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George S. Day

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Aligning the Organization with the Market

George S. Day

Pushed by their strategies and pulled by customer demands, firms today are aligning more closely with their markets. Some find the effort costly and disruptive. In this commentary, based on in-depth interviews with 15 firms, George Day identifies the perils and promise of structural realignment.

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Report Summary

Organizations are steadily evolving toward closer alignment with their markets. Firms are being pushed by their strategies and pulled by increasingly assertive customers who demand more accountability and responsiveness to their distinctive needs.

In this study, author Day finds three stages of evolution beyond product or functional silos. Stage 1 improves alignment with informal lateral coordination. Stage 2 uses integrating functions such as key account managers and segment advocates. Stage 3 involves fuller structural alignment with customer-based front-end units or matrices with segment champions. Most organizations will not, cannot, or should not go all the way to Stage 3.

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 a study of 347 companies were mixed. There was much greater accountability for customer relationships and better information sharing, but overall performance wasn't improved.

Day also made in-depth studies of 15 reorganizations and finds four imperatives that a company must address when embarking on a structural realignment around markets:

1. Have a guiding strategic rationale for the realignment such as providing solutions to customers or gaining deep knowledge of their needs. Structure must fit and follow strategy.

2. Keep everyone focused on the customer experience. Ensure there are clear accountabilities for the quality of relationships with the best customers, the integration of products, and the tracking of lost customers.

3. Adjust the pace of alignment to anticipated obstacles by proper training, keeping customers informed, and respecting cultural differences.

4. Keep realigning in response to market changes and advances in technology. Most important of all, companies should not embark on a multi-year journey to better align their organizations with their markets unless there is sustained leadership commitment. ■

Introduction

Continuous organizational flux has become the norm in most firms as they struggle to satisfy conflicting objectives and seemingly incompatible requirements. On one hand, they want to gain economies of scale and scope, while also being more responsive to the needs of individual customers. They want to cut overhead while improving coordination and information sharing across the organization, and nurture deep functional expertise while subordinating these functions within teams.[1]

These countervailing pressures are increasingly being addressed by reinforcing the customer dimension of the organization. Whether the issue is strengthening a market orientation, implementing a CRM initiative, improving market responsiveness, or offering customer solutions rather than stand-alone products, the most common prescription is to create a customer-focused organization (Galbraith 2002; Foote et al. 2001; Rigby, Reichheld, and Schefter 2002; Day 2003). The arguments for giving the customer dimension primacy over the functional, product, or geographic dimensions are buttressed by success stories ranging from such companies as IBM and Fidelity Investments to Cummins India and Capital One. Consultants such as McKinsey advocate these designs (Miller, Eisenstat, and Foote 2002; Eisenstat et al. 2001), and organizational theorists are endorsing smaller, market-responsive units as firms evolve toward decentralized "adhocracies" (Aldrich 1999; Child and McGrath 2001).

Companies are heeding this advice. Our study of 347 medium-sized to large businesses found that 32% were organized by customer groups in 2002, and 52% expected to be organized this way by 2005. Within firms that were already organized by customer groups, there was a much higher accountability for the overall quality of the relationships with their best customers, and greater freedom for employees to take action to satisfy individual customers; in addition, their customers were less likely to deal with different groups who didn't know about their interactions with other groups in the firm. Details of this study and further findings can be found in the Appendix.

We also found that firms organized by customer groups were easier to do business with, more responsive to customer needs, more trustworthy, and better at dealing with problems and queries. This did not, however, translate into superior customer retention or profitability.

The absence of apparent economic benefits doesn't necessarily mean it is not worth aligning the organization more closely with the market. A closer look suggested that the modest benefits could possibly be explained by differences in what firms meant when they reported to us that they were organized by customer groups. Did it mean simply the addition of key account managers or a more radical restructuring around customer-based front-end units? Perhaps many firms had just begun the process of reorganizing and had yet to realize the benefits. If all rivals were reorganizing the same way at the same time, then no firm would necessarily gain a performance advantage.

