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Three steps to sustainable and scalable change

Part 2: Aligning operational governance
with the business model

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About the series

Creating sustainable improvements to a company's cost structure is like building a skyscraper. The first step is choosing the right business model, which provides a blueprint for the effort. The second step is determining how decisions will be made. This serves as a strong foundation. The third and final step is mobilizing resources and putting the decisions into action, which is analogous to actually constructing the high rise. When improving their cost structure, many companies try to jump directly to the construction phase; however, the results are generally disappointing and, even if they are acceptable, they are usually hard to sustain.

Deloitte Consulting LLP's three-part series, "Three steps to sustainable and scalable change," takes a detailed look at all of the activities necessary to produce cost structure improvements that can withstand the test of time.

- Part 1, "Rethinking a Company's Business Model," provides fresh and practical views to help companies choose or confirm the right business model. This can serve as a blueprint to guide the overall effort.
- Part 2, "Aligning Operational Governance with the Business Model," presents a framework for aligning and improving the way decisions are made and executed. This step can provide the foundation for lasting improvements; yet, in our experience, it is the one step companies are most likely to overlook.
- Part 3, "Aligning Organization Design and the Service Delivery Model," explains how companies can deploy their resources to create efficient and scalable cost structure improvements that satisfy the specific needs of the business.

These three steps can help any company make sustainable and scalable improvements to its cost structure.

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The first article in this three-part series offered insights to help companies with the initial step of validating and refining their business model. This article focuses on the second step – determining how decisions are made and executed (what we call “operational governance”). In our experience, this is the step companies are mostly likely to overlook. Yet it is just as important as the other two.

Before they deploy a single resource, companies that want to increase their chances for sustained improvement must establish a foundation of effective decision making. This “operational governance” provides the means and methods for making decisions – and for institutionalizing them. These include: clearly defined decision making roles, a clear division of responsibilities between corporate and the business units (or other organizational entities), and a supporting infrastructure for key interactions throughout the decision process.

A different kind of governance

Operational governance should not be confused with corporate governance, which focuses on oversight by a company's board of directors and shareholders. That's another subject altogether. The governance referred to in this report is a management activity that centers around key operating decisions by company managers and executives. Major elements include:

- effective decision making through clear organizational roles, responsibilities, ownership, and communication
- systematic communication linked to business needs
- efficient delivery of support and other services
- continuous improvement through effective practices, policy setting, and knowledge sharing

We believe this “operational” governance is the missing link that converts a conceptual business model into tangible action and improvement.



Getting to the root of the problem

Companies that lack a well-defined operational governance structure are not nearly as effective as they could be, which can have a major impact on the bottom line. One problem is that many corporate and business unit executives don't fully understand their roles and responsibilities. This lack of clarity can undermine efficiency and waste a company's resources. For example, one executive might deploy resources to tackle a problem that is actually another executive's responsibility, leading to duplication of effort. Or worse, the executives may have no idea what their individual responsibilities are, or who is doing what, which could cause resource misalignment and even organizational paralysis. Without good operational governance, structural inefficiency reigns.

These problems can occur even in areas of the business where a corporate function or centralized group exists. For example, a company with centralized procurement might still have procurement agents operating independently within each of the business units. Similarly, a company with a corporate communications group that is supposed to handle all web communications might still have rogue webmasters and websites scattered throughout the business. In cases like these, the result is likely to be turf battles and unnecessary duplication of efforts.

The lack of a well-defined operational governance structure may also make it hard for a company to improve. Without clearly defined roles and responsibilities for decision making, a company may not

be very agile and may hesitate when responding to market changes. Moreover, if policies, knowledge, and effective practices aren't shared across organizational boundaries, the ability to leverage the company's collective wisdom and experience can be severely limited.

Establishing effective operational governance is a three-step process that occurs after a company has selected or confirmed its business model.

- **Strategic roles.** The first step is to define decision-making roles within the company and to clearly divide responsibilities between corporate and the business units.
- **Operational responsibilities.** The second step is to identify the key decisions that need to be made and to define the decision making process that will be used for each one.
- **Key business forums.** The third step is to provide forums – such as committees and councils – to foster the kind of coordination and information sharing that produces good decisions and to ensure decisions are actually executed.

