


Growth through decentralization

COMPANIES VIEW HIGHLY HIERARCHICAL STRUCTURES WITH GREATER SKEPTICISM BECAUSE THEY SELDOM MEET TODAY'S DEMANDS FOR FLEXIBILITY AND EXPANSION. DECENTRALIZED ORGANIZATION, WHICH MOTIVATES EMPLOYEES TO ACT LIKE ENTREPRENEURS, IS PROVING TO BE AN IMPORTANT FACTOR IN SUCCESS. BY BURKHARD SCHWENKER.

 **ONLY PROFITABLE GROWTH** can ensure a company's long-term future. Yet how and why do companies actually grow? We have taken a close look at these important questions over the last few years. Our analyses, studies, and surveys show that a company is ideally prepared when it is not only able to grow, but also ready to grow. Decentralized structures are a key factor for growth, a view that was confirmed by most of the managers we surveyed. It takes a positive attitude about growth coupled with the right opportunities to create the necessary dynamics within a company. Opportunities could present themselves as the ability to develop new products and market them quickly, the right growth strategy, and a decentralized organizational arrangement.

THIS INFORMATION IS IMPORTANT because the markets in which companies must distinguish themselves have become turbulent because of the dynamics spawned by increasing competition. Customers no longer stay loyal; they will leave if they perceive that the slightest advantage can be gained elsewhere. Competitors are crossing traditional sector boundaries and jumbling up existing rules, and the rate of technological progress is greater than ever before.

FOR THESE REASONS, among others, corporate management faces the challenges of developing and unleashing an entrepreneurial drive within the company that is oriented to the market's needs. In these efforts, people play a decisive role. Our interviews revealed that managers believe individuals are responsible for 42 percent of the most critical "drive" in growth processes. By comparison, the significance of process competency (30 percent) or the structure of business systems (28 percent) was rated lower than one might originally

have thought. In this context, decentralized structures are currently experiencing a renaissance as an organizational approach because they encourage entrepreneurial activities, and they support a contemporary, direct, and motivation-enhancing understanding of leadership. However, decentralized structures do present managers with a dilemma. How can decreasing transaction costs, bigger companies, effects of scale, and the other cost advantages of centralization be combined with the demands of setting up operations in a decentralized, market-responsive manner?

THE SOLUTION lies in the ability to integrate both a high degree of flexibility and a distinctive level of customer orientation. In regard to the organizational form, it means decentralization along with a strong, centralized backbone. Nowadays, both fit together perfectly—almost.

THE MOST CRITICAL ADVANTAGE of a decentralized organization is thorough and distributed knowledge about the market. Everything that needs to be known about where direct customer contact is and where branding and pricing strategies are implemented as an operative measure—that is where the ideal balance needs to be found, between overall aspects such as market strength and cost-factor optimization on the one hand and required local adaptation on the other. The real entrepreneurial types can find their calling in small, effective business units; they get to make market-related decisions quickly, motivate employees, and expand competencies—all as they see fit. These people will more likely be drawn to the decentralization principle than the ambience of centralized structures where one "plays it safe." Rather than being oppressed by current freewheeling market conditions, these entrepreneurs thrive in them.

OUR RESEARCH shows that decentralized companies are more innovative. In fact, growing companies have set up their innovation processes in a decentralized manner. First, this creates internal competition for the best ideas. Second, it directly fosters more creativity in individual units, compared with centralized organizations' sometimes cumbersome approaches. However, innovation must be encouraged through intentional tolerance, a stimulating competitive culture, and incentives. Even in decentralized structures, innovation needs centralized guidelines so as not to lose advantages of scale and networks; guidelines also ensure that competition-specific knowledge is available to the entire organization. Centers of competence, as well as clear process and system guidelines, allow companies to achieve the right balance between decentralized creativity and centralized management.

