A CEO Who Has Applied the Principles of Structure

by

Sergio Paiz, CEO, PDC

excerpt from the book

Principle-based Organizational Structure

by

N. Dean Meyer

~ FOREWORD ~

A CEO Who Has Applied the Principles of Structure

by Sergio Paiz, CEO, PDC
May, 2016

My brother Salvador and I took over the family business after my father passed away in a tragic airplane accident. I was 25, a recent engineering graduate, and new to the world of business.

While my inexperience was a source of immense stress, it may have been an advantage as well. I looked at the world through fresh eyes.

What I saw was a loosely related set of companies, with total revenues of approximately $130 million. Each company had its own Board, with a mosaic of minority shareholders.

And most had serious problems. We were consistently losing money. It seemed I was confronted with a new crisis each day.

I rolled up my sleeves in one company and helped to resolve a problem. Then, the same issue would arise in another company. Despite our admonitions to study the solutions we'd just implemented, each management team insisted on doing things its own way. Every company had different ERP systems, accounting processes, organizational design principles, compensation systems, etc.

On the positive side, these companies had tremendous potential for synergies and growth. I saw so many untapped opportunities.

Gaining Control

We faced two major obstacles to fixing the problems and achieving the potential these businesses offered.

First, change is difficult with so many different shareholders, most of whom didn't share our vision or our values. We sold several companies, and used the proceeds to buy out the other shareholders in the companies we chose to keep. The result was a single holding company with wholly owned operating subsidiaries.

Second, there was little that my brother and I could do from the Board level. The Board's role is to supervise management, not run the business. And supervising is very difficult when management controls the agenda and filters information to their advantage.

So we consolidated a majority of the businesses into a single operating company, and I took on the role of CEO of that.

The Problem

Now, I had to make this company work. What did I get myself into!?

Sales had grown threefold over eight years. Then we hit the wall, and growth stopped. With a proliferation of new lines of business, the number of departments burgeoned from 38 to 67. We had outgrown our physical and IT infrastructure, and systems were breaking down. Our business model was not scalable.

Business-unit managers insisted they needed all the support functions reporting to them. I questioned why we needed three different call centers, none particularly well managed, for example. Managers insisted that if they're to be held accountable for their results, they needed to control these resources. Many actually threatened to resign if I interfered with their fiefdoms.

In their minds, a large staff gave them power. It didn't help that our job-grading system rewarded those with more headcount.

Meanwhile, we struggled with a lack of sufficient talent to go around. With all this decentralization, we couldn't attract strong leaders or needed specialists to any of these functions.

Perhaps most telling, the company was operating at a heavy loss. I had banks calling me, concerned about our high levels of debt and deteriorating financial results.

Organizational Systems Approach

As I tackled one problem, ten more popped up. It was like patching a leaking boat, and I was the captain sinking with it! I thought about the situation, and came to two conclusions:

One, I could not afford to go on solving specific business problems, one at a time. After all, I only had so many hours in a day. I knew I needed to focus all my attention on *root causes,* and design an *organizational system* that would solve problems on an ongoing basis, with or without me.

Of all the aspects of our organizational system, I knew I needed to address structure first. Should we completely consolidate the business units? Or just centralize support services? And if we do, how can we still hold managers accountable for their businesses?

Two, I knew there was no way I could be alone in these problems. Thousands of companies must experience these growing pains. I couldn't afford organizational design mistakes or disruptive experiments; that's way too expensive and time consuming. A trial-and-error approach was not an option. I needed help.

Discovering the Principles of Structure

As is customary whenever I have a problem to solve, I went to Amazon in search of a "how to" book on organizational design. I studied several books, most HR oriented, where structure was depicted as an art rather than a science. They essentially said that structure is the product of the style and preference of the CEO.

It was frustrating. I found no real answers in that view. Surely there must be a scientific approach to structure, and a systemic approach to building a healthy organization.

Finally, I came across the work of Dean Meyer. I read his book on structure (an earlier version of this book) and immediately got hooked. In fact, I read it twice, highlighted it, and summarized it. Then I read other books by Dean, for example, one on decentralization and one on leading transformations. This was the systemic approach I'd been looking for.

Our Restructuring Process

While his books laid out the theory, I wasn't clear how to implement such a complex reengineering of the whole organization. So I decided to contact Dean. I thought there was little chance he'd reply to my email. To my surprise, he answered the next day and we scheduled a call.

In the first introductory call, Dean offered some coaching over the phone. He made a lot of sense, so I came back for more. After several sessions, we scheduled Dean's first visit to our company.

