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Assessment: Specifying Change

Prime Responsibility #1: Leaders must work with others in the organization to assess the organization's external and internal environments and specify needed changes in each.

Leadership is about change but not arbitrary change. Change can exact a huge price. Aside from resources tied up implementing functional and structural changes—in new systems, equipment, training, or personnel—there is an enormous cost in extra effort and disruption of routines. If nothing else, the organization is almost always less efficient while it undergoes change. Unless it has sufficient excess capacity to compensate, this inefficiency can adversely affect production of goods or services with a resulting loss of customers and compromised relations with suppliers and other stakeholders. Moreover, change is hard on the members of organizations; emotions run high, people work long hours, things seldom go strictly according to plan. Change is not to be undertaken lightly, certainly not for any but the most compelling reasons.

Although change for its own sake clearly is foolish, it is equally clear that an organization can be in trouble if it does not change in response to the dynamics of its internal and external environments. Therefore, it is a

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prime responsibility of a leader to work with others in the organization to assess the organization's external and internal environments, where *assess* means acquiring and interpreting information about the environments. This usually consists of information about the current status of the external and internal environments, forecasts of future status of the environments, and indications of the present and future intentions and desires of stakeholders (customers or potential customers, suppliers, shareholders, employees, the community, and to some extent, competitors). The goal is to create a picture of how the organization, with its unique internal environment, functions within its unique external environment. This in turn permits identification of existing and potential opportunities and threats and dictates the changes, external and internal to the organization, that must be made in order to address them.

Assessing the External Environment

Assessment of the external environment, often called environmental scanning, is the process of acquiring information about the presence and nature of external demands and constraints on the organization's actions. One might think of an organization as involved in a game with its competitors. The playing field for this game is the organization's external environment, defined by the ever changing rules imposed by the forces at work within that environment (e.g., industry practices; the local, national, and world economy; government regulations; resource availability; and social trends and customer preferences). Assessment of this environment is aimed at understanding the structure of the playing field and the rules of the game, its existing and potential opportunities and threats. Within the bounds of this understanding, the strategies used by the organization in its attempt to win (or at least stay in the game) depend on its internal environment: its structure and how it operates, the nature of its culture, its vision for its future, and its ability to focus its efforts on achievement of its vision. The leader's job is to make the organization a viable participant in this game by fostering an understanding of its external and internal environments and by promoting changes in both of them that enhance its ability react to or anticipate opportunities and threats, with the goal of surviving and prospering.

Environmental assessment is done at every level of the organization. On the "shop floor" (in whatever way that is defined for a particular organization), supervisors strive to be informed about what is going on and

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what part they and their subordinates play in the overall endeavor. At the next levels, managers strive to be informed, both about events within the organization and, to some degree, events external to the organization. At the highest levels, the organization's leaders strive to be informed as broadly as possible: events internal to the organization as well as events in the external environment.

Every successful leader I know is almost as well informed about the world in general as he or she is about his or her own organization. Most of these people are well educated, well traveled, and well connected. They know what is going on in the world and have a pretty good idea about how it will affect their organizations now and in the future. Their skill as leaders turns heavily on their ability to convince the members of their organizations to follow them on paths that are based on this fund of knowledge. Their workdays typically revolve around two activities: learning more about the organization's external and internal environments and translating what they learn into a steadily evolving vision, a coherent, reasonable story about the future that the members of their organizations can understand and willingly pursue.

Buying Information

Information about the external environment often is harder to obtain than information about the internal environment. Moreover, although all information is expensive, external information frequently is very expensive, so users must decide what they want and how much they are willing to invest in obtaining it. It is convenient to think of four levels of investment in information procurement and the sources typically linked with each. A low level of investment buys information from such sources as one's own knowledge and hunches, others' knowledge and hunches, or easily obtained data such as changes in monthly sales of one's products, number of customer complaints, or a competitor's exit from or entry into one's markets. Payment for this information usually is in the form of buying lunch in exchange for knowledge, hunches, opinions or advice, asking employees to do a little more work to tabulate demand or complaint data, or watching the newspapers for competitors' advertisements or articles about them in the business pages.

A medium-low level of investment buys all of the above plus generally available information from industry or government sources. Some industry sources are trade magazines, trade association information services, and the Internet, either free or from subscription services that compile

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industry- and product-specific data, informed analysis, and forecasts. Some government sources are the Census Bureau (www.census.gov), the Department of Commerce (www.commerce.gov), and the Small Business Administration (www.sba.gov). Payment is in the form of acquiring computer literacy and, in some cases, a subscription fee. Sometimes the problem is that there is so much available, of every possible description and reliability, it's difficult to find the specific information you need, and it's worse when you aren't really sure what you need. You can obtain more targeted information, cheaply, from your public library or local college or university libraries. Seek out the business librarian, a vastly underappreciated resource, who can help you find information in the library's collection, suggest sources you never dreamed existed, and direct you to relevant Web sites.

A medium-high level of investment buys even more information, this time from empirical tests. Here your product (a term that includes both goods and services) is introduced to a potential new market, or a new or retooled product is introduced to an existing market. Often this is done in a few representative sites just to test customer acceptance. If acceptance is there, the experiment is expanded; if not, the product is dropped. Payment is in the form of the cost of the experiment, such as an advertising campaign and distribution expenses. A manufacturer of ketchup, for example, might be considering adding a chili flavored variety to its product line and wants to know if people will buy it. Test markets could be set up in Albuquerque, Milwaukee, Philadelphia, and Sacramento, with an advertising blitz in each city. If everybody loves the new flavor, the manufacturer can consider marketing the new product across the country. If it is liked only in Albuquerque, the manufacturer might consider distributing the new product only in the Southwest. If it turns out that nobody likes the new flavor, the manufacturer can quietly drop the whole idea and be glad that an expensive and ill-fated product launch was avoided.