The most compelling hypothesis for the modest effects was that the data masked differences in organizations' ability to implement the realignment. The implementation failures of DEC in the 1980s and Xerox in the 1990s were notable. Both had to unwind their customer-focused organizations at great cost. Other ostensibly successful companies such as Square D have put more weight back on the product dimension, while leading companies like Samsung remain resolutely product focused and are not disposed to change.

To better understand the challenges of implementing customer-focused organizations, we undertook in-depth studies of 15 well-known companies. We found many compelling reasons for firms to strive to improve their alignment with their markets, but they were often thwarted by profound implementation problems. Managers who anticipate these pitfalls can decide whether their firm should give greater emphasis to the customer dimension, how far they should proceed, and what can be done to improve the odds of success.

Toward Customer-focused Organizations

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. Meanwhile, there is an expanding menu of designs to consider, such as process-based, team-based, or hybrid forms of organization.

Underlying this dynamic equilibrium is a steady progression toward more customer-focused structures. This evolution has been confirmed by bottom-up studies of changes in marketing organizations and top-down analyses of trends in corporate organizations.

Bottom-up perspective

The most significant, enduring shift in marketing organizations has been the introduction of the boundary-spanning roles of market segment and/or key account sales managers.[2] These roles are meant 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 because they usually have no direct control over resources or incentives. Such shifts in sales practices aim 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 organization.

Marketing activities are increasingly dispersed in the wake of these shifts (Homburg, Workman, and Jensen 2000) and are most often 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 worldwide brand image issues that were once the sole province of the marketing function.

Top-down perspective

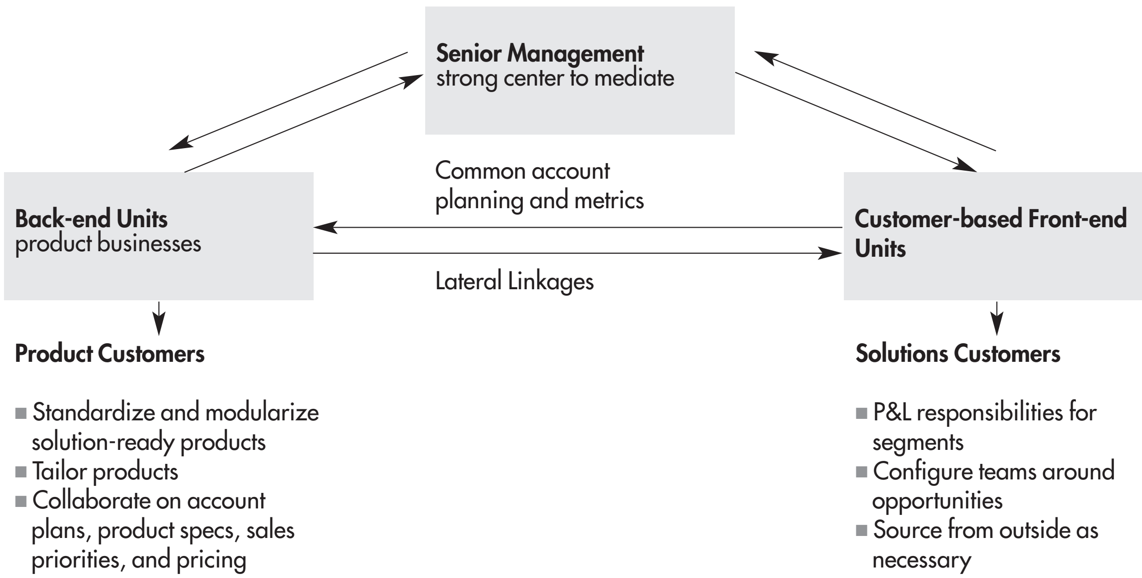
This perspective is that of the entire enterprise rather than just the marketing function. The choice of organizational design is shaped by the needs of the corporate center to leverage core competencies, improve coordination, and deliver sustained growth.

