Aligning the operating model with your strategy

How to make the redesign process a success
Dear Reader,

An operating model defines how a company goes about delivering on its purpose. Before the COVID-19 crisis, businesses already suffered from operating models which had undergone incremental and unstructured changes over time, becoming often hidden barriers to organisations delivering on their strategy. Now, through COVID-19, businesses are having to restructure under extreme pressure, and risk drifting further away from achieving their long-term goals. Redesigning and implementing a fit-for-purpose operating model is thus of paramount importance, especially through the current crisis. In this publication, we begin by highlighting the importance of an effective operating model, and then list key challenges that companies requiring such a redesign would face. We then outline our tried-and-tested approach towards leading a successful operating model redesign and unveil a succinct set of key factors that make the redesign process a success.

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What fit for purpose achieves for you

An operating model describes the way a company develops and maintains the capabilities that are required to deliver its strategy and how it fulfils its stakeholder expectations. An operating model logically stems from “why” the company exists, its purpose, and “how” the company plans to achieve its purpose, an outcome of its strategy. The operating model articulates the “how” of deploying this strategy in practice and the path through which the company will create value. It is not a static structure but rather a dynamic framework which constantly adapts to a changing environment.

An operating model is the gears in the engine room of the company, churning and meshing together to deliver value to both internal and external stakeholders. When done right, it serves as a source of consistent and coherent guidance to all the constituents of a company. For the employees, customers, and suppliers, the operating model provides clarity about the role each part of the organisation plays in delivering on-time, on-cost, and on-quality, and in fulfilling the company’s purpose.

For managers, the operating model creates transparency and enables proactive and effective leadership based on facts rather than ad hoc management often described as “firefighting”.

For shareholders, the operating model articulates how the company ensures that its key capabilities are developed, maintained and delivered upon.

An OPERATING MODEL is how strategy is deployed in practice to create value and deliver the company’s purpose.
Redesign your operating model

The hidden cost of an unstructured legacy

An imperfect operating model is often the result of historical disorderly growth. In executing their strategy, many players – across heavy industry, A&D, automotive, etc. – focus on incremental efficiency and productivity improvements for sometimes outdated operating models which do not fit current market requirements. We observed that these companies regularly struggle to prioritise and coordinate resources effectively, thus failing to reach their return on invested capital (ROIC) potential.

Our client engagements have also shown that these companies often carry significant costs in the form of excess sites or duplicated hierarchy levels, which degrades customer journeys, negatively impacts profitability and frustrates employees.

Digging further into where these additional costs come from and why these companies do not realise the opportunities, we observed that today’s operating models are frequently the result of their history of growth (which many companies achieved through M&A) rather than the result of a deliberate construct. Operating models are thus often at odds with the stated objectives of their organisations, either because of the lack of deliberate design or due to internal and/or external changes degrading the performance of what may have been an effective structure at an earlier point in time.

Performance and margin degradation driven by complexity

Inefficient operating models increase complexity, making it harder for management to steer the company and more difficult for customers, suppliers, employees, and shareholders to understand them. Our client work shows that most companies lacking a cohesive operating model often face the following five challenges:

1. **Multiple customer interfaces**

   Aside from diversification moves and holding structures, M&A activity is usually motivated by a combination of expected synergies and optimised value chain coverage. When perfectly executed, mergers or acquisitions have a neutral to positive impact on the customer experience, whereas inorganic growth with insufficient integration does the opposite. It leaves customers interacting with a multitude of independent organisations rather than one single company. This can result in vastly different customer experiences and uneven delivery quality, ultimately resulting in low organic growth rates. Multiple customer interfaces are an often-underestimated threat, causing loss of cross-selling opportunities in the short term. Worse, they can even prevent a company from capturing opportunities to grow organically in the future, thus threatening a company’s performance in the long term.

2. **Fragmented portfolios**

   Mergers & acquisitions lacking a proper equity story or those without proper post-merger integration often result in broad product/service portfolios with different underlying business models. We often see in projects that...
Operating models are often the result of an unstructured legacy rather than a deliberate construct.

**UNSTRUCTURED LEGACY**
Incremental additions to an outdated operating model

"We operate this way because we have always done it this way."

**DELIBERATE CONSTRUCT**
A fit-for-purpose operating model designed to deliver on the company's strategy

"We operate this way because it allows us to achieve our purpose."

Source: Roland Berger

any such addition to the product/service portfolio adds a new set of business drivers and increases the complexity that the management must navigate, to a point where it becomes impossible to manage the company via a coherent strategy. In contrast, most successful companies we see - regardless of the industry they operate in - build deep, scalable expertise and specialist resources in selected areas, and then align their product and service portfolio to benefit from these competitive advantages.