A high level of investment buys consultants or an in-house research group that can monitor all the other lower-cost sources of information, can perform surveys and other forms of market research, and can tap expert opinion about national and world trends and their implications for opportunities and threats for the organization.

Organizations do not devote the same amount of effort and money to assessment of every sector of their external environments. Common sense dictates that investment be heavier in sectors of particular interest to the organization and in sectors about which there is greater uncertainty and

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volatility. A pharmaceutical company, for example, might invest heavily in information about public opinion about the retail cost of drugs and about the views of legislators about how to reduce such costs because both public opinion and legislators' views are volatile. The same organization might invest less heavily in information about, say, regional real estate prices or labor costs in Third World nations because, at the moment, neither have a direct impact on their business interests.

In fact, most businesses spend their external assessment budgets rather narrowly, primarily on market research to acquire information about their customers' needs in relation to the business's products. Appendix A contains an example of a market research tool that a colleague and I developed for a large hospital that faced falling revenues due to an increase in competition from other regional hospitals. Administrators wanted to know which of the many services the hospital provided were regarded by its customers (which, surprisingly, are physicians rather than patients) as falling short of, equaling, or exceeding their needs. The information allowed the hospital to optimize its expenditures by cutting back on overprovided services, leaving acceptable services as they were, and expanding underprovided services to better meet customer needs. This resulted in increased physician willingness to send patients to the hospital.

This kind of research is expensive because it requires a trained survey staff that can ensure that the sample of customers is representative so the results will be valid. Moreover, they must analyze the data and interpret the results for top managers, who usually lack research skills. Most organizations employ market research organizations or college/university consultants to conduct their more complicated information procurement.

A relatively new profession has developed as librarians and information specialists have opened shop to provide secondary research for businesses and other organizations. These people, informally, call themselves "information brokers," and they search out data that are available on the Internet and in other archival sources. The information they provide is called secondary because it is amassed by other people, like survey companies, government agencies, or trade organizations. But unlike most of us, information brokers know where to look for specific answers to their clients' specific questions, and they have access to databases that most of us do not. They work on a client-by-client basis for negotiated fees.

Descriptions of services offered by information brokers, as well as contact information that will help in selecting a broker, can be found on the Association of Independent Information Professionals (AIIP) Web site

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(www.aiip.org). Among the diverse services offered are summaries of information about competitors or statistics about product demand, government and public policy documents, data mining or warehousing, patent searches, lists of upcoming trade shows, and copies of papers presented at scientific meetings. AIIP's contact information allows you to pick a broker that specializes in the kind(s) of work you need done. For example, one company on the AIIP contact list, Bancroft Information Services (www .bancroftinfo.com), offers to provide client and customer leads for specific services and products; the history, personnel, news stories, and other information about competitors; fact checking; industry trends and statistics; and consulting services related to effective design of your own in-house information management and research systems. To better explain its services, Bancroft's site provides descriptions of some of its projects. For example, "A publisher was planning to launch a very specific health care–related publication to a small segment of the health care market. Research was performed to determine the current market for such a niche periodical, including information on current competing products and buying habits of the potential audience."

Walking Around

Most of the assessment methods described above involve secondary sources or special research tools. But we must not overlook the importance of face-to-face discussions about the external environment with people both inside the organization and outside. Longtime employees probably know a great deal about your customers and suppliers, about recent market trends and innovations that have yet to emerge. Retired employees, particularly those who have been in leadership positions, can fill you in on the history of the organization: how it came to be what it is and how it has dealt with previous opportunities and threats. Industry consultants can help you understand the environment and provide informed forecasts of future developments. Industry colleagues like to talk shop, and conventions and industry meetings provide opportunities to learn from them.

Further afield, state and local leaders can provide information about current issues that face organizations such as yours, as well as predictions about what the future will bring. Local legislation often has a greater than anticipated impact on organizations, even those whose customers are elsewhere (tax policy, for example).

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Finally, get to know the faculty at the nearest college or university. If your organization is a business, the business faculty is a source of thoughtful analysis and information about new management techniques. If your organization isn't a business, you should get to know faculty in fields related to your organization's activities, but knowing the business faculty is still a good idea. Faculty members often are willing to help with specific problems, either by consulting or by having their classes undertake projects that address the problems. Volunteer to be on the advisory board for the program(s) of interest; you can use your expertise to help them, and they'll use theirs to help you. Don't overlook the economics department. Every organization should have access to an economist, if only to decode the analyses you come across in newspapers and magazines.

Where to Look

So much is available about an organization's external environment that tools are helpful in structuring the search for relevant information and guiding its assessment. One such tool is the search matrix (Fig. 1.1). The parts of the search matrix that are relevant will differ from one organization to another, but it is easy to customize the matrix to any particular organization.

The matrix has two dimensions: sectors and participants.