The traditional way to tighten the alignment with the market is to design a family of autonomous SBUs, each with full accountability for performance within a distinct industry or customer segment (Gould and Campbell 2002). 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. When this condition isn't met, or 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 inte-

Figure 1
Customer-based Front-end Units



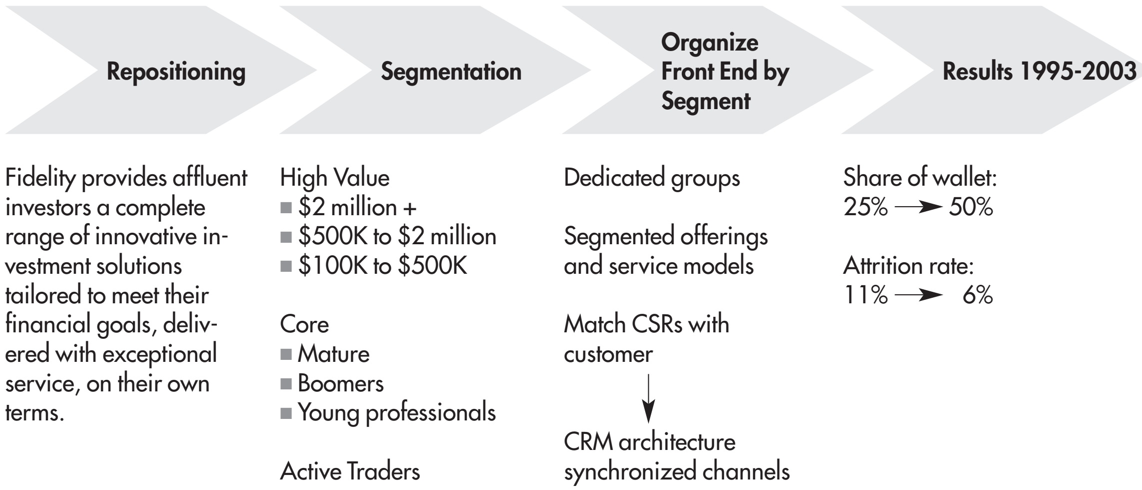
Source: Adapted from Foote, Galbraith, Hope, and Miller (2001)

grated solutions (see Figure 1) and product business units that provide the modular elements to combine into solutions.[3] 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 evolved to the front-back hybrid model to meet the challenge of discount brokers on one side and independent financial advisers on the other. Its 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 2 for further details).

A different organization alignment is needed when customers aren't seeking integrated solutions, but the organization is missing opportunities because autonomous product units pursue separate and uncoordinated marketing efforts and lack an integrated customer view. Sony Consumer Electronics USA faced this situation. Its five long-standing product divisions each had different marketing messages and strategies and little incentive to collaborate (Marketing Leadership Council 2002). The solution was a matrix that overlaid a market segment structure on the existing product structure. The head of each product business unit was given the added responsibility for one of five separate segments. Thus, the head of digital imaging products was the champion for the "double income, no kids" segment, and the head of the personal mobile products was champion for the Generation Y segment. To motivate these managers to sustain a dual focus, the variable compensation gave

Figure 2
Transforming Fidelity Investments



equal weight to segment and product line performance. The five segment champions were supported in their new roles with three new support positions (to bring deep segment expertise to the table and encourage the sales of the product line to the four other segments) and quarterly sales-tracking data on Sony product sales by segment. Because Sony sold mainly through retailers and did not have access to transactional data, tracking sales by segment proved challenging.

Sony's matrix reorganization has reportedly delivered higher growth rates and improved relationships with retailers through better co-marketing and information sharing. However, close observers believe that the matrix is a transitional step and may not survive due to the departure of the senior champions who pressed for the change and the inherent complexity of the matrix design.

