Reinventing Management

LEADERSHIP INSIGHTS

Article by Julian Birkinshaw
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We know there was a failure of regulation, a failure of macroeconomic policy, perhaps even a failure in the way our entire market system worked. But what has attracted far less attention so far is that the demise of traditional investment banking was also a spectacular failure of management.

And this “failure of management” in investment banking is far more than the story of a few CEOs losing control of their organizations; it is the story of a deeply flawed model of management that encouraged bankers to pursue opportunities without regard for their long-term consequences, and to put their own interests ahead of those of their employers and shareholders.

Consider Lehman Brothers

Of the investment-banking giants, Lehman Brothers (Lehman) perhaps suffered the greatest loss of value in the shortest period of time. What were the underlying causes of Lehman’s failure? While CEO Dick Fuld’s take-no-prisoners management style certainly didn’t help, we need to dig deeper into the company’s underlying management model to understand what happened.

Here are some contributory factors:

» The company’s risk management was poor. Like most of its competitors, Lehman failed to understand the risk associated with an entire class of mortgage-backed securities. But more importantly, no one felt accountable for the risks they were taking with these products. By falling back on formal rules rather than careful use of personal judgment, Lehman made many bad decisions.

» It had perverse incentive systems. Lehman’s employees knew what behaviors would maximize their bonuses. They also knew these very same behaviors would not be in the long-term interests of their shareholders – that’s what made the incentive systems perverse.

Many books and articles have now been written to explain the causes of the credit crisis of 2007–2008 and the broader upheaval in the financial services industry that followed.
There was no long-term unifying vision. Lehman wanted to be “number one in the industry by 2012,” but that wasn’t a vision – it was simply a desired position on the leader board. Lehman did not provide its employees with any intrinsic motivation to work hard to achieve that goal, nor any reason to work there instead of going over to the competitors.

Of course Lehman Brothers was not alone in pursuing a failed management model.

With a few partial exceptions such as Goldman Sachs and JP Morgan, these practices were endemic to the investment banking industry. It was the combination of Lehman’s model, its fragile position as an independent broker-dealer, and its massive exposure to the sub-prime meltdown that led to its ultimate failure.

A management model is the set of choices we make about how work gets done in an organization. One of the well-kept secrets of the investment banks is that their own management systems are far less sophisticated than those of the companies to which they act as advisors. For example: people are frequently promoted on technical, not managerial, competence; aggressive and intimidating behavior is tolerated; effective teamwork and sharing of ideas are rare.

General Motors – Same or Different?

From a market share of 51% in 1962, General Motors (GM) began a long slide down to a share of 22% in 2008. New competitors from Japan, of course, were the initial cause of GM’s troubles, but despite the fixes tried by successive generations of executives, the decline continued. The financial crisis of 2008 was the last straw: credit dried up, customers stopped buying cars, and GM ran out of cash, filing for bankruptcy on May 31, 2009.¹

As is so often the case, the seeds of GM’s failure can be linked directly to its earlier successes. GM rose to its position of leadership thanks to Alfred P. Sloan’s famous management innovation strategy – the multidivisional, professionally managed firm. By creating semi-autonomous divisions with profit responsibility, and by building a professional cadre of executives...
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concerned with long-term planning at the corporate centre, Sloan’s GM was able to deliver economies of scale and scope that were unmatched. Indeed, it is no exaggeration to say that GM was the model of a well-managed company in the inter-war period.

Two of the best-selling business books of that era – Sloan’s My Years with General Motors and Peter F. Drucker’s Concept of the Corporation – were both essentially case studies of GM’s management model, and the ideas they put forward were widely copied.²

So where did GM go wrong? The company was the model of bureaucracy with formal rules and procedures, a clear hierarchy, and standardized inputs and outputs. This worked well for years, perhaps too well – GM became dominant, and gradually took control not just of its supply chain but of its customers as well.

This model worked fine in an industry dominated by the Big Three. But the 1973 oil-price shock, the arrival of Japanese competitors, and the rediscovery of consumer sovereignty changed all that. At that point, all GM’s strengths as a formal, procedure-driven hierarchy turned into liabilities – it was too slow in developing new models, its designs were too conservative, and its cost base was too high.

