teams and processes; eventually move to a ‘matrix’
- Establish ‘platforms’ to develop products and services
- Establish required levels of communication/formation flows
- Revisit the allocation of experienced managers, focusing on the mid-term vision
- Reinforce delegation to operational echelons, especially for mitigating operational risks
- Define and establish required leeway (local adaptation)
- Formally organize committees to frame and prioritize decisions and make decisions through an established process
- Reinforce delegation to operational echelons, especially for business processes and normative procedures
- Introduce governance committees, giving priority to operational decisions
- Lead by example (top management)
- Devote equal importance to decision implementation as to formal decision making
These questions also need to be addressed at the level of the subsidiary and the individual unit.

The nervous system: Just as many of us give little thought to our health until it starts to fail, so executives readily neglect the system that supports their decision making until warning lights start to flash. It should come as no surprise, therefore, that many a corporate nervous system is dysfunctional:

• Poor information and decision flow management, leading to bottlenecks
• Too many connections to a single hub (i.e., many decision or information pathways all leading to one person or one team)
• Poorly interfaced structures, leading to intense traffic through specific connections

Here the main questions are about what can be done to improve the speed and efficiency of information and decision flows and decision making. Equally important, however, is to ask whether all those decisions are really needed.

The goal is to produce a nervous system that integrates the entire company, establishing processes and protocols that are simple to understand and easy to use in whichever context they apply. To be successful, the chosen approach will need to integrate the various cultures across the organization and be universal, while at the same time still retaining the necessary flexibility required to sustain the healthy functioning of company. To produce a nervous system that is both flexible and resilient requires developing an approach that is sufficiently supple to be able to retain all the advantages offered by individual cultures within the organization, while being sufficiently robust to cut across the entire organization and integrate decision making wherever necessary. The key is to control at the interfaces and manage flows to optimize decision making.

It is useful to bring together these concepts in a simplified form. Exhibit 2 shows five commonly observed forms of malfunctioning operational governance, the symptoms typical in each type, the possible causes, and the potential solutions.

It needs to be noted here that there is an essential tension in operational governance: the nervous system will of necessity be constantly evolving, adapting to changing inflections in strategy and market conditions. In consequence, neither flexibility nor resilience is optional; both are essential characteristics of a properly functioning system.
FREQUENTLY ASKED QUESTIONS ABOUT OPERATIONAL GOVERNANCE

Many executives quickly understand the basic principles of what it requires to rethink organization in terms of operational governance but are nonetheless left with a number of questions about implementation. Here are some of the more frequently asked questions.

Does a company actually need to be run using a single operational governance system or is it legitimate to have several different systems?

The purpose of operational governance is to align the entire organization as efficiently as possible, principally to ensure the effectiveness of the decision making process. However, today’s large corporations are frequently complex and contain several coexisting organizational structures. Naturally, since each structural type has its own business rationale, it also has its own specific operational governance model. The solution is to ensure that the overall governance model manages the structural interfaces with each of the specific operational governance structures.

A car maker or an aircraft manufacturer often needs to organize their businesses using ‘adhocracies’, that is, configurations that gather multidisciplinary skills from across the organization according to the needs of a particular project’s rationale (as with product line-led platforms, where there might be one for each manufactured model). Commonly, such companies also have a professional structure for each of the various professional communities: engineering, manufacturing, R&D, marketing, procurement, etc. In this case, it is indispensable that the operational governance model should coordinate the product line-led platforms with the company’s traditional professional structure. In other words, to be effective, the operational governance model should not only be applied to traditional departments and divisions (such as sales, technical, etc.) but also manage the interfaces between the product line-led platforms (comprised of multidisciplinary teams) with the traditional structures of the firm.
What are the critical topics that need to be addressed by operational governance and what happens if we change our business focus tomorrow?

While a company’s strategy drives the priorities of its business, the organization facilitates these objectives. Operational governance drives focus on the issues critical to attaining the strategy. The fact that operational governance emphasizes some topics more than others at any one point in time is not a problem – in fact it is its strength. If developing new products is the strategic imperative, for instance, then an effective operational governance system will adapt to this almost organically, encouraging people to spend more time and energy on these priorities. Once the new products have been tested and are market-ready the operational governance model can be revisited to refocus management attention and expert resources on selling the new products and providing good customer service. Effective operational governance ensures that this is achieved whilst ensuring the correct balance between all the business objectives, whatever their relative importance.

Revisiting operational governance provides an opportunity to carry out the maintenance of the organizational and people aspects of the company.

Is it necessary to regularly revisit operational governance?

Revisiting operational governance provides an opportunity to carry out the maintenance of the organizational and people aspects of the company, aspects that tend to drift off course over time. Rejuvenating operational governance opens the door for resetting individual and team accountabilities, including approval thresholds. It can also be used as an opportunity to challenge the accumulation and cascading of annual objectives, which may have become misaligned across teams or be inconsistent with what the company is currently trying to achieve.

It is also an opportunity to address more fundamental dimensions of the organization, such as the relative importance of the formal vs. the informal organization, or how digital technologies affect the flow of information and organizational responses. It can also provide a gateway to questions regarding the development of leadership skills, such as decision making and execution, managers’ abilities to explain the rationale behind their decisions, set expectations, drive execution and anticipate responses, particularly in regard to less popular decisions.
In addition to such high-level questions, it is important not to neglect the basic operational governance rules of hygiene, including such matters as setting cut-offs for the maximum number of participants attending meetings, delegation rules, escalation thresholds, or revisiting the need to ensure that all arguments are fact-based.

How can I tell if the current operational governance model is the right fit with my company?

This is a question that can be answered both by gut feeling and by metrics: both are valid approaches to such decisions. The feeling that something is wrong calls for the use of metrics to confirm or deny the intuitive signals. In our experience, an executive’s gut feelings will more likely than not be confirmed by the facts in cases where the company faces one or more of a number of common issues. Important symptoms are:

- Inefficient decision making processes or poor information flow; executive attention is only drawn to issues when the warning lights are already flashing red
- Inefficient coordination between teams; cross-departmental coordination is inefficient; information fails to reach front-line staff in a timely manner
- Stalled initiatives, rigidity of departmental silos, duplication of efforts across the organization, and slow response times to market changes all indicate a high level of sclerosis
Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

AMERICAS
+1 212 541 8100

EMEA
+44 20 7333 8333

ASIA PACIFIC
+65 6510 9700

ABOUT THE AUTHORS
Sébastien Maire is a Partner and Head of Organization Design
sebastien.maire@oliverwyman.com

Jérôme Bouchard is a Partner in Organizational Effectiveness
jerome.bouchard@oliverwyman.com

Copyright © 2015 Oliver Wyman
All rights reserved. This report may not be reproduced or redistributed, in whole or in part, without the written permission of Oliver Wyman and Oliver Wyman accepts no liability whatsoever for the actions of third parties in this respect.

The information and opinions in this report were prepared by Oliver Wyman. This report is not investment advice and should not be relied on for such advice or as a substitute for consultation with professional accountants, tax, legal or financial advisors. Oliver Wyman has made every effort to use reliable, up-to-date and comprehensive information and analysis, but all information is provided without warranty of any kind, express or implied. Oliver Wyman disclaims any responsibility to update the information or conclusions in this report. Oliver Wyman accepts no liability for any loss arising from any action taken or refrained from as a result of information contained in this report or any reports or sources of information referred to herein, or for any consequential, special or similar damages even if advised of the possibility of such damages. The report is not an offer to buy or sell securities or a solicitation of an offer to buy or sell securities. This report may not be sold without the written consent of Oliver Wyman.