

Making the Matrix Organization Work In Multi-State Utility Holding Companies

Adapted From A White Paper By

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History and Theory

Matrix organizations gained popularity in the late 70s and early 80s as many companies began to expand globally. A need to maintain both local market responsiveness and global product/service consistency found many managers playing dual roles. Parallel reporting relationships reflected the diverse and often conflicting needs of functional, product and geographic organizational groups. The principal identifying characteristic of a matrix organization is the dual reporting structures of different managers and areas of business. In most matrix organizations there are command responsibilities assigned to both product/service departments and area/geographic-based departments. This represents a substantial change from unity of command principles, utilized by most companies prior to 1980.

The matrix organization trend started in the American Aerospace industry when the US government demanded that a single company manager be assigned to each of its projects. However, the list of companies using some form of matrix organization expanded quickly. Companies such as General Electric, Citibank, Dow Chemical, Shell Oil, Texas Instruments, IBM and TRW are but a few of the companies who turned to matrix organizations as an alternative to the pyramidal functional organizations that preceded them.

In the utility industry during the 1980s and 90s, companies adopted the matrix organization as a tool to capture economies of scale, as they consolidated divisional overheads and support staff groups. In doing so they took a slightly different design approach to that taken by consumer products firms. Utilities focused more on overlapping accountability for budget dollars than on shared ownership of labor resources. For example, a regional general manager or president can have P&L accountability for all the work in his/her region. However, activities such as maintenance, new service connections, and refurbishment projects are frequently controlled by another manager, who has cross-regional accountability for their efficiency and delivery.

Strengths and Best Applications

There are several key advantages to the matrix organization. First, this design often enhances communication and commonality of purpose among managers; indeed, it literally forces managers to discuss and agree on most strategic and operational issues. Second, it permits flexible use of an organization's human resources. Individuals within functional departments can be assigned to and held accountable for specific projects, products or services. Third, matrix designs offer companies an efficient means of responding quickly to changing or unstable environments.

Whatever the industry, companies have turned to matrix organizations when it was absolutely essential that they be simultaneously responsive to multiple sectors, such as regions and services. This provides utilities with an effective means of addressing the changing needs of

different customer groups and governmental/regulatory agendas, while operating a varied set of asset types and business units across multiple territories.

Weaknesses

The major disadvantages of the matrix design have always lain in the confusion it can create around authority and accountability, its potential to foment or unmask power struggles, and the stress it places on individuals who must respond to two bosses within the matrix. When you move away from the unity of command concept, ambiguity is ordinarily increased, resulting in operational tension, which often leads to conflict. Confusion and ambiguity also create opportunity for mischievous behavior, as managers maneuver for control of various resources, rights, and authorities. The old bureaucratic structures killed flexibility and the organization's adaptability to change, but they also reduced the potential for organizational conflict. In matrix organizations, individuals often find that the loss of bureaucracy's predictability allows insecurity and stress to creep in.

Other disadvantages or risks to the matrix organization include a tendency toward group decision-making, resulting in decision strangulation, and potentially large overheads, where matrices start to develop inside of matrices. Many companies have blamed their troubles on matrix organizations, while deeper inspection reveals that the failures are the result of other factors (culture, lack of clarity around strategy or business model, managerial competency gaps, etc.), which are exacerbated under the matrix design. The utility industry is full of companies that have adopted the matrix approach, abandoned it later, and then in many cases readopted it under a different rationale. Many firms have learned that human factors, such as understanding and alignment, are huge drivers of matrix success. In fact, many believe that effective matrix management is as much a function of 'frame of mind' as it is of organization structure.