Former US presidential candidate Ross Perot, when he sold EDS to GM in the 1980s, sized up GM in this way: “At GM the stress is not on getting results – on winning – but on bureaucracy, on conforming to the GM System.”³

This story is now well known. GM’s bankruptcy was caused in large part by a failure of management just as Lehman’s was. But the mistakes made by GM were completely different from the mistakes made by Lehman. To wit: Lehman motivated its employees through extrinsic and material rewards, and used incentives to encourage individualism and risk-taking. GM paid its employees less well, it hired people who loved the car industry, and it promoted risk-averse loyal employees. Lehman used mostly informal systems for coordinating and decision-making. GM emphasized formal procedures and rules. Lehman had no clear sense of purpose or higher-order mission. GM had a very clear and longheld vision – to be the world leader in transportation products.

Like Lehman, GM’s demise can be explained by any number of factors. Some of these are purely external, such as Japanese competitors and rising oil prices in the case of GM, and poor regulation and policymaking in the case of Lehman.

A management model is, simply put, the set of choices we make about how work gets done in an organization. A well-chosen management model, then, can be a source of competitive advantage; a poorly chosen management model can lead to ruin. And Lehman and GM illustrate nicely – but in contrasting ways – the downside risk of sticking with a management model that is past its sell-by date.

Disenchantment with Management

Looking more broadly, we see evidence of a creeping disenchantment with management as a discipline. Here are some examples:

> Management as a profession is not well respected.

In a 2008 Gallup poll on honesty and ethics among workers in 21 different professions, a mere 12% of respondents felt business executives had high/very high integrity – an all-time low. With a 37% low/very low rating, the executives came in behind lawyers, union leaders, real estate agents, building contractors, and bankers.¹ In a 2009 survey by Management Today, 31% of respondents stated that they had low or no trust in their management team.⁵
Employees are unhappy with their managers.
The most compelling evidence for this comes from economist Richard Layard’s studies of happiness. With whom are people most happy interacting? Friends and family are at the top; the boss comes last. In fact, people would prefer to be alone, Layard showed, than spend time interacting with their boss. This is a damning indictment of the management profession.

There are no positive role models.
We all know why Dilbert is the best-selling business book series of all time, and why The Office sitcom was a big hit on both sides of the Atlantic – it’s because they ring true. The Pointy-Haired Boss in Dilbert is a self-centered halfwit; Michael Scott (or David Brent, if you watched the UK version) is entirely lacking in self-awareness, and is frequently outfoxed by his subordinates.

Except in sitcoms and comic strips, managers don’t usually go to work in the morning thinking, “I’m going to be an asshole today, I’m going to make my employees’ lives miserable.” But some behave that way anyway because they are creatures of their environment – a working environment that has taken shape over roughly the last 150 years. The harsh reality is that today’s large business organizations are – with notable exceptions – miserable places to spend our working lives. Fear and distrust are endemic. Aggressive and unpleasant behavior is condoned.

Creativity and passion are suppressed. The good news is that the opportunity for improvement here is vast and, if we do improve the practice of management, the payoffs – for pioneering companies, for all their employees, and for society as a whole – are substantial.

There are no simple solutions to this problem. Many thinkers and business pioneers have tackled the same set of issues, and made limited progress. But we should at least recognize that this is a problem worth working on. Management has failed at the big-picture level, as the employees and shareholders of Lehman and GM will attest. Management has also failed at the personal level, as every one of us has observed.

We need to rethink management. We need to help executives figure out the best way to manage, and we need to help employees take some responsibility – to get the managers they deserve.
The Corruption of Management

Where did management go wrong? We cannot put it down to a few rogue executives or bad decisions, and we cannot single out specific companies or industries. The problem is systemic, and it goes way back in time. Big-company executives may be the ones in the hot seats, but many other parties are complicit in the problems of management, including policymakers, regulators, academics, and consultants.