3. **Scattered footprint**

   **M&A activity** usually expands the company’s geographic and physical footprints, causing duplication of functions and roles. Ideally, a footprint rationalisation is conducted after each merger or acquisition, yet many companies shy away from it so as not to complicate the relationship with the newly acquired business. Scattered offices and sub-scale production sites are complex to manage, inefficient, and cost-intensive. We have experience of companies in need of an operating model redesign typically being able to reduce their footprint by 20-25% on average. Additionally, we think that the biggest challenge from scattered footprints lies in attracting the right management and engineering talent to sub-scale sites. If difficulties finding the right talent mean that new business generation and fulfilment are left in the hands of relatively junior resources, the business continuity is under fundamental threat.

4. **Local process ownership**

   By **standardising and aligning** processes, successful companies realise economies of scale and scope. However, in our experience, many mergers or acquisitions lead to a multitude of processes in the business, often localised to specific sites or legacy businesses. This not only increases organisational complexity, it also makes it harder to control performance. An example we often see is the procurement/sourcing process: Lack of proper supply chain integration,
and locally made sourcing decisions lead to sub-optimal sourcing owing to duplication of suppliers and high material costs as scale economies are not achieved. In this case, as part of an operating model redesign, the right level of standardisation and alignment of processes across the business can quickly result in tangible benefits and cost improvements of 5-10%. Emphasis on “right level” is key when discussing standardisation; while we are not advocating absolute centralisation – which can create lethargy – we did notice that many businesses are nowhere near where they should be in terms of process alignment.

5. Uninsightful metrics

To enable informed decision making, visibility on performance by product group and end market is needed. However, P&L responsibility in many companies is held at a production site level - thus, rather than P&L aggregation happening at a logical “product group” level (consolidating relevant products from multiple sites), it ends up occurring at the site level (consolidating a range of unconnected products). This setup seems natural when individual sites own the customer relationship and control material costs, but it comes with potentially unintended results.

Firstly, we often find that site general managers optimise individual site P&Ls rather than the company P&L and are unlikely to propose discontinuing underperforming product lines or sites as it would threaten their own role.

Secondly, it is impossible to measure how products perform by end market. As site P&Ls aggregate product portfolios that are most likely sold into different end markets, site performance can only be measured against the site’s performance in the previous year.

In every operating model engagement that we have conducted, one of the first things we did was create product group P&Ls in order to provide company-level visibility on the performance of product groups against their markets, and to drive synergies across sites.

Ability to deliver sustainable organic growth

We have noticed in recent years that for many large industrial players, inorganic growth was the go-to strategy, relying on consolidation as a route towards margin preservation.

For example; in the A&D industry, system integrators – such as Safran and UTC (now Raytheon Technologies) – became “super tier-1s” and were able to improve their bottom line by charging high premiums for aftermarket sales in the days when airframers used to focus on reducing the initial purchasing price of aircraft for their airline customers rather than the total lifecycle costs. With airframers’ increasing appetite for the high-margin aftermarket sector, and the expected slow-down in build rates in the medium term due to the lack of new platforms, many A&D players must reassess their strategy to achieve long-term sustainable growth in what will be a highly competitive market.

While developing a strategy is relatively easy, delivering it is difficult. This holds especially true when a company comprises a portfolio of acquired businesses which do not all necessarily embody the Group DNA.

As a result of the efforts to respond to shifts in the market, many companies have morphed into complex, difficult to manage organisations where limited or failed post-merger integration has negated the intended benefits, and instead impaired their organic growth potential. Due to their untapped potential, these fragmented companies became coveted targets for activist investors aiming to unlock short-term financial gains through divestitures and break-ups.

However, developing an operating model for an established, global company that is constantly evolving is a daunting task. Embarking on any operating model redesign without the appropriate planning, experience and project management can be risky, which is why many companies shy away from it and opt for strategic changes instead. But when strategy no longer protects margins, an operating model redesign is due.

The right operating model is the means to streamline operations and enable management to implement its strategic objectives sustainably.
How to overhaul the operating model

Four key elements

In many companies, the term operating model is either not clearly defined, or everyone has a different understanding of what it encompasses. For all our engagements, we first specify that the operating model is the structure that delivers, secures, and sustains the capabilities that a company requires to fulfil its strategy and stakeholder expectations.

To do so, it touches nearly every aspect of a company’s day-to-day business. In our definition, an operating model describes the following four key elements. Processes and tools: how the company does its business. Organisational structure: the structure in which it operates. Leadership model: how it is managed and its core values, and Governance: how it ensures adequate oversight.

