"Organizing for Hyper Competition:
The Legitimation of Corporate Leadership"

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Abstract

Competing in a hyper competitive environment requires a flat entrepreneurial organization, with its attendant administrative processes. The two key attributes of such an organization are its ability to generate trust and to empower its employees. This paper argues that top management's concern for stakeholder participation during the process of transformation to the new organization creates new sences of legitimacy for its leadership. These in turn help build trust in the organization. Trust is the platform on which empowerment can take place in an organization. The current wisdom of a a two stage transformation process, where restructuring (sour) precedes revitalization (sweet), is thus challenged. The trust lost in the first stage takes a long time to rebuild. The paper is based on intensive field work in a large European telecommunications equipment manufacturer, called Temco in this paper. The CEO of Temco chose to follow a more evolutionary model of change, relying on pacts with the company's key stakeholders to begin the process of change. He then built more participation in the process, thus building trust. He is now engaged in the third phase of the transformation which seeks to empower the firm's employees in preparation for the transition to an entrepreneurial organization.

Corporate transformation, Entrepreneurial Organization, Coping with Hyper Competition

Introduction

Hyper competition is an industry condition where several well endowed competitors engage in a dynamic struggle for leadership (D'Aveni, 1994). Competitive advantage is temporary. The industry environment is one of frequent disruptions punctuated by rare stable periods. The underlying drivers of hyper competition are the growing systemic complexity and the rapid rate of innovation in an industry. Competing in this new environment calls for a strategy that is highly sensitive to changing customer needs and one that can be executed with speed and surprise to competitors (D'Aveni, 1994). The traditional hierarchical organization is ill suited to the new requirements.

First, the traditional hierarchy slows down decision making. Given the speed that is now required, many industry giants like IBM, AT&T, ABB and GE, have delayered their organizations within the past five years. The number of layers between the business manager and the chief executive have been reduced, in some cases, to just three. A hierarchical organization is also extremely risk averse. While it may successfully avoid any errors of commission, it can make big errors of omission (Ghemawat, 1991). In a hyper competitive environment, the window of opportunity is open but briefly and there is seldom any room for a follower (D'Aveni, 1994). It is, therefore, not enough to delayer the organization, business managers must also be empowered to pursue entrepreneurial strategies. A third disadvantage with the hierarchical organization is the difficulty it faces in changing course once it has been set. In a hyper competitive environment, given the speed with which new investment decisions have to be made and the great deal of ambiguity surrounding them, it is prudent not to treat strategic investments as irreversible commitments but rather as the purchase of options, which may or may not expire in the money.

FIGURE 1 ABOUT HERE

The transition from a traditional hierarchical organization to a flat entrepreneurial organization (See Figure 1) is difficult under the best of circumstances. The traditional hierarchical organization typically has at least five layers of management. In contrast, the flat, entrepreneurial organization has much fewer layers, typically three (Ghoshal and Bartlett, 1993). The entrepreneurial drive comes from business managers who now enjoy considerable autonomy. Also, the business managers in this structure are all networked horizontally. The role of senior managers, is that of coaches to these front line business managers. The primary responsibility of top management is to provide a stretching vision for the organization and to design organizational processes that nurture entrepreneurship. Symbolically the organization is drawn upside down to signify that the entire organization seeks fundamentally to serve the customer.

There are not only fundamental differences in the two structures, the associated systems and processes are also different (Chakravarthy and Lorange, 1991). In the traditional hierarchy, the strategic planning process is typically top down. Top management establishes the strategic direction for the firm. Business managers merely give it shape and implement the strategy within strict budget constraints. The control process used in this organization is what is called steering control (Newman, 1975). The business manager is given periodic feedback on his/her performance against the budget. This negative feedback is expected to bring business performance in line with the budget. The incentives are tied closely to performance against the budget. Whereas this process seems to work well for managing in a stable environment, it is not well suited to a hyper competitive context.

In its ideal form, the flat entrepreneurial organization visualizes fully empowered business managers who are responsible for being market focused and opportunistic. They are overseen by a small team of business area managers, each representing a family of businesses. Strategic planning is driven by the business managers. The control process is tailored to the needs of each business, and with sufficient flexibility to allow walking away from projects if the environment so warrants. In the context of hyper competition, budgets may have to be flexible. Rewards have, therefore, to be geared also to the quality of the effort expended and not only to the results delivered. Setting up such a reward system is difficult as it involves a lot more subjective assessment of performance. Above all, what business managers seek in this context is a sense of ownership in the key decisions of the firm. The decision making process in the firm has to be truly participatory and procedurally fair (Kim and Mauborgne, 1994).

The central argument of this paper is that the trust and empowerment needed in the new organization are in fact crucially dependent on the process of transformation that the firm uses to get there. The ideas in this paper were developed during our year long field work in a large European telecommunications equipment manufacturer, called Temco for purposes of this paper. It is currently building a flatter, more entrepreneurial organization in preparation for the hyper competition that is imminent in its industry, but the legitimacy of its corporate leadership to administer this new organization was established progressively over ten years, during the long transformation from a traditional hierarchy.

The paper is organized in three main sections. The first section provides the theoretical basis for our central proposition. The next section describes the context of our study, the transformation at Temco. The concluding section analyzes how Temco achieved and maintained the legitimation of corporate leadership during this process and offers a set of propositions on organizing for hyper competition based on the Temco experience.

The legitimation of corporate leadership

One of the central arguments of this paper is that the new form of organization required in hyper competitive environments is also associated with a new form of legitimation of corporate

leadership. To substantiate our claim, we will first examine how leadership is legitimated in the traditional hierarchical firm. We will then discuss how top management of the new entrepreneurial organization must legitimate its leadership. We will draw parallels between organizations and political systems in order to develop our ideas in this section. This is an approach that was fruitfully initiated by Jim March (1962) more than three decades ago.

Legitimation in hierarchical organizations

The legitimation of corporate authority in the hierarchical organization owes its foundations to Max Weber and his theory of bureaucracy. In his seminal analysis of the basis of legitimate authority, Max Weber noted that the legitimation of authority in modern societies takes mainly a procedural form. According to Weber, this authority rests "...on a belief in the legality of enacted rules and the right of those elevated to authority under such rules to issue commands." (Weber 1978,II:954). A given command is accepted only when it is within the legitimate realm of the actor issuing it and when the command is in accordance with the formally established procedures. The formal characteristic of the legal order discussed by Weber has direct connections with his theory of bureaucracy, a link that is evident from his frequent references to the "superior" and the "subordinate" throughout the analysis. The same vertical logic permeates Taylorism and its offspring, the scientific management movement (Gulik and Urwik, 1937), whose ideas still influence the way in which business organizations are structured.

However, bureaucratic rationality, in and of itself cannot legitimate corporate leadership. Business organizations are expected to generate outputs that satisfies the demands of its stakeholders. Corporate leadership is expected to steer the organization in a way that it can generate the resources necessary to pay the "inducements" demanded by the different stakeholders in exchange for their "contributions" (Barnard, 1938). The coalitional model proposed by Cyert and March (1963) also sees top management legitimating its leadership through its skills in attaining a balance between the demands of the coalition members and the returns to the firm from their collaboration.

