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Three steps to sustainable and scalable change

Part 2: Aligning operational governance with the business model

About the series

Creating sustainable and scalable improvements to a company's cost structure is like building a skyscraper. The first step is choosing the right business model, which provides a blueprint for the effort. The second step is determining how decisions will be made. This serves as a strong foundation. The third and final step is mobilizing resources and putting the decisions into action, which is analogous to actually constructing the high rise. When improving their cost structure, many companies try to jump directly to the construction phase; however, the results are generally disappointing and, even if they are acceptable, they are usually hard to sustain.

When improving their cost structure, many companies try to jump directly to the construction phase. However, the results are generally disappointing and, even if they are acceptable, they are usually hard to sustain.

Deloitte's three-part series, "Three steps to sustainable and scalable change," takes a detailed look at key activities we believe are necessary to produce cost structure improvements that can withstand the test of time.

- "Part 1: Rethinking a company's business model," provides fresh and practical views to help companies choose or confirm the right business model. This can serve as a blueprint to guide the overall effort.
- "Part 2: Aligning operational governance with the business model," presents a framework for aligning and improving the way decisions are made and executed. This step can provide the foundation for lasting improvements; yet, in our experience, it is the one step companies are most likely to overlook.
- "Part 3: Redefining functional service delivery to achieve organizational scalability and efficiency" explains ways companies can deploy their resources to create a cost structure and performance improvements that satisfy the specific needs of the business.

We believe these three steps can help any company make sustainable and scalable improvements to its cost structure.

After clearly defining your business model, you must align operational governance with the company's business model to help position the company to deliver on its promise. Operational governance – not to be confused with corporate governance – addresses how a company's decisions are made and executed. Without effective operational governance, structural inefficiency can occur, which companies can ill afford, in particular during an economic downturn or slow recovery. Symptoms include confusion and conflict between corporate and individual business units, turf battles, duplication of efforts, and organizational blind spots. Effective operational governance can provide the foundation for lasting improvements. Yet, it is the one step that companies are most likely to overlook in restructuring or making organizational changes.

When corporate executives consider making organizational changes, they usually move straight to restructuring or realigning resources. Two steps, however, companies should consider taking before a single resource is redeployed:

First, you need to confirm, change, or adjust your company's business model. By business model, we mean the way a company organizes or structures itself to go to market, interfaces with stakeholders, and reacts to external events. The business model should serve as the blueprint for a corporate transformation or restructuring effort.

Second, as with a construction project, the foundation needs to be laid. In business, this is the operational governance – i.e., determining how decisions are made and executed – that conforms to the business model. This is the step companies are mostly likely to overlook. Yet, it is a vital step.

Before deploying a single resource, you must establish a foundation of effective decision making if you want to increase your company's chances for sustained improvement. Effectively implemented, this "operational governance" can provide the means and methods for making decisions and for institutionalizing them. These include: clearly defined decision-making roles, a clear division of responsibilities between corporate and the business units (or other organizational entities), and a supporting infrastructure for key interactions throughout the decision process.

A different kind of governance

Operational governance is very different than corporate governance, which focuses on oversight by a company's board of directors and shareholders. That's another subject altogether. In contrast, operational governance is a *management* activity that centers around key operating decisions by company managers and executives. Major elements include:

- Effective decision making through clear organizational roles, responsibilities, ownership, and communication
- Systematic communication linked to business needs
- Efficient delivery of support and other services
- Continuous improvement through effective practices, policy setting, and knowledge sharing

We believe this operational governance is the missing link that can help companies in their efforts to convert a conceptual business model into tangible action and improvement.

Getting to the root of the problem

Companies that lack a well-defined operational governance structure are not nearly as effective as they could be, which can have a major impact on their bottom line. One problem is that many corporate and business unit executives don't fully understand their roles and responsibilities. This lack of clarity can undermine efficiency and waste a company's resources.

For example, one executive might deploy resources to tackle a problem that is actually another executive's responsibility, which could lead to duplicate efforts. Or worse, executives lack clarity as to what their individual responsibilities are or who is doing what, which could lead to resource misalignment and even organizational paralysis. Without good operational governance, structural inefficiency can reign.