The Challenges of Multi-State Utility Matrix Organizations

Most regulated utility holding companies operate in a number of separate and distinct regulatory jurisdictions, each of which provides a different revenue base against which the company must deliver appropriate profits, and some of which present varying regulatory requirements. Almost all applications of the Matrix Organizational Model have the state Presidents (or local General Managers) as one dimension of the matrix organization, with functional responsibility for the major activities necessary within a vertically integrated utility as the second dimension. Many utilities think that the most important organizational decision to be made in applying the Matrix Model is which activities to place with the local organization (for state President ability to deliver responsiveness), and which activities should remain within the large centrally managed functional groups (for economies of scale and consistency of cross-state delivery). But a far greater decision, in its importance for organization structure, alignment of strategy, and ability to deliver business outcomes, is "At what level in the organization will we assign Jurisdictional P&L accountability?"

It is normally the responsibility of the state presidents to manage service delivery (at least from the perspective of distribution reliability and customer service responsiveness and satisfaction produced) and local regulatory relationships. But if the decision is made to delegate to the state level accountability and authority for "*financial results*" in addition to that for *service delivery, regulatory relationship management, and local budget compliance*, it has far reaching

implications for the job of the state Presidents. These implications include the scope of activities organized directly at the local level (vs. centrally), the performance measures and targets assigned, the plan for managing the effects of the change on people at all levels in the organization, and the skill set required for state President success.

The second dimension of the matrix organization is functional responsibility for the major activities necessary within a vertically integrated utility, including: generation (both nuclear and fossil), transmission, distribution, customer service and the overhead functions (such as finance, human resources, etc). Functional excellence, as measured by equipment performance, reliability, customer satisfaction and cost, is a key driver of any utility's overall success. Functional excellence requires specific management and technical expertise in each functional discipline. Beyond just providing economies of scale, adopting a functional organization allows the efficient pooling of expertise and helps ensure that best practices identified in one jurisdiction are readily transported to others.

In those multi-state utilities that have structured their matrix model by adopting a functionally based delivery organization, but placing accountability for earnings with the state presidents, the presidents must manage the local external environment and achieve appropriate financial outcomes, whereas the functional organizations are responsible for delivering the necessary operational outcomes (in the areas they are assigned). As in all matrix organizations, this creates two competing forces that, in theory, should result in an optimum balance between cost and operational performance. Of course, practice rarely matches theory, and such balance as is achieved is usually the product of organizational tensions rather than of harmonies. In such multi-state regulatory environments a matrix organization might be appropriate, and could be a highly effective model. However, the risks of imperfect implementation are high and many companies have encountered difficulties after adopting it. Several underlying issues are the primary contributors to the emergence of such problems:

1. Insufficient Alignment On The New Business Model

Before the transition, Functional managers each see themselves as managers of a stand-alone business, with an associated set of accountabilities, authorities, influence and prestige. These are all generally executives with many years of experience. Each of them has operated within a clearly defined set of standards for how that type of business should be managed and what its primary outcomes should be. Such standards typically reflect industry common practice, as well as the executive's own personal values as to the boundaries within which prudence and good judgment required them to operate. Until the transition to a matrix structure, their position afforded them the authority to balance all these competing demands and to make what they believed to be the appropriate financial, operational and risk tradeoffs (those within the budgetary constraints imposed on them by the corporate planning and budgeting processes). The introduction of a matrix organization is typically a dramatic shift to a new business or enterprise model for the functional units.

Where previously, good operating practice was a primary driver of functional plans and strategies, now factors such as impact on this year's jurisdictional earnings and regulatory do-ability have become critical drivers of these decisions. And, whereas the state presidents were previously considered to be senior external affairs relationship managers, they now often have

full P & L accountability for the regulated utility business in their jurisdiction. Often, at the time the change is made, the full implications of this shift are not understood by either the state presidents or by the functional leaders. Interviews with Functional leaders often suggest that some of them personalize this shift in power, producing frustration and concern about loss of influence and prestige. And, while each utility is a unique company with many differentiating drivers and circumstances, we have seen this phenomenon at many utilities where, during the adoption of a new business model, managers are moved from a “functional decision making” role to a “service provider role” and go through a period of resistance and deep resentment because of perceived loss of power and stature.