The legitimation of authority based on its ability to satisfy stakeholders' demands is also stressed in the studies on political stability. Members of a society expect political power in it to be exercised so as to help satisfy their material interests and ideals (Lipset, 1960; Linz, 1978). Obedience to authority based on the satisfaction of stakeholders demands is recognized as an important source of stability (Easton, 1965; 1975). This perspective when taken to its extreme reduces the legitimation problem to a combination of formal legality and systems outputs (Luhman, 1984).

The traditional hierarchical organization relies on an autonomous, centralized authority for reconciling otherwise incompatible motives and interests (Bendix, 1956). Political theorists, however, have pointed out that centralized decision making increases the external risks for

those who are affected by the outcomes without participating in the decision process (Sartori, 1987;I:214-247). Their support for the decisions is solely based on the system's ability to satisfy their demands. If demands are not satisfied, decision makers are likely to meet passive opposition, which under certain circumstances may also become an active challenge to their authority or lead to defections from the organization. In his thoughtful comparison between organizations and nation-states, Hirshman (1970) has labeled these active responses "voice" and "exit" respectively.

The risk of alienating stakeholders because of an organization's inability to satisfy their demands may be insignificant in contexts where the corporate leadership has access to ample slack resources It can selectively increase inducements to the dissatisfied stakeholders. In other cases, a stakeholder's ability to exert pressure may be negligible, either because of inability to put forward active opposition or because of limited "exit" options. However, such a situation is hardly a stable one. It merely keeps discontent bottled up, ready to spill at the first available opportunity.

The inertial growth of stakeholder expectations when combined with the decreasing levels of organizational slack that characterize hyper competitive environments makes alienation of stakeholders a real possibility. This is further accentuated by the likelihood of external shocks, which can easily diminish the contributions generated by the organization. When the legitimacy of corporate leadership relies exclusively on its ability to pay inducements to the different members of the coalition, both escalating demands or dramatic reductions in contributions can break up the coalition, thus eroding the leadership's ability to steer the organization out of the crisis.

There are two types of responses to the above legitimation crisis. First, decision makers may increase centralization and use extraordinary measures to assert their authority. This authoritarian response is widely documented in the analysis of the breakdown of democratic regimes (Linz and Stepan, 1978). Second, leaders may resort to pacts in which conflicting demands are re-negotiated and the balance between "contributions" and "payments" is re-set to prevent the breakdown of the system. Such pacts are common in modern democracies (Lipjhart, 1969; Schmitter, 1979), as well as in contexts of political transitions to democratic regimes (O'Donnell and Schmitter, 1986). Their importance, however, goes beyond the simple re balancing of inducements and contributions among the different groups in a society. Typically, successful pacts either introduce or revitalize participation. Whereas the use of pacts may be a necessary first step in the transition from authoritarianism, legitimation of leadership in a democratic system requires additional mechanisms as well.

Legitimation in "democratic" systems

The role of substantive procedures for decision making is a central concern in theories of political legitimation. The legitimacy of authority in a democratic system is both formally and

substantively procedural. On the one hand, democratic legitimacy is formally procedural because decisions are produced according to the law and the institutions of society. On the other, it is substantively procedural because decisions -- including the laws -- are the result of an open but regulated conflict, where different interests and perspectives have in principle the full right to participate. The process is open to all members of the system and is developed according to pre-established rules. This perspective, shared by most modern theorists of democracy, was defined by Przeworski (1986:56-57) as "...a particular system of processing and terminating inter group conflicts". The procedures through which conflicts are resolved do not refer exclusively to formal rules, but also to the participative decision-making process through which these rules are set (Dahl, 1956; 1971).

The repeated generation of decisions through structures of participation and interest representation reproduces the legitimacy of the democratic system, even for those groups whose interests may have been circumstantially harmed by a given decision. In order to be able to produce the outputs that feed the process of its own legitimation, a democratic system must succeed in developing institutions that allow for participative decision-making. At the formal level, these are the abstract procedures of the institutional and legal order. At the substantive level, these are structures of communication that potentially link interest groups and individual citizens, thus facilitating the exercise of "voice" and the generation of "loyalty" through binding agreements and compromises on the principal problems faced by the system. Empirically, these structures can be seen as structures of participation and group representation, through which conflict is processed and resolved. In a democratic system, unlike the vertical logic of bureaucratic control associated with authoritarian regimes, the horizontal logic of social control is the guiding principle. The balance between the conflicting demands of different societal groups is attained through a participative process, rather than being imposed by a central authority.

The reliance on procedural mechanisms to reproduce the legitimacy of corporate leadership does not imply that the traditional legitimation based on the balance between inducements and contributions disappears. Corporate leadership still has the responsibility of ensuring that the sum total of contributions generated by a firm's stakeholders are greater than the sum total of inducements that they have to be paid. Even in a democratic system, participation alone cannot generate the necessary support indefinitely. However, by successfully introducing participatory mechanisms, corporate leadership ensures that its legitimacy does not depend solely on short term results. It thus gives itself some buffer against environmental shocks.

Preserving Legitimation in the Transition

So far we have argued that the introduction of "voice" and "loyalty" as mechanisms to reproduce the legitimation of corporate leadership is necessary in situations of resource shortage or under conditions of turbulence such as these imposed by hyper competitive environments. The "voice" given to stakeholders would thus seem to be merely the price that

corporate leadership has to pay in exchange for stakeholder loyalty in a crisis. Yet "voice" should not merely be perceived as the cost of purchasing stakeholders' loyalty. There are at least three supplementary benefits to voice.

First, "voice" increases an organization's ability to scan its environment. Whereas the scanning ability of the organization is still limited by the cognitive limits of its members, greater sharing of their perceptions that "voice" provides improves the quality of its environmental scan (Kwun, 1993). Second, "voice" makes decision implementation easier. Stakeholders are more likely to support policies whose formulation they had a fair chance to influence. Third, the participative mechanisms that support "voice" during the transition from the hierarchical organization both erode the authoritarian culture of the firm and set the stage for the introduction of empowerment initiatives, which are essential to the survival of the organization in hyper competitive environments. While the first two benefits have been often recognized in the managerial literature on empowerment (Kanter, 1984; Kanter, Stein, and Jick, 1992), the importance of the third factor has not been stressed in studies of corporate renewal. Later in the paper, we argue that the introduction of participative mechanisms during the transition from an hierarchical to a democratic organization not only contributes to the legitimacy of the corporate leaders during the difficult period of readjustment, but it also creates structures that will facilitate the introduction of empowerment mechanisms that are vital to the entrepreneurial organization.

The Temco Context

Temco is the national subsidiary of a leading global telecommunications equipment manufacturer. It is the largest supplier of telecommunications switching, transmission and cable products for both public and private networks in its home country, and is also a significant player in China, Eastern Europe and Latin America. Its turnover in 1994 was over a billion US dollars, with nearly a third representing international sales. Temco prides itself in being a "multinational within a multinational company."