Sectors. Most organizations' external environments can be divided into five sectors, each of which can affect them and over which they have only limited control:

1. *The economy* at the local, national, and global levels affects the demand for products, the demand for shares, the availability of funds, and the size of the labor pool.
2. *Government* at the local, national, and global levels affects the ease of carrying out an organization's mission through regulation, taxation, and the provision of trained workforce through education and training programs.
3. *Society* at the local, national, and global levels affects an organization through attitudes toward its industry or its specific mission and by the demographic characteristics of the customers and labor force.
4. *The industry* of which an organization is a member affects it by imposing codes of behavior and by the directions in which the industry develops.
5. *Research enterprises* affect an organization by developing new technologies or adapting existing technologies for new problems.

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Participants. There are six categories of people and organizations that have a stake in the organization's success:

1. *Customers* receive the organization's products. A business's customers are the individuals and organizations that purchase its products. Government agencies' and nonprofit organizations' customers are the people and organizations that receive products because they are entitled to them.

2. *Owners* are the people and other organizations that acquire a share in an organization and gain or lose depending on its success (where gains and losses may be in terms of money or in terms of satisfaction in the accomplishment of some task). A business's owners are its stockholders. Government agencies' owners are the citizens and organizations whose taxes support it. Nonprofits' owners are the people and organizations that contribute money or effort to help it carry out its mission.

3. *Employees* are the people and other organizations that are paid to work for the organization. In this definition, it may be appropriate to regard a firm to which some business function is outsourced as an employee of the organization rather than as a supplier.

4. *Suppliers* are people and other organizations that provide the goods and services the organization needs to function.

5. *Competitors* are the people and other organizations that seek to provide similar products to the organization's pool of customers.

6. *Bystanders* are the people and organizations that are not directly affiliated with the organization but that have an interest in its activities and the consequences of those activities. For example, the residents of a town that depends financially on the prosperity of a business have an interest in activities that affect the local economy.

The search matrix in Exhibit 1.1 consists of the 35 cells created by crossing the five sectors with the seven categories of participants.

The first step in using the matrix is to search for information that addresses the *current state* of affairs for each cell (e.g., the current level of economic prosperity supporting customer demand and interest rates; current government regulations, tax policies, and support of education; current societal attitudes as well as the age and income distributions in the population; current ability of industry watchdogs to promote good conduct and encourage movement toward industrywide goals; currently available technologies and their ability to meet the organization's needs).

Next you look for *early signs of shifts* in the sectors (e.g., signs of economic slowdown or increase, calls for restrictive or liberalizing legislation, social calm or unrest, an increase or decrease in the birth rate, effectiveness of industry-imposed codes of behavior, reports of potential technological breakthroughs or early tests of new technologies). Then you seek *predictions of significant shifts* in the sectors (e.g., forecasts of runaway inflation, likely shifts in immigration policy, predicted increases in the birthrate, anticipated industry adoption of product safety standards, predicted availability of technology for automated production).

All of this information is written in the cell, and it often is best to phrase (or label) each entry in terms of implied *demands* or *constraints* on the organization. Information that cannot be identified as a demand or constraint may not be relevant and perhaps should be dropped from further consideration. (Note too that whole cells may be irrelevant, but don't dismiss them too quickly. They may have a relevance that you've never considered before.)

The second step in the use of the matrix is to identify the cells for which you have either a paucity of information or information about which you have questions. This helps you direct the search for new information or clarify, confirm, or refute information you already have. The goal is to obtain as complete a picture as possible, a picture that inspires confidence in its credibility.

The third step is to label each demand and each constraint in terms of whether it is a *threat* to the organization, an *opportunity* for the organization, or an *interesting combination.* This analysis sets the stage for thinking about possible courses of action the organization could undertake in order to thwart threats—or turn them to opportunities—and to take advantage of opportunities.

By the way, I prefer to sketch the search matrix on big sheets of butcher paper and hang the sheets on the walls of a conference room. I do this because I want to have a very direct feel about the information and be able to scratch out, draw connecting lines, and generally get involved in a way that helps me form a clear picture of what is going on. Later, the results are cleaned up for transfer to a computer for archiving.

Warning #1: As information procurement proceeds and the matrix fills up, some opportunities and threats may begin to eclipse others. This can lead to premature decisions about the organization's options. Although the more obvious opportunities and threats clearly need attention, it is risky to ignore the others. Subtle threats can turn out to be an organization's ruin, and subtle opportunities can turn out to be its salvation.

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		Sectors				
		Economy	*Government*	*Society*	*Industry*	*Research*
Participants	Customers					
	Owners					
	Employees					
	Suppliers					
	Competitors					
	Bystanders					

Exhibit 1.1 Search Matrix for Guiding Information Procurement in Assessment of an Organization's External Environment

Warning #2: It is important to regard the search matrix as a tool, not as a substitute for thought. It can be useful in promoting thoroughness, but it can impose limits too: If something does not fit comfortably within the matrix, it may be ignored. Good sense requires you to be aware of these limits and to think beyond the boundaries of the tool. After all, leadership is granted those who can think broadly; tools are merely aids in that endeavor.

An Example

Before turning to assessment of the internal environment, let us examine how the search matrix can be used in assessment of the external environment.

