

## **The Entrepreneurial Gap:**

### **Using Structure and Systems to Drive Strategic Change**

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### Abstract

This paper investigates the use of organizational structure and management control systems as interdependent variables to drive strategic change. We use an in-depth longitudinal case study of Henkel, a German multinational company, from 2008 through 2013. We document how changes to the entrepreneurial gap—defined as the difference between the span of control as determined by organizational structure and span of accountability as set by diagnostic control systems—contributed to the subsequent entrepreneurial orientation of the organization. This gap supports the purposeful misalignment between objectives pursued and resources controlled that entrepreneurship theory argues as a fruitful way for larger companies to reinforce entrepreneurial behavior. The findings offer a complementary structural perspective on strategic change beyond organizational identity, knowledge, capabilities, and narratives.

## **The Entrepreneurial Gap: Using Structure and Systems to Drive Strategic Change**

Changes in competitive landscapes often require organizations to radically change their strategy (Burgelman, 1983, 2002; Eggers, 2016). At these inflection points, senior managers face the difficult task of simultaneously keeping the organization generating revenue from the existing strategy while reorienting the organization to deploy the new one. The difficulty of managing this transition often results in failure (Christensen, 1997; Beer and Nohria, 2000; Tripsas, 2009; Danneels, 2010; Greenwood, Agarwal, Agarwal and Gopal, 2016). Because of the importance (and pitfalls) of changing strategy, navigating strategic change has been a captivating theme in the literature (Rumelt, 1995). Not surprisingly, organizations that have successfully transformed themselves have attracted attention from both academics and practitioners (Kanter, 1990; Burgelman, 2002; Zhang and Rajagopalan, 2010).

In addition to managing changes in dynamic capabilities (Eisenhardt and Martin, 2000; Teece, 2014), research suggests that strategic change requires attention to many informal—and difficult to manage—organizational variables including learning (March, 1991; Crossan and Berdrow, 2003), culture and symbols (Fiss and Zajac, 2006), mental models and schemata (Balogun and Johnson, 2004; Rerup and Felman, 2011), identity (Nag et al., 2007; Tripsas, 2009), knowledge (Szulanski, 1996), and power structures (Kwee et al., 2011). But, strategic change also requires redesigning formal organizational variables.

The objective of this paper is to advance our understanding of how two formal organizational variables—organization structure and performance management systems—interact to support strategic change. By focusing on formal design choices, the paper enhances our understanding of strategic change (Burgelman, 2002). We use a detailed empirical study of one (successful) company over a five-year period to generate insights on the following research question: how do

organizational structure and diagnostic control systems<sup>1</sup> jointly drive strategic change? We apply theory on decision rights and accountability to interpret the actions taken by managers at Henkel, a German-based multinational company with 55,000 employees worldwide, from 2008 through 2013, under the helm of a new CEO.<sup>2</sup>

We focus on formal organization design to analyze the interaction between span of control and span of accountability. Span of control describes the formal decision rights given to a manager over organization resources. Span of accountability captures the breath of the measures and its inherent tradeoffs for which the manager is accountable (Simons, 2005).<sup>3</sup> We find that the interaction between these two spans—we label it the entrepreneurial gap—affects search routines and entrepreneurial behavior throughout an organization. This finding indicates that these variables play a much more substantive role in episodes of strategic change than currently acknowledged.

At Henkel, executives narrowed span of control and widened span of accountability to drive strategic change. As a result, managers across the company became newly accountable for performance targets for which they did not fully control the necessary resources. This situation was a departure from the approach in place before the new CEO took over when span of control and span of accountability were more tightly aligned. The control deficit imposed on managers—by setting span of control narrower than span of accountability—stimulated search activities throughout the organization. Managers became entrepreneurs, defined as “individuals who—either on their own or inside organizations—pursue opportunity without regard to the resources they

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<sup>1</sup> Diagnostic systems are traditional performance management systems. We use the original definition of diagnostic control systems as “the formal information systems that managers use to monitor organizational outcomes and correct deviations from preset standards of performance” (Simons, 1995: 59)

<sup>2</sup> The importance of new leadership as part of strategic change has been documented (Tschang and Ertug, 2016) and described as a potential dynamic capability (Teece, 2014).

<sup>3</sup> A formal definition of span of control is: “span of control represents the total resources under a manager’s direct control” (Simons 2005: p. 39). Accountability refers to the responsibilities of a manager in terms of objectives he or she is expected to meet. Performance measurement systems including Key Performance Indicators (KPI) are used to assess whether a manager has performed up to the expectations set through his or her accountability.

currently control” (Stevenson and Jarillo, 1990). The analysis also documents changes to other aspects of Henkel organizational design, in particular its belief systems and selection mechanisms.