A well-defined operational governance model determines who is responsible and accountable for key decisions, who needs to be involved, and how decisions will be made. It also defines a clear process for resolving disputes. The rest of this article provides a detailed look at the three steps to effective organizational governance.

Figure 1. Three steps to good decision making



Step 1: Define decision-making roles and responsibilities

Effective operational governance starts with clearly defined roles and responsibilities that establish who makes what decisions. In particular, they specify how much decision control corporate executives will have, and how much will be left to the individual divisions and business units.

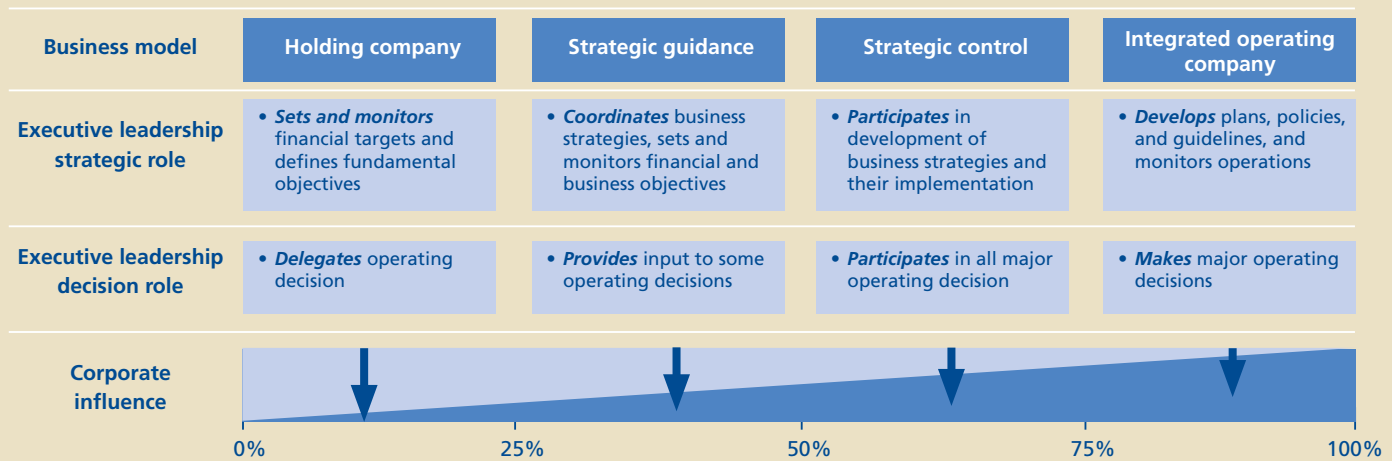
A company's choice of business model largely determines its overall approach to decision making (see Figure 2). As discussed in our first article, with a highly decentralized model (i.e., holding company) corporate executives play a hands-off role. They set financial targets and define fundamental objectives, but the individual business units are responsible for virtually all major and minor operating decisions. At the other end of the spectrum, with a highly centralized model (i.e., integrated operating company), the opposite is true. Corporate executives make all major decisions and develop plans, policies, and guidelines that the businesses are expected to follow.

Of course, every company is unique, and the vast majority fall somewhere between these two extremes. That's why it's so important for every company to clearly define who is responsible for what decisions and the role that executives at the corporate and business unit levels are expected to play in the process.

In Figure 2, the models in the middle represent the gray zone where corporate executives and individual businesses share responsibility for decisions. The "strategic guidance" model leans toward decentralized control, with individual business units acting as the primary decision makers. Corporate executives may provide input and play a coordinating role, but in most cases it's the business units that ultimately decide. The "strategic control" model leans toward centralized control, with corporate executives serving as the primary decision makers – with significant input from the businesses – and actively participating in strategy development and implementation.

Although a company's business model provides the initial direction for decision-making roles and responsibilities, effective operational governance requires an additional level of detail. The sample framework in Figure 3 breaks the responsibilities for operational governance into three roles – decide, execute, and monitor – and specifies who has primary and secondary responsibility for each role under the four basic business models.

