Introduction

In 2000, Michael Beer and Nitin Nohria published an innovative approach to change management entitled *Breaking the Code of Change*.¹ They argued that change is most effective when a focus on maximising economic value is combined with a softer, organisation-oriented approach. Their theory has since proved highly popular with organisations and theorists alike.

Nohria and Beer view change as a complex code, the solution to which is unknown in many organisations. They cite the figure, confirmed in a variety of studies, that 70% of change initiatives fail. No surprise, say the pair, since quite simply these organisations don’t know how to crack the code.

Unfortunately though, despite the book’s title, Nohria and Beer do not provide the answer. Indeed the code of change is never fully cracked. Instead, the purpose of the book is to elicit discussion, to launch a debate on the merits and shortcomings of their two theories of organisational change.

The first, Theory E, is based on economic value; the second, Theory O, on organisational capability. Nohria and Beer believe that while the two theories are valuable in certain contexts when used separately, they are most effective when integrated together.

Theory E is the ‘hard’ approach to organisational change. The purpose of this kind of change is to create economic value; in other words, to maximise profit for shareholders. Theory E approaches, then, often involve using economic incentives, consultants, restructuring programmes and redundancy to increase shareholder value. Change efforts tend to be top-driven, planned and programmatic, and focus mainly on formal structure and systems.

In contrast, Theory O takes a far softer approach. It focuses primarily on the capacity of an organisation’s members to lead change strategically and to learn from what they do. As a consequence, using financial incentives and consultants to assist change is far rarer. Theory O change is emergent, rather than planned, with the emphasis on employee participation and organisational culture.

Integrating these approaches, argue Nohria and Beer, can take two forms. Either they can be sequenced, beginning with E and following with O, or, harder still, they can be combined simultaneously. This was the approach taken by Asda in the early 1990s. In this case, two leaders worked together, one espousing Theory E, one Theory O in what could be regarded as a kind of good cop, bad cop model of change management. The approach was immensely successful; not being afraid to synthesise organisational capability with optimising shareholder value brought Asda significant gains in both fields.

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The Structure

In order to highlight the differences between the theories more explicitly, Nohria and Beer break them down into six components as follows:

<table>
<thead>
<tr>
<th>Component</th>
<th>Theory E</th>
<th>Theory O</th>
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<tbody>
<tr>
<td>Purpose</td>
<td>Shareholder value</td>
<td>Organisational Capability</td>
</tr>
<tr>
<td>Leadership</td>
<td>Top-down</td>
<td>Participative</td>
</tr>
<tr>
<td>Focus</td>
<td>Structure and systems</td>
<td>Culture</td>
</tr>
<tr>
<td>Planning</td>
<td>Programmatic</td>
<td>Emergent and non programmatic</td>
</tr>
<tr>
<td>Motivation</td>
<td>Financial incentives to drive planned behaviour</td>
<td>Financial incentives to reinforce emergent behaviour</td>
</tr>
<tr>
<td>Consultants</td>
<td>Large/knowledge-driven</td>
<td>Small/process-oriented</td>
</tr>
</tbody>
</table>

These components provide the book’s structure, with the authors devoting a separate section to each of the six components, plus an additional section on change management research. Within each section, there are four, often quite complex, articles: an introduction, an essay in favour of Theory E, another essay from the Theory O perspective, and a measured commentary aiming to balance the two extremes.

The format is a success. The essays, based on the arguments aired at a 1998 conference at Harvard Business School, are penned by 24 leading business thinkers, including Warren Bennis, Peter Senge and Chris Argyris. The commentary sections balance the debate, pointing to flaws in the argument which the reader may neglect to notice. They also reinforce Nohria and Beer’s central contention that their E and O theories are best served when used one after the other.

A useful illustration of how these arguments interact can be seen in the first of these sections, which examines the extent to which the purpose of change is to increase shareholder value or improve organisational capability.

**Theory E**

The first essay, by Michael C Jensen, presents a powerful argument in favour of the shareholder-value view. Jensen believes that for change efforts to have just one aim, maximising long-term market value, is no bad thing. Self-interest in the pursuit of a
single goal by shareholders does not mean that organisations will be any less keen to accommodate the needs and desires of their employees; provided that the resulting motivation leads to better performance and higher profits. The 'single objective function' (value creation) simply provides a means by which to guide organisational strategy, ‘to assess the trade-offs that must be made among competing constituencies’ and allow a more objective benchmark against which all change management decisions may be made. Jensen terms this 'enlightened stakeholder theory'.

For its part, the belief that caring about shareholder value above all else will lead to damaging short-termism is, Jensen thinks, unfounded; it is fatal for long-term financial growth and thus compromises shareholders’ best interests. Instead, Jensen argues in favour of 'enlightened value maximisation', which allows change managers to apply value criteria to determine how best to decide between competing stakeholders (customers, employees, suppliers, communities etc). For Jensen, all stakeholders are competing with each other 'because no constituency can be given full satisfaction if the firm is to flourish and survive'.

Theory O

In response, Peter Senge splits his core argument into two parts: one concerns the practical aspects of how to manage change in accordance with Jensen’s sole objective function of value maximisation; the other concerns the aim itself.