In the communications infrastructure sector that Temco competes in, rapid technological advances and increasing deregulation have removed the barriers that have historically separated suppliers of telecommunications, computers, and consumer electronics equipment. These companies are increasingly battling for the same customers. Established telecommunications equipment manufacturers like AT&T, Alcatel, NEC and Northern Telecom, and computer companies like IBM and Fujitsu, have all announced plans to invest heavily in the ATM (asynchronous transmission mode) switch. This switch is vital to broad band multi-media communications. The telecommunications equipment manufacturers face an equally fierce fight in the customer premises equipment (CPE) market, as the plain old telephone gives way to the telecomputer - a device that will at once be a telephone, a fax machine, a personal computer, a high definition TV, and a home entertainment box. That will bring all the leading consumer electronics firms like Sony, Matsushita and Philips; as well as computer firms like IBM and

Hitachi in direct competition with the telecommunications equipment manufacturers like AT&T, Alcatel and Siemens. The industry standards for both cost and features have tightened substantially.

The growing number of deep pocket competitors, the multiple interactions between them (both as competitors and collaborators), together with the fast pace of innovation in the industry make the environment for the supply of communications equipment hyper competitive. Temco is creating a flatter, more entrepreneurial organization to compete in this new environment. The change program is called Summit within the company, to symbolize the difficult challenge that it poses.

Summit was the program that we first sought to study at Temco. However, we realized early in our field work that the basis for Summit had already been established in the nearly decade long transformation that Temco had recently concluded successfully. What we present in this paper is one important link between the two processes - the legitimation of corporate leadership. Theory building from a single case study has its obvious limitations. We are not going to belabor the many limitations of this approach or rationalize its virtues here. We hope that the insight we have gained, i.e. the "genetic imprint" that the transformation process leaves on a firm critically influences its ability to organize for hyper competition, is of sufficient interest to the reader to provoke further study and debate.

Through the early 1980s, Temco was the sole supplier of telecommunications equipment to the national telephone company in its home country. These sales represented over 70% of Temco's revenues in 1984, and nearly 90% of its domestic sales. Despite its monopoly position, the company's financial performance was sluggish all through the 1970s. In the early 1980s Temco was caught by surprise when the simultaneous forces of technological change and deregulation first began to erode the company's monopoly power. Temco's performance deteriorated dramatically and the company made losses for the first time in its long history.

Company officials attributed its poor performance to three factors: over reliance on a single major customer, intransigent labor unions and the advent of digital technology. Given its high break-even point, Temco's profits were highly sensitive to capacity utilization. The large national telephone company could thus affect Temco's profits even by a small change in its orders. Unionized labor was very strong and over the years had successfully extracted a very favorable compensation and benefits package from Temco for its rank and file. Technology change was the third important factor. Temco had primarily produced electro-mechanical switches through the early 1980s. In the mid 1980s, electronic switches began penetrating the telecommunications market. The national telephone company had expressed a strong preference for this new switch. However, the introduction of the electronic switch was disastrous for Temco. The higher capacity of the switch and the reduced labor content in its manufacture meant that Temco could serve the switching needs of the national telephone

company with an eighth of the work force that it used to manufacture the electro mechanical switch. Technological change made over 3,000 employees redundant at Temco.

In March 1984 the Ministry of Industry together with Temco, the Socialist union and the national telephone company signed the Re conversion Plan aimed at restructuring Temco and making it competitive and economically viable again. The plan was the result of ten months of intense work and negotiations between the four major Temco stakeholders. It specified a relatively detailed course of action and a series of specific targets that had to be achieved by Temco.

Jack Thomas (a fictitious name) came to Temco as its new CEO soon after the re conversion plan was signed in 1984. He was brought in to turn the company around. When he first took charge of Temco, Thomas realized that the inducement balance of the firm was skewed toward the unionized employees (see Figure 2). Among Temco's key stakeholders, only the union was perceived as receiving a fair share of inducements. Temco's largest and most important customer, the national telephone company, was unhappy both with the product choices and prices that it was offered. Temco was a government approved monopoly. The stockholder, in this case Temco's parent, was obviously dissatisfied with the losses at Temco. The fourth major stakeholder, the government, was also dissatisfied with Temco's performance. The company's inability to create jobs, generate tax revenues and increase its foreign exchange earnings was not looked upon favorably by the government.

FIGURE 2 ABOUT HERE

Thomas did not follow the first "sour" (restructuring) and then "sweet" (revitalization) sequence that is especially popular in the transformation of under performing firms. While the performance results with this approach are immediate and tangible to the stockholders, the resulting pain for the other stakeholders of the firm is largely hidden. Instead, the process that Thomas chose to use was one of continuously balancing the interests of one stakeholder against the other and ensuring at all times that the process was perceived as fair by the key stakeholders - albeit grudgingly. Thomas did not want Temco to lose the trust of its key stakeholders, especially its employees, during the transformation process. The legitimacy that Temco's corporate leadership has consequently built with its employees is now enabling the company to move quickly toward a flatter, more entrepreneurial organization through its Summit program.

Thomas has also led the company to a performance state where each of Temco's stakeholders, now receive better inducements than they did in 1984 (Figure 2). Indeed in the ten years that he has been at the helm of Temco, Thomas has successfully transformed the company. The number of employees at Temco have since dropped by 5,600 (a 35% reduction in workforce).

He has successfully divested several politically troublesome businesses, reduced the reliance on the national telephone company, and boosted international sales from 16% to 36% of turnover over this ten year period. The company's ROE has also returned to a healthier double digit number. Above all, the organizational climate within Temco has changed to one of confidence and hope from the earlier self doubt and despair.

Renewal at Temco and the Legitimation of Corporate Leadership

The Use of Pacts in the Transition Phase

Political theorists have recognized that pacts allow for adjustment to standing contradictions between social content and political form (Kirchheimer, 1969). When the real distribution of power does not match the formal arrangements, pacts make it possible to change the institutional structure of the system without violent confrontation or dangerous exclusions of important groups. Pacts result from exchanges between interdependent groups in which both their right to participate in decision making and to defend their interests are explicitly recognized. Pacts have played a crucial role in political transitions from authoritarian to democratic regimes (O'Donnell and Schmitter, 1986). Successful pacts are not limited to a simple re negotiation of the way in which costs and benefits should be distributed. Rather, they play a crucial role in defining the rules of the participatory game in which the different players are to negotiate and defend their respective interests.

