

A NEW LOOK AT ORGANIZATIONAL TRANSFORMATION USING SYSTEMS THEORY: AN APPLICATION TO FEDERAL CONTRACTORS

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To survive in an increasingly complex and dynamic world, many firms are struggling to re-define themselves and to understand their products, processes and markets in new ways. In the United States, the need for strategic change and adaptation is critical in the unique economy that has grown around the federal government in firms whose revenue comes primarily from (increasingly precarious) federal contracts. The purposes of this paper are to propose systems theory (Katz & Kahn, 1966) as the theoretical foundation for the concept of organizational transformation and then to apply the concept to the unique situation of federal contractors.

INTRODUCTION

The notion of organizational transformation is well represented in various literatures (see, e.g., Kilmann & Covin, 1988). It is a topic that has been in the popular press, in practitioner publications and in academic journals for many years. Yet for all the attention, the field is not coherent; disagreements about basic definitions, fundamental frameworks and general values abound (Beer, 1988; Blumenthal & Haspeslagh, 1994; Kilmann, 1988). Agreement occurs primarily around very general and often vague prescriptions. In fact, most areas of agreement (e.g. the benefits of more open communication, better understanding of process, clearly understood and shared vision), while laudable, offer the consultant or the practitioner little guidance. More importantly, the organizational qualities around which consensus has formed seem to apply quite globally to *any* organization regardless of technology, market, culture or capital/cost structure.

Thus, the notion of organizational transformation seems to have lost favor among academics in organization theory, though it still attracts the attention of those in organization behavior studying leadership (e.g., Pillai, Schriesheim, & Williams, 1999). Much of what has been written about organizational transformation recently seems to have been lost in the organizational change and/or culture literature. Likewise, strategy textbooks discuss the notion of strategic change, but there is very little in the way of theoretical or empirical research to support those discussions. Here, we contend that the concept of organizational transformation still has utility for those studying both organization theory and strategy if it is viewed through an appropriate theoretical lens, which we contend is systems theory.

We narrow the focus on this issue to the case of government contractors and their need for and proclivity toward each of three types of transformations: operational improvement, corporate self-renewal programs and strategic transformation. Contractors are unique in that many of them have both public sector and private sector enterprises, and thus have had

experience with transformations from many perspectives. We base this discussion on our ten years of experience with numerous government contractors and their organizational and cultural practices and problems. In particular, we discuss systems theory as a basis for understanding several issues that impede government contractors from successfully achieving long-term strategic change and organizational transformations. Finally, we consider the implications that a more precise conceptual focus has on the practice of organizational transformation, both generally and in the specific case of federal contractors.

ATTAINING A MORE PRECISE CONCEPTUAL FOCUS

We start with the simple framework suggested by Blumenthal and Haspeslagh (1994), who distinguish among the three types of organizational transformation mentioned above—operational improvement, corporate self-renewal programs and strategic transformation. Operational improvement starts with the goal of achieving significant improvements in efficiency by reducing costs, enhancing quality, cutting cycle times or simplifying processes. The heart of this type of transformation is re-engineering business processes to restructure roles, move organizational boundaries and change work and information flow. Corporate self-renewal seeks to create organizational relationships and cultural processes that will allow the firm to continuously adapt to changing situations thus avoiding performance gaps in the future. Initiatives to create a learning organization or implement continuous improvement exemplify this second type of transformation. The third category suggested by Blumenthal and Haspeslagh, strategic transformation, is the process of re-establishing competitive advantage in the market place by recreating a productive match between core competencies and market opportunities. Strategic transformation can take the form of developing new competencies, discovering or creating new markets or, more usually, some combination of the two.

Each of these types of transformation has different objectives, different intervention strategies, different measures of effectiveness and different time lines. Though all types of transformation are long-term processes (Hall, Rosenthal, & Wade, 1993; Senge, 1990), in general, one would expect operational improvement to have the most rapid results. Corporate self-renewal requires more structural changes and longer-term expectations. Finally, strategic transformation requires the most complete paradigm shift and a time horizon stretching to a never-ending future.

While each form of transformation pursues unique specific metrics during the process, the ultimate definition of success in all three is that individual and group behavioral changes necessary for financial success become institutionalized. What varies (significantly) among the three is the specific nature of the desired behavioral changes and the new types of activities in which the members engage. Blumenthal and Haspeslagh (1994) suggest (and we agree) that many problems are caused because change initiatives frequently combine these three aspects in an undifferentiated transformation program. We contend that systems theory is a useful theoretical tool to clarify these issues.