These factors can frequently lead to a lack of true alignment across the management ranks as to the need for, and implications of, the organizational change to the new business model.

| Proposed Organizational Shift | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Past Functional Accountabilities | Matrix Functional Accountabilities |
| <ul style="list-style-type: none"> • Identify System-Wide Customer Needs • Set Capacity and Availability Standards • Define Operating Policy and Targets • Establish and Manage Costs to Budgets • Make Investment Decisions • Identify, Analyze and Define Target Levels of Risk • Deliver Optimum Service Levels For the Approved Budget | <ul style="list-style-type: none"> • Solicit Needs of State Presidents • Understand Financial, Service Level and Risk Constraints for Each Jurisdiction • Analyze Varying State Political and Economic Requirements and Define Optimum Potential Solutions • Make proposals to State Presidents and Negotiate Dynamic Operating Plans • Define Long-Term Strategies for Sustainable System-Wide Operation |

2. Conflicting Missions

After the shift, it often appears that the missions adopted by some of the functional business units, such as “keep the lights on” are not well aligned with the corporation’s mission to “maximize shareholder value”. This may reflect a lack of clarity regarding how performance will be measured, inconsistencies between the current performance measurement framework and the corporate mission, or in some cases the perception that corporate priorities (as reflected in executive incentives and disincentives) strongly favor reliability over efficiency and cost performance. Most companies have their own stories about how events of the past are still having a significant impact on the priorities and decisions of some groups.

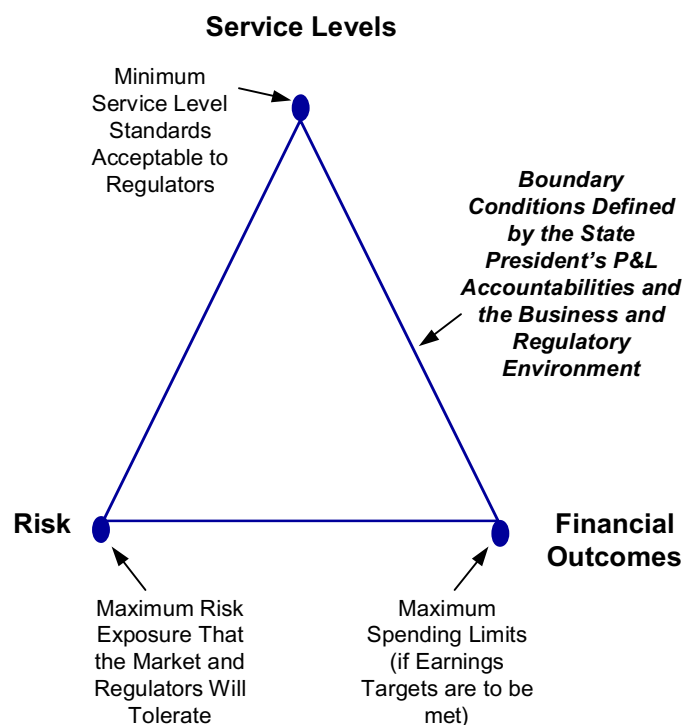
Functional missions do not have to be perfectly aligned with geographic missions to have a workable model. But, the mission of each group (and associated measures) should require it to make appropriate tradeoffs within a balanced goals framework that drives optimum outcomes. One challenge in establishing such self-balancing measures for the regulated functions is that none of them (except the regulated utility) are true P&L centers. Without accountability for impact on profits, it is difficult to avoid conflicting decisions and stress across business units.

3. Decoupled Accountabilities

There are three (3) basic accountabilities that must be managed in any business, but in particular by utilities operating in a regulated environment:

- Financial outcomes (costs and profitability)
- Service levels (delivered to customers) and Customer Satisfaction produced
- Risk (variability of outcomes produced)

These accountabilities are highly interdependent and changes to one will almost always have implications on the others. They must be managed in an integrated manner with the objective of optimizing medium and longer term shareholder value. In many cases, optimizing shareholder value will yield decisions that do not maximize short-term earnings, maximize service levels or minimize risk, but requires an appropriately balanced set of all three outcomes. Not recognizing this truth has been a significant contributor to the difficulties many companies have faced over the past decade where, as a result of spending cuts in areas that had large service level and risk implications (e.g., line inspections, fossil plant maintenance & refurbishment, tree trimming, etc), reliability fell and regulatory relationships deteriorated.