Temco's re conversion plan of 1984 is a good illustration of the use of a pact to resolve the conflicting demands of the firm's stakeholders. The three pillars of the re-conversion plan were: a labor agreement, a commercial strategy and a financial policy. Under the labor agreement, Temco was forbidden to lay off employees for a period of three years. The union agreed in turn to workforce reductions through early retirements and voluntary departures. The national phone company promised to absorb 900 Temco employees at the rate of 300 per year to provide maintenance support for Temco supplied equipment. It also agreed to help protect approximately 1,000 jobs through additional orders. This would still leave 1,250 redundant employees on Temco's payroll. The commercial strategy called on Temco to develop new international markets and to diversify old businesses. The financial policy called on the national phone company to place the bulk of its order on Temco. Temco's shareholders, primarily its parent, agreed to forego dividends and royalties for three years and to allocate additional funds for diversification and R&D. The national government, for its part, agreed to grant Temco low-interest loans to pay for redundancy compensation packages, and both the government and the national telephone company agreed to invest additional capital in Temco. The agreement also established a follow-up commission with representatives from Temco, the union, and three ministries - Industry and Energy, Labor and Social Security and Finance. The top management of Temco was required to present annual progress reports to this commission against the targets established in the Plan. Thomas saw the reconversion plan as a necessary first step in

Temco's transformation. For the long term, Thomas sought to reach a situation of stable and profitable growth based on the company's competitiveness both in the national and international markets. He wanted to reshape Temco so that it could become a market-oriented, entrepreneurial company where employees would feel motivated to contribute as partners to the company's growth.

The typical cost-cutting tactics by which a new corporate leader restores profitability were not available to Thomas. Not only did the 1984 agreement explicitly prohibit layoffs for three years, its employment targets, largely as a consequence of governmental pressures, were far too optimistic.[1] During implementation, the actual numbers were significantly different from these optimist estimates (see Figure 3). Moreover, the many conflicts during the two first years of the plan among the different stakeholders suggest that the pact was not built on solid grounds. The report submitted by Temco to the monitoring commission in 1984 made evident a series of problems that would rapidly strain the fragile commitment of the parties. Temco was clearly below target in terms of exports and overall activity, which led to an increase in the number of temporary layoffs. This did not help its relations with the unions, whose representatives in the monitoring commission were only too eager to join the government's demand for a more detailed report on the 1984 results. Temco also faced a number of problems with the new digital switches. This affected its relationship with the national phone company, its main client. The relationship deteriorated during the second year of the plan. The points of friction ranged from the phone company's refusal to accept a major shipment of new digital switches to its failure to keep its commitments on the absorption of Temco personnel, as stipulated in the reconversion plan. The disputes, openly aired in the 1985 report, attest to the breakdown in the fragile consensus reached with the 1984 pact.[2]

FIGURE 3 ABOUT HERE

By the end of 1985, the coalition that was assembled to rescue Temco was rapidly falling apart. Temco's inability to meet the targets specified in the plan eroded the balance between inducements and contributions attained in the 1984 negotiations. Although Temco did show a

[1] The initial version of the plan presented by Temco in June 1983 was not accepted by the Ministry of Industry and Energy, which asked Temco and the national phone company to revise its basic assumptions about demand and its implications for employment. In response to governmental pressure, both companies did identify some additional demand which would reduce significantly the number of redundant employees in Temco.

[2] The irksome issues comprised things such as a dispute on whether committed volume of purchases should or should not include the cost of packaging, and the client's refusal to accept price increases generated by wage raises above the target of 6.5%, even though they were caused by an adjustement of the initial figure due to inflation rising higher than the original forecast. Temco was forced to give a higher raise to its employees as per the conditions of the plan.

meager positive result in 1985, this was largely caused by including the sale of digital switches that were under dispute at that time with the phone company. By failing to establish realistic targets and to provide suitable conflict resolution mechanisms the 1984 plan did not achieve stakeholder support. The poor results against the plan did not help the top management at Temco legitimate its leadership. When the results of the 1984 plan did not meet the expectations, major tensions began to arise among the coalition members.

The discussion in this section would suggest that in transitions from a hierarchical organization, an under performing firm would find it useful to establish pacts with its key stakeholders. But if the pacts are based primarily on performance expectations, the coalition is not stable.

Proposition 1:

> Pacts with stakeholders that are based primarily on performance expectations may re set the inducement contribution balance, but they do not help legitimate corporate leadership in a stable manner.

Building in Participation

The transformation process at Temco illustrates the difference between pacts that simply redefine the inducement-contribution balance among stakeholders (thus leaving the legitimation of corporate leadership largely dependent on economic results), and pacts that attempt to increase stakeholder participation in the administering of the pact itself. The initial pact at Temco, signed before Thomas arrived, exemplifies the first type. The second agreement, signed in 1987, under Thomas' leadership, shows how pacts can be instrumental in moving the structure of an organization towards more participation, thus helping to generate stakeholder loyalty.

With his hands tied up by institutional and political constraints, Thomas knew that the only way to attain his goals at Temco was to regain the support of the stakeholders. The new CEO visited several sister companies, to meet with their managing directors and to get a feel for how Temco was perceived within the parent company. He also interviewed the corporate staff of the parent company. He met all key customers and had especially long talks with the national phone company. Also on his itinerary were meetings with officials from the Ministry of Industry and representatives of Temco trade unions. He visited all Temco companies and on these visits asked each general manager to make a brief presentation on the opportunities and challenges for his businesses and products. He didn't impose any particular format for these presentations since he wanted to assess what each of his managers felt was important issues. These meetings were essential to building the trust that eventually allowed for the successful re negotiation of the plan in 1987.

Complementary to this strategy was a definite attempt to build a strong support coalition inside the firm. This attitude was evident from the onset. At his first meeting with Temco's top

executives in July 1984, the new CEO took a matchbox from his pocket and flung it on the conference table and told his colleagues:

> If you tell me that this is an integrated circuit, I'll believe you. You are the technology experts, I am not. I am an industrial engineer not a telecom specialist. I need your help to run this company. I request each of you to give me your diagnosis of the company's problems and any recommendations you may have to change the situation dramatically for the better.

At first glance, Thomas' efforts to regain the support of the different stakeholders both inside and outside Temco does not differ from the typical balancing act of any chief executive trying to restore a broken coalition. He knew he could not possibly deliver the results that were expected under the 1984 agreement and therefore sought to re negotiate those conditions. Indeed Thomas was able to scale down stakeholders' expectations, notably in terms of layoffs, and export growth. The number of employees in the redundant list was increased to 2090 in 1987 from 0 in 1986 (the earlier plan had assumed that there would be no redundancies beyond 1986). The export targets in 1987 were scaled down to a third of the targets set for 1986. The targets for subsequent years were also reset accordingly. In addition, Thomas ensured that the political basis of the 1987 agreement was substantially different from those of 1984. He maintained direct and intense communication with all the key stakeholder even after the 1987 agreement was signed. The vice president in charge of employee relations had daily breakfast meetings with representatives from the unions to deal quickly with any misunderstanding. He not only informed them of the progress against the plan, but sought their help in resolving difficult problems. Thus, for example, when sales to the phone operator shot up in 1988, the unions wanted to cut back on the temporary layoffs and early retirements planned in the restructuring program. Temco's top management did not yield to this pressure but offered instead to raise the compensation paid to redundant workers even though it was under no obligation to do so.

