FROM THE GROUND UP

Six Principles for Building the New Logic Corporation

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Chapter One

Changing the Assumptions

The New Logic Principles for Organizing

I got my first hint of the new logic of organizing in 1961 when I read the classic book *The Human Side of Enterprise* by Douglas McGregor.[1] McGregor distinguished between two paradigms of how people can be motivated to perform in organizations. One, which he called Theory X, assumed that people had to be driven by extrinsic rewards (money and other tangibles), punishments, and bureaucratic control systems. The other, which he called Theory Y, argued that individuals can be intrinsically motivated by interesting work and can direct and manage their own behavior. At that time, Theory X guided the design and management of almost all large organizations. McGregor noted that its assumptions were so well accepted that they were rarely explicitly stated and, in fact, were neither debated nor challenged. He argued that a paradigm (or, as I call it, logic) such as Theory X is so fundamental and so critical in determining how an organization is designed that a new logic must replace it in order for new designs to be created and higher performance levels to be achieved.

Although McGregor's statement of Theory Y intrigued me because it was a simple but radical beginning for a new logic of organizing, I also wondered how practical it was. It was not clear how it would play out in the design of such key features of an organization as its financial information system, its control systems, and its formal structure. Still, McGregor's writings, along with those of Chris Argyris and Rensis Likert, opened the door to questioning the old hierarchical model and began the development of the new logic of organizing.[2]

Since McGregor's work on Theory Y, a number of new approaches have been suggested and are competing to replace the old bureaucratic logic. As was mentioned in the Introduction, some of these, such as reengineering and total quality management, have taken on the characteristics of a fad and have been wildly oversold. It would be wrong, though, to conclude that they do not make important points. They do. The problem is that they are not comprehensive. The challenge is to define not just a program or a limited approach to improving organizations but a new complete approach to organizing: one that begins with the statement of a new paradigm that replaces traditional logic principles with new logic principles.

OLD LOGIC PRINCIPLE: Organization is a secondary source of competitive advantage.
NEW LOGIC PRINCIPLE: Organization can be the ultimate competitive advantage.

OLD LOGIC PRINCIPLE: Bureaucracy is the most effective source of control.
NEW LOGIC PRINCIPLE: Involvement is the most effective source of control.

OLD LOGIC PRINCIPLE: Top management and technical experts should add most of the value.
NEW LOGIC PRINCIPLE: All employees must add significant value.

OLD LOGIC PRINCIPLE: Hierarchical processes are the key to organizational effectiveness.
NEW LOGIC PRINCIPLE: Lateral processes are the key to organizational effectiveness.

OLD LOGIC PRINCIPLE: Organizations should be designed around functions.
NEW LOGIC PRINCIPLE: Organizations should be designed around products and customers.

OLD LOGIC PRINCIPLE: Effective managers are the key to organizational effectiveness.
NEW LOGIC PRINCIPLE: Effective leadership is the key to organizational effectiveness.

This chapter outlines and contrasts the most important assumptions and elements of both the traditional logic and the new logic approach. It introduces a new way of organizing and managing based on the new logic principles.

Although they will be discussed separately in this chapter in order to clarify what each means, the six new logic principles represent an integrated approach. Thus they should not be adopted separately. Instead, they need to be taken as a whole and used as the foundation of a comprehensive approach to organizing and managing that involves new approaches to reward systems, structure, work design, communication, measurement, and human resources management—in short, all the systems and practices that are critical to organizational effectiveness. It is precisely for this reason that the first principle argues for organization as a powerful source of competitive advantage.

OLD LOGIC PRINCIPLE: Organization is a secondary source of competitive advantage.
NEW LOGIC PRINCIPLE: Organization can be the ultimate competitive advantage.

The new logic begins with the assumption that management systems, processes, and structures can be the keys to building a competitive advantage if they allow an organization to perform in a way that competitors cannot. With the right kind of organization, new products can be brought to market faster, the quality of products can be higher, and customer needs can be met more swiftly and completely.

This contrasts with the traditional bureaucratic model in which the sources of competitive advantage are assumed to include superior financial, human, and natural resources; market access; and exceptional technology. In some cases, these traditional advantages continue to be powerful. A good supply of cheap crude is still an important competitive advantage in the oil industry, for example. It is still a major advantage for Japanese and French companies to have unencumbered access to their protected domestic markets.

The Japanese domestic distribution system, for example, has long protected its market against U.S. food distribution firms and made it difficult for U.S. car manufacturers to enter the market. But these traditional sources of competitive advantage are becoming less important and less sustainable for a number of reasons.