A SYSTEMS VIEW OF BLUMENTHAL AND HASPELAGH'S TRANSFORMATION TYPOLOGY

One of the concerns regarding Blumenthal and Haspeslagh's ideas on organizational transformations is the lack of a theory base. To wit, we offer systems theory as the theoretical underpinning with which to understand and operationalize Blumenthal and Haspeslagh's typology of transformations. Systems theory has become the dominant paradigm in studying organizations since Katz and Kahn (1966) published their seminal article some 35 years ago. As a brief reminder, recall that the systems model consists of inputs (I) that are processed (P) into outputs (O) leading to feedback. The feedback impacts the entire system through both the inputs and internal processes. Organizations are seen as systems that interact with their external environment and receive feedback both internally and externally that lead to improvements in processes and outcomes. Systems theory has become the theoretical underpinning for the study of organizations in academia for nearly fifty years. Likewise, its application is also commonplace in the practitioner literature (e.g., Gavin, 1998).

Thus, Blumenthal and Haspeslagh's three types of transformations can be seen as applying to different parts of the systems model. The operational transformation focuses on the inputs and internal processes in an organizational system. Improvements are made when organizations identify different inputs and different ways to process those inputs to obtain efficiencies by reducing costs, enhancing quality, cutting cycle times or simplifying processes.

The corporate self-renewal transformation focuses on work processes and internal feedback mechanisms. Corporate self-renewal focuses on organizational relationships and cultural processes that allow the organization to adapt to changing situations to avoid performance gaps in the future. These capture the way in which organizations do business. Organizational relationships and culture are seen as the main ways in which inputs are processed and the way in which feedback, both internal and external, is received and internalized by the organization.

Strategic transformation requires a focus on the entire system. It is the process of re-establishing a competitive advantage by recreating a productive match between core-competencies and market opportunities. An organization must correctly assess its inputs, processing capabilities, and outputs to accurately assess its core competencies. Furthermore, an organization must aggressively seek feedback from external environments to understand emerging market opportunities. The combination of the competencies seen in the inputs, internal processes, and outputs, with the market opportunities seen in the feedback, provides the avenue by which an organization can establish a competitive advantage.

We argue, based on the described link between systems theory and organizational transformations, there is actually a hierarchy among the three types of organizational transformations. First and foremost, the strategic issues must be addressed, resolved and implemented. Once an organization has committed to strategic transformation, then corporate renewal efforts aimed at changing culture and re-engineering can be undertaken. Then, the organization can turn its attention to issues of enhancing efficiency and productivity through operational transformation. One compelling reason for using federal contractors for our example in this paper is that they are often forced into pursuing corporate renewal and

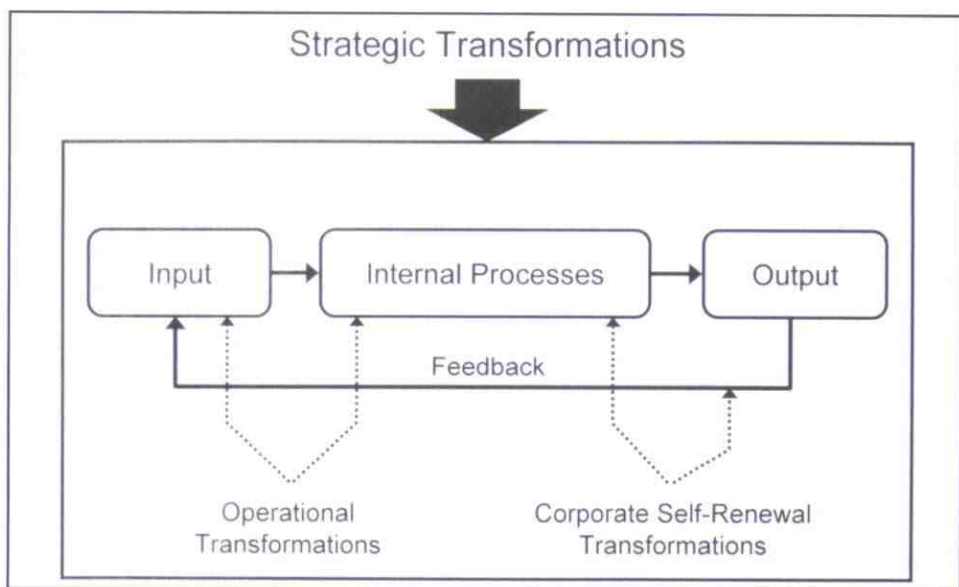


Figure 1. Organizational Transformations and Systems Theory.

operational efforts because the unique context in which they operate severely hampers them from taking a strategic perspective.

