How can firms maximize economic value while developing their organizational capabilities? In a corporate environment where change is constant, business leaders are continually challenged by this dilemma. In this excerpt from "Resolving the Tension between Theories E and O of Change," from Michael Beer and Nitin Nohria's Breaking the Code of Change, the authors present a framework toward "an integrative theory of change."

### Theory E

Theory E has as its purpose the creation of economic value, often expressed as shareholder value. Its focus is on formal structure and systems. It is driven from the top with extensive help from consultants and financial incentives. Change is planned and programmatic.

### Theory O

Theory O has as its purpose the development of the organization's human capability to implement strategy and to learn from actions taken about the effectiveness of changes made. Its focus is on the development of a high-commitment culture. Its means consist of high involvement, and consultants and incentives are relied on far less to drive change. Change is emergent, less planned and programmatic.

Table I-1 summarizes the E and O approaches to organizational change. In the remainder of this chapter we will present Theories E and O in more detail and discuss their benefits and costs. These theories are archetypes. Certain companies, including Scott Paper and Champion International, about which we developed cases, seem to be pure cases of these archetypes. An examination of many other organizations will show a mixture of these strategies, often in uneasy coexistence. We argue that both theories have validity.

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That is, each of them does promote some objectives that management explicitly or implicitly intends to achieve. But each also has costs, often unintended. The problem managers face is resolving the tension between E and O in a way that obtains the benefits of each and minimizes the negative consequences of each. Too often, these theories are mixed without the resolution of the inherent tension between them. This leads, we argue, to maximization of the costs and minimization of the potential benefits of each theory. The objective, we argue, should be to integrate these theories and their strategies in a way that resolves the tension between them. One of our goals in this book is to help academics from different fields frame research questions in a way that will lead to an integrative theory of change. Such a theory would clarify the trade-offs between different approaches to change and would aid in defining choices and consequences. This integration, we argue, is essential if executives want to develop business organizations that satisfy shareholders and yet have the capacity to adapt and survive as viable institutions in the long run.

### Theory E

In 1994 Al Dunlap became CEO of troubled Scott Paper. Like Champion International, a comparison company we will discuss as an example of Theory O change, Scott Paper operated in a highly competitive, cyclical, capital-intensive global industry. Like Champion International, it operated in two different segments of the paper industry and had several businesses in markets related to its core consumer package paper business.

Throughout the tenure of Dunlap's predecessor, Phillip Lippincott, Scott had struggled to improve its operational effectiveness at the plant level by working on process improvement and launching an effort to work cooperatively with its union. In the 1980s the company had also initiated layoffs aimed at reducing overhead, and it was planning an additional layoff of 8,300 employees at the time Dunlap took over. At the same time it invested in new paper machines and
HOW GENDER STEREOTYPES KILL A WOMAN'S SELF-CONFIDENCE

When Dunlap took over the leadership of the company, he immediately announced and implemented a reduction of 11,000 people at both the management and working levels. He fired many members of the existing top management team. Not long after these initial steps, Dunlap sold off several businesses, retaining for the time being the core consumer products business. He moved the head office out of Scott's longtime corporate building and into a much smaller building near his home in Florida.

The executives Dunlap retained and those he brought in to fill the vacancies he had created needed to sign on to his philosophy: that shareholder value was the single objective to which a corporation should dedicate itself. To focus executives single-mindedly on shareholder interests, he used financial incentives, mainly stock options. Dunlap's own compensation package (which ultimately netted him more than $100 million) was also tightly linked to shareholders' interests.

Dunlap's actions restored Scott Paper's profitability. But its long-run viability as an independent business in an industry with significant overcapacity was yet uncertain. Thus, in a last dramatic act, Dunlap sold Scott Paper to Kimberly-Clark, its longtime competitor. Even though Scott Paper ceased to exist as an independent company, the results from a shareholder perspective were stunning. In just fifteen months Dunlap had managed to increase total shareholder return by 200 percent, making rich not only shareholders but numerous employees (including himself and many top managers he fired), whose stock obtained through options increased in value dramatically. The financial community applauded these efforts and saw the Scott Paper story as a good example of what could be done in other companies to improve returns for shareholders.