These problems can occur even in organizations where a corporate function or centralized group exists. For example, a company with centralized procurement might still have procurement agents operating independently within each business unit. Similarly, a company with a corporate communications group that is supposed to handle all Web communications might still have rogue webmasters and Web sites scattered throughout the business. In cases like these, turf battles and unnecessary duplication of efforts can result.

The lack of a well-defined operational governance structure may also make it hard for a company to improve. Without clearly defined decision-making roles and responsibilities, a company may not be agile enough to respond quickly to market changes. Moreover, if policies, knowledge, and effective practices aren't shared across organizational boundaries, the ability to use a company's collective wisdom and experience may be severely limited.

Establishing effective operational governance is a three-step process (see Figure 1) that should be performed after you have selected or confirmed your business model.

- **Strategic roles.** The first step is defining decision-making roles within your company and clearly dividing responsibilities between corporate and business units.
- **Operational responsibilities.** The second step involves identifying key decisions that need to be made and defining decision-making processes for each one.
- **Key business forums.** The third step is providing forums – such as committees and councils – to foster the kind of coordination and information sharing that produces good decisions and to confirm that decisions are actually executed.

A well-defined operational governance model identifies who is responsible and accountable for key decisions, who needs to be involved, and how decisions will be made. It also defines a clear process for resolving disputes. What follows is a detailed look at the three steps to achieving effective organizational governance.

Figure 1. Three steps to effective decision making

Strategic roles

What are the roles assigned to corporate and business units in defining a company's strategic directions?

P = Primary responsibility S = Secondary responsibility	Holding company		Strategic guidance		Strategic control		Integrated operating company	
	Business Unit	Corporate	Business Unit	Corporate	Business Unit	Corporate	Business Unit	Corporate
Decide	P	S	P	S	S	P	—	P
Execute	P	—	P	S	P	S	—	P
Monitor	P	S	S	P	S	P	—	P

Operational responsibilities

What are the key decisions and how will they be made?

	What are the division proposed marketing goals and parameters?	What are the marketing goals and parameters?	What is the division's quarterly detailed marketing plan?
CEO	Consulted	Accountable	Consulted
CFO	Informed	Informed	Informed
Corporate Officer(s)	Informed		
CIO	Consulted		
Div/Group Pres.	Responsible/ Accountable	Consulted	Accountable
Corp. Marketing	Informed	Responsible	Consulted
General Counsel	Informed		
Corp. Real Estate			
Division CFO	Consulted		Consulted
Division Executives	Consulted	Informed	Consulted
Division Marketing	Consulted	Consulted	Responsible

Key business forums

What are the key business forums used for interaction and strategic and operating decisions between corporate and business units?

Sample forums
- Executive committee
- Operational committee
- Functional council

Defining decision-making roles and responsibilities

Effective operational governance starts with clearly defined roles and responsibilities that establish who makes what decisions. In particular, they specify how much decision control corporate executives will have, and how much will be left to individual divisions and business units.

Your company's choice of business model largely determines your overall approach to decision making (see Figure 2). With a highly decentralized model (i.e., holding company), corporate executives play a hands-off role. They set financial targets and define fundamental objectives, but individual business units are responsible for virtually all major and minor operating decisions. In a highly centralized model (i.e., integrated operating company), the opposite is true. Corporate executives make all major decisions and develop plans, policies, and guidelines that business units are expected to follow.

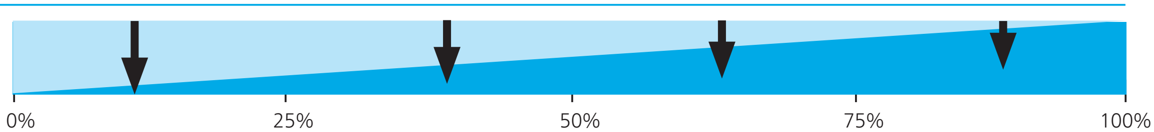
Of course, every company is unique, and the vast majority fall somewhere between these two extremes. That's why it's so important for your company to clearly define who is responsible for what decisions and what role corporate and business unit executives are expected to play in the process.

In Figure 2, the models in the middle represent the gray zone where corporate executives and individual business units share responsibility for decisions. The "strategic guidance" model leans toward decentralized control, with business units acting as primary decision makers. Corporate executives may provide input and play a coordinating role, but in most cases business unit executives ultimately decide. The "strategic control" model leans toward centralized control, with corporate executives serving as primary decision makers – with significant input from business units – and actively participating in strategy development and implementation.

