

THE END OF BUREAUCRACY, AGAIN?

By Martin Reeves, Edzard Wesselink, and Kevin Whitaker

ADAM SMITH'S "INVISIBLE HAND" famously guides market economies, in which unplanned transactions by various agents lead to collectively beneficial outcomes. This logic governs most interactions between enterprises and consumers and between enterprises today. But work within enterprises is organized mostly according to the very different concept of bureaucracy, the principles of which were codified and popularized by a later philosopher, Max Weber. In this model, activities are planned, mandated, and guided by the very visible hand of organizational hierarchy.

Despite massive changes in the business environment that have put a premium on agility and innovation—and despite "bureaucracy" having become a synonym for inertia and stagnation—the concept has shown remarkable staying power. How many of us could name more than a handful of enterprises that are not fundamentally organized as bureaucracies? We explore this seeming paradox by examining the nature and functions of bureaucracy, why it has remained the dominant para-

digm, and whether and how emerging challenges will require leaders to reinvent their organizational models.

How Bureaucracy Works

According to the transaction cost theory of the firm, companies exist because they can eliminate certain transaction costs that would otherwise be incurred in free markets, such as the effort required to discover prices or renegotiate contracts. As a result, companies can often better coordinate tasks that require a high degree of alignment between multiple parties or involve nuance or context. For example, car manufacturers typically outsource the production of car parts, because the exact shape and functionality of each part can be specified in advance. In contrast, car assembly typically happens within a firm, because the assembly process has many highly interdependent steps and can therefore be error-prone and require nuanced judgement.

Bureaucracy, according to Weber, emerged as an organizational form to create stability

and predictability, making enterprises more efficient. In particular, he identified six essential characteristics of bureaucracy that set it apart from other forms of organization:

1. Division of labor with clearly defined roles
2. Hierarchical management structure with clear lines of authority
3. Documentation that specifies required decisions and actions
4. Specialized training and meritocratic selection for each role
5. Full-time managers appointed to operate the organization
6. Static, depersonalized rules that exhaustively guide management

Most large companies today fundamentally fit Weber's definition of a bureaucracy. They task employees with job descriptions to facilitate the division of labor and arrange them in multilayered hierarchies through which directives are transmitted, executed, and monitored. Hiring and promotion decisions are based on objective criteria specific to each role. And extensive and relatively static rule sets authorize some actions and forbid others, giving only limited leeway for judgment and initiative based on circumstances.

This organizational form thrived in the stable, predictable environments in which most businesses historically developed. Hierarchical management enabled detailed planning at all levels of the organization; clearly defined roles allowed tasks to be decomposed and executed efficiently; and comprehensive, unchanging rules allowed new hires or resources to be easily integrated into the organization in pursuit of economies of scale.

Bureaucracy's Staying Power

Despite the model's popularity, the effectiveness of bureaucracy has increasingly been called into question because of structural changes in the business environment.

Uncertainty is rising, disruption is increasing, and what it takes to succeed is changing faster than ever. As a result, companies increasingly must compete on adaptiveness, learning, and innovation. But bureaucracies are inherently ill-suited for these new imperatives: static organizational rules inhibit adaptation; top-down hierarchies are predicated on forecasting and planning rather than experimentation and learning; and highly codified tasks often do not leave sufficient room for discretion or imagination. Indeed, bureaucracy's demise has been predicted for decades: "The conditions of our modern industrial world will bring about the death of bureaucracy," wrote leadership scholar Warren Bennis in 1966.

Why, then, has bureaucracy remained the dominant organizational paradigm? The bureaucratic model is simple and well-codified, allowing it to be easily understood and applied by managers in any industry. The things it does well—such as planning what needs to be done, decomposing this objective into specific actions, and coordinating those actions among employees—are still valuable in many situations. Bureaucracy is also a convenient mental model that is often employed even if the actual network of the organization departs somewhat from the formal model.