Before discussing where things went wrong, we need a clear definition of management. Leading academics from Mary Parker Follett, Henri Fayol, and Chester Barnard through to Peter Drucker, Henry Mintzberg, and Gary Hamel have all offered a view on this, but I am going to keep things simple and use the Wikipedia definition:

Management is the act of getting people together to accomplish desired goals and objectives.

Please think about these words for a few moments. There is a lot of stuff missing from this definition – no mention of planning, organization, staffing, controlling, or any of the dozen other activities that are usually associated with management. There is also no mention of companies or corporations, and absolutely nothing about hierarchy or bureaucracy. And that is precisely the point – management is a social endeavor, which simply involves getting people to come together to achieve goals that they could not achieve on their own. A soccer coach is a manager, as is an orchestra conductor and a Cub Scout leader. At some point we need to qualify this definition to make it relevant to a business context, but for now let’s use the word in its generic form.

I believe that management – as a social activity and as a philosophy – has gradually become corrupted over the last 100 years. When I say corrupted, I don’t mean in the sense of doing immoral or dishonest things (though clearly there have been quite a few cases of corrupt managers in recent years). Rather, I mean that the word has become infected or tainted. Its colloquial usage has metamorphosed into something narrower, and more pejorative, than Wikipedia might suggest.

In talking to people about the term, and in reading the literature, I have noticed that managers are typically seen as low-level bureaucrats who are “internally focused, absorbed in operational details, controlling and coordinating the work of their subordinates, and dealing with office politics.”

Whether accurate or not, this is a sentiment everyone can recognize. But it is a very restrictive view of the nature of management. And such sentiments also feed back into the workplace, further shaping the practice of management in a negative way. This is why I argue that the word has been corrupted.
Why has this corruption taken place? There are two major reasons.

Large industrial firms became dominant – and their style of management became dominant as well. A careful reading of business history indicates that large companies, of the type most of us work in today, first came into existence about 150 years ago. Back in 1850 nine out of 10 white male citizens in the USA worked for themselves as farmers, merchants, or craftsmen. The biggest company in the UK at the time had only 300 employees.⁷

But the industrial revolution sparked a wholesale change in the nature of work and organization, with mills, railroads, steel manufacturers, and electricity companies all emerging in the latter part of the nineteenth century. Helped along by management pioneers like Frederick Taylor, Frank and Lilian Gilbreth, and Henri Fayol, these companies put in place formal structures and processes and hierarchical systems of control that we would still recognize today, and which were all geared toward efficient, low-cost production of standardized products.

Of course this industrial management model was a spectacular success, and became one of the key drivers of economic progress in the twentieth century.⁸ But it had an insidious effect on the concept of management, because the term came to be associated exclusively with the hierarchical, bureaucratic form of work practiced in large industrial firms. For many people, even today, the word management conjures up images of hierarchy, control, and formal procedures, for reasons

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that have nothing to do with the underlying meaning of the term. “Management” and “large industrial firm” became intertwined in the 1920s, and they are still tightly linked today.

Such a narrow model of management blinds us to the range of alternative management models that exist, and it leads us to assume, incorrectly, that large industrial companies are inherently superior to other forms of organization. Of course there are certain industrial processes that are best suited to economies of scale and scope, but we would be misunderstanding history if we assumed that mass production was the only feasible model of industrial organization.

In a fascinating article called “Historical alternatives to mass production,” academics Charles Sabel and Jonathan Zeitlin made the case that other viable forms of organizing existed during the industrial revolution, including confederations of independent firms working collaboratively within a municipality, and loosely linked alliances of medium and small firms linked through family ties and cross-shareholdings. Often concentrated in “industrial districts” such as Baden-Wurttemberg in Germany and Emilia-Romagna in Italy, these models were quite workable in the late 1800s and many are still in existence today. Sabel and Zeitlin weren’t trying to suggest that mass production took us down the wrong path. Rather, they were arguing for pluralism – for the need to recognize that management models other than the hierarchical, bureaucratic organization have their own important merits.