ANOTHER KEY ADVANTAGE of a decentralized organization is flexibility. The days are over when a corporate strategy might last 10 years or more. Now, three to five years is a long time, and that period will still see repeated adjustments. To enhance operations to the fullest, the motto is "more decentralization is better." Decentralized units are generally small and lean, and can therefore be adapted to new basic conditions in a faster and more flexible manner. They are like barometers in that they sense a "change in the weather" faster than slow-moving centralized structures. Increased response speed from delegated responsibility is particularly effective when managers see how their salaries reflect the quality of their decisions.

AS VALUABLE AS THE ADVANTAGES of decentralized companies are, decentralization should not necessarily be pursued at any price. Each management team needs to optimize its cost position in

order to beat the competition. Therefore, the team's mission is to combine the advantages of a decentralized organization with the cost-related and scale-related gains of centralized structures. Achieving this winning combination is a matter of endowing the multi-branched structure with a load-carrying backbone. Structural support for a decentralized organization includes effective auditing systems, as well as overlapping management and service units.

INFORMATION AND COMMUNICATIONS technologies are now able to pull together knowledge that needs to be organizationally subdivided and branched out in such a manner to optimally meet market requirements. Information technology systems can provide all of the relevant data in real time anywhere around the globe. Flexible enterprise resource planning programs enable managers to retrieve any combination of performance indicators on short notice. Intelligent, Web-based benchmarking systems fundamentally improve an organization's learning curve. High-performance knowledge management systems ensure that institutional knowledge can be transferred anywhere within the company. And finally, IT allows administrative tasks to be provided at almost any location in a bundled and functional manner.

TO FULFILL ALL THESE FUNCTIONS, information technology systems must be considered tools that enable decentralization. That almost sounds like reversing a trend. To date, companies have used information technology as a means for centralization, which tended to create virtual information overload, thanks to the computers and an overly enthusiastic head office. Head offices also strove to standardize information to the utmost to minimize complexity costs and transaction-related costs. However, the needs of local markets often disappeared as a result of such excessively standardized information.

IN CONTRAST, standardized communications patterns can simplify the management of a branched structure that forms nodes wherever a

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particular market situation dictates it—whether the nodes are oriented toward regions, customers, or products. One elementary component of decentralization's load-carrying backbone is that key strategic elements and expertise are generally subject to central management. Thus, the global footprint of the value chain must be determined from overlapping perspectives that are specific to the company and its cost factors. Closely associated with this idea is company-wide optimization of the procurement process, also known as global sourcing. On the market side, market rollouts must be coordinated by means of corporate branding and clear pricing rules.

CORPORATE SERVICE CENTERS are required to successfully balance decentralization and cost efficiency. They concentrate administrative and other valuable services from across the company and provide these to the decentralized units. They are cost-efficient because they sustainably realize effects of scale, and, in particular, they are a prerequisite for future corporate optimization measures. Offshoring service functions will soon provide companies with new options for cost reduction to be tapped, which in turn will contribute to the further improvement of core corporate functions. In one study we conducted jointly with the United Nations Conference on Trade and Development (UNCTAD), 44 percent of European companies said they will soon be planning additional offshoring activities, noting that the decision has been accelerated by the European Union's eastward enlargement. Cost aspects are a certainly the main reason (70 percent of the respondents), as are improvements in service quality (43 percent) and process acceleration (35 percent).

THERE ARE ALSO OTHER CUSTOMIZED SOLUTIONS to consider. Strategic alliances or networks can create new structures that help to optimally integrate decentralization as a growth driver, with centralized proposals to improve the cost position.

A DECISIVE CRITERION for a decentralized organization is a trust-based culture. This notion is not new, yet many attempts to implement trust-based management have failed. We know why: A trust-based culture can only take hold if an organization as a whole works toward such a culture. There must be a consistent management model with defined and binding decision-making processes, target agreements, and a system of checks and balances.

IN THE LAST ISSUE of think:act we showed that if trust is taken seriously as a guiding principle, control and leadership do not have to be reduced to rigid top-down guidelines. Strategies need to be implemented in a decentralized manner by project-specific teams with exceptional knowledge about local markets or customers. They need to be coordinated, not managed, by centralized units. In fact, the head office needs to focus more on empowering its decentralized units, while also subsequently monitoring success. The head office often needs to simply abandon the classic model of process management. Today's complex business conditions demand suitable and flexible management models.