THE UNIQUE CASE OF FEDERAL CONTRACTORS

With growing demands from the public for greater efficiency on the part of government, contractors are becoming an increasingly important source of providing services to citizens (Straight, 1999). Most researchers in the field of public administration maintain that many facets of public organization culture/structure are distinct from private sector organizations due to the unique constraints that public organizations face (Bozeman, 1984; Emmert & Crow, 1988; Perry & Rainey, 1988; Starling, 1998). According to Bozeman (1984), there exists a continuum that extends between public and private organizations and that all organizations could be thought of as having some amount of "publicness." Emmert and Crow (1988) found empirical evidence to support Bozeman's model noting that the strongest discriminator of "publicness" is the amount of governmental influence on an organization's goals and the nature of the products they produce. We argue that organizations that rely heavily on federal contracts face considerable governmental influence in terms of goal setting, the products they produce, and how they define organizational performance. Thus, they tend to assume many attributes and processes frequently associated with public organizations. It is beyond the scope and intent of this article to identify all of the facets of federal contractors that differ from fully private-market firms but we shall identify several structural and cultural components that highlight the problematic nature of the strategic transformation in this context.

We argue that government contractors, by the nature of their business, are motivated to initiate operational transformations and even limited corporate self-renewal transformations but that strategic transformations may prove especially problematic. The latter are problematic

because federal contractors have a single customer who exerts extreme power over the contractor and creates a fairly volatile environment that makes long-term strategic transformations difficult. Despite the challenges inherent in implementing strategic transformation, we conclude that it offers the most promising foundation for successful transformation of federal contractors. Operational improvements offer important (even critical) benefits. However, in a firm strategically adrift, there is no context in which to evaluate various operational initiatives. Doing what the market no longer needs, however brilliantly you do it, is no plan for future success. Likewise, creating a program of constant corporate self-renewal, while ultimately very important, is often exceptionally abstract and contextually disconnected if the basic *raison d'être* of the organization is in question or changes frequently.

For example, one client organization we worked with saw its security forces downsized by 60% very suddenly. Additionally, its mission changed from a paramilitary posture with protection of real property as its main focus to one of protection of both real and intellectual properties more akin to a civilian security mission. Morale tumbled as hundreds of personnel were fired and those remaining rebelled against the new "bank guard" mentality. All of this happened in less than a year. This massive change effort was heralded as a response to a change in mission for the larger organization, and a comprehensive "culture change" effort was undertaken to transition to the new mission. Unfortunately, the members of the security force had prided themselves in their organizational identity of a paramilitary strike force, and the attempt to change the "culture" almost overnight to one of protecting intellectual property and access to information was a failure. Instead of taking the time to plan and undertake a strategic transformation to include building new skills and creating a new organizational identity, the contractor relied on corporate self-renewal efforts (i.e., culture change) as a way to deal with the operational improvements in the larger organization and its change in mission.

In the private sector, strategic transformation means helping the organization understand, discover and develop new markets and develop their core competencies to serve those markets, as a sensible first order of business (McCampbell, 1998). Sandvig and Coakley (1998) studied nine small companies that had successfully transformed from being heavily dependent on government contracts in the 1980s to a private market orientation by the mid-1990s. They found that the only transformation strategy that the nine companies had in common was to leverage their core competencies into commercial market uses. The application to public sector organizations is much the same. In the case of the security force mentioned above, the host organization would have been better served explaining the new mission in terms of new "markets" being served and developing new abilities and competencies to serve the new "customers" instead of launching a corporate renewal, culture change effort.

This certainly is not an argument to abandon operational improvement and corporate self-renewal initiatives or to put these other types of programs on hold to focus exclusively on strategic transformation. Rather, we argue that giving explicit conceptual primacy to strategic transformation creates a context for the total effort where synergies, priorities, conflicts and problems can be more clearly articulated, understood and addressed. In the specific case of federal contractors, because of their lack of control over markets served, giving primacy to strategic transformation holds the lost promise despite the challenges involved.

IMPEDIMENTS TO ADOPTING A STRATEGIC FOCUS

We argue that there are several impediments that hinder a government contractor from initiating strategic transformations. In the discussion that follows we identify five such impediments. Throughout this discussion, we further identify where these impediments enter into the entire system. We suggest that these impediments force the organization away from a total systems view and instead make it focus on specific part(s) of the system. We contend that these impediments force managers in government contractor organizations to become inwardly focused. This focus is counter to the basic open-systems notion that organizations are impacted by forces in their external environment, and managers must be constantly scanning the external environment for opportunities and threats. Finally, the inward focus on only certain parts of the system discourages strategic transformation.

In applying a systems theory perspective to government contractors, we have identified five salient issues that are impediments to federal contractors implementing strategic transformation. Each issue is discussed in terms of one or more components of the systems model (see Figure 1). We also discuss each impediment in relation to a specific model of organizational effectiveness to demonstrate how and why people exhibit specific behaviors that may otherwise seem puzzling. The five crucial impediments are summarized below.