The aggrandizement of leadership came at the expense of management. The second body blow to “management” was the apparently inexorable rise of “leadership” as a field of study.

While the classic texts on business management are now more than a century old, books on business leadership are a more recent phenomenon, emerging in the post-war years and really taking off in the 1970s. Today there are more business books published on leadership than any other sub-discipline. A few writers stuck with management – Peter Drucker and Henry Mintzberg being the most notable cases – but in most books management has been entirely subordinated to leadership.

It’s very clear what happened. To make room for leadership – which back in the 1970s was a poorly understood phenomenon – business writers felt compelled to diminish the role of management. Managers, in this new worldview, were passive, inert, and narrowminded, while leaders were visionary agents of change. And the consequences of this leadership “revolution” were predictable: people flocked to this new, sexy way of working, while management took a step backward. Let’s look more closely at the leadership versus management debate.

Today there are more business books published on leadership than any other sub-discipline.
Table 1.1 summarizes the arguments of two of the most influential leadership thinkers, John Kotter and Warren Bennis. Kotter sees managers as being the ones who plan, budget, organize, and control, while leaders set direction, manage change, and motivate people. Bennis views managers as those who promote efficiency, follow the rules, and accept the status quo, while leaders focus on challenging the rules and promoting effectiveness.

This dichotomy is inaccurate and, frankly, insulting. Why, for example, does “motivating people” lie beyond the job description of a manager? And “doing things right” versus “doing the right things” is a nice play-on-words but a rather unhelpful distinction. Surely we should all be doing both?

Now, Kotter and Bennis are smart, thoughtful people who are more right than they are wrong. And they have a logically flawless response to my critique: namely, that “leadership” and “management” are roles that the same individual can play at different times. I can put on my leader hat in the morning when speaking to my team about next year’s plans, and then in the afternoon I can put on my manager hat and work through the quarterly budget. This makes sense. But I still think the aggrandizement of leadership at the expense of management is unhelpful, because management – as a profession and as a concept – is vitally important to the business world. We should be looking for ways to build it up, rather than tear it down.

Here is my view on the management versus leadership debate. Leadership is a process of social influence: it is concerned with the traits, styles, and behaviors of individuals that cause others to follow them. Management is the act of getting people together to accomplish desired goals. To make the distinction even starker, one might almost argue that leadership is what you say and how you say it, whereas management is what you do and how you do it. I don’t want to fall into the trap of making one of these seem important at the expense of the other. I am simply arguing that management and leadership are complementary to one another.

Or to put it really simply, we all need to be leaders and managers.

We need to be able to influence others through our ideas, words, and actions. We also need to be able to get work done through others on a day-to-day basis.

How did Barack Obama win the presidency? Yes, he ran a well-managed and innovative campaign, but I think it was his leadership qualities – his vision, his charisma – that made the difference. Perhaps we can attribute one-quarter of his success to good management, three-quarters to good leadership. But now that he is in office the relative emphasis switches, as he seeks to deliver on his election promises, resolve competing agendas, and prioritize the issues that land on his desk.

Table 1.1: Leadership versus management

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<thead>
<tr>
<th>Role of a Manager</th>
<th>Role of a Leader</th>
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<tr>
<td>Focuses on efficiency</td>
<td>Focuses on effectiveness</td>
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<tr>
<td>Accepts the status quo</td>
<td>Challenges the status quo</td>
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<tr>
<td>Does things right</td>
<td>Does the right things</td>
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<tr>
<td>Coping with complexity</td>
<td>Coping with change</td>
</tr>
<tr>
<td>Planning and budgeting</td>
<td>Setting direction</td>
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<tr>
<td>Controlling and problem-solving</td>
<td>Motivating people</td>
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I believe his job is now three-quarters management and one-quarter leadership, and that the success (or not) of his administration will rest primarily on his qualities as a manager.

To make progress, we need first to reverse out of the cul-de-sac that management has been driven into. We need to rediscover the original meaning of the word, and we need to remind ourselves that leadership and management are simply two horses pulling the same cart.

