Putting an end to “command and control”: 12 principles to defining the 21st century organization.

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Business, markets and society have changed. But by and large, the principles of management, the methods and concepts of leadership and performance management have not. Rigid sales quotas, fixed performance targets, "pay for performance" and micro-management from the top are still widely established standards.

There is no lack of criticism of these traditional methods – both in practice and in the business literature. One thing is clear: we need a new understanding of motivation, performance, and responsibility. What is this new understanding going to look like?

New thinking instead of new tools

The problems companies face today can't be solved using the thinking and the processes that created them in the first place. A more productive approach is to define what the 'right' things are, and thus to examine root of the problem, rather than just treat the symptoms. To take this road, we need to put into question and possibly overcome an entire set of existing convictions.

Most of us work in organizations within the traditional model of command and control. This system may be budget control, target negotiation and subsequent top-down setting, employee evaluations, organizational diagrams, guidelines and policies, central departments, or employee questionnaires. These have been used for decades.

It is, therefore, often difficult to appreciate the amount of talent, time, and money that is wasted through these tools. Mutual trust, employee involvement, intrinsic motivation, and voluntary willingness to perform are being eroded. To question the traditions and to look for alternatives means pioneering work with a model beyond command and control.

Contemporary concepts of human nature allow for new levels of performance

If we want to build a better performance management model, then a clear understanding of human nature is paramount. The intuitive understandings that can be found in practice tend to oscillate between two extremes introduced by Stanford researcher Douglas McGregor more than 40 years ago:

- *Theory X:* The conviction that employees are to be treated like children. That they have to be taken by the hand and forced to perform through incentives and related control systems.
- *Theory Y:* The belief that employees should be treated like adults who are naturally "driven" and intrinsically motivated.

In the knowledge economy, Theory X-based organizations have proven to be out of touch with the people we deal with in our organizations. Theory Y assumptions, on the other hand, allow us to introduce modern leadership and management practices that truly make use of peoples' talents. Assuming that employees are driven by the desire to contribute and are searching for recognition and meaning in their work creates the conditions for more productive performance management systems.

Eight core myths of performance management

If we accept this contemporary perception of the people in our organizations, then eight core statements concerning corporate performance can quickly be exposed as myths:

1. *Shareholder Value or EVA (Economic Value Added) is the ultimate reason for doing business.* Fact is: EVA is not a reason. It is just a result and a necessary side effect of business activities.
2. *Companies must provide the financial markets with earnings guidance and will be rewarded for this.* Fact is: Providing shareholders and analysts with predictions of future results results in a "fixed performance contract" which forces delivery of the promises made at all costs. Companies including UBS, Porsche, Google, Coca Cola, and Citigroup have abandoned this practice.
3. *Growth and profit are the most important measures of success.* Growth can in some cases be a good indicator of superior value creation and competitiveness. Often, however, it is not.
4. *It is possible to measure the performance of individual employees.* Fact is: It is not. Organizations are "living systems" in which performance always depends on interaction between different players.
5. *It is possible to measure performance objectively.* Fact is: Measurement is never objective. It is always based on assumptions previously made either consciously or unconsciously, and is only an indication of actual performance.
6. *With the right indicators, a good manager can manage the organization.* Fact is: Indicators can provide "indications" with regards to performance, but never answers. They are useful if they raise questions in teams and among employees, but can be highly dangerous if interpreted as "objective."
7. *Performance is over-proportionally influenced by top management.* Fact is: Heroic management is ineffective in dynamic and complex environments. Decisions cannot be efficiently and effectively be taken at the top of organizations any longer in constantly changing and highly dynamic environments.
8. *The reasons for poor performance can be attributed with individual employees.* Fact is: It is more important to ask what inhibits a person or team of performing well. We should focus on how changes in the system would enable teams to perform better.

Towards a new, "relative" performance contract

Since 1998, the Beyond Budgeting Round Table, and then the Beyond Budgeting Transformation Network, or BBTN, have drawn upon case study-based research to conclude that companies with a contemporary view of their employees don't control them with plans and fixed targets, but that they reach a "relative" performance agreement with them instead. The 12 central principles of the relative performance contract-based management model, contrasted against the assumptions of fixed performance contracts, are shown in Figure 1.

Figure 1: The 12 principles of the Beyond Budgeting model

	Principles	Do this (Beyond Budgeting model)	Not that (Budgetary control model)
Leadership culture principles	Customer focus	Focus everyone on improving customer outcomes	Achieve vertically negotiated targets
	Accountability	Create a network of teams accountable for results	Centralized hierarchies
	Work environment	Champion success as winning in the marketplace	Contractual approach
	Performance	Give teams the freedom and capability to act	Adherence to fixed plan
	Governance	Base governance on clear goals, values and boundaries	Detailed rules and budgets
	Transparency	Promote open and shared information	Restricted to 'need to know'
Management process principles	Target setting	Set aspirational goals for continuous relative improvement	Fixed annual targets
	Rewards	Reward shared success based on relative performance	Meet fixed targets
	Planning	Make planning a continuous and inclusive process	A top-down, annual event
	Controls	Base controls on relative performance indicators and trends	Variances against fixed plan
	Resources	Make resources available as needed	Annual budget allocations
	Coordination	Coordinate cross company interactions dynamically	Annual planning cycles

Relative performance contracts are based on the assumption that it is unwise to set fixed targets for managers and teams and then to control their behavior and activities in terms of these targets. The implicit agreement is that management's task is to provide a challenging and open work climate within which employees agree to aim for continuous performance improvements. Managers and employees must use their knowledge and their own common sense to adapt to changing conditions and environments.