Background. Recall the little story about Poor Wayne that opened the Introduction to this book. The fictionalized company that Wayne had led so badly is an old firm that we will call "Steller Art Frames," located in a Southwestern American city near the Mexican border, a city in which many people are bilingual and in which many families have strong ties to northern Mexico. The company was founded in the 1920s by a cabinet-maker, George Steller, who began making custom picture frames using motifs from the turn-of-the-century arts and crafts movement in domestic architecture. His frames particularly complemented mission-style furniture and interior design, which had become extremely popular throughout

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the United States. The designs were especially favored for framing California-school and Southwest art: soft lines, gilded with gold or silver leaf for a mellow, antiqued finish. All of the work was done by hand, and sales initially were to individual artists or by special order through high-end framing shops and art galleries. In addition to high quality, Steller frames were known for never warping and never separating at the corners. This was achieved by a patented fastening technique, invented by Mr. Steller, which kept the frames rigid. Competitors tried to devise similar fasteners but gave up after receiving unpleasant letters from Steller's lawyer.

The business grew over the years as Steller began selling through a wide range of shops and department stores, aided by a steadily growing interest in mission-style decor. Because production was labor intensive, the number of employees had reached 42 when the George Steller died in 1958. George's daughter Beth expanded the business by adding frames imported from Britain as well as a line of mission-style frames made both with oak and with aged wood salvaged from old buildings throughout the Southwest and Mexico. By 1996, the company employed 107 people, fairly equally divided among producing the original frames, producing the new line of wood frames, importing the English frames, and administrative services. An annual catalogue was published, for which requests were received from throughout the world, but little effort was made to expand sales beyond the United States and Canada.

From the beginning, Steller's administrative staff was reasonably stable, but there was high turnover among frame makers. This was because Steller's couldn't afford high wages, so shop employees tended to be young people, usually new immigrants from Mexico who were looking for their first job. In addition to low pay, the work was rather dull and repetitive, so workers moved on when opportunities arose. The result was that the four shop supervisors spent a great deal of time training new workers and monitoring product quality. High turnover was regarded by Beth and the board of directors as Steller's greatest weakness.

Steller had gone along peacefully for years, growing slowly but not actually changing much, making just enough money to meet its payroll, pay its bills, and stay in business. Things began to go wrong when the demand for arts and crafts designs leveled off at the same time that the taxes on Steller's building jumped (it was located in a historic area that was becoming very trendy, making property values skyrocket). The result was that Steller's lost money for the first time since it was founded.

The company clearly was in trouble by the time Beth retired in 2002. The board of directors, most of whom were elderly relatives of the company's founder, hired a manager whom they charged with turning things around. The manager's first reaction was to cut costs, beginning with staff layoffs. Costs indeed went down, but profits stayed flat because the layoffs slowed production and delayed deliveries, leading to a decline in sales as long-time customers were forced to go elsewhere for lower-quality frames. Moreover, the layoffs so distressed the surviving employees that they simply resisted all attempts to make any further changes. Before long things got so bad that the directors were forced to fire the manager and search for a replacement.

Enter, Poor Wayne. Without trying to figure out Steller's problems, Wayne, like his predecessor, was charged with making the company profitable again, and like his predecessor, he immediately began to implement solutions. But Wayne's solutions were far more grandiose. He produced a plan that nobody understood or accepted; he offered special discounts to Steller's two best customers, on which he lost money; he bought equipment to automate the gilding of wood for frames, which produced more gilded wood than the framers could use, and the machine gilding was shoddy compared with hand gilding; he partnered with a high-profile chain of picture frame shops to sell rather nondescript little frames under their joint names, which lost money and ended when the chain abruptly pulled out; and he entertained offers to merge with one of Steller's competitors without telling the directors. Exit, Poor Wayne.

Wayne's replacement, Carson, was uninterested in quick fixes and had no taste for grandiosity. More important, she had read this book. She began by learning about the company and its problems, in the course of which she created a committee of employees to conduct an assessment of Steller's external environment, guided by the search matrix in Exhibit 1.1. (Incidentally, the assessment committee's members thought of themselves as "team players" and named themselves "The Mighty Carson Art Players," after a feature on the old Johnny Carson TV show. They found this label humorous on a number of levels, but nobody else did, and it soon was forgotten. However, it resulted in everyone affectionately referring to Carson herself as "The Mighty Carson," a nickname she publicly discouraged but secretly relished.

The membership of the assessment committee represented a cross section of Steller's employees, people who clearly were influential opinion makers as well as some of the older employees who knew a lot about

Steller's history and the picture frame business. In addition, Carson sent out a notice to all employees asking for nominations to the committee and added two people she hadn't previously considered. Perhaps as important, she asked the board of directors to assign one of their members, ex officio, to the committee to represent the board's viewpoint and to serve as a communication link with the board.

This assessment committee began by examining each of the sectors for each customer category in the search matrix, recording what they already knew in each cell of the matrix. Thus, for example, in the cell for economy/customers they listed Steller's current customers and how the current state of the economy influenced their demand for Steller's products, how perceived short-term and long-term economic trends would influence their demand, and the constraints these placed on Steller's actions.

Then the committee did the same thing for the economy/owners cell in the matrix, with a focus on profits and performance demands. Next they did it for the economy/employees cell, with a focus on employee mobility and pressures for pay increases, both of which posed potential demands on Steller and both of which were threats. The committee proceeded in this manner through participants, suppliers, and competitors. Then they did the same thing for government/customers, which in Steller's case was a vacant cell because there didn't seem to be anything that government was doing or was about to do that would cause customers to stop buying its products. On the other hand, the government/owners cell was important because Steller's owners were distressed by the steady increase in property taxes as their building's value increased. Similarly, the government/employee cell was important because of ongoing proposals at the federal level to change Social Security and because of rumors of federal legislation that could influence employee health care benefits.