The evolution of organizational alignment

The inherent complexities, compromises, and varieties of organizational designs have masked the underlying trends. Now, there are enough data and different studies to cut through the fog of company and market idiosyncrasies and make it possible to confirm a steady evolution toward more customer-focused organizations. This evolution has three distinct stages (see Figure 3).

Stage 1 keeps the existing functional or product organization, but tries to improve alignment with informal lateral coordination. Either sales or product management takes informal steps to cross silos and solve customer problems.

Stage 2 gains partial alignment with integrating functions such as global accounts coordinators and market segment advocates. These moves are designed to break away from the product focus inherent in the product or brand manager system.

Stage 3 requires comprehensive long-term and potentially risky moves to get fuller structural alignment using customer-based front-end units or matrices with segment champions. Most organizations will not, cannot, or should not go this far.

How far a business proceeds through these three stages of evolution depends on the balance of facilitating forces and countervailing pressures summarized in Figure 4.

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

Figure 3
Stages of Evolution for Customer-focused Organizations

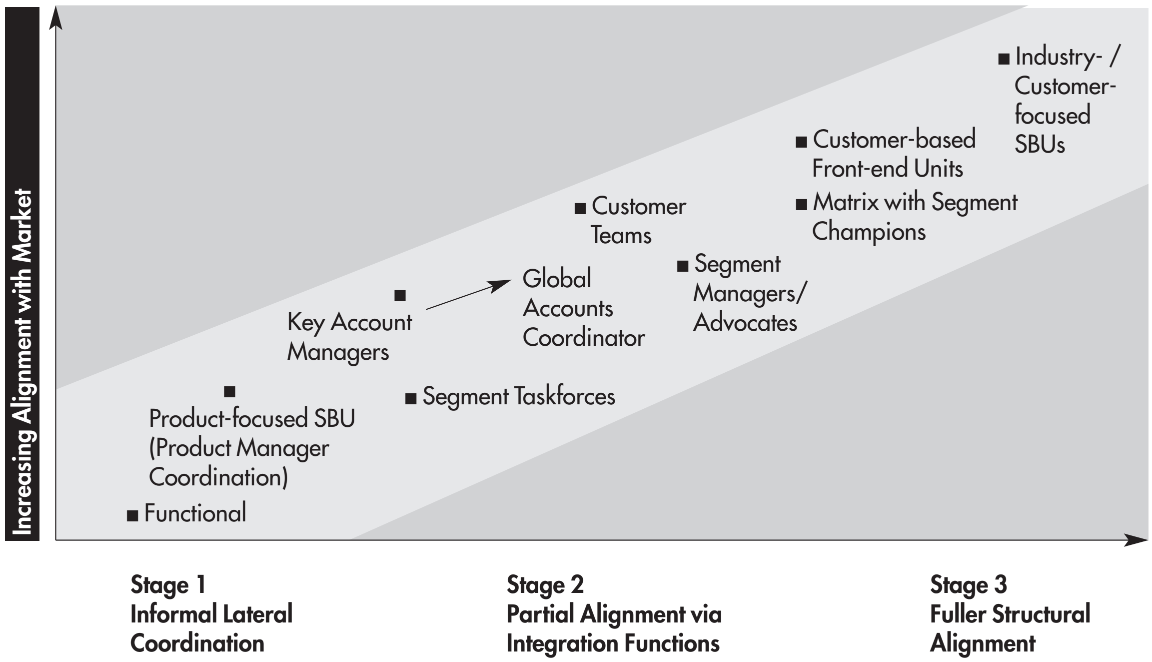


Figure 4
Balance of Facilitating Forces and Countervailing Pressures

Facilitating Forces
- Strategic emphasis on relational value
- Need for clearer accountability for customers
- Recognition of lack of sharing of market information
- Dissatisfaction with marketing productivity
- Pressure from large customers

Countervailing Pressures
- Lack of segment sales/profit data
- Cost
- Tolerance for complexity
- Legacy effects (inertia/organizational resistance
- Homogeneity of customer base

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 strategy 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 usually doesn't require more than a Stage 1 structure.