Dean explained how we could design and implement a new structure in an open, participative process that engaged our leadership team. Together, we crafted a detailed project schedule, and a communication plan (which was equally important).

Then I announced the plan to our leadership team. There were about 50 people in the room. My message was brief:

"We need to restructure our company. My promise to you is that no one will lose employment because of organizational changes. However, all of you will lose your titles as we work together on a 'clean sheet of paper' design. Please throw your business cards in the trashcan as you leave this room. I will rehire you into the new positions that we'll design together."

You could hear a pin drop. People were stunned. Some were furious. I had just destroyed their fiefdoms.

But with Dean's facilitation, we got them working on the design of the new organization. Dean taught them the Principles and the Building Blocks described in this book. Then, we analyzed which lines of business were present in each department. We even color-coded them by Building Block, and it was quite a colorful chart! (This was the Rainbow Analysis described in Chapter 17.)

The gravity of the problem quickly became evident to everyone:

* **Fragmentation:** Functions were scattered. There were no real centers of excellence. The color coding made the extent of the problem very graphical; and people began to understand the waste, lost economies of scale, and lack of synergies.

* **Gaps:** There were many critical functions that everybody thought somebody else was doing, but in fact no one was really accountable for them.

* **Rainbows:** When we color-coded each group by line of business, we saw a lot of "rainbows." Everybody was doing everything. With multiple functions under each leader, nobody could focus and specialize to the point of being particularly good at anything.

We put the lines of business on post-it notes, and sorted them into Dean's five Building Blocks on posters around the meeting room. Then, we jointly designed the new structure, sorting those post-its into stacks that would represent the departments under me.

I was afraid this would be a political free-for-all, with everybody fighting to rebuild their fiefdoms. But in fact, the Principles and Building Blocks, along with Dean's facilitation, led us to a fact-based discussion of what would be best for the company.

The New Structure

To their credit, most participating leaders understood the benefits of becoming one integrated organization. And Dean explained how everybody could be an empowered entrepreneur running a small business within a business, and how teamwork could give everybody access to the right specialists anywhere in the company, without having to have them reporting to you.

So the leadership team opted for a fully consolidated structure. We established product managers (profit centers) for each of the product lines — a list that included food and household products, lubricants, and real-estate financial services.

Everything else became an internal shared service. Yes, everything! That includes sales, marketing, manufacturing, logistics, customer service, business planning, as well as all the traditional support services like IT, HR, and Finance. All were there to serve the product managers (and each other).

We opted for the ideal — the maximum in synergies and economies of scale. And every box on the organization chart was designed as a business within a business — an entrepreneurship chartered to serve customers inside the company or outside.

The new structure was simpler, cleaner, and easier for everyone to understand.

And then, we started investing in teamwork, understanding how all these businesses within the business provided their services to companywide teams (the process described in Part 8 of this book).

The Hardest Part

There certainly was some resistance, with a few leaders still trying to build fiefdoms. And there were leaders who just weren't able to understand the new operating model; it wasn't the way they'd always done things, or they didn't have the leadership skills to succeed in that empowered, accountable environment.

A challenge for me was resisting the temptation to compromise the structure to accommodate people. In fact, the hardest part of my job was letting go the people who needed to leave, and recruiting the right talent. This has taken a few years. It was personally painful, and drained huge amounts of my energy. But it was the right thing to do, really the only thing to do.

Impacts on Culture

This new structure hinges on a business-within-a-business model. Every group is defined as a business that "sells" products and services to customers, inside or outside the company. (We don't cross-charge for internal services.)

This requires that managers behave as entrepreneurs. I expect them to deliver high levels of customer service at competitive rates (costs), and to manage their businesses as if they were their own.

Contrary to popular belief, entrepreneurs are not motivated by money. In talking to my peers (other successful entrepreneurs), they're driven by the desire to become better versions of themselves. They value the freedom to decide what to do with their time, while they know they're measured on results (not effort). And at the end of the day, they're proud to see their work flourish and do some good in the world.

This is exactly the kind of thinking I want to permeate every corner of our company. And it's really starting to take hold.

The contrast is remarkable. Before the restructuring, business units were insular, and the culture was hierarchical. Now, it's open, empowered, and collaborative.

Before the restructuring, support functions thought their job was to control the business units, not serve them. Now, every function is customer focused and service oriented.

Before the restructuring, all except the few most senior executives believed their job was to manage resources and processes. Now, everyone is accountable for delivering results.

As we empowered our internal entrepreneurs, motivation went through the roof. People couldn't believe they had the authority to run their businesses their way! Of course, we were very careful to make sure that accountabilities matched managers' authorities.