After everything the committee members knew was entered into the matrix, they began to search for information to fill in the holes and to confirm or refute what they thought they already knew. In this case, they turned to an experienced information broker who helped them clarify their thinking and to formulate meaningful questions. As the answers flowed in, they reformulated many of their questions and often came up with wholly new ones. After a while, they found themselves with fewer and fewer questions and with all of the cells filled in or identified as irrelevant.

When they were comfortable that they had a reasonably complete picture, they began to assess the demands and constraints in each cell and how these resulted in opportunities and/or threats. Thus, owners' concern

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about possible tax increases leading to decreased profits was coded as both a demand (taxes must be paid) and a constraint (profits are difficult to increase, and costs can be cut only so much), which pose threats (effects on Steller's already meager profits of paying the increased property taxes and the fact that it would be difficult to pass tax costs on to the customers) as well as opportunities (increasing production and decreasing costs by moving production to a new city-designated enterprise zone that offered low-cost leases on old warehouse space and tax relief in exchange for hiring unemployed youth; moving production 50 miles south to Mexico and taking advantage of tax provisions related to NAFTA, the North American Free Trade Agreement). This suggests a possible scenario in which Steller's six supervisors officially become trainers, with appropriate raises, to create and supervise a workforce in either the enterprise zone or in Mexico. The goal would be to make the training so thorough that product quality could be maintained. Then, by training large numbers of workers (which would keep the trainers busy) and increasing production (which would keep the new workers busy), prices could be lowered to gain a larger share of the existing market. In addition, if new designs were offered, other markets could be accessed, reducing Steller's dependence on mission-style frames.

This scenario raises new questions that require further information search: Are appropriate workers and production facilities available in the zone or in Mexico? Can Steller's supervisors be convinced to become full-time trainers? Can they be taught to teach even better than they do now? Is increased production a good thing? That is, would demand for mission-style frames increase if prices were lower, and how much would sales at the lower price have to increase to compensate for the new workers' wages? For raises for the trainers? Do markets exist for other designs? Would the support staff in the home office have to be increased if production increased or new designs were offered? Would it be possible to meet these increased costs and still increase profits? Are there tax and other NAFTA advantages to moving production to Mexico, and if so, do they compensate for the awkwardness of splitting the company between two geographical locations? Are the advantages of moving to the new enterprise zone sufficient to offset the disadvantages of giving up the building that had been Steller's home for over 80 years and hiring from what might be an unreliable work pool? If the answers to these questions make one or the other of these scenarios tenable, then they are retained as options in the planning process to be described in Chapter 4. If the answers show the scenarios to be untenable, the scenarios should be rejected (or tinkered with until they

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become tenable) and different scenarios must be sought to deal with the assessed threats and opportunities for each cell in the search matrix.

As you can see, this is not an easy task, but important tasks seldom are easy. Moreover, the matrix is not a perfect tool; it is an aid to thought, but it doesn't replace it. The matrix is merely a framework that helps you keep things straight as you go about the search for information about the external environment and as you interpret that information in terms of the threats and opportunities it reveals. Recall our metaphor of the external environment as a playing field. The purpose of being in the game at all is to play well enough to survive and prosper. The strategy for doing this is to understand the demands and constraints of the playing field and how they threaten or provide opportunities for your team to advance toward its goal. But, you can't begin to advance until you know where you are on the playing field and in which direction you need to move in order to reach the goal. Additionally, even if you know in which direction to move, you can't figure out how to do it unless you know your team's strengths and weaknesses. Knowledge of strengths and weaknesses is gained by assessing the organization internal environment, to which we now move.

(A final note to our story: The people Carson put on the assessment committee worked together so well and did such a good job that she asked them to stay on to do the internal assessment. This, in turn, worked out so well that the assessment committee became the vision committee (Chapter 3) and then, with a couple new members, it became the planning committee (Chapter 4). But a new group took over when it was time to implement the plan (Chapter 5) because the members of the old committee were worn out. All of this is very hard work.)

Assessing the Internal Environment

An organization's internal environment consists of its purpose, its efforts to differentiate itself from competitors, its component functions, the organizational structure within which these functions operate, how authority and power are distributed and exercised, and the values and beliefs that constitute the organization's culture.

All of these can be changed if changes are called for as a result of identifying opportunities and threats in the external environment. The ease and success of attempting to make changes in all the others, however, rest on making changes in the culture. This is because all the others are enmeshed

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in the culture, and changing them requires making concomitant changes in the culture, which often is difficult. Because culture and culture change are so important, Chapter 2 is entirely devoted to them. Therefore, in what follows, we will concentrate on assessment of other aspects of the internal environment and then move on to a more detailed discussion of culture in Chapter 2.

Documents

Assessing the internal environment often is easier than assessing the external environment because leaders frequently have a background in the industry and they frequently have moved up through the organization they are leading or one very like it. This experience is invaluable because it provides a core of information to which assessment information can be added. Moreover, there usually is a vast supply of written documents pertaining to the organization: annual reports, brochures, internal memos, policy statements, and records. Although some of these documents are little more than propaganda, it is possible to learn from them, if only how the organization attempts to present itself. Careful reading can yield information about the organization's products, customers, employees, board of directors, business strategy, organization structure, and its financial state. Greater detail can then be obtained by talking with people in the various functional areas of the organization (e.g., accounting, marketing, production, human resources).