Our theoretical starting point is the well-established idea that authority should equal responsibility (Zimmerman, 2016) to optimize strategy implementation. We examine in detail the extent to which the decision rights given to managers (span of control) align with the measures for which they are accountable (span of accountability). We extend existing theory by describing the interaction between these two variables as a critical design decision that influences search activity and innovation for strategic change.

The importance of the interaction between organization structure and accountability dates back to the writings of Fayol (1917). As companies decentralized their expanding operations in the 1970s, researchers developed theory and concepts related to responsibility centers (defining decision rights for division and department managers), management control systems (setting accountability for those responsibility centers), and transfer pricing policies (Anthony, Dearden, and Vancil, 1965; Solomons, 1965). The controllability principle underpinned all of this work: accountability measures should be aligned with decision rights.

Agency theory also focused on the interaction between decision rights, performance-based accountability measures, and incentives (Zimmerman, 2016; Nagar, 2002). It pointed to the need to balance effort-inducing incentives and the risks that they impose given the agent’s decision rights. Again, the controllability principle suggested that performance evaluation measures used for incentive provision should be aligned with decision rights (Antle and Demski, 1988): measures that are broader than the related decision rights allocate too much risk to the agent; conversely, measures that are too narrow fail to capture the multi-task aspect of managerial work.

**Figure 1** illustrates the conceptual structure of the study. Decision rights are embedded in organization structure at the macro level and in span of control at the individual level.

Accountability is reflected in diagnostic control systems at the macro level and in span of accountability at the individual level. The interaction of span of control and span of accountability determines the entrepreneurial gap. A positive entrepreneurial gap indicates accountability beyond the resources under control. Conversely, a negative gap indicates more resources than required given manager's accountability. No gap ("line of sight in performance measures") depicts a situation where accountability and resource control are perfectly aligned. The concept of entrepreneurial gap as an organizational design decision to activate search routines for sensing, seizing and transforming opportunities informs our knowledge about the micro-foundations of dynamic capabilities as facilitators of strategic change (Helfat and Peteraf, 2014).<sup>4</sup>

*Insert Figure 1 here*

The detailed case study also documents the interaction between the entrepreneurial gap and informal elements of the organization. During its process of strategic change, Henkel changed its mission and value statement and intensely communicated these new beliefs. Strategic change leveraged the interaction of formal and informal organizational design variables. The findings complement previous work on organizational identity, the narratives that shape it, mental models, knowledge inventory and organizational capabilities in episodes of strategic change.

In addition to strategic change, we also contribute to the management control literature. The traditional contingency approach to the design of management control systems has treated organizational structure as an exogenous contingency variable (Chenhall, 2003). This study describes how, in the context of strategic change, managers make organization structure decisions simultaneously with decisions about the design and use of diagnostic control systems. The study

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<sup>4</sup> The design decisions that Henkel adopted can also be analyzed from an ambidexterity perspective. Henkel pushed a more entrepreneurial orientation across the organization, activating search routines and innovation, while it continued to execute its prior strategy (Raisch et al., 2009).

portrays management control systems as more than packages (Malmi and Brown, 2008) and configurations (Widener, 2007) but rather as systems (Grabner and Moers, 2013) that are strategically integrated with other organizational design variables. The findings suggest that diagnostic control systems are not solely mechanisms for communicating and monitoring strategy implementation, but can also act as levers of strategic change.

The remainder of the paper is structured as follows. We first introduce the conceptual framework drawing on both the strategic change and management control literatures. Then, we present the research design of the five-year study at Henkel. Next, the paper describes how the company implemented the new strategy by changes to formal and informal aspects of organizational design. Finally, the paper discusses the findings and their implications to our understanding of organizational structure and diagnostic control systems as levers of strategic change.

### **Strategic Change and Organizational Design Decisions**

Research on strategic change and renewal (Agarwal and Helfat, 2009) has focused on the need to reimagine organizational identity (Nag et al., 2007; Tripsas, 2009), comprising mental schemata, narratives, and cultures. Strategic change also requires redeploying resource-based capabilities (Teece, Pisano and Shuen, 1997) and knowledge (Szulanski, 1996). These variables have proven to be difficult to change since capabilities, knowledge and organizational identity are strongly embedded in routines and processes (Gioia et al., 2013; Karthikeyan, Jonsson, and Wezel, 2015).