Because capital now moves freely about the globe, it is difficult for any company to gain a competitive advantage through superior access to financial resources. Similarly, human talent is hard to sustain as a source of competitive advantage when individuals, as we have already discussed, are increasingly willing to move from one company to another, in some cases taking critical knowledge and technology with them.

Equally important is the rising education level around the globe and the new access to highly educated talent in many countries that, until recently, did not participate in the global economy. The fall of communism, the rise of free trade, and the dramatic growth of capitalism have added more than a billion people to the world economy. Many of them are unskilled and willing to work for a few dollars a day, but some are highly skilled. For example, skilled computer programmers are now available in the former Soviet Union, and many Asian countries have skilled engineers and production workers.

Finally, technology is being developed by more and more countries and companies. Japanese and Korean companies, for example, now spend a great deal of money on technology development and have proven to be adept at gaining access to technology developed elsewhere.

A classic example: going into the 1980s, IBM had all the traditional competitive advantages. It had the highest possible financial rating and, as a result, access to low-cost capital; world-class core competencies in the right technologies; research labs that were (and still are) respected for their ability to innovate and make technological breakthroughs; a great global brand name; and international subsidiaries (IBM Europe and IBM Japan) that had access to markets around the globe. Indeed, at the beginning of the 1980s, IBM looked so powerful that the U.S. government was suing it for antitrust violations because they thought no one could compete with them.

However, as the 1980s played out, it became clear that IBM lacked the essential ingredient it needed in order to maintain control over the information- and data-processing marketplace. It lacked a strategy and organizational approach that fit the realities of a rapidly changing, dynamic, and extremely explosive market situation. It was slow to develop and market new products, particularly personal computers. It was a high-cost competitor because of its extensive overhead. And it was not good at focusing on customers and what satisfied them.

Before long, IBM was losing market share to companies that did not even exist at the beginning of the 1980s. Apple, AST, Dell, Compaq, Gateway, and Sun Microsystem all took market share away from IBM, despite the fact that they began the decade with few if any of the traditional sources of competitive advantage. Their one advantage: they understood the market better and were organized to perform in ways that IBM could not.

Realizing this, IBM tried to match its competitors by creating a new personal computer unit in the early 1980s. The leaders of it were told to break the IBM mold and do what was needed to produce a competitive product. They did just that, by changing IBM management practices in many ways, and by starting a new location in Florida. The effort made IBM a major player in the PC business, but a few years later the unit was closed down and the PC business was integrated into the rest of IBM, with a resulting decline in performance. As will be discussed in more detail later, the start of a rogue unit and its eventual shutdown are common events when large bureaucratic organizations try to change.

In one respect, focusing on organization and management in order to gain competitive advantage is not new. Organizations have always tried to do a better job of organizing and managing themselves. However, they have operated within the traditional framework. They have accepted the wisdom of using established management methods such as job descriptions, performance appraisal systems, budgets, and hierarchies and believed that the way to gain an organizational competitive advantage was to use them more skillfully. This, in fact, is precisely what IBM did and did well. It was often recognized as the best-managed company in the world.

No doubt, improving existing practices can lead to some performance improvement, as in the case of streamlining a propeller-driven airplane or giving it higher-powered engines. But it does little to differentiate one organization from another, and it is unlikely to produce dramatic gains in performance. To get those gains, new technology—like jet engines—must be acquired. The new logic argues that a superior and well-executed approach to organizing, one better suited to the realities of today's work force, global competition, and technology than the bureaucratic approach, can provide a significant and sustainable competitive advantage—an advantage that is based not on continuous improvement or incremental improvement but on discontinuous change and dramatic performance improvements.

Convincing evidence that management practices can provide competitive advantages is beginning to accumulate.[3] A study done in 1995 by my Center for Effective Organizations found that companies in the Fortune 1000 which were high users of employee involvement and total quality management had higher returns on equity (22.8 percent versus 16.6 percent), higher returns on sales (10.3 percent versus 6.3 percent), and overall higher productivity than did low users.[4]

There is also considerable evidence from companies that specific management practices make a difference. For example, Motorola data indicate it gets a 30-to-1 return on money it spends on training. Xerox says it has cut manufacturing costs by 30 percent by cooperating with its union. For years, Procter & Gamble has argued that its use of self-managing work teams in its plants has reduced manufacturing costs by 30 percent or more. All told, a growing body of evidence supports the argument that by putting together the right management systems, organizations can gain a significant competitive advantage.