Our approach to development and lessons learned

We have used our four-step approach to redesign the operating model of clients in various industries, including A&D, automotive and industrial products. While the duration of each step varies depending on the starting point and the allocated resources, each of the steps is fundamental to ensure fitness for purpose and buy-in for an actionable transformation. There are no shortcuts, but the resulting operating model is robust and reliably delivers strategic opportunities while adjusting to challenges.

To help you avoid the most common pitfalls, we have collected the key lessons we learned in our projects and incorporated them into our proven four-step approach. On the following pages we will briefly explain our project approach and share the key lessons learned along the way.
4-step approach to redesign your operating model

1. Top-down blueprint design and target setting

The first step for a successful operating model redesign is agreeing that such a review is needed, and conveying confidence around the decision-making process. To make a convincing case for change, we start by establishing a clear fact-based baseline. During this phase, we also rally relevant stakeholders to formulate design principles against which we evaluate the target blueprint options we generated, including the business case outlining benefits and risks.

2. Bottom-up validation of top-down blueprint and targets

The second step is validating the target operating model, including its business case and targets, with staff at key sites. We build more detail into the blueprint via workshops with key personnel, who will become change leaders. This phase requires rigorous analysis to document the detailed business case, to set challenging yet pragmatic targets, and to anticipate and plan for associated risks. At the conclusion of this bottom-up validation, we aim for the workforce to be committed to the required change and to delivering their targets.

3. Implementation & communication plan development

Operating model redesigns are deeply transformative, thus requiring detailed implementation plans including HR processes. Then, having identified the main communication groups and their top-of-mind concerns, we define relevant messages, channels, and tools to reach them. Communication should not be an afterthought, but rather a well thought through enabler of the transformation. Key to the change management process is securing buy-in from various stakeholders. Without a clear understanding of what will change and full buy-in, there will be no change.

4. Organisational transformation & ongoing monitoring

The final step is to roll out the implementation plan. We have noticed greater adoption of the redesign if we pre-emptively develop a proof-of-concept through pilots in multiple sites. This allows us to test and refine the detailed operating model and fine-tune the change management approach. The governance setup should enable the leadership team to act in a timely fashion. This means setting up weekly accurate reporting of the income, cash, and FTE effects from implementing the target operating model.
1. **Top-down blueprint design and target setting**

**Build the fact base, case for change, and design principles**

If done right, a new operating model is likely to touch the everyday ways of working of nearly all employees. One of the biggest challenges in operating model redesign projects – especially at the beginning – is resistance to change from within the organisation. To successfully embark on an operating model redesign and break the resistance, the management team needs to clearly communicate “what” the new operating model is trying to achieve (the design principles) and “why” it is required (the case for change).

We recommend using an agreed-on “fact base” – which explains the as-is organisation with its strengths and weaknesses – as the fundamental component for what we call the “case for change” and “design principles”. The case for change is a crucial and often-overlooked element at the beginning of the operating model redesign. Once defined and aligned, it is the main communication piece to explain the rationale for why the redesign is needed, and to break up the resistance to change from relevant stakeholders. Combined, the as-is fact base, the case for change, and the design principles turn out to be the most important elements for starting an operating model redesign. Together, they build a strictly defined set of financial and operational performance indicators that should be the base for any discussion or question that arises during the project.

**Define divisions and hierarchy (top down)**

*It is essential* that the concept for the organisational blueprint is drawn up with a strategic target in mind, independent of the existing state of operations. If the concept definition is done bottom-up without this top-down view, then the outcome will most likely remain too grounded in today’s reality, and as such, is destined to not introduce substantive changes. The top-down view must be developed with a small, core, cross-functional team, who wholeheartedly buy into the case for change, and whose knowledge captures the vast majority of the work done by the company.

Drawing on the design principles, the most important step in operating model redesign is to develop the divisional structure since this defines how the business is managed, and how customer interaction is organised. In general, there are two options for the divisional structure: Business line focused and function focused. In a business line structure, the goal is to...
Divisional structure

Where does the P&L responsibility sit?

Hierarchically high P&L responsibility

- Enables alignment of processes and standardisation
- Improves exploitation of synergies
- Increases organisational lethargy

Hierarchically low P&L responsibility

- Fosters flexibility and agility
- Increases complexity for both customers and employees
- Limits the unlocking of synergies

P&L line items allocated to hierarchy levels

- Allows synergies to be unlocked for selected P&L line items
- Improves focus on delivery of line items
- Provides "sense of ownership" of the P&L for both division and site managers
- Introduces the risk of optimising for each P&L line item rather than for customers and/or the entire P&L
- Introduces a new potential source of debate/conflict between the division and site

Source: Roland Berger

combine similar elements (e.g. products, geographies) such that they can be managed as a single organisational unit. In a functional structure, functions are clustered based on the overarching business process.