Purpose. Every organization exists for a purpose, usually summed up in a mission statement. Generally, an organization's mission statement is accurate, insofar as the people who wrote it understood what the organization actually does. Sometimes, however, the statement's authors had a limited view of the organization, and the mission statement is therefore limited. For example, the mission statement for a famous company said that it was in the restaurant business. Then someone pointed out that it actually owned and operated only a few restaurants. Most of its revenue came from franchising, leasing shop space to its franchisers, and providing supplies to those same franchisers. Recasting the mission statement to emphasize that the company was primarily a franchising business with capabilities in managing property and supplying food and other products prompted recognition of previously unconsidered opportunities. Similarly, in an example to be described in Chapter 3, a charity hospital that always had defined its mission as providing health care for the poor found that it was only by providing care for paying patients that it could afford to continue doing charity work. Recognition of this broader mission led to changes that saved the hospital from closing.

The lesson here is that leaders can learn from their organizations' mission statements as part of the appraisal of the internal environment, but it is unwise to be limited to what the statements say.

Differentiation. Most organizations operate in a competitive environment, whether they are businesses that compete for customers, government agencies that compete for tax dollars, or nonprofit organizations that compete for donations or grants. Each must find a way to differentiate its products from those of its competitors in order to attract the resources they need to survive. Exactly how they differentiate depends on what they perceive to be their products' strengths vis-à-vis competitors': quality, availability, efficiency, beauty, exclusivity, innovation, novelty, value for money, ethical superiority, moral rightness, or some other characteristic that is important to those who control the needed resources. For example, discount stores differentiate themselves from department stores by offering brand name goods at lower prices. In fact, some low-cost merchants boast that they will not be undersold, lowering their prices below those of other low-cost merchants in an effort to make sure that what differentiates them from their competitors remains intact. In contrast, makers of luxury products differentiate on quality and exclusivity; quality is a claimed attribute of the product, and exclusivity is ensured by charging so much that ownership is limited to those few who can pay for reputed high quality. Even when products are not particularly different, advertising can produce the illusion that they are. Relief agencies, for example, compete in helping poor children in Third World countries advertise on American television in the hope that name familiarity will increase their share of charitable donations.

Functions. Every organization must distribute tasks among its members. In a small organization, a few members may share in the tasks, with one or the other taking primary responsibility. Larger organizations need more formal task assignment, if only so members will know where to go to get what they need to do their jobs. This leads to creation of units within the organization that have exclusive responsibility for a particular area of the organization's activities. Thus we see production, finance, accounting, marketing, human resources, and product development assigned to different units, each overseen by a manager who reports to higher management. Each of these units may have its own internal subunits; the human resources departments will have subunits for hiring, for benefits, for training, and so forth.

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Structure. The structure of an organization consists of the way in which its various functional units relate to each other. This often is depicted in an organization chart; boxes represent units, and lines represent the reporting relationships among them.

There are some five or six prototypical structures for organizations; what is "best" depends on the organization's purpose, size, and the characteristics of its external environment. This is not the place to go into more detail; textbooks on management (e.g., Robbins & DeCenzo, 1998) discuss it under the rubric of organizational structure or organizational design.

Authority and power. Authority and power are not exactly the same. Authority comes with the job and often includes power, but power sometimes exists outside the organization's formal structure. Authority can be traced by examining the organization chart. In the typical hierarchical organization, the president or CEO is at the top of the pyramid; the vice presidents of the various divisions are at the next level; the managers of departments are next; the managers of the subunits in the departments are next; and the rank and file is at the bottom. The degree of hierarchy differs from one organization to another, but the structure of most is some variation on this classical form. To the degree that hierarchy prevails, the lines of authority are clear; the people at each level receive orders from the level above, translate them into actions appropriate to their unit, and transmit orders about these actions to the level below them.

Authority is downward and accountability is upward. Accountability means that performance of assigned tasks is evaluated by the authority on the next higher level of the organization, who then administers rewards or penalties. Accountability, which justifies performance evaluation, is intrinsic to a hierarchical organization structure. Accountability often is less clear in organizations that have less hierarchical structure.

The power that accompanies authority and the ability to reward or punish is often called *coercive power* (or *reward power* or *legitimate power*) because it derives from subordinates' fear of reprimand, dismissal, demotion, penalties, or absence of rewards. Although the term is more pejorative than it probably needs to be, coercive power often makes subordinates do things that they might prefer not to do. This is not necessarily bad if it is used to serve the best interests of the organization and its various stakeholders, but the potential for abuse is obvious.

Because both authority and coercive power tend to be vested in relatively few people in the organization, these few people have an immense influence over the working lives of everybody else. This imbalance of power in organizations mirrors a larger imbalance in society, an imbalance that has incited everything from the foundation of trade unions, to experiments in socialism and communism, to revolutions and civil wars. At issue is how to balance the virtues and drawbacks of authority-backed coercive power—especially in business and government—against the virtues and drawbacks of broad participation in deciding how that power will be used and how the resources it controls will be distributed. This struggle underlies the debate about centralized versus distributed government (Washington vs. the states and the states vs.counties and cities), as well as issues about totalitarianism versus democracy, command economies versus demand economies, and so on. Many of the milestones of history reflect this struggle (e.g., the Magna Charta, the American Civil War, and the disintegration of the Soviet Empire). The balance between coercive power and participation has been the major drama for at least the past three centuries and shows no sign of abating. Indeed, it underlies almost any conflict you can name, on the global level, on the national level, locally, and in virtually every organization, large and small, public and private.