As discussed in the Introduction, organizational capabilities are central to this new way of thinking about organization as a competitive advantage—especially when they are developed to a level that can produce superior performance. A number of studies of the automobile industry from 1970 to 1995 have demonstrated just how important organizational capabilities can be.[5] When the Japanese car companies started successfully exporting cars to the United States, the domestic automobile industry blamed a host of factors for their loss of market share. In the early 1980s, it started to become obvious that Japanese auto firms were winning against U.S. firms largely because they were "better managed." Since that time, study after study has shown that the better quality and productivity in Japanese automobile companies come not from technology or different government regulations but from superior quality management systems, from better employee relations, and from the use of integrated design and production teams to speed up the new-product development process.

Once the U.S. auto companies began to recognize that their lack of organizational capabilities was putting them at a competitive disadvantage, they began to respond and have gone on to close much of the gap between them and their Japanese competitors. Chrysler, Ford, and General Motors have all undergone massive restructurings that have introduced total quality management, eliminated levels of management, and changed their relationship with their unions. As of 1996, though, none of them had yet reached the manufacturing quality and productivity levels of their Japanese competitors. J. D. Power surveys still show Honda, Toyota, and Nissan with fewer manufacturing defects than Chrysler, Ford, and General Motors, clearly demonstrating how management systems can provide a long-term competitive advantage.

Although it took place in 1984, I still remember clearly an interview that I did with a Japanese manager who was restarting the General Motors assembly plant in Fremont, California, that was to become the NUMMI facility. Toyota and General Motors had decided to reopen this formerly unsuccessful plant as a joint venture with Toyota managers in charge because of Toyota's success in running assembly plants with their "lean production" approach.

The manager that I interviewed said that because workers who had worked previously in the GM plant were going to be rehired, they needed to receive twice as much training as Toyota normally would give to workers who had never worked in the auto industry before. When I asked why, he told me that he expected that half of their training would be devoted to unlearning GM habits and the other half to learning the correct habits for the new organization they wanted to create. He went on to add that this would double the cost that would be required for the typical Toyota plant start-up but that it would result in performance levels that no U.S. plant could equal.

So while an organization still needs good human resources, capital, and technology to win in the marketplace, they have become just the ante to get into the game, something all competitors are likely to have. Today, organizational capabilities are the key to winning, because they can provide difficult-to-match performance.

> OLD LOGIC PRINCIPLE: Bureaucracy is the most effective source of control.
> NEW LOGIC PRINCIPLE: Involvement is the most effective source of control.

In every organization, there must be a way to control and coordinate individual activities; otherwise, individuals cannot accomplish the collective goal that brought them together. The debate in organization theory about control is not about whether it is necessary but about how it is best achieved. The traditional logic (Theory X) argues that control can best be obtained through extrinsic rewards, close supervision, hierarchy, and careful delineation of responsibilities and accountabilities. What Theory X ignores—and what McGregor recognized—is the real-life response of employees to controls. Sometimes workers will be obedient, but they often put as much effort into sabotaging the controls as doing their jobs. Ever since I worked my first summer job in the trucking business, I have been impressed with the ingenuity of the American work force when it comes to defeating management control systems. Somehow, the individuals I worked with always managed to get a daily nap without being caught and were able to manipulate the foreman so they got to work as much overtime as they wanted.

Years later, as a consultant to the auto industry, I saw example after example of how employees eased their work loads by shortcutting work methods and procedures even though they were under close supervision. In other industries with assembly lines, I have seen employees figure out ingenious ways to put the product together incorrectly, simply to prove to themselves that they could do it. They found it much more satisfying to beat the controls than to conform to them and make the product as specified by the company's engineers and work methods experts.

The new logic of organizing has a solution to counterproductive responses by workers. It builds on McGregor's statement of Theory Y by arguing that if individuals are involved in their work and in the business of the organization, they will not only figure out what they should be doing and do it, they will also provide their own controls. It further argues that when people are involved in the business, their energy and creativity will be focused on positive results such as improving production processes and creating better products and services, instead of on beating the system. As a result, much of the costly, bureaucratic control structure in traditional hierarchical organizations becomes unnecessary.

Perhaps the simplest way of expressing how control works in the new logic is to say that it is better to have a customer and the external market controlling an individual's performance than to use a set of bureaucratic rules, procedures, and a supervisor for control. In order to move control into the hands of the market or customer, the entire organization has to be structured so that employees can get feedback from customers about their performance and their responses to customer needs. This can guide performance in ways that a supervisor or a system cannot duplicate, because the customer—not some person or system that is acting as a proxy for the customer—is the ultimate arbiter of success. The customer is more likely to point employees in the right direction and to prompt change as the customer and the competitive environment change.

Admittedly, hierarchy can allow lower-level employees to act quickly with a high degree of precision and conformity through programmed decisions. But the downside of programmed actions is that strict guidelines and controls may prevent employees from acting on their own to meet a demand or to solve a unique or particularly nettlesome problem. The result all too often is slow decision making and poor-quality decisions when it is not business as usual.