Reinventing Management

So what is the future of management? In the face of all these challenges, can management be reinvented to make it more effective as an agent of economic progress and more responsive to the needs of employees?

One school of thought says management cannot be reinvented. The argument here can be summarized as follows: management is fundamentally about how individuals work together, and the basic laws of social interaction have not changed for centuries – if ever. While the business context will evolve, the underlying principles of management – how we set objectives, coordinate effort, monitor performance – are never going to change. For example, Henry Mintzberg, in his recent book Managing, argues that the nature of managerial work has hardly changed for decades: “Managers deal with different issues as time moves forward, but not with different managing. The job does not change.” Indeed, it is interesting to note that most of the major innovations in management – the industrialization of R&D, mass production, decentralization, brand management, discounted cash flow – occurred before 1930. Most of the recent innovations – Six Sigma, the balanced scorecard, re-engineering, for example – have been little more than incremental improvements on existing ideas, rather than entirely new ideas in their own right. If we extend this train of thinking, we could conclude that the evolution of management has more or less run its course.

Of course there is some validity in arguing that the basic laws of human behavior are not going to change. But the practice of management is enormously context dependent, and as the nature of business organizations evolves, so too will management. Yes, there will always be the need for some sort of hierarchical structure in a large organization, but the nature of that hierarchy can potentially change dramatically.

Management in a Changing World

Recent trends have led to a fundamental change in the economic logic of the firm. In the traditional model, capital was the scarce resource, and the strategic imperative of the firm was to transform inputs into outputs as efficiently as possible. Today, the scarce resource is knowledge, and firms succeed not just on the basis of efficiency, but also creativity and innovation.

Of course, depending on your worldview, these trends are either threats or opportunities. They are threats insofar as they make it even harder than before to retreat back into our traditional models of management. And they are opportunities because new ways of working are opening up before our eyes.

Management was in need of reinvention anyway. But with these technological, economic, and social changes afoot, the urgency of the task has become that much greater.

To make progress, we need first to reverse out of the cul-de-sac that management has been driven into.
The other reason I disagree with the argument that “management cannot be reinvented” is that there must be a better way of running large companies. The first part of this article documented some of the problems with management as it functions today, and I believe we cannot just accept that our current model is as good as it gets.

Another school of thought says we are on the cusp of inventing an entirely new model of management. The argument here runs as follows: management as we know it today was developed for the industrial era, in which capital was the scarce resource. Today, it is knowledge. Firms gain advantage not by working efficiently but by harnessing initiative and creativity.

And, most vitally, the information technology revolution is making it possible for entirely new ways of working to emerge.

MIT Professor Tom Malone has made this case clearly:

We are in the early stages of another revolution... that promises to lead to a further transformation in our thinking about control. For the first time in history, technologies allow us to gain the economic benefits of large organizations, without giving up the human benefits of small ones. This revolution has begun.

Many other writers have made similar claims. For example, technology writer Howard Rheingold observed that “the most far-reaching changes [from new technology] will come, as they often do, from the kinds of relationships, enterprises, communities, and markets that the infrastructure makes possible.” Wired editor Jeff Howe argues that the Internet driven phenomenon of crowdsourcing “will change the nature of work and creativity.” Again, the argument is persuasive, and one that we can all relate to as we try to come to grips with the potential ramifications of Internet technology.

The trouble is, I have a nagging concern that we have been here before. All the arguments around decentralization and empowerment have been debated for a very long time. Fortune magazine ran a series of articles on “The New Management” in 1955 in which these themes were discussed. And every generation of management writers since then, including such luminaries as Peter Drucker, Gary Hamel, Rosabeth Moss Kanter, and Sumantra Ghoshal, has also argued for its own version of revolutionary change in the years ahead.

Harvard Professors Robert Eccles and Nitin Nohria wrote a very thoughtful critique of this perspective in Beyond the Hype. Writing in 1992, they observed five principles of the “new organization” that were being preached to managers – smaller is better than larger, less diversification is better than more diversification, competition must be replaced by collaboration, formal authority must be diminished, and time cycles must become shorter. Needless to say, these five principles are still being preached 20 years on.