Tempering the decision to proceed all the way to Stage 3 with fuller structural alignment are: (1) a lack of information on 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 sys-

Table 1
Classification of Companies Interviewed
(Success classification is based on management judgment plus objective measures of performance improvement)

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

1. Gerstner (2002) was an important source of insight into the strategic logic of aligning the IBM company toward solutions.
2. This case is described in Day (2003), and the findings were confirmed in follow-up interviews two years later.
3. This case is described in Day (1999).
4. Based on a speech and discussion by Dr. Marijn Dekkers, CEO of Thermo Electron Corp. at the CMO Summit, Harvard Business School, October 2004.
5. A full description of the Sony USA organizational redesign can be found in the Marketing Leadership Council (2002).
6. The main source was Gulati and Puranam (2005), with follow-up interviews with a number of Cisco executives.

tems. These countervailing pressures are a warning that while the evolution toward closer alignment is the correct direction, it is insufficient to support robust prescriptions. The appropriate structure is guided as much by implementation realities as by the strategic imperative to get closer to the customer.

Implementing Customer-focused Organizations

[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 (Gerstner 2002).

In this quotation, 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 pitfalls and solutions, we interviewed senior managers at 14 firms that had undertaken a large-scale redesign in an effort to gain a closer alignment with their markets. Our dataset also includes a study of the reorganization of Cisco by Gulati and Puranam (2005). Our method was to follow up on previously publicized reports or announcements of a firm realigning its organization around market segments. We asked the following questions of senior managers familiar with the reorganization who were also in a position to judge the outcome:

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 15 firms in our study were classified by degree of success (see Table 1), using the judgments of those familiar with the history of the realignment process. Only four were unqualified, sustained successes. Two others were judged to be successes within one region, but their approach had not been adopted by their parent in the home market. In two cases the firms had shifted back to a product-focused structure.

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. Six firms were in the midst of realignment and judged that 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.

By comparing the most successful with the less successful programs, we uncovered four imperatives that any firm embarking on an organizational realignment around markets must address in their implementation:

1. Ensure that the structure fits (and follows) strategy.

2. Reinforce the structural changes with clear accountabilities.

3. Adjust the pace of the alignment process to the anticipated obstacles.

4. Be prepared for continual organizational change.

Ensure that the structure fits (and follows) strategy

The reason given for a major reorganization of Motorola, launched by the new CEO Edward J. Zander, in late 2004, would have resonated with each of the firms in our study (Crockett 2004). The intent was to dismantle Motorola's debilitating bureaucracy and end a culture of rivalry among product divisions that behaved like "warring tribes." The reorganization 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 companies surveyed consistently reported that there had to be a compelling strategic rationale for a realignment 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 what and how they could contribute. As one manager noted, "It is not sufficient to merely follow fashion or the moves of competitors."

Numerous combinations of strategic rationales were behind the realignments we studied and were readily classified by degree of success (see Table 2).

Implementing a Solutions Strategy. IBM, Fidelity Investments, Thermo Electron, and Cummins India all cited this strategic rationale as a reason to realign. This strategy requires 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 (Sharma, Lucier, and Molloy 2003).

Cummins India is representative of an evolution to a Stage 3 market alignment based on solutions. It began with an 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 its domi-

Table 2
Combinations of Strategic Rationales

	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
Number of companies giving reasons	**15**	**17**

*Two companies gave two supporting reasons.

nant 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 ongoing needs of its customers and showed that the margins on custom service bundles were 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 focused on a particular solution. By being made 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" and able to offer competitors' 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. 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 its offering, and provide extensive maintenance and testing programs. Overall, the realignment is viewed as a success, with market share and revenue slightly increased at the same time as sales of the core product business of engines and generators dropped by 30%.

