Organizational Design during Financial Crisis

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Organizational leaders are currently faced with increasing stress on their financial systems due to worsening national and world economic conditions. Even when the current crisis abates, better financial planning will be needed to help minimize the risk of further economic crisis. In this article, the author introduces the idea that organizational design itself offers a means of protection and mitigation of many financial risk factors and can be addressed in times of financial crisis to increase chances of survival. Discussion, case examples and organizational change models are offered to assist leaders in evaluating their individual organization's situations.

The year 2008 has taught organizational leaders many hard financial lessons.[1] Organizations wishing to remain in business have to remain solvent, with enough revenue on hand to meet short-term demands and enough capital available to meet future requirements. This is true of both for profit and not-for profit organizations.[2] Over this period, leaders have also been finding out how dependent their operations are on how well others manage their finances.[3] Many leaders are coming to the conclusion that their organizations may not be structured as efficiently as possible, resulting in tough choices in a number of areas including product quality and production; property and plant management; acquisition and expansion; and personnel.

When faced with significant changes in finances, organizations generally either accept some changes or they "tough it out," hoping for more comfortable conditions in the future. This article explores financial concerns and their impacts, as well as three areas of organizational design (operations, personnel and finances) that can be manipulated in times of financial stress to help offset the resulting concerns. Models for leaders to use in determining which areas of organizational design to modify are offered for consideration, as well as an outline of action

steps that leaders can take to assist them in making the most of their organization's design elements. While it is preferable to have a flexible enough organization to stave off economic crises without corrective action, many organizations are not able to do so. By carefully assessing their own requirements, leaders can use information provided here to develop an implementation plan for organizational design that works.

Financial Issues

No matter what product or services an organization produces or offers, how large or small they are and what the source of their income is, all organizations are involved in some exchange of resources. It is important for leaders to know how these exchanges work. "New leaders and managers should soon go on to learn how to generate financial statements (from bookkeeping journals) and analyze those statements to really understand the financial condition of the business." [4] McNamara notes that when leaders avoid this, they invite trouble. Finance issues are playing an increasingly greater role in helping shape organizational governance decisions at all levels. It might go without saying that businesses like AIG and Lehman Brothers would not have been in the shape they are currently in if their financial decisions were based on a more protective risk analysis of the products they were dealing with and their own internal operations.[5]

Organizations need resources, most recognizably money, to operate. Non-profits solicit donations and often attempt to obtain grants to create some form of social impact; while for-profits typically look to sales and investments to earn money for the organization.[6] It is often quoted that people are an organization's real resource, and while I do not disagree, it is important to note that with more cash available there is potential to hire better quality employees. Organizational resources are identified and utilized in many differing ways, especially in very large and complex organizations. Materials, supplies and equipment must be purchased; salaries, rent or mortgage payments and taxes paid; and investments acquired by means of finances. For the purposes of this discussion, these items can be considered as the *direct* impacts of finances on an organization, because they have immediate impact on the organization everyday from its start. *Indirect* financial impacts are those secondary concerns, oftentimes resulting from direct impacts that can and do influence an organization's operations and financial situation. These include items such as financial processes and reporting, credit rating, insurability, appreciation and depreciation of real assets and "experience" (in terms of insurance resources utilized over a specific period of time). They can also include other external factors such as market climate, competition, supplier reliability and regulation.

The bottom line is that perhaps more than any other single issue financial matters directly impact an organization's ability to function. Some financial matters are controllable internally and some

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are not. It is the role of the organization's leaders to design a system for the efficient management of those factors that control internal financial factors and one that offers adequate protection for those uncontrollable financial factors.[7]

Designing for Financial Stability

Organizational design theorists group design issues generally around the themes of *mission, people* and *operations*. In other words, organizations are designed in certain ways to accomplish certain specific missions, provide structures policies and protocols to manage people in specific ways and develop systems and procedures for carrying out certain internal and external operations. Included in these themes are issues such as physical locations and environments, as well as processes that bridge internal and external systems such as sales, public relations and research design processes.[8] To provide a better understanding of the relationship between organizational design and finance during a crisis, each will be discussed in turn. It is important to keep in mind that since organizations vary widely, only selected issues will be covered here. Leaders are encouraged to consider the specifics of their individual organization's situation in some detail when reflecting on possible financial impacts of their organizational designs.