Figure 2. Decision-making roles and responsibilities vary by business model

Business model	**Holding company**	**Strategic guidance**	**Strategic control**	**Integrated operating company**
Executive leadership strategic role	• Sets and monitors financial targets and defines fundamental objectives	• Coordinates business strategies, sets and monitors financial and business objectives	• Participates in development of business strategies and their implementation	• Develops plans, policies, and guidelines, and monitors operations
Executive leadership decision role	• Delegates operating decision	• Provides input to some operating decisions	• Participates in all major operating decision	• Makes major operating decisions

Corporate influence



Although your company's business model provides the initial direction for decision-making roles and responsibilities, effective operational governance requires an additional level of detail. The sample framework in Figure 3 breaks operational governance responsibilities into three roles – decide, execute, and monitor – and specifies who has primary and secondary responsibility for each role under the four basic business models.

At the extreme ends of the spectrum, the analysis doesn't require much rigor. In a holding company, business units operate autonomously and have primary responsibility for all three roles – decide, execute, and monitor. Corporate has only secondary responsibility to help decide and monitor. On the other end of the spectrum, the delineation is simpler. In an integrated operating company, corporate has primary responsibilty for all three roles because there are no business units.

The real action takes place in the middle. Moving from the holding company model to the strategic guidance model, business units continue to have primary responsibility for core and staff functions; however, corporate begins to exert more influence over staff functions. Business units have primary responsibility for making and executing decisions, while corporate has primary responsibility for monitoring results.

A greater balance exists between corporate and business units in the strategic control model. Business units "own" the core functions and are primarily responsible for execution. Corporate owns the staff functions and has primary responsibility to make decisions and monitor results.

For example, corporate marketing has primary responsibility for establishing overall guidelines for marketing spend, media usage, and key messages – and for monitoring business units and ensuring guidelines are being followed. Business units have primary responsibility for executing the business strategy in accordance with corporate guidelines. However, in their role as secondary decision makers, they are also free to propose alternate guidelines for corporate marketing to consider.

Figure 3. Assigning responsibility for all aspects of operational governance

P = Primary responsibility
S = Secondary responsibility

	Holding company		Strategic guidance		Strategic control		Integrated operating company	
	Business Unit	Corporate	Business Unit	Corporate	Business Unit	Corporate	Business Unit	Corporate
Decide	P	S	P	S	S	P	—	P
Execute	P	—	P	S	P	S	—	P
Monitor	P	S	S	P	S	P	—	P

Note: In cases of an integrated operating company, there are no business units. Functions within corporate own responsibility to decide, execute, and monitor.

Defining key decision processes

The next step involves identifying your company's key decisions, defining processes, and detailing responsibilities for how these critical decisions will be made. This includes identifying who the decision maker is, who needs to be involved, and what is the specific timing and sequence of their interactions. Whether the issue is pricing, new market entry, or expanding production capacity, you need clear policies and procedures that define who has the authority to make decisions, who reviews and provides input, and who simply needs to be informed.

This second step goes well beyond the roles and responsibilities defined in step one, systemically clarifying the key interactions needed for timely and sound decisions.

Figure 4 provides examples of what the decision-making process might look like when developing a three-year strategic plan. The example on the left shows the decision process for a company operating under the strategic control model, where there is significant give-and-take between corporate and the business units. In this case, corporate sets the overall direction, but it's up to the business unit to propose a strategy and budget. The proposal goes back to corporate for review and approval, and then the business unit puts it into action.

The example on the right shows the process for an integrated operating company. In this case, corporate does it all — sets direction, recommends a strategy, and reviews and approves the plan and budget. Functional units have little or no input; they simply execute the decision handed down from above.

You can use a RACI matrix to map out detailed decision-making roles and responsibilities. Its name stems from the fact that it divides decision-making activities into four categories: Responsible, Accountable, Consulted, and Informed.