I experienced a good example of failed hierarchical decision making when a recent flight that I was scheduled to take was several hours late. Because of the delay, this dinner flight was not going to leave until 10 P.M., and the passengers at the gate wanted to know if they could get a dinner voucher for the airport restaurant. The gate agent responded that he could not make the decision and would have to call his supervisor, which he did. Unfortunately, other flights were late, and the supervisor was busy. By the time the supervisor did arrive, an hour later, most customers had left the gate area angry and hungry. And even though he did give vouchers to the remaining customers, that did not help assuage their negative impressions of the airline, and it did nothing for the customers who had already left to get dinner on their own.

Programmed decisions dictated by hierarchy are particularly problematic when it is difficult to anticipate what decisions need to be made. With the business environment changing rapidly and with more complex situations, products, and services, fewer and fewer of an organization's actions lend themselves to carefully planned, programmed decisions. So unless organizations abandon the bureaucratic approach, they end up with more and more hierarchical "approvals" needed for decisions. As a result, decision makers are overloaded, decision making is slowed (as with my delayed flight), and even simple transactions turn into complicated ones.

Decision quality also can become a problem under a hierarchical approach. Decisions made at higher levels often miss the critical subtleties that the people who are close to the problem and the customers know intimately. Besides, in service situations, telling an irate customer you have to get approval or you are just following the rules does not help to quell anger and dissatisfaction. Customers want immediate action on their requests and problems. They want the first person they encounter to satisfy them. Nordstrom, the department store chain, recognizes this and has given its customer service associates only one rule with respect to refunds and exchanges: satisfy the customer. Ritz-Carlton Hotels has done the same; it too says "satisfy the customer" and gives each employee the power to spend thousands of dollars to do it.

Effective involvement depends on developing an organization structure in which individuals feel that they are accountable for their own and their organization's performance because they have customers that they serve who provide them with feedback. An organization cannot meet this challenge just by grafting customer satisfaction measures onto a hierarchical structure that relies on bureaucratic and supervisory control as well as extrinsic rewards (pay, bonuses, and so on) and punishments (such as firing) in order to coordinate behavior and ensure that customers are satisfied.

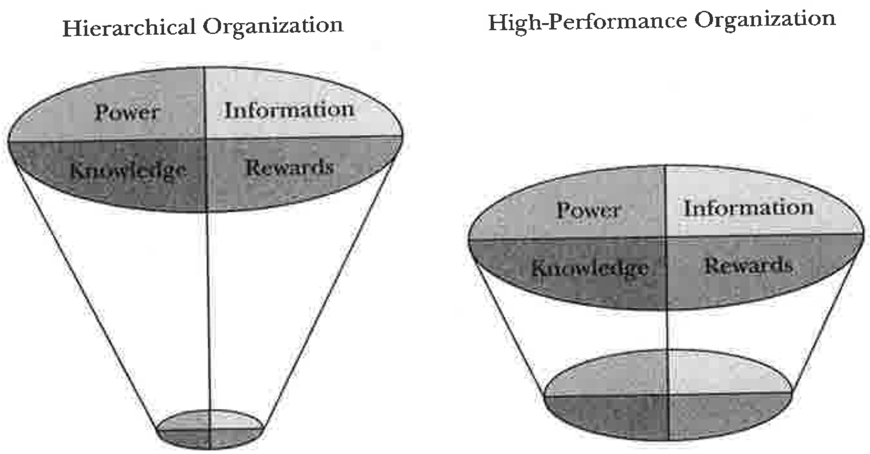
The new logic calls for replacing bureaucratic controls with the following four components of effective employee involvement:

- Information about business strategy, processes, quality, customer feedback, events, and business results
- Knowledge of the work, the business, and the total work system
- Power to act and make decisions about the work in all of its aspects
- Rewards tied to business results, individual growth, capability, and contribution

When these four elements are appropriately positioned, involvement can be an effective source of control and organized action.[6]

Involvement requires that the amounts of information, knowledge, power, and rewards that individuals have be balanced and that all employees have significant amounts of them. This does not mean that those at the top have any less knowledge, information, power, and rewards; it does mean that the organization becomes flatter (that is, it has fewer levels) and that the information, power, knowledge, and rewards that were in the middle of the organization are pushed down so that they are spread throughout the organization. This is what makes effective decision making and involvement possible at lower levels in an organization. Figure 1.1 presents this thinking in graphic form.

Figure 1.1. Power, Information, Knowledge, and Rewards.



It shows that involvement-oriented and traditional organizations position these four key elements very differently. In well-designed, traditional, hierarchical organizations, individuals at the lowest levels have little information, power, knowledge, and rewards, while individuals at the top have large amounts of all four. In the involvement approach, individuals at the lowest levels have much larger amounts of these elements.