Solutions strategies are most suitable for service companies such as Fidelity Investments or systems manufacturers like IBM that are 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 2 realignment with key account managers to represent its whole line of bundled lab instruments, augmented with financial and maintenance services and lab information systems using integrated software platforms. It is attempting to correct a deeply flawed, fragmented business model in which each of 24 subsidiaries sold their individual products to the same customer as other subsidiaries—with consequent duplication of effort and annoyance of customers. One legacy 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 its journey to closer alignment with markets, it has added market segment managers for each type of laboratory. Their job is to know everything about their segment and support the salesforce by pulling resources from the product groups.

Getting Closer to the Market. While getting closer to the market 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 a product orientation" were seen as strong supporting reasons. Further impetus came when the customers tired of visits from multiple salespeople from the same company 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, 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-1990s as a collection of seven product-focused businesses in rapidly commoditizing markets. The first move was to divest five noncore businesses and concentrate on data-storage media and devices. Even though Imation does not sell directly, it chose to realign its 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, composed of 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 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 of these account managers is also a member of a business team. Imation is not selling solutions; its advantage comes from deeper customer knowledge that strengthens its ties with distributors and retailers. Other benefits are a much more "aggressive" culture (Imation's term) with a stronger productivity mentality. By setting clearer strategic priorities, it was able to reduce SG&A costs by 2%.

Pursuing Segment Growth Opportunities. Both Sony USA and Nokia realigned themselves around market segments because their uncoordinated and product-centered organizations were missing growth opportunities, and their 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.[4] Because each product line had its own target customers—with Walkman focusing on the youth market, for example—other segments such as active mature customers 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.

Other Reasons for Reorganizing. Among the secondary reasons for reorganizing, four companies cited improving marketing productivity by better targeting of sales resources and elimination of redundancies in marketing activities. Two companies gave competitive pressures as a reason. As we'll see later, competitive pressures loom larger as issues when a customer-focused organization slips out of alignment with the market.

Implementation Caveats. As with any change program, there must be senior management commitment, persistence, and intense communication to overcome the resistance to change (Kotter 1996). Beyond this, there are two specific caveats about strategies that hinge on realigning an organization with its markets.

First, the principle of requisite complexity proposes that the complexity of the firm's structure should match the complexity of the environment (Ghoshal and Nohria 1993). But each new job function adds a bit more bureaucracy and cost, and causes market knowledge to be more widely dispersed. Fortunately, the envelope of feasible organization designs is expanding as information technology breaks the constraints of hierarchies. Now, with open standards for information exchange and global communication, it is possible to sidestep the assumption that information flows cannot be rich and broad simultaneously (Evans and Wurster 1997).

Second, any realignment that pursues a solution strategy has to recognize that not all customers are equally valuable, and not all will want solutions. This reality introduces further complexities and demands hard strategic choices. Their resolution requires a strong viewpoint on the size and growth of the segment that values solutions (versus price) and the ability of other competitors to offer solutions.

Reinforce structural changes with clear accountabilities

The benefits of a more customer-focused organization are first realized through clearer accountability for the overall quality of the relationships with the best customers. Organizations with 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 customers' 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 lifetime 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 *information* that is filtered through linked databases and delivered in a coordinated, 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.[5] 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*, guided by both strategy and objectives. Thus, most firms in our study 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 of the components of the offer (service versus product, for example), but it is also a cumbersome, unreliable measure.

The best metrics support the strategy, are meaningful to employees, and are leading indicators of performance. Enterprise Rent-A-Car can rank its 5,000 branches with two customer survey questions, one about the quality of the rental experience and the other about the likelihood they would rent from the company again. A more generalized version of these questions is

"How likely is it that you would recommend [company X] to a friend or colleague?" (Reichheld 2003).