In the business arena, the power-participation issue within organizations has come more sharply into focus as service industries become an increasingly large part of modern economies. Some businesspeople, and some academic theorists, have proposed that service organizations might work best if the usual hierarchical structure were turned upside down. The frontline members of the organization would be at the top as befits their importance as the people who encounter the customers and deliver the service. Every level of management below them would exist primarily to support them. The CEO would be at the very bottom, the ultimate provider of support for the entire organization.

The inverted hierarchy is a pretty idea; it has value in emphasizing the importance of frontline people in service organizations; and it may even make a difference in how some organizations think of themselves and how they conduct business. But merely turning the organization chart upside down does not change the fact that the power hierarchy is right side up, with the CEO at the top, because the ultimate power to reward lies with the CEO. On the other hand, inverting the structure prompts recognition of a particularly important truth: leadership has two seemingly conflicting roles in organizations: (a) to control and direct through wise use of power and (b) to support and enhance the actions of the frontline people. The paradox of power is that in order to do their jobs well, leaders must simultaneously direct and serve those whom they lead.

There is a subclass of coercive power that derives from the organization's structure but which does not rely upon the authority that this structure engenders. This is the power deriving from the ability to bypass the formal structure of the organization in order to get things done quickly and efficiently. The prototype is the administrative assistant who has risen through the ranks with all the other administrative assistants and who can accomplish the impossible with just a phone call. This ability to use friendships and swap favors gives the person enormous local power; everyone around him or her comes to depend on this power to cut through bureaucratic red tape. Indeed, the more hierarchical the structure, the more bureaucratic the organization tends to be (in the bad sense of bureaucratic), and people who know shortcuts can be extremely powerful. Again, this kind of power can be very valuable, but it also can be abused, especially when there is favoritism in who is granted access to it.

In contrast to coercive power, which sometimes prompts people to do things they do not want to do, *persuasive power* prompts people to want to do them. Coercive power is granted by the organization to its leaders, but persuasive power is granted by those who would be persuaded. Persuasive power derives from other people's belief that an individual is informed, well intentioned, trustworthy, unbiased (or at least has the "proper" biases), and not out solely for personal gain. Such individuals can be anywhere in the organization, exercising their persuasive powers on their coworkers, either formally or informally. Formal persuasive power might be exercised by a particularly popular and trusted shop steward. Informal persuasive power might be exercised by an ordinary worker who has the courage to speak out against abuses or in favor of newly introduced policies that he or she thinks are beneficial. These people often exert such strong effects on employee opinion that they must be taken into account by the formal power structure; leaders do well to know these people and what they think and, where possible, to work through them. Better yet, leaders should conduct themselves in ways that result in their being granted persuasive power by organization members.

Walk Around

Documents can provide only so much information about the internal environment of an organization. This must be fleshed out—made into something living and vital—by getting to know the people in the organization and what they do. A great deal of this kind of insight is gained simply by walking around and talking with people at each level of the organization. This sort of inquiry, however, must be done with care; the problem isn't so much who you talk with as who you don't talk with. People may be leery of talking to "the Boss," but they will be far more upset if the Boss talks to others and not to them, or to their subordinates and not to them. This means that you need a strategy that will show even-handedness but that will get the information you are seeking. It is a good idea to know all your managers, if you possibly can, and to talk with their subordinates after you have talked with them.

Everybody likes to talk about their job. The problem is keeping them on track so they actually tell you what they do and what it contributes to the organization (or at least to their unit). In the course of this, you can learn what they see as the organization's purpose and how they envision the organization's present and future. Of course, the questions you ask must not be too leading, but you don't want to get bogged down in gossip or end up with a litany of complaints (although you can learn a lot from both). The problem with listening to gossip and complaints is that the former often is bad information and the latter comes with the expectation that you will do something to remedy things. The point of doing a walk around is to learn about the organization, not to receive bad information or build expectations that you may be unable to meet.

A walk around should include each functional unit of the organization, both line functions and support functions. Many leaders find line functions, such as production or distribution or sales, more interesting than, say, accounting or human resources, because they so obviously contribute to the organization's mission. The support functions, however, are equally important and must be understood. Organizations get into trouble more frequently from financial and personnel problems than from inability to produce decent goods or services.

Finally, your walk around should proceed beyond the immediate confines of the organization. If there is a board of directors or an advisory board, you should take time to talk to each member, asking them much the same questions you asked people in the organization. Then you should try to get to know the leaders of competing organizations; they will have opinions about your organization and about the external environment in which your organization and their organizations compete. You cannot

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collude with them, but you need not be personal enemies simply because you are competitors.

In some sense, the local community is as much a part of the internal environment as the employees are, if only because the employees and their families live in the community. Therefore, you should seek out community leaders at various levels to see how your organization is viewed locally. Many highly respected organizations are hated by their neighbors for failure to contribute positively to the community. In some cases, this local animosity makes it difficult to hire good people or be treated evenhandedly by local government or other community organizations. I once consulted for a company that had so outraged the community that its employees' children were harassed by schoolmates and job vacancies went unfilled because people were unwilling to be identified with the company. One service worker told me that in the old days he had been greeted as a hero when he arrived to make repairs, but now he was treated as though he were personally responsible for there being a problem in the first place. He had stopped telling new acquaintances where he worked.