Recently, as the result of some consulting work that I was doing with General Electric, I saw this flattened, cone-shaped approach to the four elements taken one step further. It showed a cone that was wider at the bottom. I was told this was where GE is heading. Not only don't I think GE is heading there (I cannot see an assembly line operator having more knowledge, information, power, and rewards than the CEO, Jack Welch), I do not think they should be. As will be discussed in Chapter Three, senior management needs to set the direction for the organization, and this requires and warrants a larger amount of these four elements.

Balance among information, power, knowledge, and rewards is critical to effective involvement. In general, they are well managed and balanced when individuals are rewarded based on how effectively they exercise the power that is associated with their position and when they have the information and knowledge to exercise their power effectively. Individuals should not have more power than they can exercise effectively given the amount of information and knowledge they have, nor do they need significantly more knowledge than they can use given their power and information. Having more power than knowledge or information is particularly dangerous, since it can lead to poor decision making.

Finally, as will be discussed in more detail in Chapter Nine, rewards must fit the kind of power individuals exercise, the type of knowledge they have, and the information they receive. Otherwise, individuals will not be correctly motivated, and there will be a lack of accountability for performance because there are no consequences attached to it.

In a well-designed, high-involvement organization:

- Individuals understand the business. They know its strategy, how it is doing, and who their customers and competitors are.

- Individuals are rewarded according to the success of the business. They are owners and share in its performance so that what is good for the business is good for them.
- Employees are able to influence important organizational decisions. They decide on work methods, participate in business strategy decisions, and work with each other in order to coordinate their work.

In summary, the new logic argues that the best control comes from the marketplace and the customer. Through involvement, it creates employees who act like owners and managers, who exercise self-control because they are involved in satisfying the customer and meeting market demands. It rejects the traditional approaches to control as too expensive, ineffective, and in many cases dysfunctional.

> OLD LOGIC PRINCIPLE: Top management and technical experts should add most of the value.
>
> NEW LOGIC PRINCIPLE: All employees must add significant value.

The new logic turns the traditional equation of who adds value to the organization's products and services upside down. It constantly pushes for individuals throughout the organization to add more value by

- Doing more complicated tasks
- Managing and controlling themselves
- Coordinating their work with the work of other employees
- Suggesting ideas about better ways to do the work
- Developing new products and ways to serve customers

This is in sharp contrast to the traditional hierarchical organization where individuals at the lower levels carry out prescribed, routine, low-value-added tasks in a controlled manner while senior management adds major value through their work on organizational design, strategy, and the coordination of the work of different groups and functions.

There is little chance for employees to add value to simple repetitive work. Many relatively untrained, low-wage workers in companies and countries around the world can do such work, making the people who do it a commodity. This accounts for the current movement of many industrial jobs out of developed countries.[7] Employees who are doing simple repetitive work in the United States, western Europe, and Japan often are simply overpaid relative to the global value of their skills and the value they add to products. Sometimes the only solution to this problem is to move work to low-wage companies and countries. But this is not always the right or the best answer. The "overpayment" of employees may be the result of organizations following the old logic and as a result not allowing its employees to add all the value that they can.

All too often today, when individuals try to add value through making suggestions or managing themselves, the work systems will not let them. Thus, even though employees earn wages that suggest that they add significant value, the organizational designs and structures—which support top-down decision making and control—do not allow them to add it. This is precisely how companies in developed countries end up with wage levels that are not globally competitive. If they want to compete in a global market, they must create high-valued-added work that requires skills and knowledge. Individuals must have the opportunity to manage themselves and coordinate their work with that of their co-workers.

The relationship between compensation levels and technical knowledge is relatively straightforward and clearly demonstrated. Less straightforward—and perhaps less well established—is the relationship between affordable wage levels and management practices. Simply stated, if work is designed so that employees take on many of the management duties that are typically done by supervisors and staff specialists, then they warrant higher levels of pay. They are in essence adding the value that a highly paid manager or someone in a technical staff role might otherwise contribute.

Information technology as well as advanced automation processes in the manufacturing world can help to transform work. Automation in manufacturing, such as the use of robots, can create work that involves high levels of problem solving, technical complexity, and coordination and can thus make it possible for employees to add considerable value. Employees end up doing programming, skilled maintenance, and machine setup instead of simple routine manual tasks. The downside is that fewer employees are needed. The upside is that those who remain can be paid good wages because they contribute more to organizational effectiveness.