Figure 2. Decision-making roles and responsibilities vary by business model



Source: "Rethinking a Company's Business Model", Part 1 in our series on "Three steps to sustainable and scalable change"

At the extreme ends of the spectrum, the analysis isn't very interesting. With a holding company, business units operate autonomously and therefore have primary responsibility for all three roles – decide, execute, and monitor. Corporate has only secondary responsibility to help decide and monitor. On the other end of the spectrum, things are even simpler. With an integrated operating company, corporate has primary responsibility for all three roles because there are no business units.

The real action takes place in the middle. Moving from the holding company model to the strategic guidance model, the business units continue to have primary responsibility for core and staff functions; however, corporate begins to exert a bit more influence over staff functions. The business units have primary responsibility for making and executing decisions, while corporate has primary responsibility for monitoring the results.

Sliding over to strategic control, there is a greater balance between corporate and the business units. Business units "own" the core functions and are primarily responsible for execution. Corporate owns the staff functions and has primary responsibility to make decisions and monitor the results. For example, corporate marketing would have primary responsibility for establishing overall guidelines for marketing spend, media usage, and key messages – and for monitoring the business units and ensuring the guidelines are being followed. Business units would have primary responsibility for executing the business strategy in accordance with the corporate guidelines. However, in their role as secondary decision makers they would also be free to propose alternate guidelines for corporate marketing to consider.

Figure 3. Assigning responsibility for all aspects of operational governance

	Holding company		Strategic guidance		Strategic control		Integrated operating company	
	Business Unit	Corporate	Business Unit	Corporate	Business Unit	Corporate	Business Unit	Corporate
Decide	P	S	P	S	S	P	—	P
Execute	P	—	P	S	P	S	—	P
Monitor	P	S	S	P	S	P	—	P

Note: In cases of an integrated operating company, there are no business units. Functions within corporate own responsibility to decide, execute and monitor.



Step 2: Define key decision processes

The next step is to identify the company's key decisions and define processes and detailed responsibilities for how these critical decisions will be made, including: who the decision maker is, who needs to be involved, and the specific timing and sequence of their interactions. Whether the issue is pricing, new market entry, or expanding production capacity, companies need clear policies and procedures about who truly has the authority to make decisions, who reviews and provides input, and who simply needs to be informed.

This second step goes well beyond the roles and responsibilities defined in step one, systemically clarifying the key interactions needed for timely and sound decisions.

Figure 4 provides examples of what the decision-making process might look like when developing a three-year strategic plan. The example on the left shows the decision process for a company operating under the strategic control model, where there is significant give-and-take between corporate and the business units. In this case, corporate sets the overall direction, but it's up to the business unit to propose a strategy and budget. The proposal goes back to corporate for review and approval, and then the business unit puts it into action. The example on the right shows the process for an integrated operating company. In this case, corporate does it all—sets direction, recommends a strategy, and reviews and approves the plan and budget. Functional units have little or no input; they simply execute the decision handed down from above.