In describing his style of leadership, Thomas noted:

> "I try to keep in close touch with the representatives of all internal stakeholders. Some are for change. I value their ideas. Others are against it. I value their caution. The fine art of managing any change process is not so much in knowing where to go, but rather what is the prudent speed to get there. I believe in participation. That does slow things down a bit. But whoever said revolutions are the way to go? I believe in evolutionary change."

The importance of Thomas' approach to generating stakeholder support is evident when analyzing the results for 1986 and, subsequently, the figures for the period 1987-91 (See Figure 4). Net income continued to be depressed during the second plan period, in 1987-91. The sales for the period 1987-91 do show some improvements but this was largely due to the unpredicted but fortunate explosive growth of the domestic market. But Temco lagged considerably behind in its export commitments.

FIGURE 4 ABOUT HERE

The one figure that improved all through this period was employee productivity measured as a ratio of sales to active number of employees at Temco. This is a healthy trend, when the redundant employees were finally phased out at Temco in 1991, placed the company's productivity on par with industry leaders. Figure 3 compares the performance of Temco under both the 1984 and 1987 plans. Figure 3 suggests that Temco's leaders could have been challenged on its results in 1986-91, as they were in 1984-85. Yet the evidence from the reports to the monitoring commission indicate that the performance of the leadership team was not challenged after 1985. Moreover, the initial targets were routinely readjusted in negotiation with the major stakeholders, notably on export targets. We argue that this was possible because Temco's management team derived its legitimacy from a participative process in which the delicate political balance between the different stakeholders was actively managed by the CEO.

In order to adapt successfully to the conditions of hyper competition, an organization needs to generate loyalty among its stakeholders. They must be willing to support corporate leadership even in circumstances where the organization is unable to meet their expectations in terms of inducements. Following Hirshman (1970), we will argue that loyalty is incompatible with centralized decision-making, for it creates a need for "voice." Active stakeholder participation in the decision making process is necessary for maintaining the legitimation of corporate leadership in firms that are under performing. These mechanisms are similar to the substantive procedures that institutionalize participation in democratic regimes. This is one of the most important justifications for the "empowerment" strategies recommended by management gurus and adopted by business organizations. The inability of top management to recognize how such "empowerment" fundamentally alters the way in which corporate authority is legitimated often leads to organizational failure. Top management cannot demand loyalty without actually given voice to the organization stakeholders. As it is the case with democratic political systems, the new organization needs to include substantive procedures for stakeholder participation.

Most existing business firms are structured according to the hierarchical, authoritarian model. Moreover, the leaders of these firms are likely to have been weaned on the rules of a hierarchical organization. Informal patterns of sponsorship and the resulting networks of mutual obligations often reinforce the hierarchical culture. Strong inertial forces, rooted in the informal and formal power structure of the hierarchical organization, continuously reproduce the logic of bureaucratic control and its legitimating mechanisms.

There are two important ways in which these forces may prevent the transition to the new organization. First, inertial forces may favor centralized, authoritarian responses to the performance decline that typically precedes the transition. This in turn will seriously limit

management's ability to introduce a participative process after the crisis. Second, the dominant hierarchical culture may contaminate "empowerment" programs. They may be used (and perceived as such) as cooptive tactics to obtain loyalty rather than as an authentic attempt to promote alternative mechanisms of social control and participative legitimation. These two factors reinforce each other, since authoritarian responses to performance crisis are likely to erode the credibility of management as a true champion of participation.

The conditions under which the transition to the new organization is likely to start typically involve more or less severe threats from the environment, which translate into output decay and financial constraints. In this context, the authoritarian model is likely to be strengthened, for corporate leadership may feel the need to increase its autonomy vis-a-vis stakeholders -- especially labor -- in order to successfully steer the organization out of the crisis. Indeed, this is the implication of the "sour-then sweet" approach that dominates the normative literature on corporate renewal.

We argue, however, that an authoritarian management of the transition into hyper competition is likely to erode the very basis the organization needs for its renewal. The apparent gains in terms of lower decision costs during the transition -- which may translate into short-term financial results -- eats into the social capital of the relationship between corporate leadership and major stakeholders, notably the employees. Yet it is precisely this social capital that is needed to build the new organization (Pfeffer, 1994) and to create the new legitimation mechanisms that will help corporate leadership to endure future shocks.

The participative process that Thomas used at Temco seems to have created this social capital. The government was happy with Temco's passionate mission to be a net exporter within the parent company, and a major multinational corporation in its own right. This would help the trade surplus of the country. The trade unions were satisfied with the planned way in which the company had halved its workforce in less than ten years. A leading newspaper described Thomas as a man whom the unions could trust. It reported that the 1992-93 wage negotiations with the unions lasted a mere five minutes. Thomas had frozen the salaries of top executives and had awarded the union employees a wage increase of 5%. But he also asked for and got the right to limit future wage increases to less than inflation and to expand the variable component of employees' wages based on their contribution to the company's strategic objectives. Independent surveys of employee satisfaction showed that it actually improved, albeit gradually, at Temco during the transformation period from 1987-91. Thomas' obvious regard for customer satisfaction appealed to Temco's major customers. His no nonsense approach to delivering on budgeted commitments appealed to the parent company. During the transition, Thomas was successful not only at balancing the multiple demands of his stakeholders, but also at establishing an alternative legitimation formula for corporate leadership.

The discussion in this section leads us to another important proposition.

Proposition 2:

> The introduction of participative mechanisms in administering pacts with stakeholders may weaken vertical control, but it generates trust between stakeholders.

Summit: The Medium is the Message

The process of transformation at Temco between 1984 and 1991 left behind much more than good feelings among the stakeholders. It created the basis for launching Summit - the creation of an entrepreneurial company.

In 1993, when the long transformation process was coming to an end and the viability of Temco was no longer at stake, Thomas sought to transform the corporate culture of Temco to one of constant improvement and a fully committed workforce. To this end, he launched Summit. Speaking of Summit, Thomas noted:

> In the nine years that I have been managing Temco, we have made enormous progress: restructuring our business portfolio, downsizing our workforce, diversifying into new businesses and into foreign markets. The fight for survival kept us all motivated. Now that we have achieved some significant results, there is always the danger that we may get complacent. But our competitive context requires us to improve continuously.
>
> Moreover, the achievements in the past were due to a handful of generals; now I want the entire organization (army) to be mobilized for change. Zenith is the program that I have chosen to create this new culture. It defines a set of values that must be present in all activities of Temco: customer orientation, consistency with the firm's strategic intent, personal initiative and ambition for achievement, setting a good example through every action, teamwork and underlying all of these, a striving for constant improvement in all that we do.

The annual budget for the Summit program was set at only $800,000, emphasizing the primarily catalytic role of the program. The Summit team was not to be the driver of change but rather its facilitator. The team was responsible for designing the program, organizing the necessary training for it and monitoring/evaluating progress against the Summit objectives. The members of this team included junior employees with different backgrounds and age, but each knew the company well and was respected in his/her respective department. The Summit team was supported by an Advisory Committee made up of people selected from different Temco businesses and presided by the Summit program's director. The new program sought to empower employees at all levels. In order to facilitate this, Temco had successfully negotiated with its unions the right of the company to offer differential wages to employees based on their contributions to the Summit program, an achievement that would have been unthinkable in the late 1980's. The unions agreed. They now had more trust in management.