Yes, there will always be the need for some sort of hierarchical structure in a large organization, but the nature of that hierarchy can potentially change dramatically.
Is there a third way here? Can we identify a useful way forward that avoids the extreme positions of these other two schools of thought? I believe there is.

**We need to develop a more comprehensive understanding of what management is really about to make better choices.** By going back to a basic definition of management – the act of getting people together to accomplish desired goals – we can frame our discussion of the activities and principles of management much more explicitly. And armed with this new understanding, we can help managers make better choices within the universe of known possibilities, rather than suggest they invent something that has never been thought of before.

Here is an example. Why should we assume that all important decisions get made by the people at the top of the organizational hierarchy? Traditionally this was certainly the case, but is it possible that important decisions might be made in less hierarchical or nonhierarchical ways? Yes it is. In fact, entire books have been written on the “wisdom of crowds” and “crowdsourcing” techniques for aggregating the views of large numbers of people to make better decisions. So it would be wrong to assume that all decisions made in the future will be made exclusively by those at the top of the hierarchy, and it would be equally wrong to assume that crowdsourcing will entirely replace traditional decision-making structures.

Of course, the right Management Model depends on a host of contingencies, including the nature of the decision being made, the company’s size and background, the interests and capabilities of the employees, and so on.

In the field of business strategy it is often argued that there are two different and complementary pathways to success – devising a distinctive strategic position and implementing a particular strategy effectively. Southwest Airlines, Dell Computer, and IKEA have prospered because they developed and protected a distinctive strategic position. Toyota, McDonald’s, and Tesco have prospered by executing their plain-vanilla strategy better than anyone else in their industry. The same logic applies in the field of management: you can make distinctive choices about the management model you are going to use, and you can have high-quality managers who simply do their jobs well. Ultimately there is no trade-off needed between these two approaches. High-performing companies typically...
do both well. But I emphasize the former – it is about how you choose the best management model for a given situation. Of course the quality of the individuals you employ, and the extent to which they do their jobs well, are important, but the focus here is on the overall architecture of management – the choices we make about how we work. We make these choices through four linked steps (Figure 1.1).

» Understanding:
You need to be explicit about the management principles you are using to run your company. These principles are invisible, and often understood only at a subconscious level, but they drive the day-to-day processes and practices through which management work gets done.

» Evaluating:
You need to assess whether your company’s management principles are suited to the business environment in which you are working. There are risks associated with whatever principles you employ, so you need to understand the pros and cons of each one so that you can choose wisely.

» Envisioning and experimenting:
You need to be prepared to try out new practices as a way of reinforcing your choices. Your management model can only become a source of advantage if you find ways of working that separate you out from the crowd. So it is important to take a creative approach to management, by envisioning new ways of working and experimenting with them.

Lehman Brothers and GM Revisited
It’s worth noting that these companies got it wrong in two distinct (though linked) ways. Mistake number one was that the executives subconsciously assumed (incorrectly) that there was only one valid management model in their industry, i.e. the one they had always used. Mistake number two was that they failed to adapt their existing management model to the changes under way in the business environment, with the result that their earlier strengths turned gradually into liabilities.

It is very easy to go astray. For example, a decade ago, the mantra in many large companies was “bring the market inside” – use market-like mechanisms to overcome the stifling problems of bureaucracy and hierarchy. This advice was aimed at companies like GM. It worked well in Shell and others, as they created venture capital-like seed funding systems such as Gamechanger. But it was disastrous in Lehman and the other investment banks, which were destroyed by opening themselves up to market forces.

And it was disastrous in Enron. The message, in other words, is that the right management model for a big oil company is not necessarily the right management model for an investment bank. But more importantly – how crucial it is to get it just right.
References:

1. At the time of writing, GM had just emerged from Chapter 11 bankruptcy protection, but its future as an independent company was far from secure.


8. Peter Drucker has gone so far as to state that “Management may be the most important innovation of the twentieth century” (Management, fourth edition).


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