First, the contractor organizations exist in an environment where "risk" refers to the probability of winning of contracts, and thus focuses on the *input* side of the systems model. Organizational effectiveness is thus defined by the ability of the organization to attract resources (i.e., contracts) which is known as the "systems resource" view of organizational effectiveness (Yuchtman & Seashore, 1967).

Second, a *crisis mentality* is characteristic of contractors and tends to focus attention on the *internal processes*, including the management systems, used to process inputs into outputs. The crisis mentality emerges when people, programs and projects are cut in response to fluctuating federal budget allocations and result in the never-ending quest for even greater efficiencies. This leads to a measure of effectiveness termed the "internal processes" approach (Georgopoulos & Tannenbaum, 1957).

Third, federal contractors have *accounting, funding and information systems* based on facilitating control rather than providing incentive and opportunity for business (Elmore & Rezaee, 1992). The emphasis here is on *outputs*, and the relevant model of organizational effectiveness is the goal-centered approach (Etzioni, 1964), where the goal is most often staying within budget allocations.

The fourth issue is that government contractors are subject to extensive federal government *regulatory oversight* usually involving special surveillance structures. This oversight often makes managers focus on internal issues and government stakeholders, thus losing sight of what is going on outside the organizational boundaries. The regulatory oversight and performance metrics focus the firm's attention on *feedback from the external environment*. Unfortunately, the feedback is narrowly defined and draws the firm's attention away from the overall system to the particular part of the system being regulated.

Finally, *performance metrics* are mandated by the terms of the contract, and not drivers such as market forces as is the case with the private sector. Moreover, "the rules of the game" can change with little or no notice. Thus, rapid, unforeseen changes make it difficult for contractor managers to think strategically about the external environment and again focus only on the government stakeholders.

Note that the *regulatory oversight* and *performance metrics* focus the firm's attention on *feedback from the external environment*. This perspective sees organizational effectiveness in terms of a *stakeholder approach* that focuses on the ability of the organization to meet the expectations of key external constituencies such as legislators and regulatory agencies.

To guide the discussion, we will be using examples from our extensive experience working with federal contractors (both large subsidiaries of nationwide firms, and small, local R&D firms) and our work with a national research laboratory. Note that our discussion is not meant as a criticism of federal contractors in general or the members of our client organizations specifically. In our experience, most people in these firms are hardworking, conscientious and talented and most are explicitly aware of the characteristics of their situation. We offer these examples to simply illustrate and clarify the issues and to highlight the differing, and sometimes conflicting, perspectives on effectiveness. We now discuss each impediment in detail.

Inputs: A Unique Conception of Risk

The word "risk" as used by federal contractors often carries connotations not seen in the world of free market business (Bozeman & Kingsley, 1998). These different connotations are predictable because the world of federal contractors has differed in many important ways from totally, free-market business (Emmert & Crow, 1988). In the world of federal contracts, the customer (the government) has often paid for the development of new technologies which has largely eliminated contractors' concerns about product development risk. The customer has been clearly defined and, in general, demand has been predictable. For small firms, the business assumes no risk because it does not conduct any work without a grant. The downside here is that these small businesses live from one grant to the next. This translates into a limited concern for market development and market response risk that minimizes opportunity for strategic transformation. Thus for people experienced in the world of federal contracting (at all levels in the organization), "risk" often refers to the low probability of winning any specific contract, technical problems in fulfilling contracts or the possibility that contracts will be canceled or fees reduced. Indeed, there are even simulation models developed to help contractors assess the probability of winning a competitive bid (e.g., Cagno, Caron, & Perego, 2001). However, the concept of financial, entrepreneurial risk—committing resources today for potential rewards in the future—is not usually directly in federal contractors' experience or their culture (Bozeman & Kingsley, 1998).

Managers in federal contractors are often accused of being risk averse. However, in our experience, they are not risk averse precisely, so much as they simply have a different concept of risk than private-sector business people and thus respond differently to the management of risk (Bozeman & Kingsley, 1998). Contractors of both small and large size often approach risk management as an exercise in portfolio management. Their initial inclination

is to search for more contracts to add to a portfolio of contracts or to minimize the "risk" of losing a current one. Private-sector business techniques, designed to address more market-oriented strategic risks, do not come as quickly. Searching creatively for potential matches between developing core competencies and market potential, investing company resources to build new competencies, evaluating market potential of a new product line are all techniques of risk management in which contractors often have little experience (Helbig & Capps, 1996).