Functional groups are usually inclined to manage the standards for generation and transmission service levels and risk, without direct accountability for the profit impacts of those decisions. It is not surprising that they have significant influence over the cost and profit elements of financial performance. (G & T spending is often more than 50% of total spend in regulated non-fuel/non-purchased power O & M and Capital). Frequently, the state presidents' management of financial

outcomes cannot be successful if it is attempted to be done in isolation of decisions affecting Generation and Transmission service levels and risk.

4. Conservative Functional Standards

Service level standards and risk management philosophy adopted by functional groups are often not optimal, especially when the additional dimension of cost is considered. The de-facto service level strategy is often to drive towards industry top quartile service levels, without first clearly understanding the value to customers, community or regulators that such improvements from current performance would provide, nor clearly defining the likely impact of related expenditures on profits, returns or shareholder value.

Usually, improvement must be made to how the functional groups view risk. These groups are often inclined to act very conservatively, viewing risk as a negative element of the business to be avoided, rather than as an inherent element of all businesses, requiring intelligent (and cost-effective) mitigation and ongoing management. Furthermore, these managers sometimes see their ability to apply their own standards (often deeply held convictions) for business priorities and outcomes, as seriously compromised by the matrix model. Some may even feel they are being forced to violate their principles and core values of safety and security for the assets and employees under their charge. If the matrix accountability model is working as intended, the functional groups would be forced by budget pressure from the state presidents to analyze and understand the costs and value of these various standards and would be positioned to (and likely more willing to) refine and optimize their proposed plans to deliver both adequate service levels and appropriate costs in line with Jurisdictional financial constraints.

Considerations For Multi-State Utilities On The Matrix Path

Business Strategy

Any discussion about organization design must begin with the principle that “form follows function”. This poses a challenge for many utilities today, as their business strategies appear to be evolving, with market conditions and regulatory pressures taking new directions. And, with deregulation slowing to a crawl in some jurisdictions, flexibility and adaptability will be critically important for the foreseeable future.

The matrix organization model is well suited to this current situation. Its multiple information channels permit the organization to identify and understand external complexity, and its overlapping responsibilities tend to reduce parochialism and ensure flexibility in the company’s response to change. With both jurisdictional and functional managers focused on and responding to pressures from the market, business strategy will continuously evolve. The linkages between target business outcomes and organizational accountabilities will also need to evolve.

Organizational Accountabilities & Authorities

With broad based movement across the industry toward local management responsibility for regulatory relationships (and for reliable delivery against commitments), there is one element of organizational strategy that must be decided before much else can be done in setting up accountabilities and authorities. This is the question of how profit and loss targets will be managed in the organization. Obviously, this means requires someone with authority over both

of scale from their functional work specialties and still is able to provide customized services to the standards of each state president. They need to answer questions about which services need to be held /delivered separately to serve the unique needs of each Jurisdiction, which can be pooled for best scale, and which standards can be held in common (at the Corporate level) so that state organization diversity does not drive the functional managers into the asylum. The basic strategy should be organizing to manage the assets over the long term in the most effective way possible. The presidents, for their part, will really need to learn how to become strong customers and at the same time, demonstrate meaningful commitment to the success of the service organizations.

The matrix organization, with its revised accountabilities and authorities, (and potential perceived loss of stature) will force some difficult personal transitions for certain members of the executive team, but is likely to be a highly effective strategy for the multi-state utility in meeting today's regulatory challenges.