Some companies have boldly experimented with alternative organizational forms, moving away from the planned, top-down nature of bureaucracy. (See the exhibit, "Alternative Organizational Models.") These philosophies share some characteristics, including a focus on avoiding top-down hierarchy and allowing teams to self-manage, with the aims of increasing adaptiveness through decentralized action and increasing innovation through greater employee engagement and motivation. Zappos has gone further than most companies in breaking free from the restrictions of bureaucracy. By fully empowering each team to determine the value propositions it offers and make its own investment decisions, the company effectively brings market forces inside the organization. (See the sidebar, "Zappos' Journey to Bring the Market into the Organization.") However, such

Alternative Organizational Models

ALTERNATIVE MODEL	ORIGINS	WHAT IT IS
Teal	Frederic Laloux <i>Reinventing Organizations</i>	<ul style="list-style-type: none"> • Motivation: “Workers and employees are seen as reasonable people who can be trusted to do the right thing. With that premise, very few rules and control mechanisms are needed.” • Principles: Wholeness, self-management, and evolutionary purpose • Features: No hierarchy, self-steering teams, judgement over rules • Example: Patagonia
Holacracy	Brian Robertson “Organization at the Leading Edge: Introducing Holacracy”	<ul style="list-style-type: none"> • Motivation: “No single person designs the organization, and no single group sits down and designs the organization. Rather, an organization’s design emerges from an evolutionary algorithm.” • Principles: Self-organization, dynamic steering (continuous adjustment based on new information) • Features: Self-organizing teams called “circles,” bidirectional information flow, integrative decision making (consulting stakeholders and incorporating their concerns) • Example: David Allen Company
Market-Based Dynamics	Tony Hsieh <i>The Zappos Triangle of Accountability</i>	<ul style="list-style-type: none"> • Motivation: “Have the minimal number of constraints; enable maximum freedom, as well as maximum accountability.” • Principles: Holacracy-based, adding internalized market dynamics and self-managed investment decisions • Features: Self-organizing circles, menu of services (value propositions offered by a circle), customer-based budgeting (circle-level P&L, linked to customer outcomes) • Example: Zappos
RenDanHeYi Microenterprise Ecosystem	Zhang Ruimin <i>The Haier Innovation Model</i>	<ul style="list-style-type: none"> • Motivation: “With the RenDanHeYi model, we move away from being something like an empire to be more like a rainforest. Every empire will eventually collapse. A rainforest, on the other hand, can be sustained.” • Principles: Led by user demand; full employee autonomy; market-based and ecosystem-oriented • Features: All teams are microenterprises using common standards; internal contracting; ecosystem-focused • Example: Haier
Scaled Agile Framework	Dean Leffingwell <i>Scaling Software Agility: Best Practices for Large Enterprises</i>	<ul style="list-style-type: none"> • Motivation: “Agile practices have been defined and recommended primarily for small teams. Scaled Agile Framework describes how agile methods can be applied to enterprise-class development.” • Principles: Organized around value, decentralized decision making, preserved optionality, incremental and fast change • Features: Iterative planning and delivery, multidisciplinary teams, minimized work in process, fixed cadence, customer testing • Example: Deutsche Bahn
Lean Startup Methodology	Steve Blank “Why the Lean Startup Changes Everything”	<ul style="list-style-type: none"> • Motivation: “While existing companies execute a business model, startups look for one. This distinction is at the heart of the lean startup approach. It shapes the lean definition of a startup: a temporary organization designed to search for a repeatable and scalable business model.” • Principles: Hypothesis-driven, continuous customer testing, agile development • Features: Customer discovery; build, measure, and learn loop; minimum viable products • Example: GE R&D department
Open Organization	James Whitehurst <i>The Open Organization: Igniting Passion and Performance</i>	<ul style="list-style-type: none"> • Motivation: “The open organization—which I define as an organization that engages participative communities both inside and out—responds to opportunities more quickly, has access to resources and talent outside the organization, and inspires, motivates, and empowers people at all levels to act with accountability.” • Principles: Open exchange, internal and external participation, rapid prototyping, meritocracy, community • Features: Consensus-based change, embrace of failure, bottom-up innovation, fluid organization boundaries • Example: Red Hat

Source: BCG Henderson Institute research.

ZAPPOS' JOURNEY TO BRING THE MARKET INTO THE ORGANIZATION

Tony Hsieh joined Zappos as an advisor and investor in 1999 and eventually became CEO. After ten years of rapid growth, Zappos was bought by Amazon in 2009, but as part of the deal Hsieh negotiated that Zappos would retain significant independence in operational control. As a result, Zappos has had the freedom to experiment with its management philosophy, which has increasingly broken with the bureaucratic model.