Commitment through participation was both what Summit was all about and what it sought to achieve for Temco.

Like most terms that make it into the management hype, "empowerment" is loaded with multiple meanings and ideological connotations. To understand how the concept can easily slip into a self-defeating ritual, we must examine how empowerment differs from other actions aimed at increasing the cooperation between management and employees.

FIGURE 5 ABOUT HERE

Figure 5 distinguishes four forms of stakeholder involvement in organizational decisions and the level of cooperation that each is likely to elicit. The most elementary way of involving stakeholders is by keeping them informed. Even though decisions are centrally made, management makes special efforts to keep stakeholders informed on all major decisions. This is unlikely to obtain more than acquiescence from stakeholders and may even be met with passive resistance to the extent that the decisions affect the interests of stakeholders negatively. If the interests affected are vital, and if stakeholders have either an opportunity to exit or the ability to voice their opposition, the resistance may even become active. The second way in which stakeholders may be involved in the decision making process is through two-way communication. In this form, stakeholders' views are actively sought and recorded by management. While stakeholders have the opportunity to influence the final decision, the organization does not have any established mechanisms through which such influence can be secured.

The third and fourth forms of stakeholder involvement presuppose the availability of institutional mechanisms through which stakeholders' "voice" can actually influence the decision-making process. Cooptive tactics were well-described by Selznick (1980) in his classic study of the TVA organization. The essence of these tactics is not to share power, but to assimilate potential or actual sources of opposition. Cooptive mechanisms do not call into question top-down management; rather, they circumstantially release bureaucratic control as a way to deal with a de facto distribution of power that does not match the existing formal arrangements. Although any form of participation may create the potential for exercising influence, the aim of cooptive arrangements is to de-activate sources of opposition rather than to democratize decision-making. Cooptive tactics may at times elicit active support, but acquiescence is the most likely outcome.

Empowerment involves a change from a system of hierarchical control and coordination to one in which the initiative relies on the individuals performing the task. As such, empowerment not only presupposes ample information sharing and communication within the organization, but also an effective culture of participation. This active involvement of the employees has been

cited as one of the most important practices in use by effective firms (Pfeffer, 1994) and has proven impact on job satisfaction and productivity (Levine and Tyson, 1990). As such, empowerment is the only of the four forms of stakeholder involvement discussed here that is likely to generate the kind of active support and loyalty required for firms facing hyper competititve environments. Yet attempts to introduce empowerment mechanisms may easily sound hollow when they are implemented within an hierarchical culture reinforced during the first stages of the "sour-then sweet" model of corporate renewal.

Based on discussions in this section, we offer our final proposition:

Proposition 3:

> A participatory process of change is better able to create an empowered organization than one that is authoritarian.

Conclusions

There are not too many examples of successful transitions to a flat entrepreneurial organization. GE (Tichy and Sherman, 1993) and ABB (Bartlett, 1993) are the two frequently cited examples of such a transition. In the case of GE, the process was long drawn. Eight years after Jack Welch, GE's new CEO, had introduced dramatic changes in the company its front-line business managers were still asking their leader in 1988: "If this is the best business in the world, why do I go home feeling so miserable?" (Tichy and Sherman, 1993, p 195). The managers did not feel empowered. Trust in the system was low. GE subsequently introduced a new program called Work-Out to address these and the related problems of bureaucracy and turf protection. In contrast, ABB - the merger of Asea and Brown Boveri, seems to have had a better start. Despite the difficult task of merging several different companies, each with its own distinct culture, trust and openness seem to have been established a lot sooner at ABB. This admittedly bird's eye view of two very complex processes can of course be misleading. Nevertheless, the two case studies point to an important difference in the approach to transformation that the Temco case has highlighted.

The transformation at GE has been closely identified with Jack Welch, its brilliant CEO. His very first act as a CEO was to demand of each GE business either to become a No 1 or No 2 player in the world, or else face divestiture. He saw huge inefficiencies in the GE organization and pressed for dramatic productivity improvements. With the benefit of hindsight, these were both vitally important moves for GE. But Welch had a difficult time selling his message even to his senior management colleagues. As one of them recalls (Tichy and Sherman, 1993, p 73):

> "I think Jack had the vision very early, and he articulated the vision almost immediately. The trouble was, he expected to get everything done quickly. He did not understand how big GE was. He didn't understand how deep he had to go to effect these changes."

In the first few years on the job, Welch was perceived as ruthless - he was even called by some "Neutron Jack" because of the large layoffs that he forced at GE. Despite the growth in profits and stock price, Welch's authoritarian style began to transform passive resistance within the company to active opposition.

In contrast, what sketchy data we have on ABB (Bartlett, 1993) would suggest that the transformation there was from the very beginning much more participatory. Within weeks of the merger announcement in August 1987, Percy Barnevik - the newly appointed CEO, had formed a ten-person top management work group (five each from Asea and Brown Boveri) to analyze how the operations of ABB could be best integrated and to propose an organization that would best suit the new company. This sense of participation seems to have pervaded much of ABB's decision process during its transformation - whether it had to do with the shutting down of a facility, investment in a major new project, or in the re-allocation of scarce resources. The strategic decision process was communication intensive and was constantly open to challenge by all levels of management.

The two contrasting case studies would suggest that the process of transformation that a firm uses to move away from a traditional hierarchical organization (as both GE and ABB have done), plays a determining role in creating trust and openness - two important characteristics of the new entrepreneurial organization. The more participatory approach to transformation that Barnevik seems to have used at ABB, provided quicker legitimation to his leadership role in the flat entrepreneurial structure that was eventually introduced at ABB.

A participatory transformation process need not be limited only to the internal stakeholders of a firm. Especially in the case of a loss making firm, it faces additional conflicting external demands as well. Clearly, the stockholders would like a quick improvement in performance. Employees would try to ensure that this performance improvement is not achieved at their expense. Customers would expect dramatic improvements in both costs and product offerings in exchange for their renewed loyalty. Finally, the community at large would expect evidence of growth and stability in exchange for its fresh vote of confidence.

The central proposition of this paper is that the legitimacy that top management establishes during the transformation process, in managing the conflicting demands of its key stakeholders, leaves a lasting imprint on the organization. The popular sequence of restructure first (sour) and then revitalize (sweet) is not an effective way of building a flat entrepreneurial organization. It can be created in form, but the trust underlying much of the behavior in such an organization depends crucially on how its transformation was handled. The Temco case study provides initial support for this claim.