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 its customers, and that poor performance was caused by variability in meeting delivery promises. Both early and late delivery caused problems. GE Plastics used its well-honed Six Sigma discipline to measure and manage delivery span—the variation in delivery date from the promised date. By tying incentives to progress in narrowing this span and following progress closely, GE 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 behavior. Thus, Thermo Electron rewarded salespeople for sharing customer leads with other market segment groups.

Implementation Caveats. A good general rule is that employees only willingly accept new accountability when they feel they can trust and influence the metrics with their actions. This rule is violated when the following pitfalls are encountered:

1. Employees lack confidence in the measures. For example, segment-level sales data are often hard to obtain. Proxy measures of revenue based on surveys may be good enough for decision making, but not for incentive compensation. A common problem is that accounting systems configured for product costing are generally useless 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.

2. Employees learn they can game the metrics. The well-known manipulation of customer satisfaction scores by auto dealers certainly compromises the value of this metric (Reichheld 2003, p. 49).

3. Employees don't see how they can have an impact on 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, GE Plastics' measure of the span of delivery performance is meaningful to all functions, including procurement and manufacturing, which would not normally consider the impact of their activities on customers. By focusing on the attribute of greatest importance to the customer, GE improved the overall alignment to the market.

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 common impediments. Fidelity Investments managers estimate that it took them at least three years to accomplish 60% of their reorganization goals, mainly because of systems constraints.

Overall, the biggest impediment to the timely completion of a reorganization is 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, then-CEO Paul Allaire, who saw that a shift of the Xerox strategy to focus on "the document" would have the greatest impact on customer relationships, commented, "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" (Howard 1992).

To overcome the rigidity of an extremely functional organization and present a single face to the customer, the sales and service people were first organized into geographic customer operations divisions. This structure served Xerox well through the 1990s. Then growth slowed, and "outsider" Rick Thoman came from IBM to take over as CEO. He soon concluded that the next logical step was to assign the salesforce, not geographically but in industry groups, to sell document solutions. This seemed to reinforce the direction set by Allaire and meet the intensifying competition from HP and Canon. Unfortunately, none of these benefits were realized, and Xerox was seriously damaged. Soon after, Thoman lost his job.

Our interviews and other autopsies of Xerox found a mix of strategic misjudgments and serious implementation missteps. In retrospect, it was not clear that all industry segments wanted a "document solution" at a time when many people wanted paperless offices. A hybrid model would have served Xerox better, with the solution limited to industry vertical markets such as law offices or pharmaceutical companies where document management was crucial. There were unrealistic expectations about the abilities of the salesforce. 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 salesforce in their new assignments, and customers were not adequately prepared to understand the changes. Salespeople complained about losing long-standing client relationships and being pulled into time-consuming meetings while still being judged on customer calls and sales results. The fallout was very damaging; the sales cycle lengthened, aggrieved customers slowed their payments, and a third of the salesforce left the company.

The Cultural Imperative. A firm's culture can either give or deny permission to proceed with 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 its 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 industry practice that began 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 a culture is mature and has absorbed dysfunctional beliefs such as "the salesforce owns the customers," "we'll sell to whoever will buy," or "customers don't know what they want." This was the type of environment that Lou Gestner faced when he joined IBM, and it also contributed to Xerox's plight.

Cultural obstacles are among the most difficult to anticipate and may surface only later as subtle resistance or an unwillingness to share information. One proven way to deal with them is with successful results. Thus, Square D was divided into core and noncore markets (the latter dealing mostly with new opportunities). Market-segment management began in the noncore markets because they didn't have strong legacy cultures to overcome. Once the leaders of the noncore markets demonstrated the payoff 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 in our study anticipated and dealt with these obstacles because they are a familiar feature of all organizations. The firms were more likely to miss two less familiar obstacles to realignment:

1. A common economic rationale for realignment around customers is that different customers are treated differently according to their cost-to-serve and lifetime value. But long-standing, 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 may have friends and advocates within senior management and the salesforce who may take their side. In anticipation of this obstacle, a company has to design a careful migration path for these customers to avoid jeopardizing the whole program.

