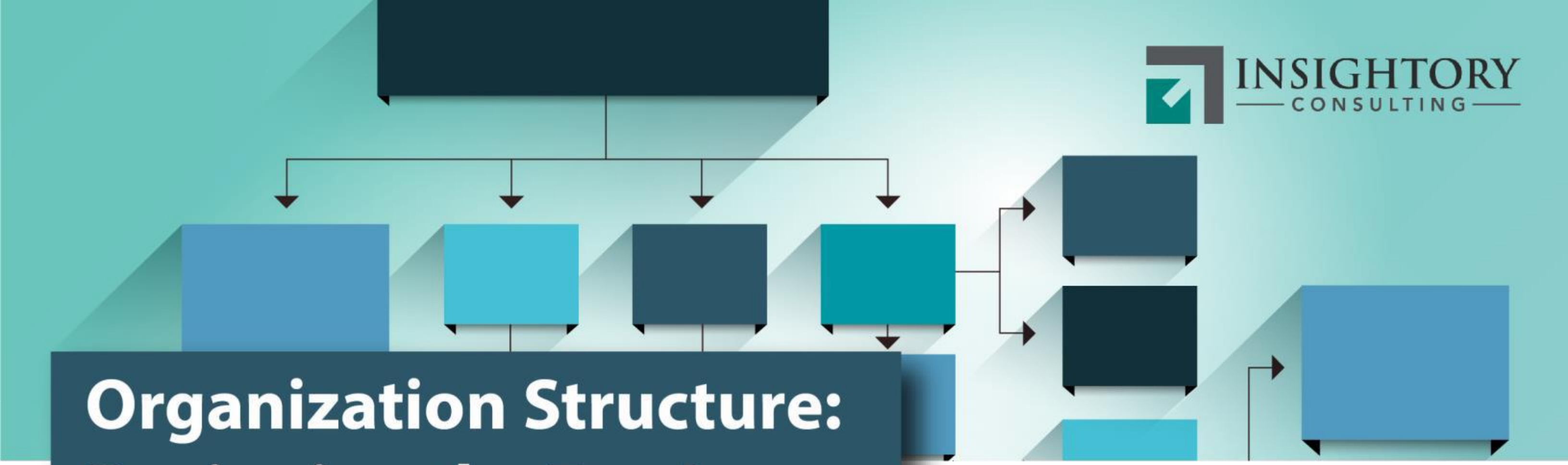


Organization Structure: Designing the Top Layer

Organization Design Matters

“Moving from a Functional to a Business Unit Structure has worked out really well for us. It forced me to elevate the caliber of leaders in my ELT. And that has allowed me to focus on our most strategic and impactful issues.” This was the feedback from the CEO of a publicly listed 6,000-employee business services firm. Two years after the redesign, their topline growth is running at 18% (versus 14% previously) and their stock is up 42% (versus 30% for their peer group). They are working on a transformative acquisition with deep involvement from the CEO.

This example – and countless others like it – shows that **organization design matters**. Especially the part of organization design in which you define the top layer (direct reports to the CEO) – that makes a very significant impact on resource allocation, what the CEO pays attention to, what type of executives join and stay with the organization, and how enterprise performance is managed.

What Is Organization Design Anyway?

If the business model defines the **what**, the operating model and organization structure define the **how and who**.

This article is focused on one specific aspect of the organization structure i.e., how should the top layer of the organization be designed?

Designing the Top Layer – What Are the Options?

The most common options are Function, Geography, Business Unit/ Division/ Product and Process.