The focus here is always on the input side to ensure that enough resources are entering the system to keep it functioning at some sustainable level. Thus, the effectiveness of the organization is judged using the "systems resource" model (Yuchtman & Seashore, 1967) and managers are evaluated on their abilities to bring new contracts and "business" to the organization. One of our clients was a national laboratory that was trying to diversify away from reliance on federal funding. But the scientists were reluctant to venture out to the private sector with proposals because of the risk of obtaining funding in a more competitive environment. Better to play it safe and stay with established sources as the reward structure only focused on inputs. There was no reward for trying to protect the long-term viability of the organization by building new relationships.

Internal Processes: The Crisis Mentality

It is conventional wisdom that severe organizational crisis is an important, even necessary, catalyst to organizational change (Posner & Rothstein, 1994). While this may be true for organizational transformations in general, there is another side to crisis that impedes strategic transformation significantly. Specifically, after a steady stream of furloughs, layoffs, early retirements and pay cuts (both in the organization and reported in the media) nearly every employee in federal contractors recognizes a crisis situation (Pearson & Clair, 1998). Further, in an effort to cut costs quickly, "non-essential" programs have been pared. In many contractors, human resources programs, employee benefits, building maintenance, library services and graphic support have all been cut.¹ Organizational effectiveness is strictly a matter of doing more with less. The never-ending quest for further efficiencies is a classic application of the "internal processes" approach to organizational effectiveness (Georgopoulos & Tannenbaum, 1957).

In an era when "empowerment" is a common theme of change programs, people at all levels often feel powerless in the face of the crisis. As Deming (1982) suggests, everyone doing their best is not the answer; rather, the system must be changed. Yet for many people, attempting to do their best for the company seems the only option. In most of our client organizations, members routinely work long, uncompensated hours, expect to work weekends and accept draconian "temporary" assignments or short-notice transfers as necessary. At a time when we want people to take risks, to be creative, to forge new visions, to be empowered, they often feel weak, helpless, and needy (Janoff-Bulman & Freize, 1983; Weick, 1993). When managers need to be open, they can easily feel under siege. When leaders need to be charismatic and visionary, their audience can be tired, skeptical and frightened.

The crisis environment causes organizations to examine, often in a frenzied way, how they process inputs into outputs, continually emphasizing cost reductions and increased efficiencies. The use of information technology to reduce the costs of procurement is part of

that search for efficiency, but even that does not ensure increased performance (Rasheed & Geiger, 2001). The focus on work processes results in organizations initiating two of Blumenthal and Haspeslagh's organizational transformations, namely the operational and corporate self-renewal transformations. In an effort to become more efficient, organizations seek operational transformations, so as to reduce costs, enhance quality, cut cycle times, and simplify processes. Instead of moving towards a coherent new set of business activities, the organization opportunistically creates an idiosyncratic pastiche of contracts from whatever is available. Thus, building confidence, enhancing focus, and developing a sense of priority is a significant challenge for strategic transformation in federal contractors.

In one client organization, a newly negotiated contract mandated that the contractor perform certain economic development activities. The contractor built up an economic development department, which shortly afterward was dismantled when the government no longer mandated this activity. Employees were shifted to new work. In such crisis situations, the firms view the only way to improve the lot of the employee as being a corporate self-renewal transformation designed to improve morale. Yet such transformations have little effect when employees know that the next reorganization or upheaval is inevitable and do not see any overall strategy other than crisis management.

Outputs: The Accounting Structure and a Search for Coverage

The accounting structure of federal contractors has a great effect on day-to-day operations and the strategic transformation process (McCampbell, 1998; Elmore & Rezaee, 1992; Musso, 1992). Specifically, the accounting structure (which is designed and certified according to federal regulations) is created primarily for control (Elmore & Rezaee, 1992). The accounting system assigns costs to specific projects so auditors can insure the government only pays for contracted work. Thus, the focus is on staying within budgets, meeting targets and completing work as planned, all of which is consistent with the "goal-centered" approach to organizational effectiveness (Etzioni, 1964). Performance evaluations and promotions are directly tied to "meeting the numbers."

Everyone in the organization must account for every moment of their time, charging against a specific contract, company funded projects or "overhead." Furthermore, traditional accounting methods and government contracts limit billable overhead based on a volume related criteria such as a percentage of total hours or dollars (Musso, 1992). Although some contractors have considered alternative accounting methods to help them more precisely identify the proper allocation of overhead costs, few have actually adopted such methods because of the complexities involved (Musso, 1992). And, the likelihood that these accounting practices will change soon is very remote. In nearly all situations then, charging directly to a contract is considered vastly preferable to charging against "overhead" which carries a non-productive connotation in many ways.