Today, given the realities of a global work force, it is critical to structure organizations so that in high-wage countries employees at all levels add significant value. Organizations can no longer afford the combination of high pay and low value-added work and workers. By making the assumption that individuals at all levels of the organization can add significant value, through new logic approaches to organizing, and through the use of information technology, new logic organizations can be more cost-effective than high-wage old logic ones and in some cases even more effective than low-wage ones. The key is that individuals must know more and do more. If, by following the principles of the new logic, an organization's work can be designed to help create high-value-added jobs, it can be a win-win situation for organizations and for individuals. Organizations can end up with a competitive advantage, and individuals can end up with higher-paid, more rewarding work.

OLD LOGIC PRINCIPLE: Hierarchical processes are the key to organizational effectiveness.

NEW LOGIC PRINCIPLE: Lateral processes are the key to organizational effectiveness.

The new logic puts much less emphasis on hierarchical reporting relationships and much more on lateral, or side-by-side, relationships. It stresses that effective lateral relationships are the key to creating organizations that can perform well on speed, cost, quality, and innovation. Both reengineering and total quality management address this point: they emphasize that when employees at different steps in the work process coordinate their behavior effectively, it can lead to significant gains in organizational performance.

It's not that the traditional logic denies the importance of lateral relationships. Quite to the contrary, it views them as so important that they must be closely controlled and monitored through a hierarchical management and information-system structure. However, there are two problems with the hierarchical approach.

First, individuals tend to compete with each other to move up the hierarchy; thus, employees end up spending their energy and efforts trying to please the boss and the boss's boss rather than concentrating on what is important—that is, relating to customers, vendors, and other employees at their level with whom they need to work in order to produce a successful product or service. This is hardly surprising given that the organization chart shows them reporting to a higher-level manager, not to a peer or customer. Indeed, the only formal connection among peers occurs because they all report to the same level of management.

Second, there is often a lack of accountability for important organizational goals as employees are simply engaged in individual activities, rather than trying to accomplish important objectives. Most hierarchical organizations group employees not by customer or product but by common activities such as sales, production, and accounting. They put those people who do the same things together rather than grouping people who are trying to accomplish the same goals and who are working on the same process.

For example, in the purchasing department of a Ford plant I studied, separate groups communicated with suppliers, checked the price on the bill, matched the purchase order to the bill, wrote the check, determined whether the material had arrived, and so on. A bill passed through ten pairs of hands before it was paid. The result: no one was responsible and no one had an overview of what was happening, mistakes were common, payments were slow, and suppliers could never find out what had happened to their bill.

This is precisely why an organization that operates laterally can have an enormous competitive advantage. When all employees who are working on a product work together and share a common purpose, it increases the chance that the product will be well designed and manufactured. Similarly, when all who serve a particular type of customer work together, they can go beyond their function or step in the service process and grow to know and care about how customers are being served. This can lead to more ownership of both jobs and customers and, thus, to better service and products.

It can also lead to faster decision making and service because information does not need to be moved to someone higher up to integrate it and make a judgment. It can be done at the point of contact with the customer or product—a particularly crucial advantage in rapidly changing businesses.[8] Further, because a laterally focused organization needs fewer control systems than a hierarchy, it can eliminate levels of managers and reduce overall costs.

Only if all of an organization's systems are designed to support it can an organization truly operate in a lateral manner that produces superior performance. This means changing the human resource management systems, the communication systems, and the work structures of vertical organizations to ones that are consistent with a lateral approach. For example:

- Employees need the ability to meet in groups and problem solve together.
- Reward systems must be in place that reflect peer input and reward group and team behavior.
- Team-based work designs are necessary.
- Communication systems must move information and customer data laterally without going through levels of supervisory control.
- Managers need to facilitate lateral interaction and learning.

As will become evident in the discussion of the next principle, organization structure is also crucial to creating lateral relationships that reduce costs, improve quality, and speed decision making.

> Old Logic Principle: Organizations should be designed around functions.
>
> New Logic Principle: Organizations should be designed around products and customers.

The traditional logic of organizing emphasizes functional excellence and expertise and assumes that good performance grows directly out of these qualities. It further assumes that functional excellence is the result of getting the best possible individuals in each specialty and putting them together. This enables functional specialists to learn from each other as well as get training and development tailored directly for them. The managers, also experts in the specialty, are charged with developing the department's technical competence. In this approach, staff groups in areas such as human resource management, finance, and law typically review the plans and operations of the other parts of the organization and determine whether they are up to their standards. If this all sounds eminently sensible, it is because most organizations have been structured and managed this way for decades.

The main flaw in this approach: no single function—not human resource management, not finance, not marketing, not R&D, and not even manufacturing—can, by itself, make products or serve customers. None alone can create satisfied customers. Only when individually strong areas of expertise are brought together to produce high-quality, innovative products and services that are sold at an attractive price does the organization become effective and satisfy customers.