An even more important decision, however, is to define where the P&L responsibility sits in the new organisation. Hierarchically low P&L responsibility fosters autonomy, flexibility and agility but can lead to complexity for both customers and employees, as well as limiting the exploitation of synergies. Hierarchically high P&L responsibility enables alignment of processes and standardisation but can lead to organisational lethargy.

From our experience, it is crucial in this project step to develop an in-depth understanding of all underlying business models that exist within your company. In a business line organisation, similarities (or differences) in the underlying business models will have a major impact on the divisional structure. At the same time, a functional structure should only be considered if all business models are already similar.

Once you establish a profound understanding of how your company operates, it is worth looking beyond the boundaries of your own company by analysing your competitors’ answers to your industry’s business challenges. Understanding how competitors – who in most cases face similar challenges – organise their business has proven to be a powerful tool, especially when crucial stakeholders need to be convinced. Comparing the results of the business model and competitor analysis against your design principles will provide you with all the information required to select the best possible divisional structure for your company.
2. **Bottom-up validation of the top-down blueprint & targets**

*Validate blueprint design in key sites (bottom-up)*

Up to this point, the future operating model has been developed top-down by a group of selected key decision makers. However, the operating model redesign aims at changing habits and ways of working that have potentially been followed for years. This requires testing whether the proposed design really works and securing buy-in from formal and informal leaders of the organisation. Bottom-up validation is an opportunity to test the concept with people who know best how the work is done, and, in parallel, to identify early adopters and champions within the organisation who can become change agents during implementation.

Finding the right level of detail and the right partners to validate the design with is key for a quick but thorough bottom-up validation. Validation should include key sites from different divisions and geographies, as well as formal and informal leaders to ensure that local characteristics are considered before further detailing the design.

"A bottom-up validation stage is necessary as it leads to the heated ideological debates required to assess the operating model. Therefore, you need to come armed with the fact base: to create a common, agreed databank from which to spark discussions and get people on board."

*Kai Balder, Partner*

It is worth noting that the organisational chart is often of little help when identifying informal leaders. In most cases, an informal organisation exists within the company and reveals more accurately how the organisation works. It’s important to identify such an informal organisational chart at this stage of the project – if not before – to ensure the right validation partners are selected.

**Define processes and functional links in depth**

This is the point where the operating model must become detailed, as we begin to consider processes and (sub-)functional responsibilities in depth.

An operating model redesign is a valuable opportunity to “straighten the spaghetti” of widely differing processes with convoluted process steps, creating a more process-efficient organisation that allows you to capture economies of scale and scope. After all, if you do not transform the workload, you will not be able to free up resources to focus on other activities (either inside or outside the company). It is thus paramount that structural elements of operating model design are considered in parallel with processes.

Here, the devil is in the detail as the functional breakdown must be collectively exhaustive: No task should fall through the cracks between functions/sub-functions and organisational levels, and touch points between tasks must be thought through in depth. This is also the point where headcount discussions are likely to start. We strongly recommend avoiding any debate over headcount at an earlier stage, as it triggers defensive and subjective discussions that are potentially difficult to control. That said, cost reduction is likely to be one of the design principles, and personnel costs usually account for a significant portion of the target cost reduction. To calculate savings correctly, baselining the as-is headcount is key but can be a difficult task as, most likely, different

"A clean HR data file is painful to create but an asset for years to come."

*Robert Thomson, Partner*
Case study
ORGANISATIONAL DESIGN ALTERNATIVES
FOR A BUSINESS LINE STRUCTURE

Multi-contact approach

Lead product group

Customer-facing business units (BUs)

Product & customer BU

PM and SCM in charge

Tier-based structure

Customers

Ownership of customer relationships
Showcased here are 6 commonly used business-line-driven organisational design alternatives.

We often see the “multi-contact approach” at engineering companies in which engineering is the heart and soul of the company. However, the “multi-contact approach” vastly complicates the customer interface as customers who buy from different divisions have individual customer interfaces with each division.

The next five alternatives simplify that customer interface and enable the company to speak to the customer with one voice, which is vastly preferable to understand customer needs and identify opportunities.

The “lead product group” design and the “product & customer BU” design additionally minimise the overlap between divisions either by introducing “lead product groups” that own the customer interface or by implementing “global councils” that ensure a consistent functional approach.