The problem is exacerbated as contract revenues have declined and firms experience process inefficiencies. With fewer and smaller contracts restricting output, fixed costs and overhead continue to consume an ever-increasing percentage of a shrinking revenue base. The resulting inefficiencies cause unit costs to rise and make the company's ability to win future contracts more problematic. As a result, most contractors face increasing pressure to reduce "non-

productive" costs across the board. Hence, pressure on individuals to secure direct contract coverage has amplified tremendously.

There is also increasing pressure to reduce projected costs on specific contract bids. Although the federal government has attempted to change the cost-estimating system behind government contracting, progress has been slow (Figura, 1999). In the short-term, there is little a project manager can do to change the cost structure he or she faces. Wages and salaries are not easily variable and overhead rates, as a percentage of direct labor hours are negotiated and established for each certified cost center.² Nonetheless, in the current contractor environment, cost competition is keen and high overhead multipliers as well as high labor rates are seen as a severe competitive disadvantage. Thus, within the confines of the specific contract, proposals are written with unprecedented concern for reducing total cost. This focus on cost reduction leads to an emphasis on operational transformations, in hopes of having a more immediate return on investment on the contracted work.

Tactics for accomplishing this are numerous and familiar to experienced federal contractors. They include trimming hours and equipment to the absolute minimum, using low-cost team members wherever possible, shifting contracts to low cost centers, and cutting "extras" such as travel budgets to the bare minimum. Kelley and Watkins (1995) found that among durable goods manufacturers, price undercutting was a more common competitive practice among defense contractors than firms not associated with government contracting. The result is that those contracts which are won have squeezed all (and more) slack from the system.³ On many contract bids, due to severe and immediate cost competition, firms have gotten the "lower cost" cart well before the "re-engineered" horse (Hammer, 1990).

This accounting structure and the resultant systemic pressures work against strategic business transformation both culturally and structurally. Culturally, this way of categorizing one's time and effort, the value system that prizes "direct charge," and the non-productive connotation of "overhead" are so taken-for-granted that it is very difficult for individuals to conceive of or desire pursuing the kind of activity strategic transformation demands. Such activities are often seen to get in the way of doing "the real work" on direct contracts. Specifically, given the current organizational pressures, people without the "security" of direct contract coverage are, in fact, at risk of losing their jobs; overhead funds are actually being cut. Thus, the most likely transformation for a contractor to adopt to respond to the accounting constraints will be an operational transformation. This focus will preclude the organization from taking a systems-view of how it does business and will prevent the organization from adopting strategic initiatives and transformations.

The effect of the accounting structure on the culture cannot be overemphasized. Employees in some organizations have been forced to charge their time to over 20 projects to avoid charging to overhead. Such fragmentation decreases the likelihood of the ability to focus on strategic transformations. In addition, employees doing contract work often resent upper management because they see management as contributing to high overhead rates which they perceive to reduce the likelihood of securing subsequent contracts.

System Interaction with the External Environment

Regulatory oversight. Most government contractors face special oversight procedures that go beyond the oversight experienced within the private sector (e.g., OSHA, EPA, etc). One reason for the additional oversight is that contractor work is sometimes deemed riskier than what is done in the private sector. As a result, regulatory oversight is much stricter than would be found for private companies. This reflects both risk aversion by the government for its own activities, and the lack of a profit motive. Still, the impact is that contractors will be inclined to focus their transformational energies on operational improvements that will allow them to meet the demands of the regulatory agencies conducting surveillances of work processes. These outside inspections tend to increase the crisis mentality described earlier, making it less likely that contractors will be able to sustain attention to their strategic initiatives.

The existence of unusual regulatory pressures on the government contractor focuses their attention on whatever part of the system the regulatory agency is monitoring. The part of the system being monitored will most likely be either:

- (1) the inputs – *Are procedures being followed for initiating work?*
- (2) the internal processes – *What procedures do workers follow during the conduct of work? What controls are in place to make sure that certain procedures are followed?*
- (3) the outputs – *What are the critical outcomes relating to compliance? How did the organization do on several measures of safety (e.g., lost work days, etc.)?*

Contractors are likely to engage in operational transformations to address how work is set up and completed. In addition, they will engage in corporate self-renewal transformations to institute a culture of compliance and to respond to changes in the regulatory environment. Still, the focus of the external regulators on only a part of the system will draw the attention of the organization away from the overall system, thereby impeding the initiation of strategic transformations.