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Figure 1
Ideal Types of Organizations

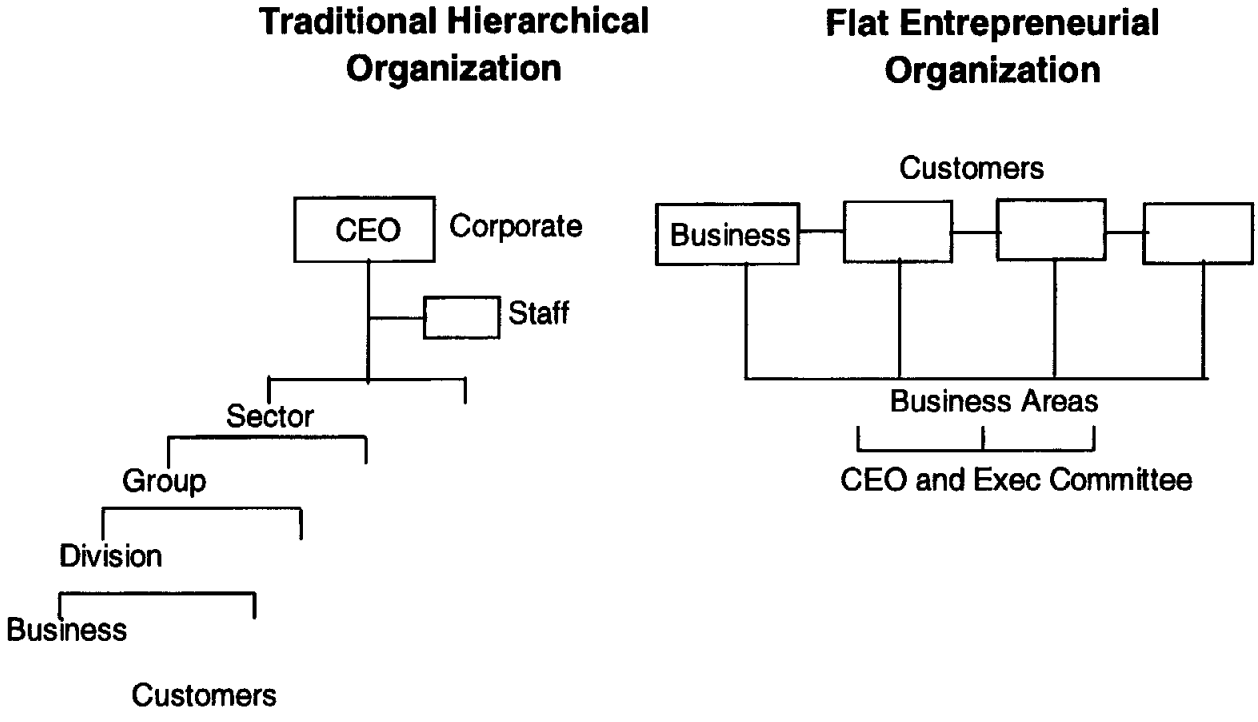
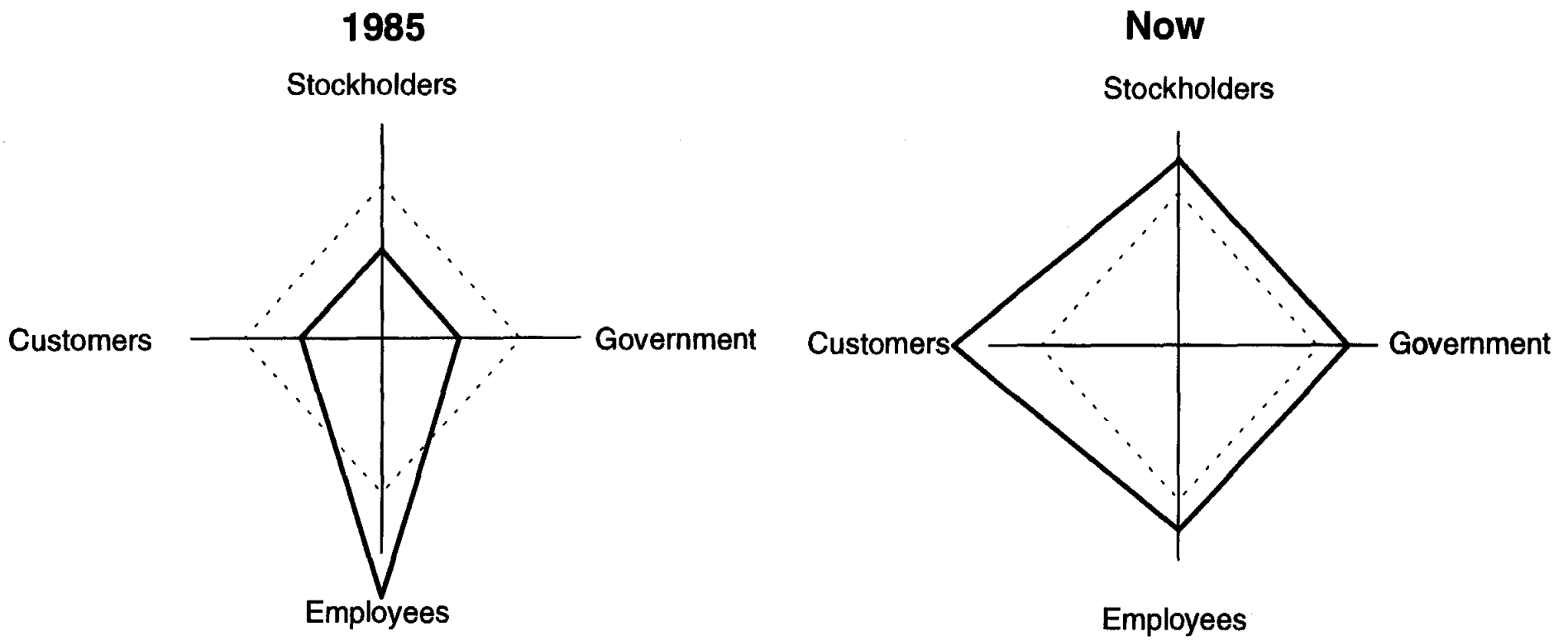