What to Look For

Your inspection of documents and your questions as you meet with people in the organization should address both specifics about their jobs and generalities about how the organization works. The following is a partial list of these generalities, although there will be others for any particular organization:

1. Do members believe themselves to be a part of the organization or merely being employed by it? If the latter, are they merely marking time until they can leave, and where will they go?

2. Do members believe themselves to be part of a team or merely a member of a unit, responsible for only their own duties?

3. Do members believe they are encouraged to be innovative and entrepreneurial in how they do their jobs? Do they believe that their ideas get a sympathetic hearing and that they are recognized appropriately for their contributions?

4. Do members believe that performance is fairly evaluated?

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5. Do members believe that rewards and penalties are fairly distributed and accurately reflect actual contributions to the organization?

6. Do members believe that conflict within the organization is handled well by management?

7. Do members believe that authority and power are used to further the proper interests of the organization or to control for control's sake?

8. Do members believe in the effectiveness of existing channels through which decisions can be appealed or complaints made?

9. Do members believe that management decisions take into consideration the impacts on subordinates, their families, and the surrounding community?

10. Do members believe that management adequately understands the external environment?

11. Do members believe that management adequately understands the internal environment?

12. Do members believe that management adequately understands the changes that must be made in the external and internal environments in order to address threats and take advantage of opportunities?

To be continued . . .

Discussion of internal assessment won't be complete until we have examined the organization's culture in detail. In the course of walking around and asking questions of employees, however, you'll begin to get a clear picture of the culture (organizational beliefs and values) and the climate (whether employees are generally satisfied or dissatisfied with the organization and how things are going). Climate changes over time as a function of good and bad things happening, but culture is robust, changing slowly unless prompted to change. As we shall see, culture can be an obstacle to change or it can promote it. When it is an obstacle, and when changing is crucial to the organization's fortunes, culture change becomes a priority. In Chapter 2, we will discuss the nature of culture and how it can be changed when change is required.

But first . . .

Before we move on to Chapter 2, let us return to our fictionalized company, Steller Art Frames, and some of the results of its assessment

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of its internal environment. The gist was that Steller's long-time employees were found to be extremely loyal to the company and that they understood that as things stood at the moment, the company was likely to fail and that something substantial had to be done if failure were to be prevented. However uncomfortable it made them to think of change, they were willing to cooperate with any reasonable measures to save the company and their jobs. They were concerned, however, that efforts to turn things around might compromise what they saw as the company's greatest assets: the high quality of its products and the pride they took in their work. Moreover, they were afraid that changes would result in Steller's becoming a less satisfying place to work, especially if it were to get larger. They felt that their input could help shape changes, but most of them felt they lacked the wisdom to know what those changes should be. They looked to The Mighty Carson and the assessment team for guidance, withholding judgment until they better understood the nature of the threats and opportunities the company faced and until a new vision was presented for the company's future. Many employees confessed to a deep unease about the future, whether the company tried to ride things out by sticking to the status quo or tried to reinvent itself to meet its challenges. They simply were waiting to see what happened next.

A significant discovery during the internal assessment was that Steller's patented fastening system was more versatile than previously thought. One of the perquisites of being a senior frame maker was the use of Steller's shop and its tools for noncommercial projects on the weekends. In the course of the internal assessment, one of the frame makers told the committee that he had used Steller's fasteners on some furniture he had built for his daughter's twin sons. These extraordinarily rambunctious boys had used the furniture for 3 years and, aside from scratches and dents, hadn't been able to harm it. This prompted Carson to have Steller's lawyers make sure the company had a solid lock on the fastener system, with an eye to licensing it to furniture makers and creating another income stream for Steller.

Summary

To ensure mastery of the foregoing material, summarize it for yourself it by filling in this topic outline:

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Assessment: Specifying Change

I. Assessing the external environment
   A. Buying information
   B. Walk around
   C. Where to look
      1. Sectors
      2. Participants
      3. States
   D. The search mix
   E. What to look for

II. Assessing the internal environment
   A. Documents
      1. Purpose
      2. Differentiation
      3. Functions
      4. Structure
      5. Authority and power
   B. Walk around
   C. What to look for

Exercises

1. Arrange* to interview a current or retired leader of a medium-to-large for-profit, nonprofit, or governmental organization. Prior to the interview, write each question you want to ask at the top of a clean sheet of paper and then take notes on his or her answer in the space below the question. Questions should focus on each of the topics discussed in this chapter (e.g., external and internal environmental assessment, differentiation, power, participation). At the close of the interview, seek permission to return with further questions. (Future interviews will focus on the topics in each of the chapters following this one.)

2. Arrange* similar interviews with people—either currently working or retired—at other levels of the same or a similar organization. This should include officers of the organization other than the president or CEO (i.e., department heads, supervisors, team leaders). Contrast their

answers to your questions with those given by the leader and the other interviewees.

3. Write a short essay on the results of your interviews in an attempt to integrate what you have learned into a personal viewpoint about leadership at different levels of organizations.

4. Place this and future essays in a notebook to create a record of your views about leadership and organizational change.

* If you do not know anyone suitable, ask your instructor or the alumni coordinator of your institution for suggestions and a letter of introduction.

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