Four Options for Designing the Top Layer

	Function	Division	Geography	Process
Description	• Primarily grouped by functions e.g., Operations, Product, Sales, Finance, IT, etc.	• Primarily grouped by business divisions e.g., Business Units, Segments, Product Lines, etc.	• Primarily grouped by geography/ regions e.g., Americas, EMEA, APAC, etc.	• Primarily grouped by horizontal processes, e.g., Transformation, Digital, etc.
Works best when the company …	• Has a single or small number of products & business models. • Values functional specialization and depth over customer responsiveness. • Wishes to align org structure with career paths & job architectures.	• Has relatively distinct Products/ BUs and wishes to drive clear accountability for key outcomes e.g., revenue, profit, product innovation. • Values decision speed/ quality over economies of scale. • Wants to enhance cross-functional coordination.	• Wishes to develop localized products, services or operations. • Values regional responsiveness over functional or divisional specialization. • Has critical mass in multiple geographies/ regions.	• Wishes to elevate or highlight certain processes/ outcomes – permanently or temporarily. • Has a self-management culture at all levels.

None of the options are right or wrong – it is simply a question of what is more appropriate for the business.

Are you an industrial company with three relatively distinct products – each with their own R&D, manufacturing, and sales, contributing at least 15% of total company revenue and EBITDA? You should really consider a Division/ Product Line structure with the leaders who are responsible for Division/ Product innovation, strategy, and P&L reporting directly to the CEO.

Are you a home health company with insurance payers as the main customer (i.e., one product, one business model), looking to scale into different markets? A Functional structure at the top, with Geographically aligned sales and operations at the second layer may be the best model for you.

What if you're a software company with four different applications targeted to different user groups/ industry verticals, but all built upon a single platform? You will probably need the classic software "trinity" of Functional leaders i.e., CTO, CPO and CRO, with Product-based or Industry-based Sales and Product Management at the second layer.

What if – in the software example above – the product takes off in the European market? Or in the Automotive industry? And that region or industry becomes 35% of the total company revenues, growing 2x faster than any other region or industry? Should you move to a mixed model and elevate the Europe/ Automotive leader to the C-Suite? We would suggest sticking to the Functional model since the way the product is developed and sold didn't change. You may need to get the CPO and CRO an apartment in Frankfurt or Detroit, but you shouldn't need to add a new role in the top layer.

In terms of prevalence, Functional structures are by far the most common. As conglomerates with their “Strategic Business Units” went out of favor starting in the 1990s – and companies faced a growing number of stakeholders – they responded by elevating functional positions to the C-Suite. In our experience, well over 60% of companies have a largely or entirely functional model.

One Functional leader that is almost always in the top layer is the CFO. Beyond the CFO, the representation of other functions varies significantly by industry, size, business model, company history, and even CEO and Board preferences. COO can be an idiosyncratic role with a lot of variation in scope, but if a company has a COO, they will almost always be a part of the top layer. Sales, Marketing, or Revenue may be in the top layer or may be under P&L Divisions if the company has a decentralized sales model. IT and HR may be in the top layer or in the second layer (typically, under the CFO), especially for smaller companies. Process leaders (e.g., Strategy, M&A, Innovation, etc.) are not as common in the top layer, but they do occur – either because the company is trying to signal the importance of that process, or because it is trying to provide a talented internal or external hire a voice in the C-Suite.

While the Functional structure is the simplest and most prevalent, it isn’t right for all companies. It may lead to more siloed perspectives which require the CEO to play the integrator or tie-breaker role. Elevating too many functional positions into the top layer may lead to P&L roles getting “crowded out”.

Secondary Axis and Matrix Effectiveness

Global multi-product organizations must balance many more constraints than smaller, simpler organizations. They typically have multiple products, countries, and stakeholders; large numbers of vendors and suppliers; and less tolerance for risk. They typically require a secondary axis to ensure organization alignment, which gives rise to the matrix. Although a matrixed organization is often pilloried in management and popular media and is often associated with bureaucracy – those who have led large global organizations know that it is often necessary.