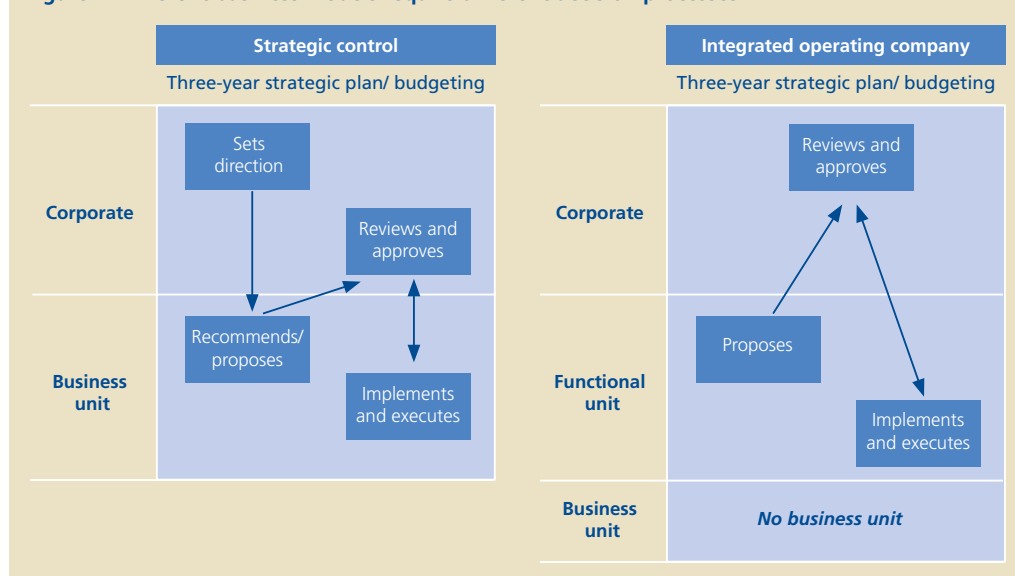
A RACI matrix is a decision matrix that can be used to map out detailed decision-making roles and responsibilities. Its name stems from the fact that it divides decision-making activities into four categories: Responsible, Accountable, Consulted, and Informed. Figure 5 shows how a RACI matrix can be applied to major marketing decisions. A company's business model largely determines the level

of involvement required from the CEO, president, CFO, CIO, and key business unit staff. In the example in Figure 5, the company is operating under the strategic control model, which means the division president is the decision maker for division-proposed marketing goals and quarterly marketing plan. At the same time, the CEO is responsible for setting overall marketing goals and parameters.

Figure 5. A decision matrix for marketing (sample)

	What are the division proposed marketing goals and parameters?	What are the marketing goals and parameters?	What is the division's quarterly detailed marketing plan?
CEO	Consulted	Accountable	Consulted
CFO	Informed	Informed	Informed
Corporate Officer(s)	Informed		
CIO	Consulted		
Div/Group Pres.	Responsible/Accountable	Consulted	Accountable
Corp. Marketing	Informed	Responsible	Consulted
General Counsel	Informed		
Corp. Real Estate			
Division CFO	Consulted		Consulted
Division Executives	Consulted	Informed	Consulted
Division Marketing	Consulted	Consulted	Responsible

Figure 4. Different business models require different decision processes



Step 3: Provide forums to support good decisions

When mapping out decision processes and assigning responsibilities, it's generally more effective to start by focusing on key decisions, particularly those that tend to create confusion and conflict between corporate and the individual business units (see figure 6). These "hot spots" often include: media spend in marketing, business unit strategies in strategic planning, and hiring of staff.

Figure 6. Decision-making "hot spots"

Topic/area	Key decisions
Strategic planning	<ul style="list-style-type: none"> Resource allocations Business unit strategies (development and process) Management of link to financial and operating plans Measurement/monitoring of plans
Support	<ul style="list-style-type: none"> Hiring Staff reductions/additions Compensation plans
Marketing	<ul style="list-style-type: none"> Media spend Research decisions/budget Promotion plan
Procurement of outside vendors	<ul style="list-style-type: none"> Marketing/research/agencies Consultants



Forums are a supplement to the structured decision-making processes described earlier. They should improve the quality of decisions by bringing people from different parts of the organization together to exchange ideas, set direction, coordinate activities, and discuss effective practices. They also provide an ongoing mechanism to ensure decisions are executed and monitored.

Forums can help a company:

- significantly improve the effectiveness and efficiency of decision making
- clearly establish objectives, roles, and outcomes of different functions
- leverage the collective power of the organization.

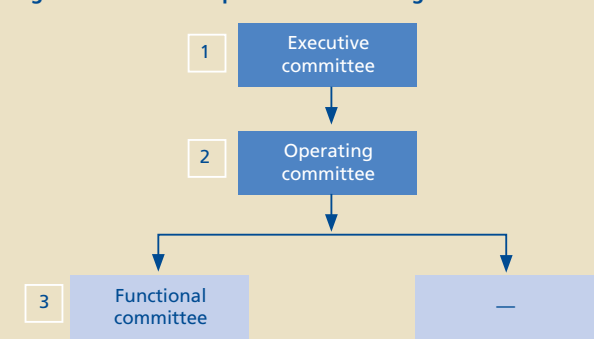
They can also promote continuous improvement through the open sharing of information, ideas, and lessons learned.