In one client organization, the upheaval caused by regulatory oversight increased with staffing changes in regulatory agencies. New staff members interpreted regulations differently than their predecessors. Their interpretations were based on the environments in which they had previously provided oversight. The contractor was forced to take extra measures to bring the regulators up to speed on the type of work being done. In addition, internal issues within the regulatory organization caused some regulators to try to raise the standard of performance, i.e., reinterpreting regulations. The contractor saw the implications of the regulatory implementation changes to have such a significant potential impact on the contractor's performance fee that attention was directed to the issue at the highest levels of the organization. Clearly upper management will have difficulty focusing on strategic transformations if their attention is focused on issues resulting from staffing changes at regulatory agencies.

Defining Performance. The definition of performance for government contractors can change radically with little forewarning. In the private sector, change is more gradual. Businesses will monitor consumer preferences and values and look for the trends that would require strategic transformations. For government contractors, there are typically key metrics that are used to

assess performance, e.g., critical outcomes. These metrics can change in the course of a contract or at the time that a contract is renegotiated. These sudden changes, which are mandated by the government, force rapid operational transformations in order to maintain a positive bottom line. The unpredictability of these changes, both in terms of timing and direction or trend, discourage long-term strategic change or transformations and encourage shorter term operational transformations.

From a systems theory perspective, the emphasis on changing metrics of performance draws the organizations' attention to its inputs and processing of those inputs; for it is by these that the organization will achieve its performance standards. When the performance metric is changed, the organization will need to initiate operational transformations to meet the challenge. Contractors seek ways to be sure that they are performing well on the metrics being used. Their attention will be drawn away from other kinds of feedback regarding their true productivity. Instead, they will focus only on the metrics being used in this discrete time period. This emphasis on only part of the system will deter the organization from taking a more holistic view of themselves and their environment and responding through strategic transformations.

Changes in performance metrics can create a crisis mentality. Changing metrics have been seen in many areas. For example, while the goal of economic development may remain constant for some period of time, the measurement of the goal may change frequently. Possible metrics include the number of jobs created, number of businesses created, salaries of jobs created, number of minority owned businesses started, etc. Similarly, in attempting to measure safety the metrics may include lost work days, number of accidents, number of reported incidents per worked hour, etc. Each time performance metrics change, the contractor must respond quickly. They often undertake operational transformations to adjust to working to the new metric.

DISCUSSION

A Total Systems Perspective

Instead of focusing on each stage of the systems model and trying to define effectiveness and performance in three different ways (i.e., inputs, internal processes, outputs), we argue that a total systems perspective has the most utility for federal contractors. Indeed, to accomplish strategic transformation, that is the only viable option. Business-level strategic transformation does not proceed in a vacuum. Within the larger corporate picture there are a myriad of initiatives, issues and imperatives that can color such transformation efforts. While efforts to match core competencies with the market proceed at the business-level, corporate-level questions of overall business portfolio suitability, investment attractiveness and corporate vision must be evaluated simultaneously (Montanari, Morgan, & Bracker, 1990). This makes life for strategic managers at the business level even more difficult. The most obvious possibility (and one on the mind of many members of contracting organizations) is that the business they seek to transform has already been doomed by corporate-level decisions to focus exclusively on obtaining federal contracts. Harvesting and retrenchment strategies that seem so impersonal in textbooks can prove to be insurmountable distractions to strategic transformation programs.

Less obvious, but no less distracting, is the possibility that corporate-level decision-makers amplify the kind of confusion Blumenthal and Haspeslagh (1994) predict. For many federal contractors, multiple quality initiatives, cost containment programs, team development, learning organization seminars, re-engineering programs and strategic transformation are all on-going. This potpourri can confuse the total effort, make it difficult for individuals to focus their attention, blur outcomes assessment and help create a "flavor of the month" mentality. Increasingly in our client organizations, the transformation market is saturated and competing for members' attention is increasingly difficult.

Thus, systems theory provides a framework where the role of organizational transformations can be clearly seen. In the case of federal contractors, the volatility of their environment and their lack of control due to having a single customer, takes their attention away from the overall system. Inattention to the entire system leads to an inability to pursue strategic transformations. Instead, contractors attempt to respond to their environment by using operational or corporate renewal transformations. Yet based on a systems theory perspective, these transformations do not impact the entire system and cannot therefore help the contractor respond adequately to the overall environment.

The Need for Strategic Transformation

The case of federal contractors is an obvious situation in which giving primacy to strategic transformation can provide clarity and enhance the overall effort. If the organization is committed to strategic transformation as the prime mode of overall change orientation, then tradeoffs become clear. It is known at the outset that building new core competencies to match an emerging market potential requires full-time attention over multiple years. People engaged in the kind of activities strategic transformation requires can be "protected" from diversions if various other training and intervention programs (e.g. teaming techniques, statistical process control, etc.) can be framed in terms of their role in the strategic transformation process.