The first part of Senge’s argument, an exploration of the practical difficulties of profit-oriented change, is based on the concept of system dynamics. In Senge’s world, the unpredictable, nonlinear nature of organisational behaviour means that concentrating on one particular aim, such as value maximisation, may be counterproductive. The simpler and clearer the goal, says Senge, the less likely it is that it will be achieved.

Senge explains himself by citing experiments undertaken by John Sterman in the late 1980s which demonstrate how difficult it is for people to grasp systems and manipulate them to their advantage, no matter how clear the goal. For example, participants within a production-distribution system with just four interacting decision-making roles produced costs ten times the viable minimum. Even with a fairly simple system like this one, the participants’ causal theories were simply inadequate for them to successfully achieved what was requested of them.

For Senge, the only way to tackle the problems inherent in these causal theories is to develop new ones. Predictably, Senge argues that it is only through organisational learning that this can be achieved. However, he acknowledges that there are significant barriers to organisational learning, barriers which are strengthened by a focus on clearly prescribed goals. Senge describes working with a small team on the dynamics of claims management in a large insurance firm. Their work led them to the discovery that cutbacks in the company’s expenses was reducing their ability to adequately assess claims, resulting in record payouts of some 80% of total costs.

2 Beer & Nohria, p 51.
3 Beer & Nohria, p 50.
However, the company was also very pleased with the way it had been steadily reducing its expense outgoings over a number of years, even though these represented just 20% of total spending. When the vice president in charge of claims recommended reversing this trend to a meeting of senior management, the response was less than positive. Increasing investment in the form of more and better trained loss adjusters would, he claimed, result in increased market value by avoiding unnecessary payouts.

His ideas were dismissed as ludicrous. In a culture where reducing expense spending had become a source of great pride, and was believed to be the main area where value could be maximised, the team’s suggestions, even when legitimised through the support of a senior manager, were simply too radical.

Senge argues that the most successful change initiatives require radical changes in current practice, but that Jensen’s focus on the single objective function may cloud organisational judgement to such an extent that the necessary change programmes may never be put in place.

Senge takes a further step away from Jensen’s economics-based view of organisational purpose when he moves on to question the very concept of organisations which exist solely to maximise shareholder value. For Senge, this notion runs counter to his view of organisations as living systems. Influenced by a 1997 book by retired Shell executive Arie de Geus, Senge’s feeling is that well-established firms have a sense of purpose and identity and a set of core values ‘that transcend what they do’.

Senge is careful to make a distinction here between what he believes is an organisation’s function, and an organisation’s purpose, which is significantly broader. Organisational function, according to Senge, is closely related to its design: organisations today are designed so as to maximise value for themselves and for society at large. An organisation’s survival is dependent upon this, just as a human is dependent upon oxygen. Purpose, on the other hand, is emergent. It continually evolves in response to collective wishes and aspirations. Senge sums up the distinction:

You and I need oxygen to survive. But life is about more than breathing. So, too, can a corporation as a living community generate purposefulness. This is different from its function.

An organisation’s function (maximising value) will only change if its design changes significantly. With its function linked to its design, the only way its purpose can change (to encompass much wider aims than simply existing to maximise value) is if its design changes first. Happily, says Senge, design is emergent, and the way it evolves is influenced by its embedded sense of purpose. So those organisations which develop a wider sense of purpose can also change their function. To focus then on one unmovable function is therefore misplaced, as its function will develop in tune with the sense of purpose felt by the organisation.

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5 Beer & Nohria, p 76.
6 Beer & Nohria, p 78.
An alternative view

Joseph Bower is not convinced by either of these arguments. As he states, both focus primarily on the purpose of change, but Senge and Jensen’s conceptions of purpose are very different. Indeed, as he puts it, ‘their arguments exist in separate dimensions of reality’. Where Jensen sees purpose as a formula for measuring economic value, Senge views it as the organisation’s very raison d’être.

Yet Bower regards these arguments as only ‘partial analyses of a problem more complex than either acknowledges’. The practical-based tone is refreshing for the manager facing a change programme and unsure how to link his organisation’s purpose with the complex theoretical versions proposed by Senge and Jensen. Bower provides an alternative change model which focuses on the organisation as a system for allocating resources. Resources for change are deployed according to a variety of organisational perspectives:

• technological and economic
• allocation of human and financial resources
• systemic contexts

Each of these are assessed according to three criteria, corporate, integrating and operating, and carefully illustrating with a variety of real life case studies.

In the construction of his model, Bower is careful to acknowledge the complexity and interlinked nature of the change process, and laments the lack of detailed empirical research to substantiate much of the theory. He argues for greater numbers of comparative, longitudinal studies ‘using a shared model of strategic activity’ which take into account the whole organisational system. Without these, the effectiveness of change will always remain at least partially haphazard.

Conclusion

In this article, we have profiled just one of the seven three-part sections which make up the book’s 500 pages. The format of Nohria and Beer’s book works well. After presenting their change theory to the reader, they leave the floor entirely and allow an impressive body of business writers and academics to resume the debate on their behalf. The complexity of the argument, although off-putting to some, is also indicative of its quality. For those overseeing organisational change in any context, Breaking the Code of Change can be recommended as an important work of reference.