Hsieh believes that bureaucratic organization models ultimately limit adaptability and innovativeness and are not conducive to human flourishing and happiness. This is in contrast to the market-based models found, for example, in cities and economies. As Hsieh says, “Companies don’t innovate, markets do.” That is why Zappos is increasingly introducing market-based elements into its organizational model.

Zappos’ first major departure from the standard bureaucratic model came in 2015 when it formally converted to holacracy, a model focused on breaking down hierarchy and enabling self-organization. The company has since evolved its organizational model into a form it calls “market-based dynamics”—which extends the logic of self-organization to decentralize financial and investment decisions as well—because the budgeting decisions in holacracy were still centralized, which ultimately limited the capacity of teams to self-manage. Zappos is still experimenting with its new model, but it has demonstrated that there are viable alternatives to bureaucracy.

Structurally, holacracy breaks a firm into independent teams called “circles.” They function like startups with their own independent purpose, but each purpose aligns with the overall organizational purpose. Although the goal of each circle is prescribed, circles are free to organize

however they want to achieve their goals. Holacracy does have an element of hierarchy; circles can be nested inside other circles. However, in contrast to typical bureaucracies, circles can have overlapping responsibilities. Additionally, the lines of accountability between supercircle and subcircle are bidirectional and consent-based, so supercircles don’t control subcircles.

Employees are highly autonomous in this model—they can choose which circle or circles to join, and while they agree to deliver specified outcomes for each role they take on, they are completely free to decide how to achieve those outcomes. Unlike bureaucracies, circles don’t have full-time managers; instead, decision making happens through structured group conversations. Consequently, career development works in a very different way. Career paths are characterized by either expertise development or skill set broadening, in contrast to the typical hierarchical career ladder. As lead organizational designer John Bunch says, “Career progression moves from a ladder to a jungle gym. Don’t look up; rather, look around for opportunities and do what fits you best.”

Market-based dynamics extends self-management by not only giving circles the freedom to determine how they achieve their goals but also allowing them to decide what their goals are, as long as they are profitable and consistent with Zappos’ purpose and values. Circles decide on their goals by specifying the “menu of services” they offer (customer-facing services like sales, for example, or internal services like development), and they are free to sell these services to both internal and external stakeholders. Each circle is free to invest profit as it wants, within the constraints of the purpose of Zappos. As Hsieh says, “If an employee wants to

ZAPPOS' JOURNEY TO BRING THE MARKET INTO THE ORGANIZATION (continued)

start up a circle to set up a cupcake bakery, that would be great. The only demand is that this bakery abides by our purpose to deliver the very best customer service, customer experience, and company culture.”

Additionally, if a circle needs to use specific services to deliver its offering, it can source these services internally or externally, except for a small set of centralized services—like payroll, core IT systems, or legal—that each circle must use and for which it pays a contribution margin. Recruitment and salary levels are currently centralized, but the company plans to decentralize these aspects too over time, which will give circles complete freedom in recruiting new employees and setting salary levels, within the bounds of their own profitability.

New tools are needed to support this decentralized model, because the typical tools assume standard hierarchical structures and decision rights. For instance, Zappos has its own internal platform that allows for decentralized budgeting, and an HR tool that allows for people having multiple roles in overlapping circles.

Success is defined as a balance between efficiency, stability, and resilience. Business metrics typically focus heavily on efficiency and stability but neglect resilience. In order to address this gap, one of Zappos' primary metrics is the percentage of circles' income that comes from new sources, because increased income from new sources means that circles are more entrepreneurial, which makes the larger company more resilient.

Eventually Zappos aspires to blur the boundaries between the firm and the market even further by allowing non-employees to set up Zappos circles as

well. These external circles would leverage the basic set of services that Zappos offers, for a fixed percentage contribution margin. Just as software as a service and computing as a service (cloud computing) lowered the barrier to developing new technology, Zappos hopes that this model will lower the barriers to start a business by offering “entrepreneurship as a service,” while allowing Zappos to scale faster. This would move its model even further away from the typical bureaucratic command-and-control structure; it would incorporate people that are not directly managed by the company.