Figure 4. Different business models require different decision processes

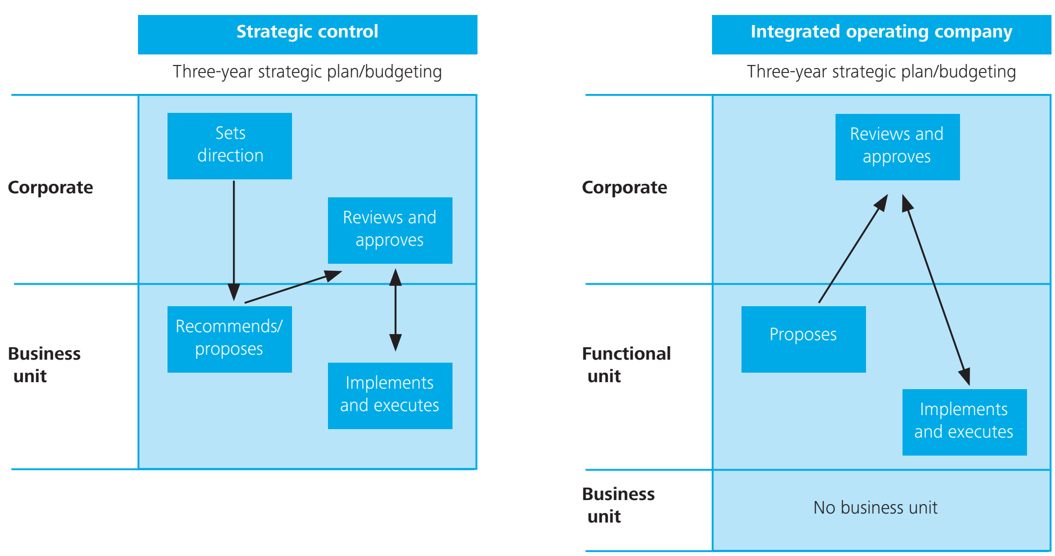


Figure 5 shows how a RACI matrix can be applied to major marketing decisions. A company's business model largely determines the level of involvement required from the CEO, president, CFO, CIO, and key business unit staff. In the example in Figure 5, the company operates under the strategic control model, which means the division president is the decision maker for division-proposed marketing goals and quarterly marketing plans. At the same time, the CEO is responsible for setting overall marketing goals and parameters.

When mapping out decision processes and assigning responsibilities, start by focusing on key decisions, particularly those that tend to create confusion and conflict between corporate and individual business units (see Figure 6). These hot spots often include media spend in marketing, business unit strategies in strategic planning, and hiring of staff.

Figure 5. A decision matrix for marketing (sample)

	What are the division proposed marketing goals and parameters?	What are the marketing goals and parameters?	What is the division's quarterly detailed marketing plan?
CEO	Consulted	Accountable	Consulted
CFO	Informed	Informed	Informed
Corporate Officer(s)	Informed		
CIO	Consulted		
Div/Group Pres.	Responsible/ Accountable	Consulted	Accountable
Corp. Marketing	Informed	Responsible	Consulted
General Counsel	Informed		
Corp. Real Estate			
Division CFO	Consulted		Consulted
Division Executives	Consulted	Informed	Consulted
Division Marketing	Consulted	Consulted	Responsible

Figure 6. Decision-making hot spots

Topic/area	Key decisions
Strategic planning	• Resource allocations • *Business unit strategies (development and process)* • Management of link to financial and operating plans • Measurement/monitoring of plans
Support	• *Hiring* • Staff reductions/additions • Compensation plans
Marketing	• *Media spend* • Research decisions/budget • Promotion plan
Procurement of outside vendors	• Marketing/research/agencies • Consultants

Providing forums to support good decisions

Forums supplement structured decision-making processes. They can help improve the quality of decisions by bringing people from different parts of the organization together to exchange ideas, set direction, coordinate activities, and discuss effective practices. They can also provide an ongoing mechanism to confirm that decisions are executed and monitored.

Forums can help you:

- Significantly improve the effectiveness and efficiency of your decision making
- Clearly establish objectives, roles, and outcomes of different functions
- Use the collective power of your organization

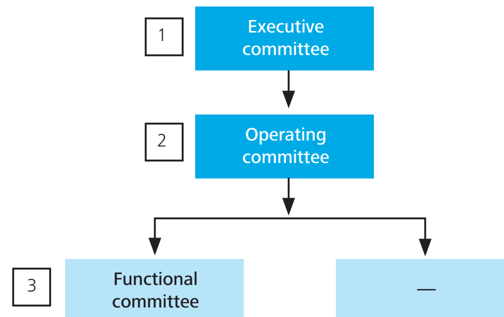
They can also promote continuous improvement through the open sharing of information, ideas, and lessons learned.