Theory O

In response to poor performance, a decade of adversarial relations with unions, and a prolonged and costly mill strike, CEO Andrew Sigler of Champion International launched an organizational change effort in 1981. It was designed to alter fundamentally the culture and behavior of management, unions, and workers. Sigler gathered his top executives to develop a vision of the new Champion called the Champion Way. "The Champion Way statements described a vision and values for the company and how it would relate to its stakeholders. Key values included involvement of all employees in improving the company, fair treatment of workers, support for the community around its plants, and openness and truthfulness in the company."

Unlike the vision statements of some companies, the Champion Way document did not remain an inert reminder of management's failure to translate its words into action. In the years that followed, Champion's management orchestrated one of the most effective organization development efforts we have seen in several decades. With the help of a few very talented organization development consultants, Champion was able to use a high-involvement method called sociotechnical redesign to change its approach to organizing and managing people in all of its plants. The transformation effort started with a few new plants and by the early 1990s included all of Champion's operations.

To support these changes Champion improved its relations with its unions through cooperative mechanisms. It applied the same high-involvement sociotechnical method to redesign the organization and management of all its corporate functions, including research and development. And by the early 1990s the corporation had completely reorganized itself around a market by function matrix structure intended to focus on customers. Compensation systems were aligned with culture change objectives. A skill-based pay system was installed in all production facilities to encourage employees to learn multiple skills. A corporationwide gains-sharing plan was introduced to mold union workers and management into a common community of purpose.

Throughout the decade of change, there were no layoffs, although many managers at the plant and corporate level were replaced if their management style did not fit the new philosophy.

By 1997 employee surveys and productivity data clearly showed that Champion had achieved the cultural transformation embodied in the Champion Way. Nevertheless, new CEO Richard Olson was faced with an uncomfortable reality. Though the company had survived a difficult economic period and had improved its performance along several key operational indicators (such as plant yields, quality, etc.), the company's shareholders had not seen a significant increase in the economic value of the firm. Champion's share price had not only failed to keep pace with the S&P 500 index; it had failed to keep pace with companies in its own industry. Return on assets, return on equity, return on sales, and sales per employee were all below those of comparison companies in the paper industry.

Resolving The Tension Between E And O

The arguments for E and O change are equally persuasive. Theories E and O approach the problem of organizational change from two different but equally legitimate perspectives. Although employing one or the other of these archetypal approaches to change may be the easiest and the most natural, for reasons already discussed, neither achieves all the objectives of management in most cases. Scott Paper under Dunlap delivered dramatic increases in shareholder value. The firm's market capitalization at the time of sale was three times what it was at the time Dunlap took over the firm only a few months earlier. But there is little doubt that the organizational capability to compete in the long run had not been built. Equally ineffective was Champion's pure Theory O strategy: A more effective organization that still does not create economic wealth for its shareholders will not long survive. Indeed, Champion was acquired in early 2000. For 1.5 times its market capitalization when CEO Sigler launched his cultural transformation in 1981.

Where the objective is to enable an institution to adapt, survive, and prosper in the long run, Theory E change must be combined with Theory O. In effect we are arguing for the and/also, for the management of a paradox. It is the way to get rapid improvements in economic value while also building sustainable advantage inherent in building organizational capability.

The and/also is also the hardest approach and thus requires great will, skill, and wisdom. The alternative—an arbitrary and halfhearted mixing of E and O—is extremely confusing and debilitating to an organization. Instead of this halfhearted approach, managers are better off picking a pure model: a clear Theory E approach with its benefits and costs or a pure Theory O approach with its benefits and costs.

How can E and O be integrated? There are only two ways. A company can sequence the two approaches, or it can employ them more or less simultaneously.
Changing Looks for Female Students. Starting around 1900, secondary schools for women similarly embraced uniforms for their student bodies. Instead of Western-style military uniforms, though, the trend was toward hakama, traditional pleated trousers or skirt worn over a kimono. Female school uniforms began to change in the 1920s, with Western-style clothing increasingly becoming the norm. Many students at the time enthusiastically welcomed sailor suits, helping establish the look as the standard uniform. The transition from hakama to skirts and jackets, however, created a new dilemma for school administrators.