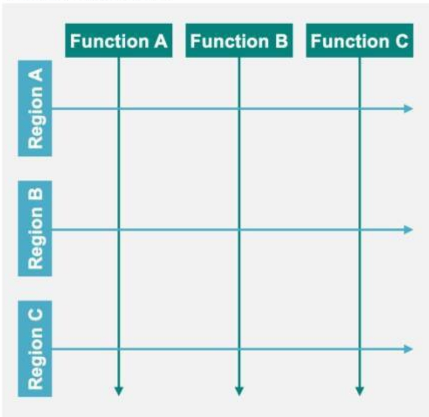
A global organization cannot afford to elevate a Business Unit (e.g., Foods Division) at the expense of a Geographic Region (e.g., Asia-Pacific). They cannot have their Transformation Lead for Europe be more aligned to the SVP of Europe (Geographic) and less to the Global Transformation Leader (Process). They simply must find ways to achieve alignment on two axes, without losing much agility in the process.

Discussions on solid vs. dotted line reporting miss the point about both dimensions being equally important and accountable for the success of the matrixed employee. From the employee’s perspective, they need both managers to provide complementary (and not conflicting) guidance from their unique perspectives rather than getting into turf issues.

Done right, a matrix structure provides a way for the top layer of the organization to see, influence and direct employees that don’t naturally fall under their reporting structure. It reduces the downsides of a “pure” Functional or Divisional structure.

Designing a Matrix Structure That Works

Matrix Structure



Keys to Success

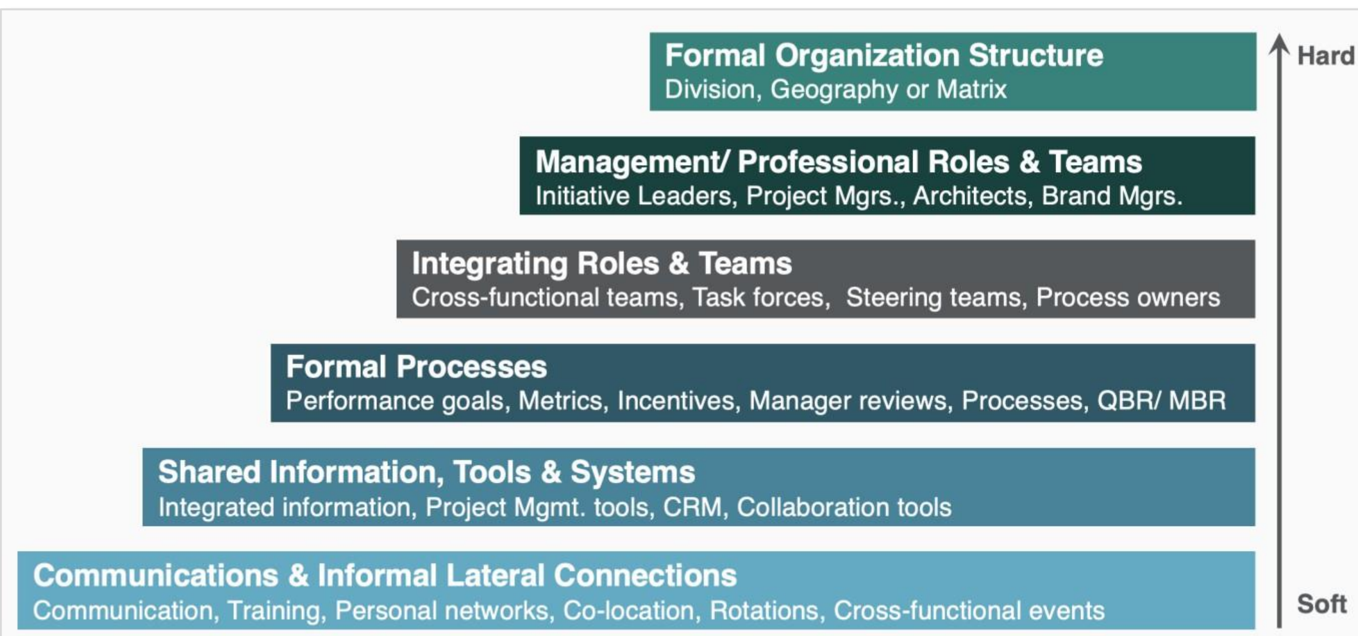
Use Sparingly	• Only when goals cannot be achieved through informal mechanisms
Limit to Senior Management	• Only one level should be matrixed – generally senior level managers • Majority of employees should be exclusively aligned to one function, region, etc.
Ensure Axes are Complementary	• Matrix axes should be distinct (e.g., a region and a function) rather than overlapping (e.g., two functional leaders)
Limit to Two Axes	• Third axis (e.g., BU + region + function) adds enormous complexity • Manage the 3rd axis through informal mechanisms
Clarify & Reinforce	• Don't assume everyone will understand & accept the matrix model • Invest in communications, case studies & tools that make it real • Reinforce through other HR processes e.g., Performance & Incentives