Sometimes known as "councils" or "committees," forums focus on a particular aspect of the business, such as human resources (HR), finance, manufacturing, site services, or marketing. Of course, each company and business model has different needs and may require different kinds of forums.

Forums are not intended to add new layers of control. After all, the last thing a busy executive needs is to attend more meetings, particularly ones that lack focus or purpose. Forums are designed to promote effective and efficient decision making, not bureaucracy or management by committee. In fact, once forums are in place, the result is often a significant reduction in unnecessary meetings because forums bring the right decision makers to the table and sharpen the focus.

Typically, three levels of forums are used: (1) executive committees, (2) operating committees, and (3) functional or cross-functional committees for areas such as HR, finance, marketing, investments, due diligence, legal review, and real estate.

Figure 7. Forums help ensure decisions get executed



Beyond these three major categories, additional forums may be created to support project-specific needs

Many forums meet monthly and are part of a quarterly business review. However, the exact frequency and timing varies based on what a particular forum needs to accomplish. For example, an executive forum consisting of CXOs and your company president might meet monthly to develop and manage the corporate vision and strategies. A strategic planning forum might meet once a year, a marketing plan forum might meet once a quarter, and an operating review forum might meet once a week.

When examining forums at your company, first find out what forums currently exist, including who participates, how often meetings occur, and what each forum is designed to accomplish. Then determine which forums to add or discontinue.

The forum's type and your company's business model determine who participates (see Figure 8).

Executive committees: The CEO is always part of the executive committee, regardless of a company's business model. Under the holding company and strategic guidance models, business unit presidents are also included, while corporate executives are not. Under the strategic control and integrated models, the reverse is true. The one exception is that business unit presidents are sometimes included in the executive committee at strategic control companies.

Operating committees: Under the holding company and strategic guidance models, business units have significant autonomy. Therefore, business unit presidents and executives comprise the primary members of the operating committee. Conversely, under the strategic control and integrated models, corporate has the most control, and the operating committee centers around corporate executives.

Functional committees: Under the holding company and strategic guidance models, functional executives in business units are included on functional committees, but their corporate counterparts are not. Under the strategic control and integrated models, the opposite is true. Typically, the only exceptions are that corporate functional executives are sometimes included on functional committees under the strategic guidance model, while business unit functional executives are sometimes included at strategic control companies.

Figure 8. Forum participation varies by business model

Required   Optional

		Holding company	Strategic guidance	Strategic control	Integrated operating company	Frequency
Executive committee	Corporate	CEO	CEO Corporate Executive	CEO Corporate Executive	CEO Corporate Executive	Quarterly/ monthly
	Business unit	BU President	BU President	BU President		
Operational committee	Corporate		Corporate Executive	Corporate Executive	Corporate Executive	Monthly/ biweekly
	Business unit	BU President BU Executive	BU President BU Executive	BU President		
Functional committee	Corporate		Corporate Functional Executive	Corporate Functional Executive	Corporate Functional Executive	Monthly/ biweekly
	Business unit	BU Functional Executive	BU Functional Executive	BU Functional Executive		

Forums can foster coordination and communication

A major clothing manufacturer grew significantly through a series of acquisitions over 18 months. To capture more synergies, the company decided to shift its business model from strategic guidance to strategic control. Under this new model, corporate now exerts more influence over strategy and direction. Yet, each division continues to have significant control over its tactical operating decisions.

To improve coordination at the tactical level, the company established a number of function-specific forums to foster communication and alignment across divisions. For example, a council of marketing vice presidents from each division convenes four to eight times a year to discuss ideas, coordinate activities, and share effective practices. Specific focus areas and outcomes include:

- **Coordinated purchasing.** Thanks to the marketing council, marketing groups within each division now pool and coordinate their purchases. At first, there was resistance and skepticism, but the council helped work through impasses. Once divisions start working together, they are more likely to figure out better ways to get things done.