Mission

The mission may best be understood by the organization's mission statement. Basically, the mission is the reason for the organization's existence, describing its purpose and vision.[9] The financial implication of an organization's mission become apparent when one determines what kind of organization it is:

- Profit or not-for-profit
- Service or manufacturing
- Type of ownership: sole proprietorship, corporation, limited liability company, etc.
- Where its revenue streams generally come from: sales, donations, grants, investment dividends, etc.
- The basic costs involved in meeting that mission

Consider the differences between the start-up costs of opening a bicycle stand on the beach and a car dealership. It is likely that for a few thousand dollars a well-equipped bicycle stand could be up and running, while it is likely to cost well into the millions to open a typical car dealership.

How does mission come into play during a financial crisis situation? During a crisis (hopefully prior to a crisis) organizational leaders may want to revisit the mission, because the financial

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situation may require a strategic shift that calls for a redefinition of what is most important to the organization at the current time.[10] They may not need to change it entirely, or not at all, but it is a good idea to examine the mission to make sure there is alignment between the mission and what the organization is actually doing. It might then be an easy step to cut out anything that is not mission related, thereby saving resources.

In extreme cases, the mission may need to change in order to keep the organization operating at all. For example, let us say Peach Day Care opens with the mission to provide day care services for two to four year-olds in an area dominated by families of factory employees. Everything goes along well for the first few years, until factory closures in the area force families out. Retired couples and older families without children at home take their place. With no young children to serve, Peach can either close its doors or determine a new mission, perhaps offering adult education classes. An organization's mission will influence its financial matters.

People

As stated before, people are often described as an organization's most valuable resource. It is by the actions of people that the organization's mission is realized as they effect operations. Yet, people come at a cost: hiring, training, compensation and other items such as transporting, feeding, sheltering, communicating with and protecting people combine into budget heavy items. Along with the individuals themselves, there are issues to consider such as the number of people required for the organization to produce its goods and services. This can vary depending upon factors such as the time of the year, weather conditions, knowledge, skills and motivation of workers. In the same way, the number of managers and supervisors required to assure that workers are doing what they should be doing will vary.

Personnel are often one area first affected during financial crisis. Layoffs, reduction in force (RIFFs) and downsizing are all fairly commonplace at the current time as businesses, especially financial services sector organizations, strive to remain afloat. It is easy to see why cash strapped organizations would look there first for quick cash. Of course, the problem with that is that the organization is left with fewer workers to meet its obligations, it is often forced to reduce its output and quality may suffer. Admiral Hyman Rickover once said, "Organization doesn't really accomplish anything. Plans don't accomplish anything either. Theories of management don't much matter. Endeavors succeed or fail because of the people involved." [11] In other words, it is the employees and other *people* involved in organizations that make things happen and without them, the mission fails every time. Other factors enter the picture if the organization is unable to meet its contractual demands or is then perceived to be foundering by customers or creditors as a

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result of reducing staff. While layoffs, even relatively small ones, can have the positive affect of freeing up capital initially, they can also result in severe long-term consequences.

Sergio Marchionne describes being required to lay people off when he arrived at his new company, Fiat. This was as a result of a history of utilizing "the Great Man" model of leadership in which only the person at the top makes decisions.[12] Overtime, Marchonnie was able to identify natural leaders from within the organization and provide them with the authority to be innovative and make decisions that created value within the organization and ultimately for its customers. He also developed relationships with his employees, conducting performance reviews on the top seven hundred and engaging them personally and informally in conversations and via texts and email to help spread the feeling that he cares about them and the organization. As of 2008, Fiat has improved its financial standing and is becoming a force to be reckoned with in the world of automotive manufacturers. By taking steps to restructure the way people interacted with each other in his organization, Marchionne was able to positively and significantly impact the financial stability of his company.

Operations

Operations concerns how the work gets done. It may be cutting trees and creating lumber; designing buildings; digging ditches; or putting together a music album. It all depends on the mission of the organization. In addition to the actual work that is accomplished, there are a number of supportive services happening within organizations to make sure that the work is done as required.