Figure 2
The Performance Maps for Temco: Current and Desired States



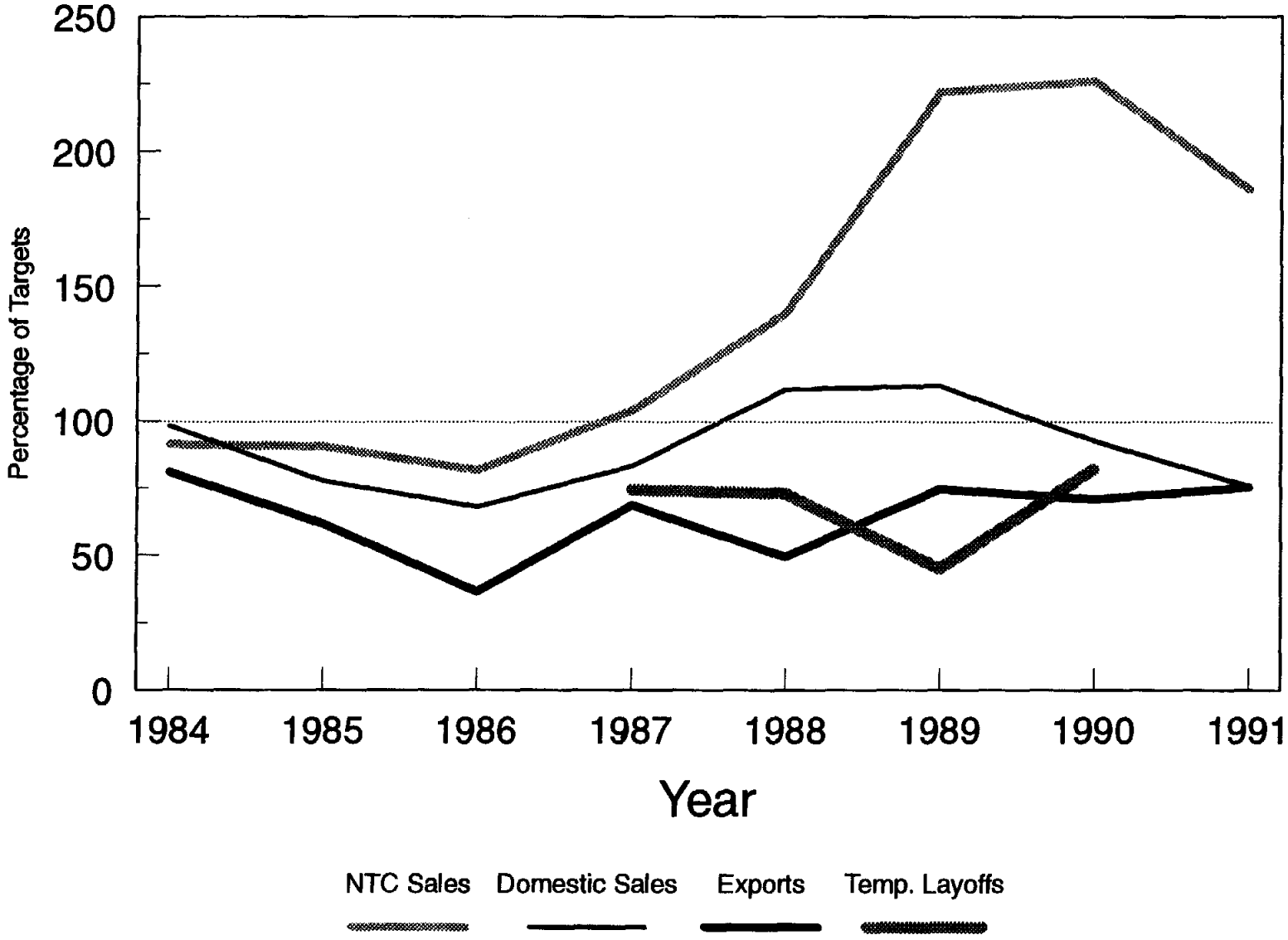
- - - - - - Performance Threshold

——— Actual/Desired Performance

This figure is illustrative of the performance maps that Temco used. It is not drawn to any scale

Figure 3

Actual Vs. Commited Performance, 1984-1991



Temporary layoffs not available 1984-1986 and 19

Figure 4

Sales, Employee Productivity and Net Income

(1985=100)

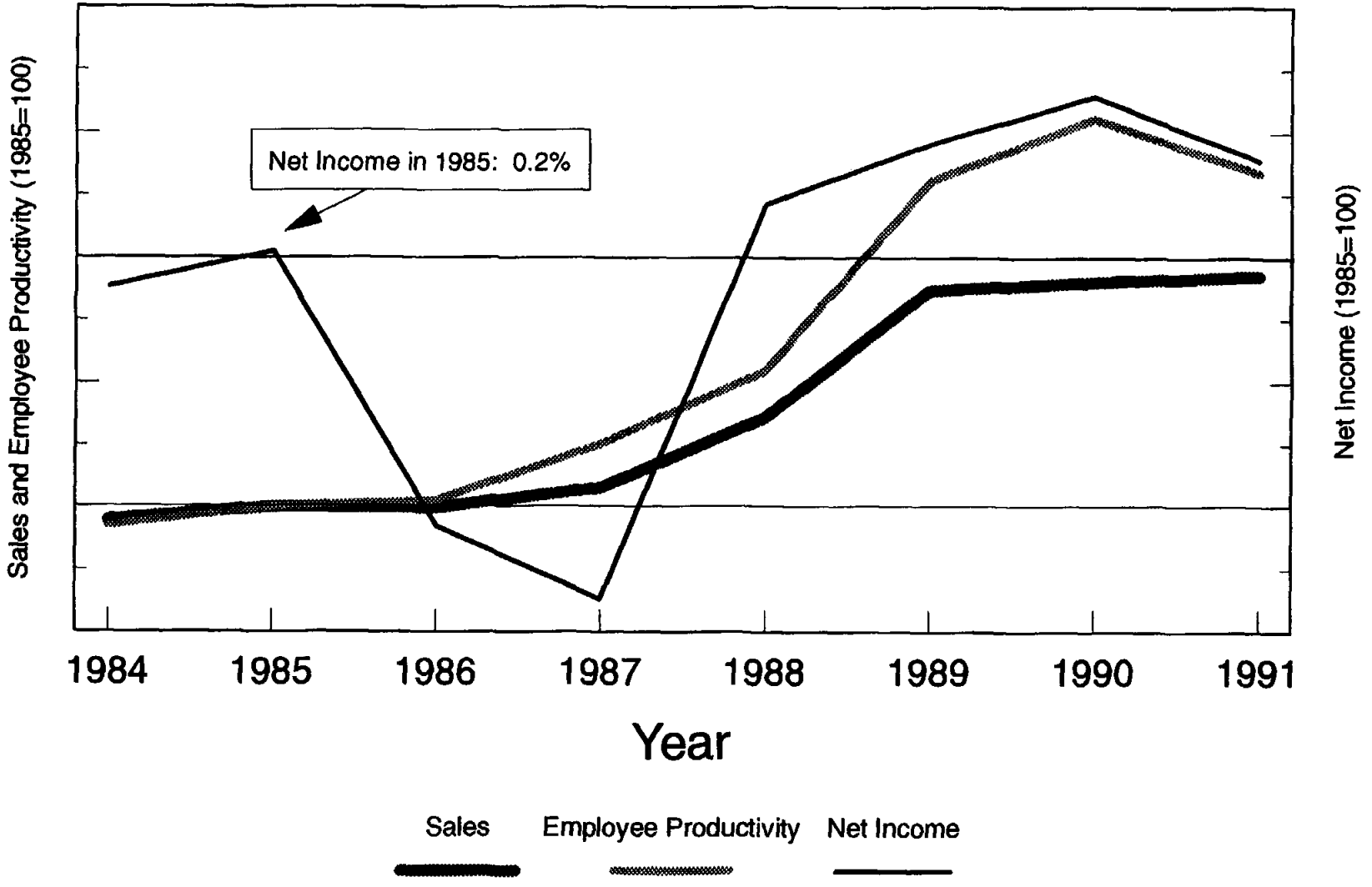


Figure 5
Stakeholder Involvement in Decisions