- **Agency selection.** The marketing council worked with each division to compile a list of services needed from advertising agencies. The council reviewed the collective needs, evaluated potential candidates, and negotiated a companywide contract. The council also monitors the agency relationship, oversees the progress of projects, and confirms that costs are being managed.

These are just some of the many ways the company uses forums to significantly improve operations and use the collective knowledge and power of its individual businesses.

Council consolidates site services

A large pharmaceuticals company wanted to centralize its site services function, which was responsible for everything from security and grounds maintenance to copy machines, creative services, travel, fleet management, aviation, and more. To support this goal, it established three councils to manage the start-up, transition, and ongoing management of a new site services organization.

- **Executive council:** Senior executives from each division set the strategy and budget and approve programs and service levels.
- **Operations council:** Site services managers and users create and maintain service-level agreements, manage vendor performance, and help implement the site services rollout.
- **Customer council:** Local users and site services managers gather customer input, identify needs for new or updated service-level agreements, and communicate those needs to site services management.

The company's centralization activities – including the creation of a centralized site services organization – have already delivered approximately $60 million in savings.

An HR council fills the gaps

A company that had grown rapidly through acquisition established an HR council to help tackle a variety of people-related issues. To get started, council members were interviewed to determine the current state of HR. Here's what they said:

- The company should view HR as a change leader during the transition
- HR needs a vision for its future direction
- HR employees are trying to do the right thing but don't understand the big picture
- The role of corporate HR is still unclear
- HR needs to focus more attention on organizational development and compensation strategies

Next, company employees were surveyed to determine what HR could do better. The survey results showed that HR was considered a professional, responsive department that did a good job at recruiting -- but it was not seen as a strategic business partner. The department received favorable ratings in most areas; however, significant gaps in training and organizational development existed.

That's where the HR council came in. At its first monthly meeting, the council discussed a broad array of topics, including interview findings, survey results, performance gaps, HR benchmarks, and existing HR initiatives.

At its next two meetings, the council talked about HR's overall vision and mission, as well as specific roles and responsibilities for corporate HR and division HR. It also discussed effective practices and the current status of key HR initiatives, including: succession planning; compensation analysis; performance management; policies, procedures, and ethics; performance metrics; Human Resources Information Systems (HRIS); and the launch of a new business service center.

Subsequent meetings focused on assessments for people and technology, integration plans for recently acquired businesses, and a stronger partnership between HR and the business.

Outstanding issues include how HR can:

- Fill training and development gaps
- Reconcile differences in compensation strategies across the company's new and existing businesses
- Create more value for the business once basic HR needs are met

The council plans to continue its monthly meetings to address these issues and more, laying the groundwork for continuous improvement and value creation in HR.

Completing the skyscraper

Choosing the right business model and establishing an appropriate operational governance structure can provide your company with a strong foundation for sustainable cost reductions. In alignment with your company's business model, effective operational governance standardizes and unifies the processes by which decisions are made across your organization by making sure the right people are involved at the right time and have appropriate authority. This second step is crucial if you want to sustain the improvements that begin with a clearly defined business model.

The next step is to refine how your company deploys resources and takes action on those decisions. The third article in our three-part series presents a service delivery model to help you in your efforts to determine how to deploy your resources more effectively. The service delivery model provides a framework to help decision makers understand what types of services should be delivered at the corporate level – in order to significantly increase efficiency, service levels, and flexibility – and what types of services should be delivered by business units. A large discrepancy often exists between the way services are currently delivered and the way they should be delivered. This is the final step to creating a more efficient and scalable cost structure.

Evaluating your Operational Governance Alignment

Does your operational governance structure need an overhaul? These questions can help you decide:

- Is everyone clear about decision-making roles and responsibilities?
- Are people certain about who is responsible for key decisions?
- Do key strategic decisions seem expected to many company executives?
- Are unique resources working on projects, avoiding any duplication of effort?
- Is decision making prompt and not overly time-consuming?
- Do you have the necessary processes and infrastructure for key interactions and decisions?
- Are councils and committees viewed as efficient and a good use of time?
- Do business units usually work in concert?
- Are your company's support services reasonably priced and efficient?

If you answered "no" to many of the above questions, it is worth reconsidering your current operational governance structure.

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