These services include tangibles like providing a space to work; equipment to accomplish the tasks; information and communications systems; and utilities to make people more comfortable. These also include intangibles such as organizational culture and climate, market factors and workforce changes. Issues of time and scheduling, inventory management and delivery/distribution systems also come to bear on operations. In addition, this issue concerns decisions about expansion, relocation and plant closures as means to increase revenue or decrease liabilities.

During financial crisis, there may not be sufficient cash or credit to purchase the raw materials and supplies needed to meet demands. Unplanned problems in obtaining leased equipment or services may arise as these items become scarce. Property foreclosures or cash flow difficulties that result in late property rent or lease payments can result in eviction, utility shutoffs or loss of insurance. Organizations can take collateral operations "hits" such as their suppliers being unable to fulfill orders and their creditors or other service providers going out of business. Operations,

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and therefore finances, can also suffer from changes in regulation, natural or man-made catastrophes and advances by competitors that render the organization's operations or products obsolete. There is potential to "build in" safeguards. Consider the following steps organizations can take:

- Develop relationships with alternate suppliers
- Create memorandums of understanding with lower production limits or longer delivery schedules during times of economic slowdowns
- Attempt to work out better credit or loan repayment terms with banks and other creditors when cash flow lessens.

Yet, these options are best done as a means of prevention, rather than response. Done in that way, they indicate good stewardship and proper planning. The better able an organization is to respond to either operational problems that cause financial instability, or financial crises that in turn lead to operational problems, the more likely it is that the organization will maintain its place within a given market.[13]

Design Components for Evaluating Financial Risk

For organizations, financial issues, like most other matters requiring strategic thinking, are really exercises in risk management. "A company's success is closely linked to the role risk plays in its culture."[14] In organizations with poor oversight of financial systems and decision making and those that fervently embrace the notion that, "to spend money is to make money," it should be no surprise that they operate at high levels of risk. Our discussions so far have concerned what might be termed a utopian setting, in that no mention has been made to risk and loss associated with theft, fraud and other criminal activities that can and do impact financial stability. These factors occur daily in many organizations from employees, non-employee outsiders and customers. These types of issues should also be considered as part of a comprehensive risk management plan, so are not belabored here. Organizational design can be used to respond to all kinds of financial risk by building in factors that help organizational leaders become aware of, evaluate and ultimately mitigate the risk.

In a companion article regarding risk, Buehler, Freeman and Hulme outline a five-step plan to help manage risk:

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- Identify major risks and determine which risks provide an advantage to own and which should be transferred
- Determine how much risk your organization can reasonably carry
- Embed the risk, or take it into account, in all critical decisions and processes
- Align governance and organizational management around risk monitoring and management[15]

The key to any good decision, even those related to risk, is to first have good information. Finance department heads must be knowledgeable and experienced enough to provide information and reports that give senior leaders a clear and complete sense of the organization's finances and the financial risks associated with certain circumstances in a timely manner, so the information can be acted upon as quickly as possible. With this as a base, it is possible to hypothesize the effects of situational changes, making it probable that safeguards in the forms of either immediate changes or preliminary action plans can be created to offset the potential harmful effects of losses in other areas.

It is, therefore, necessary for the organizational design to allow for all financial related information to flow through the finance department and for the finance department head to have direct links to the senior leadership. Most organizations do this by the use of computerized systems for tracking data, although some continue to use more traditional hard copy invoices, work orders and billing/accounting systems. In the case of either system used, backups and redundancies are important to help assure that information is not lost.

Communications can also be enhanced by use of lateral processes such as informal processes. An example is rotating employees through different positions and departments. It has the added benefit of cross training employees to perform a variety of tasks adding greatly to workforce flexibility. Interdepartmental training events and meetings allows for cross departmental relationship building and sharing of ideas.[16] Galbraith also suggests that organizational departments can be physically located nearer to the other departments that they work most closely with. Contingent rewards systems can be designed that require cross-functional cooperation between departments, again to increase the amount of lateral communication. By increasing lateral communication, leaders can open up opportunities for a wide variety of information to be shared, including financial risk information.