Forums are sometimes known as "councils" or "committees." Regardless of what they are called, most focus on a particular aspect of the business, such as Human Resources (HR), finance, manufacturing, site services, or marketing. Of course, each company and business model has different needs, and may require different kinds of forums.

Forums are not intended to add new layers of control. After all, the last thing a busy executive needs is to attend more meetings, particularly meetings that lack focus or purpose. Forums are designed to promote effective and efficient decision making, not bureaucracy or management by committee. In fact, once forums are in place, the result is often a significant reduction in unnecessary meetings because the forums bring the right decision makers to the table and sharpen the focus.

There are typically three levels of forums: (1) the executive committee, (2) the operating committee, and (3) functional and cross-functional committees for areas such as HR, finance, marketing, investments, due diligence, legal review, and real estate.

Figure 7. Forums help ensure decisions get executed



Beyond these three major categories, additional forums may be created to support project-specific needs

Many forums meet monthly and are part of a quarterly business review; however, the exact frequency and timing varies based on what a particular forum needs to accomplish. For example, an executive forum consisting of CXOs and the company president might meet monthly to develop and manage the corporate vision and strategies. A strategic planning forum might meet once a year, a marketing plan forum might meet once a quarter, and an operating review forum might meet once a week.

When establishing forums, start by understanding all of the forums that currently exist, including who participates, how often meetings occur, and what each forum is designed to accomplish. Then determine which forums to add or discontinue.

Forum participation is determined by the type of forum and the company's business model. (See Figure 8 for examples).

Executive committees: The CEO is always part of the executive committee, regardless of the company's business model. Under the holding company and strategic guidance models, business unit presidents are also included, while corporate executives are not. Under the strategic control and integrated models, the reverse is true. The one exception is that business unit presidents are sometimes included in the executive committee at strategic control companies.

Operating committees: Under the holding company and strategic guidance models, business units have significant autonomy. Therefore, the business unit president and business unit executives comprise the primary members of the operating committee. Conversely, under the strategic control and integrated models, corporate has the most control and the operating committee centers around corporate executives.

Forums can foster coordination and communication

A major clothing manufacturer had grown significantly through a series of acquisitions over a period of 18 months. In order to capture more synergies, the company decided to shift its business model from strategic guidance to strategic control. Under this new model, corporate now exerts more influence over strategy and direction. Yet each division continues to have significant control over its tactical operating decisions.

To improve coordination at the tactical level, the company has established a number of function-specific forums to foster communication and alignment across divisions. For example, a council of marketing VPs from each division convenes four to eight times a year to discuss ideas, coordinate activities, and share effective practices. Specific focus areas and outcomes include:

- **Coordinated purchasing.** Thanks to the marketing council, the marketing groups within each division now pool and coordinate their purchases. At first, there was resistance and skepticism; but that's one reason the council was established—to work through impasses. Once divisions start talking, their people can figure out better ways to get things done.
- **Agency selection.** The marketing council worked with each division to compile a list of services that were needed from advertising agencies. The council reviewed the collective needs, evaluated potential candidates, and then negotiated a company-wide contract. The council also monitors the agency relationship, oversees the progress of projects, and ensures that costs are being managed.

These are just some of the many ways the company is using forums to significantly improve operations and leverage the collective knowledge and power of its individual businesses.