Integration Mechanisms

Any structure, by its very design, creates silos that are optimized to achieve their own goals. An effective organization is one that strikes the right balance between siloed/ specialized work (i.e., differentiation) and collaborative work (i.e., integration).

There are many ways to drive collaboration and integration across silos – ranging from "soft" to "hard". Which one(s) you use depends on the degree of impact you're trying to achieve, the time available, how much change authority you have, and whether you're trying to create enduring change or just smooth over some short-term friction in the organization.

Integration Mechanisms



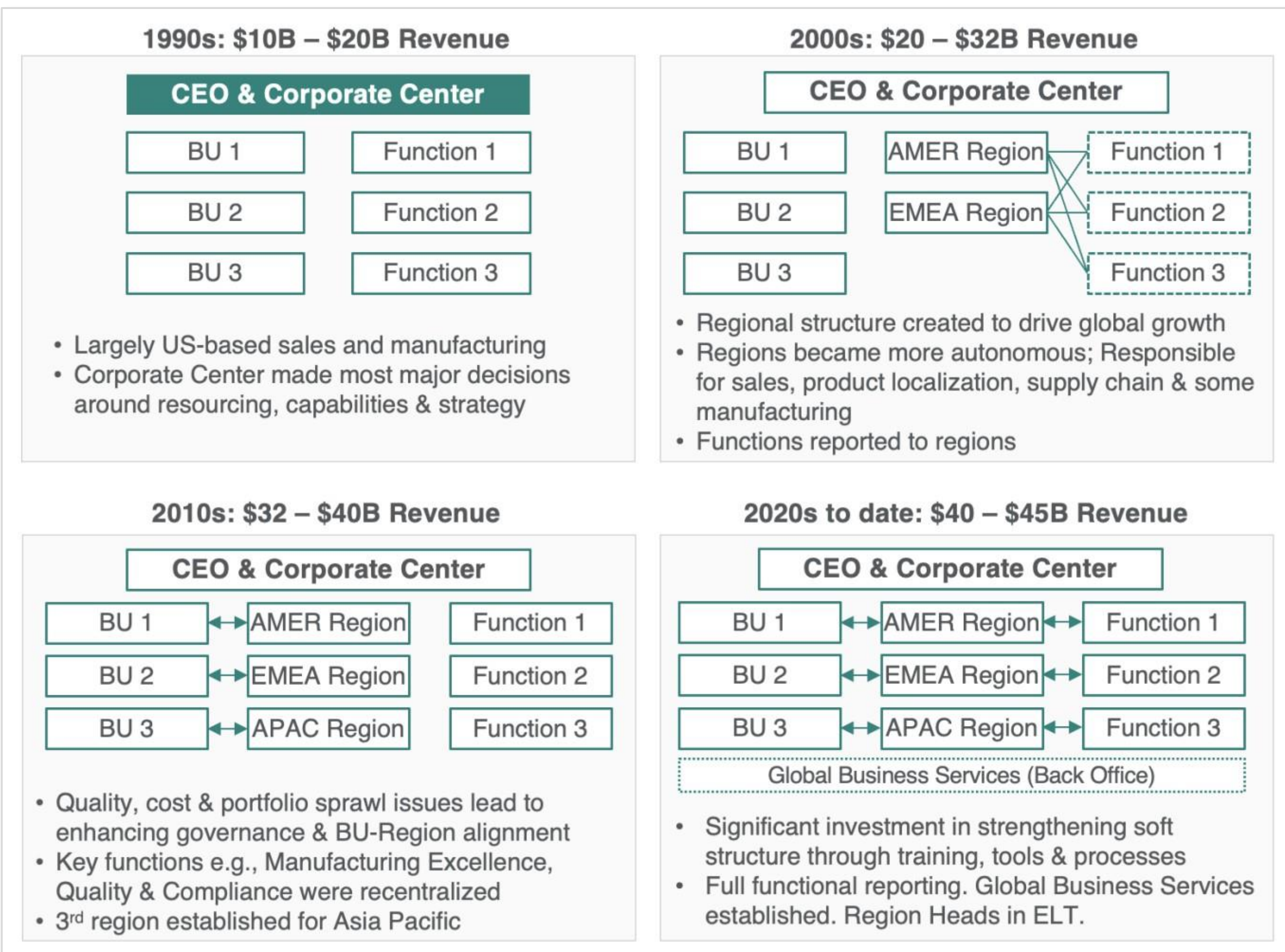
The soft mechanisms can be implemented by employees, supervisors, first-line, and middle managers. They don't take a lot of resources to execute but they do require continuous reinforcement. The hard mechanisms are more invasive, require executive support and should be used very infrequently.