The “PM and SCM in charge” and “Customer-facing business units” designs reduce complexity by either including a supply chain management function or a dedicated customer-focused group, able to implement central improvement programmes and represent the “voice of the customer”. However, this design approach is only viable for large-scale operations.

Finally, the “tier-based structure” differentiates according to the nature of customer interaction: the products delivered to tier-1s require a direct customer interface, while the products delivered to tier-2s are sold and fulfilled through distributors and therefore require limited to no direct customer interaction. Although both the customer facing BU and the tier-focused structure make life simpler for the customer, they do generate internal complexity for both product groups and BUs.

legacy systems are used, and headcount is tracked locally. However, we see this as an opportunity: The operating model redesign is a chance to clean up the data and get a clearer picture of the organisation.

3. Implementation & communication plan development

**You could develop** a new strategy and operating model from the office, and it might be analytically sound, but if you do not naturally engage with the key stakeholders and change agents in the process, and especially in the implementation, they will not fully understand it, they will not fully own it, and they will therefore not fully implement it.

To cost-effectively minimise the risk of implementation failure, we recommend testing your implementation plan and critical processes, such as bidding for new contracts, developing and delivering new products or supporting customers after sales, in a war gaming exercise. This is best conducted by building a responsibility assignment (RACI) matrix for each process and using it to clarify roles and responsibilities in each process. This gives a clear picture of where responsibilities and accountabilities sit in the new operating model and whether the developed processes work the way they were intended.

You need to ensure that you have dedicated, experienced and highly professional project management capacity in place from the start. Without responsible, empowered project management that takes ownership of the new operating model, implementation is doomed to failure.

Much of the implementation success depends on how effectively it is communicated to all levels within an organisation. Therefore, we advocate investing time in developing the communication strategy and communication plan in detail before expected implementation starts. The first step in defining the communication strategy is to identify the communication goals, factoring in both internal priorities, e.g. relieving uncertainties and maintaining productivity, and external priorities, e.g. informing customers and suppliers about the changes. The implementation plan must holistically
anticipate the sequence and timing of HR actions, and thereby prepare for all required actions ahead of time to ensure that there are “no surprises”. Then, together with the client management and focus groups, you need to set the communication guiding principles to ensure discipline around what and how information flows. The communication plan is derived from analysis of the target audience, defining key messages, channels and tools for each one. You need to secure the implementation of the communication action plan by agreeing deliverables/milestones, assigning responsible owners, and establishing performance measures.

4. Organisational transformation & ongoing monitoring

Transformation of the organisation and thereby the implementation of the newly developed operating model is a significant project in itself. Depending on the complexity and the urgency of change, it can take up to two years. Organisations need to consider whether a gradual migration or a “Big Bang” change is the most appropriate for their situation and chosen targets.

In our experience, piloting the transformation of the operating model before the full roll-out can have a hugely positive impact. By conducting multiple pilots, you will understand situation-specific nuances and prevent any manipulation of results by change-resistant employees, which is time well spent. During the pilot and transformation phase, success really depends on the engagement of change agents and the leadership: Empower your change agents and make them own the new operating model. Also, measure their actions and hold them accountable against clearly defined targets. Monitoring performance against targets is key to allocate management focus appropriately and ensure timely course correction.

Key success factors for redesign

Operating model redesign is a challenging task. Having conducted numerous operating model redesign projects across many sectors, including the A&D, automotive, and industrial products sectors, we have identified five key success factors to make your operating model redesign a success.

The operating model ...

... should be based on the company's strategy rather than its legacy.

... should optimally satisfy clearly defined design principles.

... should be designed and tested by the employees who know what's best.

... should be designed for implementation.

... should have its redesign process communicated proactively to all stakeholders.
All companies experience business cycles and operate in a continuously changing environment. As they grow, their business model evolves, and they introduce new structures and models through mergers and acquisitions. Combining the internal developments with a constantly changing business environment leaves many companies with an obsolete or sub-optimal operating model.

However, the hallmark of a company that achieves long-term success is that it constantly questions itself: Do we have the right strategy? Do we have the capabilities to deliver the strategy? Are we operating in the best possible structure to develop and preserve the capabilities required? Winning companies constantly reassess and rewire their operating model to adapt to their environment and to optimally deliver their strategy, rather than relying on a historical structure that is likely out of date.

Operating models touch every aspect of a company’s business. Companies that do not regularly take up the challenge of rethinking and optimising their operating model ultimately lose their competitive edge and face failure. Conversely, good operating models are decisive in delivering a company’s long-term success and offer an opportunity to reduce costs and accelerate organic growth that must not be missed.

The operating model is the key element to create value and deliver the company's purpose in a constantly changing business environment.