Our entrepreneurial culture unleashed everyone's creativity. Here's one great example: One manager told me that his team was motivated to grow their business and wanted to sell their services to external customers. We analyzed this and decided it would be a good idea. It would create economies of scale that would reduce internal costs; and it would improve the quality of internal services.

With Dean's advice, we put two conditions on selling internal services externally: 1. External sales must not interfere with the cost and quality of the services sold internally. 2. You must not sell services to the company's competitors.

Within these two constraints, other areas began to sell services outside the organization, now including IT, Logistics, and Merchandising Services. Entrepreneurship was contagious!

Our new entrepreneurial spirit applies within the company as well. For example, our Health, Safety and Environment (HSE) group was doing great work in manufacturing sites. When these bright people were empowered to run HSE as a business, they sold their services to other departments like Logistics and Administration.

Our Operations Research team extended their services beyond truck-route optimization. Now they're helping the Warehouse optimize layouts, and Sales plan its territories and routes.

Also, in the past, staff had little regard for costs. Budgets were padded, and cost control was left to our Finance group and ultimately to me. The haggling over budgets led to an unsatisfactory compromise; I couldn't really be sure we'd cut out all the fat, or that we hadn't cut into the bone.

Now, managers have a clear understanding of what businesses they're in, and who their competition is (outsourcing). So everybody is more cost conscious.

I know we have more to do on our financial and governance processes — what Dean calls the "internal economy." I look forward to the day when budgets are based on the services each group provides; all manager have profit-and-loss statements; and each function's costs are benchmarked against its competitors.

I've seen some seasoned leaders struggle with these changes in our culture. I think that's good. It's developing real leadership skills. Another nice benefit is that some young talent is thriving in this environment; these are our future senior leaders.

Structure is not the same as a comprehensive treatment of culture; I know we have more to do. But structure has had a tremendous positive effect on our culture.

Business Results

At the beginning of our transformation, we lost sales and EBITDA. This was in part due to our shedding companies where we couldn't buy out other shareholders, and divesting or closing several less-profitable lines of business.

But of course the restructuring had a cost, too. It took a lot of our leadership team's time and attention, which may have taken our eyes off business challenges to some degree. Plus, we've had to invest in bringing in some qualified senior leaders that we'd been missing in the past structure, for example, over the consolidated sales, engineering, and manufacturing groups.

But after that initial stage, the new structure has been an engine for our growth.

Part of that growth came from improved performance in every function. People are better focused and more specialized, and individual accountabilities are much clearer. This filtered out the low performers, and enhanced everybody else's performance.

Career paths were a problem when little pockets of a given profession were scattered among our various business units. Now, we're able to attract excellent talent into well-focused jobs, with better career paths in each profession.

For example, IT used to be comprised of small pockets of staff who tried to do everything for their respective companies. Now IT is a single group, with different sub-specialties. IT staff now learn from one another. They have better career opportunities. And economies of scale have enabled more training, better tools, and improved infrastructure.

Also, we eliminated redundancies and drastically reduced internal friction. This saved money, and improved staff's job satisfaction. We now have a very positive, cohesive team.

Beyond that, we found business synergies which otherwise couldn't have happened. For example, we achieved tremendous efficiencies in Transportation when we integrated the traffic from all our business units into a single delivery service.

An even better example came from our lubricants business. Originally, it was run as a separate company, selling lubricants to industrial customers. Now that all product lines share sales and distribution services, we also sell oil to consumer outlets including 40,000 mom-and-pop stores. This has resulted in significant growth for the brand in the past three years.

And conversely, we sell food to cafeterias within our industrial customers, companies that previously only bought lubricants.

Our structure is highly scalable. For example, we acquired a bleach company. Everything integrated perfectly into our well-designed structure, and everybody was clear on what to do. Bleach became a new product line within our existing product-management group. Its manufacturing plants fit in nicely under our existing operations group. Bleach is distributed through our existing warehouses and transportation services. And of course it's sold through our existing sales forces.

And when we won the distributorship of lubricants in a new country — a huge increase in revenues for us — we were able to clearly define accountabilities for its success in all our functions.

Of course, the real proof is in the numbers. In the past three years (since the restructuring), we're back on track with growth in sales (22 percent per year). And after a decade of losses, we are now profitable. In fact, EBITDA has been growing at a sustainable 44 percent annually.

I honestly don't think we could have attained nearly these results without our new structure. And this is just the beginning.

I am certain this scientific approach to organizational structure has profoundly transformed our company. It's given us the right framework to continue building a profitable and scalable company for many years to come. I'd have to say that a principle-based structure has been one of the best investments I've made.