Mastering the soft(er) mechanisms is key to solving issues that live in the white spaces between the silos created by the top layer design.

The Top Layer Evolves Over Time

The top layer changes over time to reflect different priorities of the organization. The visual below shows how the top layer of a $45B Manufacturing Organization evolved over ~35 years. Despite over 20 acquisitions, they remained anchored around three primary Divisions/ Business Units. However, they made major changes in the number, type, scope, and responsibilities of all the other roles in the top layer. As a result of these changes, the BU leader role has evolved from an all-encompassing "CEO of the Division" to "Product and Operations leader". Their current model tries to get the best of all worlds – Business Units, Regions, and Functions. Their focus in the last 5 years has been less around tweaking the top layer, and more around making the model more effective (largely through cross-functional integration mechanisms and cross-BU platforms) and efficient (largely through outsourcing back-office functions and setting up a "Global Business Services" structure).

Top Level Organization Structure Evolution for a Global Manufacturing Company



Executive Leadership Team

This article is focused on designing the top layer, but it doesn't cover two related concepts – i.e., who (and what roles) should be on the Executive Leadership Team (ELT) and what is an appropriate span of control for the CEO? We will cover those in detail in subsequent articles, but some of the main considerations are listed below.

- Business size and complexity.
- Board/ Investor expectations of how results are rolled up and how accountability is cascaded down.
- Regulatory and industry-specific requirements (e.g., Chief Medical Officer in healthcare, Chief Underwriting Officer in insurance, etc.)
- The CEO's background, leadership style, and prior experience with small or large ELTs.
- Additional roles held by the CEO e.g., Chair of the Board, or Private Equity Operating Partner.
- Caliber and maturity of leaders on the ELT.
- Combined roles (e.g., dual hat or two-in-a-box).
- Career progression and span-breaker roles (e.g., COO, CAO).

Making It Work

The effectiveness of any structure, governance and integrating mechanism depends on how employees and leaders make it work. Organization design cannot prevent poor leaders from sub-optimizing or even sabotaging the structure to maximize their own outcomes. Conversely, great leaders will always figure out a way to get the required outcomes, regardless of the structure given to them. Notwithstanding all this, getting the top layer aligned with the business objectives makes it easier to succeed even if you don't have great leaders in every role. And when you do find great leaders and give them a structure that makes their job easy – you get a winning combination.