Zappos acknowledges that it does not yet have firm data to prove that its model is superior to bureaucratic alternatives. However, it does see encouraging signs that this model could in the long run deal much more effectively in dynamic business environments. As Hsieh says, “Typically, reorganizing is a long process that is fraught with failure. In contrast, our organization chart changes multiple times a day—that’s our new normal. This allows us to respond to changes incredibly quickly.” Zappos is still experimenting at a rapid clip, and it hopes to eventually develop a full-fledged, market-based organizational philosophy.

Zappos' experimentation teaches us valuable lessons about the power—and the limits—of current alternative organizational forms. It is a clear demonstration that the tenets of bureaucracy are by no means the only way to operate a successful business, and even quite radical departures from the bureaucratic model can deliver commercial success. It also shows that the process to develop an alternative is by no means rapid or straightforward; Zappos has experimented with alternative models for half a decade and still hasn't achieved its full ambition.

alternative organizational models are still not proven, scaled, or codified to the degree necessary to make them accepted alternatives for mainstream companies today.

Toward a New Organizational Paradigm

So is bureaucracy's dominance here to stay, in spite of its frequently heralded demise? We believe not, as further changes in the business environment will likely push it past its breaking point. Uncertainty and dynamism continue to rise, which puts an even higher priority on learning, resilience, adaptiveness, and innovation. In addition, AI's rapidly increasing power presents new challenges, because organizational models must encompass both human and algorithmic decision making. Technology also expands the range of possible organizational solutions, because algorithmic decision making allows activities to be coordinated on much shorter timescales and across a much wider set of participants (within and beyond the company).

Leaders must therefore reconceive the organization—from a static hierarchy and rule set to a continuously evolving model; from being human-centric to encompassing both humans and algorithms; and from being contained within company boundaries to encompassing connections and activities with external partners. They also need to reframe how their enterprises compete—from serving a relatively standardized and static set of offerings more efficiently to competing on the rate of learning, in order to discover and act on new opportunities. For that they will need a new generation of organizational models, which we collectively call the “hybrid learning organization.”

Although we don't have a blueprint for the hybrid learning organization, we can already identify several emerging design principles:

- Integrated data systems, data communications, and decision engines that allow routine decisions to be made at algorithmic speed

- New human ways of working that foster imagination and higher-level cognition, rather than rote decisions and actions, which will increasingly be handled by AI and automation
- Data-driven feedback loops to facilitate learning on multiple levels—from product offerings, to culture and organizational models, to business models, to the learning approach itself
- The ability to operate and learn at multiple clock speeds—from split-second algorithmic timescales to the decadal timescales of social and ecological change
- The ability to be ambidextrous, balancing exploitation of current models with exploration for new ones, developing a mosaic firm that uses bureaucracy when appropriate but also employs more dynamic organizational forms when needed
- Seamless coordination with both internal and external stakeholders, through digital platforms and multicompartment ecosystems
- A dynamic organizational model that is continuously adapted and refined based on the context

Perhaps not surprisingly, the first glimpses of organizations that embody such principles can be found in some technologically advanced companies. Some of the new ways of working can be seen at Zappos, as described earlier. Alibaba has developed the “self-tuning enterprise” concept, in which algorithmic learning principles are applied throughout the organization. Its decision engines autonomously experiment, modulate, and improve over time, relying on information from the company's vast data ecosystems, and decentralized teams are free to trigger new initiatives when they see market potential. Whereas most organizations have a static vision and organizational structure, Alibaba continuously evolves its vision and organization design. Amazon (Zappos' parent company)

demonstrates similar elements, such as data systems that are interconnected throughout the organization, allowing all parts of the company to react to new information without guidance from a centralized authority. Employees often take a “hands off the wheel” approach, validating algorithmic decision processes and setting guardrails rather than intervening directly, which allows them to focus on more creative efforts such as imagining new businesses and business models.

ognizing the new imperatives they face, winning organizations will embrace bureaucracy where useful but also boldly experiment with new organizational models that harness both technology and human ingenuity where needed. The exact shape of these new models is still undetermined, but enterprising leaders are currently developing them. In some of the companies described in this article we can see hints of a revolution that will likely affect all companies and sectors eventually.

THE CHALLENGES FACING businesses today are evolving rapidly, yet most firms are still organized along the entrenched 19th century paradigm of bureaucracy. Rec-

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