The new logic does not say that there is little need for strong expertise in particularly critical functions. But it does stress that it is possible to have strong functional expertise and not have a particularly effective organization, because traditional, functionally structured organizations have trouble developing the teamwork and coordination that lead to successful products and services.

The first course I took in organizational design helped establish in my mind the importance of fitting individuals with different skills together in order to form effective teams. Early in the course, Pete Newell, who had just finished coaching the 1960 gold-medal U.S. Olympic team, talked to us about putting together a winning basketball team. His team was an early "dream team" with a number of excellent college players (Jerry Lucas and Oscar Robertson, to mention two of the most famous). The members of the class sat back with an attitude that said, How could anyone lose with a team like that? As Newell pointed out, despite the individual excellence of each of the players, there is a major problem in putting a team of all-stars together. In college, each one of these star players had the ball about 40 percent of the time when their team was on offense. Clearly, there was not enough time, nor enough balls, for each of them to do that on the Olympic team. Newell had to train virtually all of them to play without the ball for the first time in their lives.

The same challenge often exists in large, complex organizations with individuals who are strong in particular functions. They need to be trained to work with other functions and to focus on product and service excellence rather than functional excellence. In short, they and their function can't have the ball all the time.

The new logic argues that you have to organize around units that are focused on products and customers if you want employees with different specialties to work well together. This ties directly to the idea of control coming from customers and the market, the importance of lateral processes, and the need for individuals at all levels to add significant value.

In order for these aspects of the new logic to work, all employees must be part of units in which everyone can see how their behavior affects organizational performance; in other words, they must have a line of sight to the business and its success. Then and only then can individuals feel that they are market driven, that they are responding to a particular customer or managing a specific product. And only when they feel this type of business involvement do the benefits of the new logic occur.

In many cases, applying the new logic means that certain functional specialties will be support services to organizational units focused on making particular products or offering particular services. Functional experts in law, marketing, and finance, for example, will supply knowledge and expertise to other parts of an organization who are their customers. Staff groups will no longer approve or disapprove the actions of a business unit; they will serve more in a consulting or educational role. Alternatively, they may join product development or customer service teams to help those teams to be more effective. The net effect of this repositioning of expertise should be to reduce the amount of corporate overhead in organizations and to create organizations that are primarily structured around customer- or product-focused units.

OLD LOGIC PRINCIPLE: Effective managers are the key to organizational effectiveness.

NEW LOGIC PRINCIPLE: Effective leadership is the key to organizational effectiveness.

Because of the old logic's emphasis on managers, particularly top managers, as the ones who add the most value, their effectiveness is correctly considered to be the critical element in a traditional organization's performance. At the core of the hierarchical approach is the belief that effective management means defining, evaluating, structuring, and coordinating the work of others. At higher levels, management involves setting strategy, making critical business decisions, and defining the accountabilities and responsibilities of others.

The old logic places little emphasis on leadership, because bureaucratic management systems are designed to operate as substitutes for leadership that tell employees what to do and provide the motivation to do it. Leaders are not needed to make an organization successful. Indeed, historically, the senior managers of large companies such as AT&T, Sears, Mobil, and Exxon have not been well known and have not demonstrated great leadership skills. Who, for example, can remember any of the presidents of AT&T from the period when it was the world's largest corporate employer?

In the new logic, leadership, not bureaucratic management, is central. Leadership is not easy to define; it is easier to recognize when you see it. What's the difference between leaders and managers? Managers do things right; leaders do the right thing. Managers influence through bureaucratic systems; leaders influence through vision and challenge. Managers motivate through rewards and punishment; leaders motivate through values and shared goals.

In the new logic, many traditional managerial functions are in essence rendered unnecessary through a combination of organizational design and employee self-management, but leadership is not. It is a critically important substitute for hierarchy and bureaucracy. The old logic emphasizes managerial processes and de-emphasizes leadership processes. The new logic emphasizes leadership behaviors and de-emphasizes managerial processes. It does not, however, advocate turning organizations "upside down" so that senior management is simply there to serve the rest of the organization, as some have suggested. They should not be servant leaders, because they have more important things to do.

The new logic—even more than the old logic—requires that top-level managers create the key organizational systems and processes and that they provide strategic direction. They are almost

always in the best position to add value by setting direction and defining the organization's agenda and by sensing conditions and events in the business environment that affect strategy. Finally, they are important role models for others.

In many respects, effective top management leadership is more important in a new logic organization than in a bureaucratic one. A traditional organization can operate without an effective leader at the top and in fact often needs an effective manager, not a leader. Historically, many chief executive officers of large U.S. corporations have been effective because they were good at managing budgets, control systems, and organization restructurings.