Informal and internal discussions and evaluations of financial reports and related data can be completed by department heads and senior executives as part of regular management meetings or

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in the form of special activities dealing with only selected areas of interest, as a means of keeping abreast of financial risk factors on the horizon.

Another way to evaluate financial risk is to undertake a formal financial risk analysis. While these can be accomplished by means of internal sources and regular reporting to the senior leadership on finances, I suggest, especially when a financial crisis is looming, that external auditors be used on a regular basis to remove any bias that might be associated by purely internal audits. Formal risk analysis can take some time and do cost money if they are to have any value. In them, assets and liabilities are defined and evaluated, as are financial processes and protocols. Assumptions are made about projected market conditions, potential growth or loss and other items. A report is generated that can supply a more detailed picture of actual and projected risks, depending upon the scope of the review. As with any similar audit or review, a great deal depends on the accuracy and ease by which information in supplied to the reviewing parties.

Decisions about personnel during financially stressed times require significant review and should not be done in a "knee-jerk" fashion, for reasons already noted. Employee input during such times is invaluable and can help guide leaders to making the right choices. Functionality, the ability to remain operational, is a key factor. Employees expect to be treated fairly and equitably. This treatment usually results in them giving their best efforts. In the best case scenario, organizational leaders will have contingency plans in effect for how to manage slowdowns and crisis. Yet, even these should be reviewed in light of the current situations before they are implemented. This is because the circumstances for which they were developed may not be the exact circumstances the organization is facing at the present time, and because personnel changes may have already taken place that negates the impact of the previously developed plan.

Idea Models

The following models contain suggestions based on selected review of current research that can be used by leaders to help determine areas of organizational design to target during financial crisis. Figure 1 is a model that gives an outline for preventative action. Figure 2 highlights responsive action for organizations.

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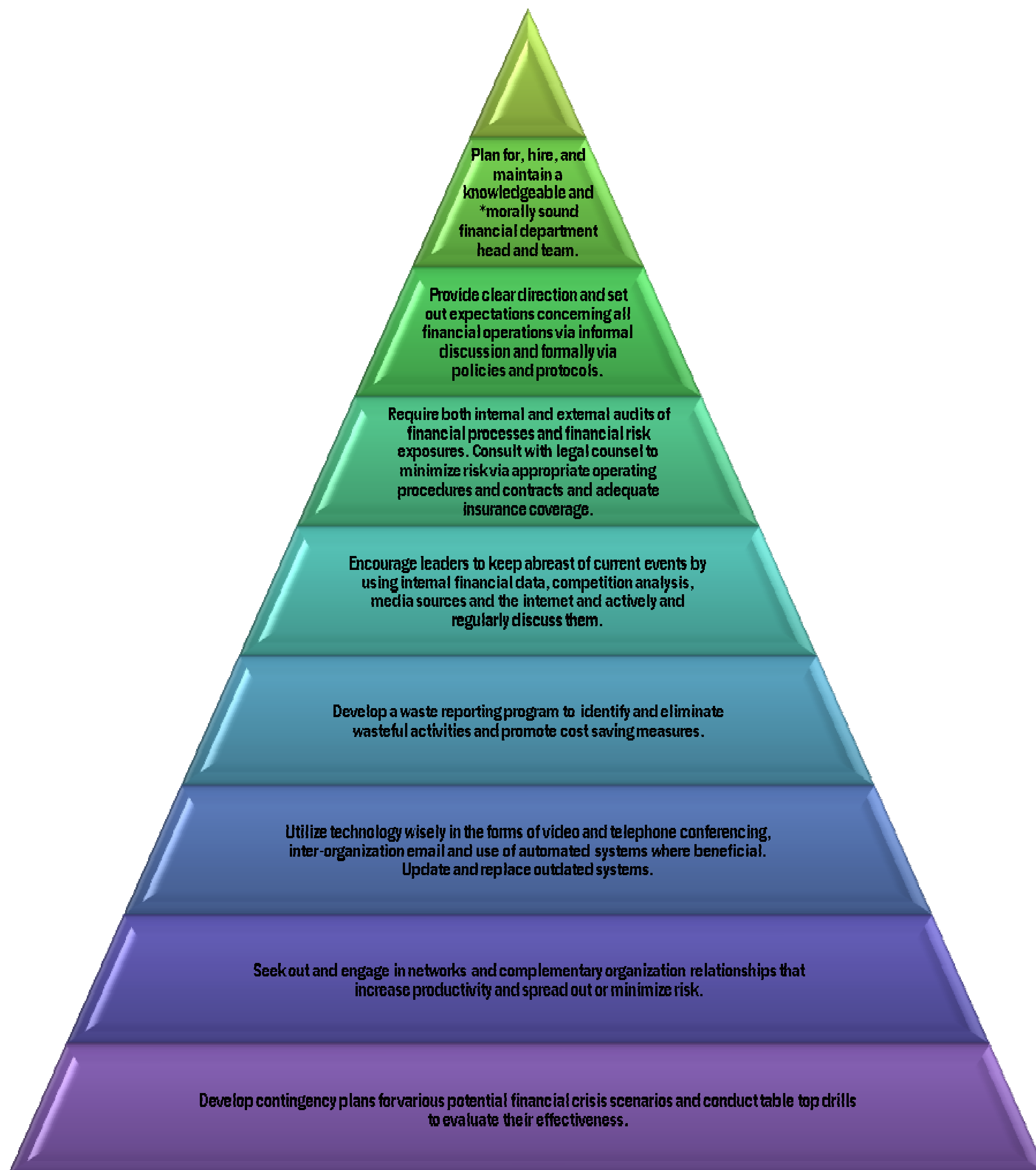