2. 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 results are often expensive duplication, infighting, and a poor experience for customers. These adverse results constitute a very sizable transition cost for the new organization—and a deterrent to ambitious reorganization plans.

Be prepared for continual organizational change

The overall evolution toward more customer-focused organizations will continue. Firms are being pushed by their strategies and pulled by increasingly assertive customers who demand more accountability and responsiveness to their distinctive needs. Further encouragement comes from success stories providing templates for the redesign, and advances in technology that facilitate information sharing and decision coordination.

Although this overall conclusion is directionally correct, it needs to be carefully qualified. As we have seen, there are many variations on this broad theme, and most firms will be well served with a Stage 2 or partial alignment using integration functions such as a key account manager or segment champions. Full-scale alignment with customer-based front-end units is warranted only when there is a compelling strategic rationale, because these designs are both risky and time consuming to implement. Yet the rewards can be great, as we saw with IBM, Fidelity, and Capital One. When the strategy, structure, and systems are fully aligned,[6] the competitors are hard-pressed to match the inherent responsiveness to diverse customer needs.

Organizational Flexibility. 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? The roster of high-value accounts keeps changing, so teams must be able to form and reform continuously 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, its intended destination. Because of this momentum, it is easy to overshoot and overalign, so savvy managers 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 its biggest global accounts, it encountered a number of problems. Some were the natural fallout of managing teams across many time zones and the resistance in some country cultures at not having a local person as the boss. It also found it couldn't fully customize its entire service organization. Nor did all accounts want a highly linked collaborative relationship that looked like a virtual joint venture. Now it is moving to a hybrid organization with global teams for the top customers. The others will be served with regional teams.

Competitive Realities. Alignment with a market means responding 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 grown any faster than the underlying markets. At the same time, its large manufacturing customers, such as the Big Three automakers, were globalizing and wanted integrated solutions. To get closer to these customers, it 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 1990s, 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 organization, with the 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 be 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." Square D found it was easier to implement cost measurements and make cost allocations to the product side and hold them accountable for cost savings. In this way, Square D has shifted back to a 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 3 design, with three separate semi-autonomous lines of business.[7] Each LOB independently developed, manufactured, and sold customized networking solutions to distinct customer segments: Internet service providers, enterprises, and small to medium-sized businesses. With this structure, Cisco 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 in this structure. Because each segment-facing LOB developed and built its 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 Cisco'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 11 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 farther 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 for them to remain connected to other technology groups. By the end of 2003, Cisco was 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—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 rode their fully customer-focused organizations to rapid growth during the 1990s, 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 firms pursuing a solutions strategy.

In both cases, the realignment was eased by 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 more than boxes, arrows, and lines, but their 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: 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. We sent out 1,100 surveys 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%. 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 the representativeness of the data.

Respondents were asked: "How are you organized now?" and "How do you think you will be organized in three 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
Average total number of organizational dimensions	2.13	2.37

The first analysis treated organization by customer groups as a binary dependent variable and used logistic regression to seek potential antecedents. An equation with eight market characteristics, two company demographics, and six 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.

Notes

1. The trade-off between specialization and coordination was first identified by Lawrence and Lorsch (1967).

2. These shifts were identified and documented in Homburg, Workman, and Jensen (2000), 459-78.

3. This description draws heavily from Galbraith (2002), chapter eight, and from Foote et al. (2001). The stream of research described in this chapter also confirms the evolution toward customer-focused organizations.

4. Portions of this description are drawn from the Marketing Leadership Council (2002), 169-79.

5. M. Sawhney presents a similar notion (2001), 101-8. 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.

6. For further insights into the benefits of integration and alignment, see Fuchs et al. (2000), 118-47.

7. This description of the Cisco reorganization is based on Gulati and Puranam (2005).

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