Processes and Tools

Changes in structure or accountabilities need to be reinforced by processes that are either newly developed or retrofitted to support people in their actions across organizational boundaries. This applies to both the 'customer' (State) and 'service provider' (Functional) organizations. First, the major shift of accountability and authority to the "customer" organizations will require significant strengthening of performance management processes. People and departments will see significant changes to the outcomes they are being called on to produce and the visibility of their results will increase. This is a substantial challenge for most firms, given the state of the performance management processes. A second area where shifting accountability often implies process change, is the way that budgets are designed, developed, and approved. Decision makers in the each of the customer organizations need to be given clear roles and authority in a new budget process, and people in the services organization need to have some method for having their view of budget requirements meaningfully included in the final version. Finally, work processes of all types that cross organizational boundaries typically need to be redefined, at a minimum, so that people within the structure understand what is required from them and are not confused by changes in roles.

Culture

The accountability model that accompanies the matrix organization will drive significant change in the perceptions of executives and managers that live within it:

- How the state presidents and the functional unit managers perceive their role in the company,
- Perceived power and stature within the organization (and accompanying pride and identity),
- Clarity around the rules of the game
- Confidence that individual executives can win this game ("What's in this for me?" and, "Do I have the skills required to win?")

Redesigning organization structure is a blunt and often brutal tool for change. New, more effective relationships and better decision making often take months or years to emerge. Hastily implemented matrix organizations are likely, without successful interventions, to result in:

conflict, frustration, misalignment, and ultimately even the possible loss of several key executives. The greatest risk, based on the recent experience of electric utilities around the world adopting similar organizational changes, is the emergence of a “Master/Slave” relationship between the state and functional organizations. Such a master/slave relationship can kill the matrix organization by creating subordinate and subservient service organizations. Each functional service provider would serve a number of customer groups, and would be expected to jump at the command of the jurisdictional presidents, who would in turn control the cost, service level and level of acceptable risk, by controlling the budget \$’s.

Such problems do not usually emanate from deteriorating personal relationships of senior management (the state presidents and the functional executives). At that level, sufficient discussion and work has usually been done to clarify the rationale for the shift and to show each individual their own success path. But in the levels below, relationships are typically less strong and the communication challenges of producing real understanding among all individuals involved are much greater.

The only way to avoid this problem is to design the organization so that relationships are based on clear mutual commitment and clear mutual value. A one-sided relationship (favoring either side) cannot work over the long term. Giving the state presidents total budget authority without a complementary obligation to protect the sustainability of the functional service organizations would likely produce short term functional cost reductions, but long term burnout and service failures. Similarly, giving the Functional groups complete budget autonomy would likely protect long term service levels, but render the state presidents impotent. To manage their P&L accountability, we believe that the current organization model would benefit from an effectively balanced set of accountabilities.

Accountabilities, goals, targets, and rewards must therefore be redefined for both groups (state and functional) in ways that de-emphasize power in the relationship, and favor mutual support and commercial success in the marketplace.

Change Management

People, more than structures, are the key to managing complex strategies and organizations. And people, especially Americans, like to play to win. One problem with the change suggested by matrix accountabilities is that it represents a fundamental redefinition of the game being played by the Functional groups. Simply redefining the rules of the old game will leave some of the players feeling diminished and devalued. It will be important to demonstrate that this is in fact, a significantly different game, and one equally worth playing and winning.

A substantial change management program is almost always required to align the organization at all levels with the changes proposed. Such a program must begin with the leadership team and focus on building the readiness and willingness of each leader to authentically speak in support of the change, even if the new structure is not precisely what that leader may have wished. The program must equip and prepare these leaders to create a context for this change that helps employees see the change as critical to taking care of their future at the same time as it takes care of the company’s future. This context should form the basis for a comprehensive formal and informal communication effort, designed to influence the thinking of all key

stakeholder groups. In the end, leaders must be ready to personally take a position with their own people that these changes are required for their organization to win the game.

Change management programs need to be systematic and managed with the same rigor and outcome-focus as any engineering project would require. Some program outcomes can be easily tracked and measured; installed changes in organization charts, for example. Other aspects are less easily measured. Quality of relationships across organization boundaries, and morale are two examples. It is important that any company taking this organizational path not avoid committing to these more elusive outcomes, as, in the end, these will contribute more to 'dollarizing' the changes in which they are investing than the easier to measure outcomes.