Figure 3. This model gives an outline for preventative action.

**Morally sound* refers to a personality characteristic in which the individual makes decisions based on universally accepted standards of right and wrong, ethical, professional standards of behavior, as well values that are held by and promoted within the organizational culture.

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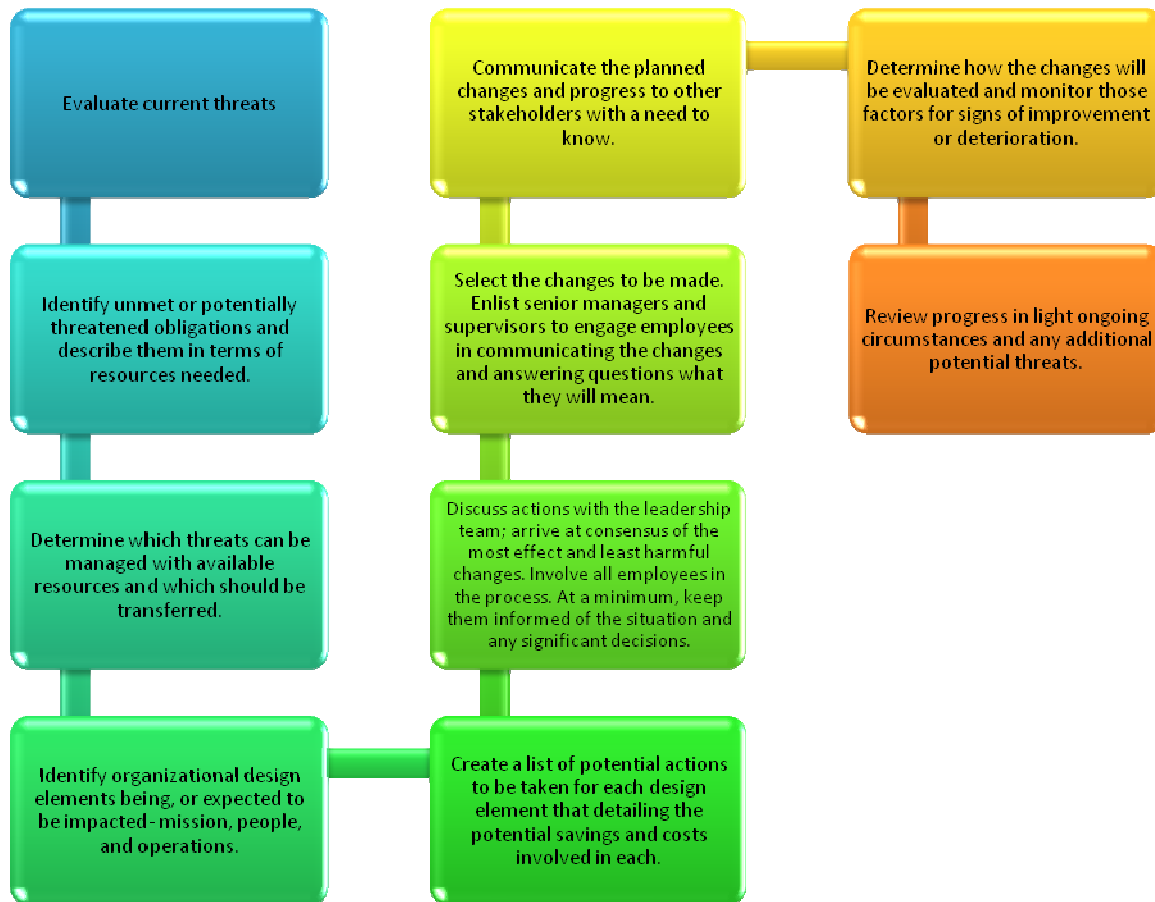