In the new logic, effective leaders substitute for bureaucratic controls and structures. They provide a sense of mission, vision, direction, and rationale. Without this kind of leadership, new logic organizations can drift like a ship without a rudder. Herman Miller, the furniture manufacturer, found itself in just this situation when its longtime leader, Max De Pree, retired. An adequate replacement was not found, and for the first time, the organization had performance problems.

In the new logic, it is critically important to have leadership throughout the organization, not only at or near the top. Flatter, more lateral organizational structures and a decrease in the number of traditional means of control call for more, not less leadership from everyone. Teams, for example, rarely operate effectively without someone or some set of individuals who lead by challenging the group, helping it set priorities and addressing performance problems. In traditional organizations, formal systems or hierarchical processes deal with these issues. In the new logic, individuals within the group must take on leadership roles to help the team address them.

In the new logic, all employees need to think of themselves as both managers and leaders. They are managers in the sense that they participate in structuring their work, influencing and coordinating with others and managing themselves. There are times, however, when self-management may not be enough; leadership is needed. Individuals need to motivate and inspire others through words, visions, recognition, and, of course, through modeling the "right behavior" and exhibiting all the leadership acts that encourage others to realize the organization's larger vision.

The new logic does not require an abundance of charismatic leaders, despite the fact that they are currently favored in the leadership literature.[9] Indeed, since there seems to be a scarce supply of charismatic leaders (those who create excitement and inspire commitment as a result of their ability to communicate an attractive vision, who behave in unconventional and symbolically important ways, and who have an extraordinary, almost god-like aura), it is important not to depend on them. Often new logic organizations can benefit from the presence of charismatic leaders, but they need not and probably should not rely on them. In some respects, the ideal leader for a new logic organization is aptly described as the "post-heroic leader" or, as the Chinese proverb says, "The best leader is one who, when he is gone, they will say, we did it ourselves." The heroic leader who commands adulation, respect, and deference and who distances himself or herself is not the type who is needed in a new logic organization.

In their work on what leads to long-term organizational success, Jim Collins and Jerry Porras use the metaphor of a clock for understanding what new logic organization leaders should do.[10] An effective leader, they say, creates an organizational clock that allows people to "tell time for themselves." The leader sets direction for the organization and builds mechanisms to allow people to understand what that direction is and to measure their progress. If the organization is designed properly the leader does not have to spend time reminding everyone of the strategy, telling them how they are doing, and pointing out what customers need. Remember: an effective leader designs an organization so that people know what to do and, at the end of a journey, say they were responsible for completing the trip.

It is particularly difficult for managers who have grown up in traditional bureaucratic organizations to become post-heroic leaders. One of my colleagues, Jim O'Toole, has stated that although 95 percent of American managers understand the logic of the new leadership and can state it, only about 5 percent of them can practice it. I am not sure that O'Toole's numbers are accurate, but I am sure that his overall point is right on. There are clearly many more managers who can profess the new leadership than those who can practice it.

Judging by what I observe in organizations and by the industry that has grown up in the last ten years to identify, train, and develop leaders, it is clear that there is more and more recognition of the importance of leadership. Indeed, there may be an overemphasis on leadership training and development. I am very skeptical about the ability of many of these leadership programs to actually change behavior. Charismatic leadership, in particular, is not easily developed and is unlikely to be influenced by programs that last only a few days and deal with artificially created cases, simulations, and adventure games and exercises (the current favorites of management development programs). Further, the academic literature suggests that the emergence of a charismatic leader is at least partially the result of the situation being right for this to happen.

Given my rather pessimistic assessment of the ability to develop leaders, it is legitimate to ask whether new logic organizations can actually find the quality and quantity of leaders they need to be successful. I believe that they can, but they need to recognize that leadership is a critical commodity and that it is important to develop the leadership skills of the many, not just those of the few who may reach senior management positions. Leadership skills need to be developed over a long period of time through a combination of personal experiences, training programs, and a focus on individual values and skills.[11] They also need to be considered when individuals are hired by new logic organizations.

The six principles of the new logic clearly establish a new paradigm or way of thinking about how to create effective organizations. Together, they can form the basis for developing, from the ground up, organizations that are both different from, and more effective than, the ones that have dominated our lives during the twentieth century. The challenge now is to take these principles and incorporate them into the foundations of an organization.

What types of practices, structures, and systems does an organization need to put in place in order to follow the new logic? To begin answering this question, an overview of the key elements of an organization is presented in the next chapter, along with a discussion of what makes an organization and individuals perform effectively. The chapters that follow focus on applying the six principles to the organizational elements in order to create a high-performance organization.