THE FUTURE BELONGS TO decentralized organizations because they will be able to tap more growth opportunities. Models of decentralization need to be further developed to be sector- and company-specific. This development can be done by management with consultation. The right balance between decentralization and maximizing the benefits of scale is no simple matter. It demands that every function, every management process, every link in the value chain formulate a customized strategy for each company and market—a strategy that is to be implemented in both a centralized and decentralized manner. This topic is definitely worth discussing in depth because the right answer is the basis for profitable growth.

Five Steps to Greater Flexibility

GIVEN THE HIGHLY DYNAMIC NATURE OF CURRENT MARKETS, UPPER MANAGEMENT MUST CONTINUALLY DEMONSTRATE ITS CAPABILITY TO ACT AND REACT APPROPRIATELY. FLEXIBILITY IN STRATEGIC CORPORATE MANAGEMENT HAS THUS BECOME IMPERATIVE.

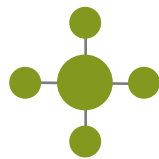
Strategic planning is one of the core tasks for executive managers. Yet closer scrutiny appears to show that strategic planning does not run efficiently and professionally enough in many companies. That finding is the result of a survey of CEOs of major companies, conducted by Roland Berger Strategy Consultants. The discrepancy between theory and reality is surprising because the continuously increasing dynamism of many markets should be compelling companies in all sectors to place the utmost emphasis on flexibility in identifying and pursuing their respective objectives.

According to the study, top managers believe that their companies are particularly underperforming in the areas of target planning, strategy formulation, strategy implementation, and performance measurement. Thus, 95 percent of the companies consider increasing their own value

to be a primary strategic objective, yet only 60 percent are satisfied that the proper procedures are implemented to do so.

The role of group headquarters is especially disputed. Ninety percent of the companies claim it contributes to the organization's value; however, 73 percent of them are unwilling to give it the role it requires to be as effective as possible. There is also little confidence in in-house ability to motivate employees. Although 91 percent of the queried executives believe that it is necessary to win over employees in undertaking sought-after changes, only 36 percent are successfully doing it.

To close the strategic gap and to manifest a company's development opportunities, management needs to analyze the strategic planning process and promptly eliminate any vulnerabilities. Below are five steps toward achieving greater flexibility.



1.

EARLY DETECTION

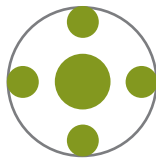
Because dynamic markets require abandoning rigid strategies, flexible systems with "rolling" planning and budget allocations are better suited to take up new developments. Early detection and risk management systems provide the necessary information so that upper management can make quick decisions on the fly and change course if needed.



2.

FLEXIBLE CUSTOMER ORIENTATION

To be better than the competition, it is necessary to know what they will do today and not do tomorrow. Target-oriented benchmarking helps to locate competitive strengths and weaknesses. It is the only way for companies to seize immediate opportunities, identify risks, and avoid pitfalls. Formulating alternate strategies also becomes more straightforward.



3.

INTELLIGENT INTEGRATION

Milestones are only achieved if strategic and operational planning work hand in hand. Isolated solutions and confusion about responsibilities are unnecessary hindrances. Ideally, planning processes build on each other and have integrated interfaces. Tools such as balanced scorecards should be implemented with IT support systems.



4.

MEASURING AND MONITORING

A company's appreciation in value should be the objective of any strategy. Accordingly, it should be possible to measure and monitor the strategic targets. In order to identify a company's activities as value-adding or value-diminishing, all units must be painstakingly analyzed for their overall contributions to generating value.



5.

MOTIVATING EMPLOYEES

"Command and control" leadership is long gone. Solving problems, allowing for some errors and looking forward is leadership that inspires confidence in employees. In turn, motivation and a sense of corporate responsibility will increase. To sustain the positive trend, appropriate incentives and reward systems should be set up.