Under this performance contract, decisions are not made at the top. Instead, they are distributed, decentralized, and devolved as far out as possible. This type of performance contract is based on mutual trust. Increased transparency and higher expectations (compared to competitors or their equivalent) provide a permanent challenge, which either has to be matched to or whose failure will lead to equally transparent negative consequences. Responsibility for performance and decision-making are gradually shifted away from the center of the organization towards the periphery.

The story of a pioneer: Svenska Handelsbanken

In 1971, Swedish bank Svenska Handelsbanken began to transform its organizational units into self-managed profit centers with clearly defined customer relationships and highly devolved responsibility for the results. This network now consists of more than 550 subsidiaries, legally independent regional banks, and service departments. The center of the bank is not the head office, but the subsidiary network. The autonomy of the bank's branches has been extended continuously since the 1970s. As a result, their status and reputation within the company are better than at other financial service providers.

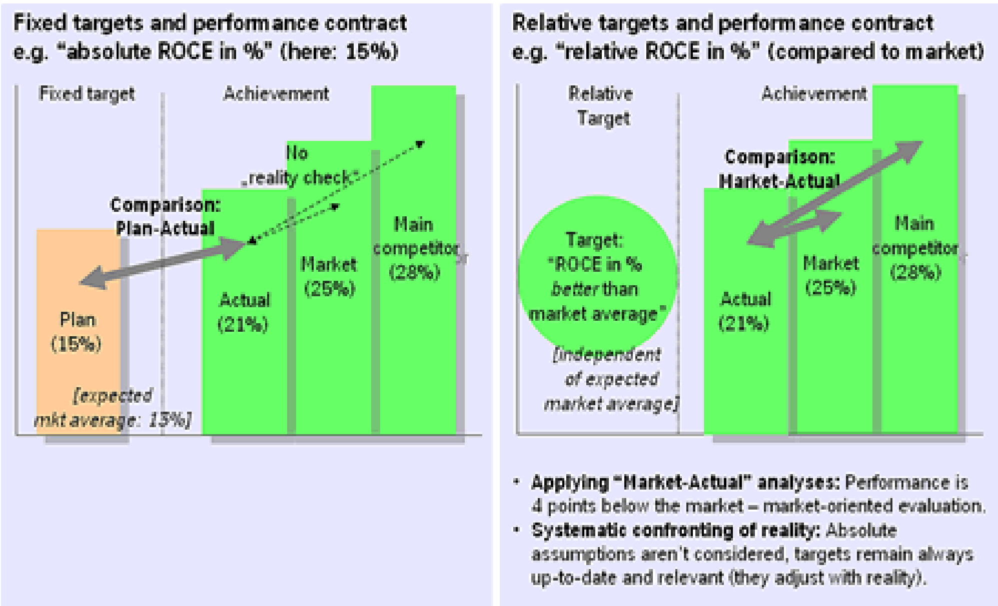
This cultural change was necessary to root the decentralization concept in the organization not only superficially, but for the long term. At the same time, the radical decentralization of decision-making towards the bank branches meant the end of product selling and of the authority of marketing departments to issue directives.

The company's main focus is on the customer, not on the profitability of individual products. Svenska Handelsbanken has no central marketing department and no product managers. Instead it has "product companies," which are paid for their services by the regional banks and their branches for the development and provision of attractive products. There are no product-related targets or quotas. Turnover is always a result of not meeting customer needs.

To manage performance, Handelsbanken developed a simple control system within which employees and teams work on the basis of relative performance measurement based on actual performance data. Success is no longer measured according to negotiated plan data, but relative improvement as measured using a limited number of key figures. To do this, the bank as a whole compares itself with its closest rivals.

Similarly, regional banks assess their performance monthly and in comparison with other regions, and branches are compared with other branches. All targets, performance assessments and reporting systems are thus based on internal or external competition and continuous improvement.

Figure 2: From "fixed" to "relative": Example of a financial performance indicator



Absolute targets weaken control and create misleading incentives (left), while relative measurement enables transparency and adaptive control (right).

A self-regulating ranking system

The ranking system has proved to be highly self-regulating and has required only minor modifications. It does not depend on any annual adjustment, hierarchically integrated planning, or internal negotiation. At the same time, "internal markets" and a system of 2,000 internal prices guarantee the transparency of the service relationships, align value-adding process aligned with their external customers, and create permanent pressure on internal service providers.

Handelsbanken decided to avoid the use of any kind of incentives and motivation measures. Instead, employees benefit equally from the company's success through a profit sharing concept in which all employees have an equal share. Employees are driven not by individual targets or group incentives; rather, the system appeals to employees' need to be valued and recognized for their role in helping the organization succeed.

Achieving competitive success with an alternative, coherent model

The example of Svenska Handelsbanken proves that a radically de-centralized management model can be maintained over a long period of time (in this case more than 35 years) and through several generations of employees and top management. Handelsbanken also shows that the decentralized model works well in both good and bad times, in times of high or low interest rates, and in the increasingly demanding environment of the capital markets.

Other successful companies such as Southwest Airlines, Toyota, and Guardian Industries have developed models similar to the Handelsbanken approach. There are enough examples of pioneering companies to give us the courage to overcome traditional thinking and to search for new ways to success in the knowledge economy.

About the Author

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He is a management consultant, speaker, and author of numerous publications. His latest book, *"Leading with Flexible Targets. Beyond Budgeting in Practice,"* (Campus) was published in 2006 and chosen by Financial Times Germany and GetAbstract as Best Business Book of the year.

The book presents 12 case studies of outstanding "Beyond Budgeting" pioneers including Semco, W.L.Gore, Southwest Airlines, Svenska Handelsbanken, and Toyota.