To the extent possible, contractors should also seek other customers so that they are not subject to the power exerted by a single customer—the government. This effort will require a redefinition of risk and the willingness to invest in and reward efforts that allow the company to expand its client base. The return will be a type of stability that will encourage more focus on strategic transformation.

In one client organization, the contractor had received excellent performance ratings and had managed to keep the contract for many years. The government agency overseeing the work chose on several occasions simply to renew the contract rather than open it for bidding. In situations such as these, the contractor can exert more power because of their proven competencies. For example, this particular contractor began to work to persuade the government to reduce or change certain types of oversight to be more in line with private sector organizations doing comparable work. The contractor pushed for more internal control and self-reporting regarding compliance with regulations and provided data to the government in an effort to influence the nature of performance metrics. Finally, studies were conducted on cost savings the government agency could experience through changes in the oversight methods. Each of these efforts was directed at increasing control and stability. In doing so, the contractor positioned the organization to attend to larger strategic issues.

Finally, cost competitiveness is often the key to being awarded contracts. While contractors will have little room to negotiate fee structures, they may be able to exert influence on *how* the work is done. Contractors can potentially reduce the crisis mentality, volatility in regulatory oversight and volatility in performance metrics by negotiating for fixed practices over the life of the contract. Again, this will allow contractors to shift their attention from addressing their environment through operational or corporate self-renewal transformations to focusing on strategic transformation.

CONCLUSION

In this very brief application, we have demonstrated some of the benefits Blumenthal and Haspeslagh's framework offers. Giving primacy to one type of organizational transformation and developing the others in an explicitly supporting role brings clarity and precision to a potentially confused arena. It provides a useful starting point to examine systemics of the specific organization, establishes a value system to examine tradeoffs and set expectations and an outcomes orientation for the overall transformation program. It also provides a detailed context to understand how current practices affect the desired organizational transformation. Basically, applying such a framework can take what is often a very abstract and general conversation to much increased specificity.

Clearly, this paper has been only a very modest exploration of these possibilities. Our focus has been on providing a theoretical basis for Blumenthal and Haspeslagh's typology, identifying the impediments that limit an organization's ability to make such transformations, and arguing that their framework can help a company focus its transformation efforts. This area deserves much more research and greater experience through applications. Several immediate questions present themselves: What role should level of analysis—corporate, business, functional—play in organizational transformation efforts? How does the firm sort through existing transformation programs (often with multiple, independent consultants) to orient the total effort? What role should consultants play in this "meta-transformational" arena? As global competition and developing technologies continue their inexorable sculpting of business organizations and market opportunities, these questions will become increasingly important.

We further suggest that the impediments to strategic transformation in federal contractors are also impediments in the public sector in general and in organizations that are more public in their orientation. This may be a fruitful area for future research. For example, a private hospital, while not in the public sector, is still highly dependent on Medicaid payments. As the rules for Medicaid reimbursement change, it has been our experience that such hospitals automatically shift their focus away from strategic issues to transform their operational processes, to ensure maximum payment. Similarly hospitals spend a tremendous amount of effort in other activities that distract from a strategic focus. These include seeking contracts from HMOs, responding to changes in the regulatory environment, and responding to changes in definitions of performance that impact payment structure (e.g., in physical, mental, or drug rehabilitation).

Hospitals, both private and public, continually experience all five of the issues we identify as impacting federal contractors: 1) a redefinition of risk, 2) an unpredictable environment that

begets a crisis mentality, 3) accounting, funding, and information systems that facilitate control rather than provide incentive, 4) regulatory oversight by external agencies that can shift the focus of the organization away from a systems perspective to a more narrow focus on inputs, and 5), changes in the definition or measurement of performance. As in the case of federal contractors, hospitals struggle to maintain a focus on strategic transformations and tend to become absorbed by operational and corporate self-renewal transformations. There are likely a wide variety of organizations, both public and private, that experience some if not all of these pressures that divert organizations from much needed strategic transformations.

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ENDNOTES

- ¹ In many cases, overhead rates have not been fundamentally changed. These initiatives are an immediate cost reduction, not a long-term re-engineering program.
- ² Overhead multipliers are high, but not beyond many private-sector organizations. For example, consulting firms' traditional "rule of three" multiplies direct hour costs by three for overhead and to ensure a profit (Kelly 1986, p. 84). Federal contractors' overhead multipliers are similar.
- ³ This is clearly an area where transformation as operations improvement is appropriate. Business process re-engineering offers a way to address this precise need, improve process efficiency, generate organizational slack and thus contribute directly to strategic transformation. In many federal contractors though, the immediate pressure to reduce costs is strong and the benefits of such possible process improvement have not been felt at the contract management level.