Figure 4. This model highlights responsive action for organizations.

Building a values-based, morally-sound organization can be accomplished in several ways. The hiring process should include background checks for criminal records, ethical or moral violations in the community or at work and may include personality assessments. Organization policies, procedures and protocols should reflect the credible values and behaviors expected of employees. Leaders and other supervisory personnel should model the norms and values being upheld. Training and professional development opportunities that describe and support the organizational value set needs to be required for all employees. Appropriate systems of recognition and reward for deserving employees are important; as are the inclusion of performance and supervision protocols that are mentor based and provide for genuine and caring feedback to employees. It is also important to offer employees opportunities to increase job

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satisfaction by providing input into decision making, increasing levels of individual responsibility and obtaining employee feedback concerning job related wants and needs.[17]

Organizational leaders can also consider the congruence model, suggested by Nadler, Tushman and Nadler as additional means to explore their organization's design and assist them in determining if design change is needed. Step one calls for assessment and evaluation of the organization for areas of current concern or potential concern; a regular part of strategic planning processes. This is accomplished by:

- A detailed review of various outcome data elements surveys and focus groups on items like production and sale
- Identifying the organizational design(s) that support areas of concern and determining any congruence between the components of the processes
- Formulating a model of the cause of the concern identified
- Creating an action plan to address the issues, paying attention to any congruent processes that may also be affected
- As always, the final phases include monitoring and tweaking, if needed [18]

When faced with a bleak 1981 economy, large layoffs of their customer base and a recent history of poor product quality prompting extremely poor sales, Jim McCaslin, CEO and one of the then new owners of Harley-Davidson, and his management team took steps to turn their company around. The organization had dropped 1,800 of the 4,000 employees in an effort to survive. By reviewing its design the organization was able to identify several areas in need of attention. They implemented a materials-as-needed on demand system, instituted tighter data driven control operations and provided opportunities for greater employee input, all with a renewed focus on improving quality and addressing customer perceptions and value. With fewer resources being tied up in inventory and waste, as well as a decreased payroll, cash flow increased and allowed the organization to remain solvent. With additional innovations, over time the company has continued to grow and now employees over 9,000 employees with over five billion dollars in revenue last year.[19]

Conclusion

The economic pressures of 2008 have opened the eyes of many organizational leaders to the realities of the significant financial risks their organizations face. A significant number of these risks can be manipulated, transferred and mitigated by strategic decisions concerning organizational design. Focal points to these processes include reviews of the organization's mission, personnel and human resources practices and operations systems along with targeted

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interventions within these areas. In times of financial crisis, organization's often use design change to help keep their doors open and their operations running. Leaders who plan ahead for such times, who follow a reasonable and considered approach to decision making during crisis, stand a much better chance of managing financial risk, while also maintaining efficient and productive operations compared to those who make rushed decisions in a panic stricken response. Rushed decision making in addition to decision making that is not based on an organization's key values, often leads to additional complications that are then difficult to overcome when the crisis is over. All that is required is a leader's desire to use these tools and make changes to the design of the organization so it remains functionally sound.

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