Figure 8. Forum participation varies by business model

		Holding company	Strategic guidance	Strategic control	Integrated operating company	Frequency
Executive committee	Corporate	CEO	CEO Corporate Executive	CEO Corporate Executive	CEO Corporate Executive	Quarterly/ monthly
	Business unit	BU President	BU President	BU President		
Operational committee	Corporate		Corporate Executive	Corporate Executive	Corporate Executive	Monthly/ biweekly
	Business unit	BU President BU Executive	BU President BU Executive	BU President		
Functional committee	Corporate		Corporate Functional Executive	Corporate Functional Executive	Corporate Functional Executive	Monthly/ biweekly
	Business unit	BU Functional Executive	BU Functional Executive	BU Functional Executive		

Functional committees: Under the holding company and strategic guidance models, functional executives in the business unit are included on functional committees, but their corporate counterparts are not. Under the strategic control and integrated models, the opposite is true. Typically, the only exceptions are that corporate functional executives are sometimes included on functional committees under the strategic guidance model, while business unit functional executives are sometimes included at strategic control companies.

Council Consolidates Site Services

A large pharmaceuticals company wanted to centralize its site services function, which was responsible for everything from security and grounds maintenance to copy machines, creative services, travel, fleet management, aviation, and more. To support this goal, it established three councils to manage the startup, transition, and ongoing management of a new site services organization.

- **Executive Council:** These senior executives from each division set the strategy and budget and approve programs and service levels.
- **Operations Council:** These site services managers and users create and maintain service-level agreements, manage vendor performance, and help implement the site services rollout.
- **Customer Council:** These local users and site services managers gather customer input, identify needs for new or updated service-level agreements, and communicate those needs to site services management.

The company's centralization activities – including the creation of a centralized site services organization -- have already delivered approximately \$60 million in savings.

An HR council fills the gaps

A company that had grown rapidly through acquisition established an HR council to help tackle a variety of people-related issues. To get started, council members were interviewed to determine the current state of HR. Here's what they said:

- The company should view HR as the change leader during these times of transition
- HR needs a vision for its future direction
- HR employees are trying to do the right thing, but don't understand the big picture
- The role of corporate HR is still unclear
- HR needs to focus much more attention on organizational development and compensation strategy

Next, company employees were surveyed to determine what HR could do better. The survey results showed that HR was considered a professional, responsive department that did a good job at recruiting -- but was not seen as a strategic business partner. The department received favorable ratings in most areas; however, there were significant gaps in training and organizational development.

That's where the HR council came in. At its first monthly meeting, the council discussed a broad array of topics, including: interview findings, survey results, performance gaps, HR benchmarks and existing HR initiatives.

At its next two meetings, the council talked about HR's overall vision and mission, as well as the specific roles and responsibilities for corporate HR and division HR. It also discussed effective practices and the current status of key HR initiatives, including: succession planning; compensation analysis; performance management; policies, procedures, and ethics; performance metrics; Human Resources Information Systems (HRIS); and the launch of a new business service center.

The council's fourth meeting focused on the idea of a people skills assessment. The next meeting focused on a technology assessment, integration plans for recently acquired businesses, and a stronger partnership between HR and the business.

Outstanding issues include:

- How can HR fill the gap in training and development?
- What should be done to reconcile differences in compensation strategies across the company's new and existing businesses?
- How can HR create more value for the business, once the company's basic HR needs are met?

The council plans to continue its monthly meetings to address these issues and more, laying the groundwork for continuous improvement and value creation in HR.

Completing the skyscraper

Choosing the right business model and establishing an appropriate operational governance structure can provide a strong foundation for sustainable cost reductions. The next step is to deploy resources and take action.

The third article in our three-part series will present a service delivery model to help companies determine how to deploy their resources more effectively. The model provides a framework to help decision makers understand what types of services should be delivered at the corporate level – in order to significantly increase efficiency, service levels, and flexibility – and what types of services should be delivered by the business units. In our experience, there is often a large discrepancy between the way services are currently being delivered and the way they should be delivered. This is the final step to creating a more efficient and scalable cost structure.

Checklist

Does your operational governance structure need an overhaul? These questions can help you decide.

- Is there confusion about decision-making roles and responsibilities?
- Are people unsure about who is responsible for key decisions?
- Are duplicate resources working on the same things?
- Is decision making slow and overly time-consuming?
- Do you lack the necessary processes and infrastructure for key interactions and decisions?
- Are councils and committees viewed as bureaucracies or a waste of time?
- Do business units often work at cross-purposes?
- Are your company's support services expensive and inefficient?



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