Strategic change, with enhanced expectations for performance, also involves organizational learning.<sup>5</sup> Pressure for change activates search routines (March, 1991; Greve, 2003) to explore the possibilities that the new strategy creates. Research has studied organizational performance as

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<sup>5</sup> Organizational learning is the process of acquiring, translating and enacting new knowledge through organizational routines that systematically alter subsequent behavior (Argote and Miron-Spektor, 2011). Knowledge is defined as the theories and assumptions about cause-effect relationships that organizations use to form expectations about their activities and define their representation of their environment (Daft and Weick, 1984).

learning outcomes (Argote and Miron-Spektor, 2011), but the empirical evidence on how this learning takes place is still emerging. This research has examined changes to managers' processing of information as learning occurs (Aranda, Arellano and Davila, 2017), the evolution of narratives to incorporate the learning from unusual experiences (Garud, Dunbar and Bartel, 2011), and the co-evolution of routines and interpretative schemata (Rerup and Felman, 2011).

In addition to learning, the simultaneous execution of the current strategy (exploitation) and the crafting of the new strategy (exploration) (March, 1991) create unique demands for new search routines. A variety of studies have proposed structural designs that can either foster the creation of new opportunities or the exploitation of existing resources to support different competitive strategies (Gupta et al., 2006; Smith and Tushman, 2005; Rivkin and Siggelkow, 2003).

Strategic change also leads to tensions in day-to-day activities as the enactment of new identities and routines clashes with the existing order. These tensions create structural barriers to organizational learning (Brown and Starkey, 2000) that block the integration of new knowledge and the redeployment of resources that current employees fear to lose. In many cases, existing capabilities might be unsuited to address exploration-exploitation and cognitive tensions that strategic change generates. During these periods, existing search activities are often unsuited the new strategy (Helfat and Peteraf, 2003; Rahmandad and Repenning, 2016). The difficulty of crafting appropriate capabilities for addressing these challenges has been found to require unique CEO skills (Herrman, and Nadkarni, 2014).

At the micro level, strategic change triggers new search routines by individual managers. However, these routines can only be enacted if the organizational context supports the initiatives of corporate entrepreneurs and guides them through the process of institutionalization (Burgelman, 1983; Teece, 2014). As a result, entrepreneurial behavior has been identified as a critical aspect of



dynamic capabilities (Teece, 2014) as managers sense, seize and transform opportunities into value in the presence of limited resources (Stevenson and Jarillo, 1990).

Entrepreneurial behavior as a dynamic capability builds on the concept of entrepreneurship as “how, by whom and with what effects opportunities to create future goods and services are discovered, evaluated and exploited” (Shane and Venkataraman, 2000: 218). Similar to the entrepreneurship that is characteristic of startups, corporate entrepreneurship emphasizes the crucial role of individuals within organizations who are willing to take risks and innovate. The entrepreneurial actions of such individuals provide the dynamic counterbalance to the standards and routines that promote stability, but often limit novelty and experimentation. In describing corporate entrepreneurs, Burgelman (1983) portrays organizations as “opportunity structures” within which managers can innovate. Corporate entrepreneurs, much like their startup counterparts, are motivated to pursue business goals even if they don’t have adequate resources: they may, for example, try to find ways to launch a new product when they do not have the necessary financing, production, or distribution resources.

Notwithstanding the advances in understanding corporate entrepreneurship, organizational context—particularly the role of accountability systems and organizational structures—has received scant attention (Raisch et al., 2009). Yet, as we shall argue, such mechanisms are important in motivating individuals in complex organizations to take on the task (and risk) of identifying and transforming opportunities into profitable initiatives. Minkes and Foxall (1980) framed the basic question that remains unanswered today:

The traditional entrepreneur was conceived as an individual who by dynamic force and flair recognized, seized or even invented opportunities ... The rise of large and complex organizations with managerial discretions at various levels means that the entrepreneurial role is dispersed among individuals and departments.

The microfoundations of dynamic capabilities (Helfat and Peteraf, 2014) encompasses not only skills but also “processes, procedures, organizational structures, decision rules, and disciplines ... (that make) enterprises with strong dynamic capabilities intensely entrepreneurial” (Teece, 2007: 1319). These formal attributes of organization design support entrepreneurs who activate new the search routines during episodes of strategic change. Understanding the design of organizational structures and diagnostic systems informs our knowledge of the mechanisms underlying organizational learning when new strategies require the emergence of new dynamic capabilities across the organization.

### **Strategic Change and Accountability Systems**

Management control systems have been depicted as tools of strategy implementation (Simons, 1991; Burgelman, 2002). This strategy-based perspective dates back to the first published definition of management control as, “the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization's objectives” (Anthony, 1965: p. 17). While a large body of research has examined individual management control systems in cross-sectional settings (Chenhall, 2003), recent work emphasizes the need to study management control as integrated packages (Malmi and Brown, 2008) and holistic frameworks (Merchant and Van der Stede, 2012; Adler and Chen, 2011).

An example of such a holistic approach is the levers of control framework (Simons, 1995) which has been widely used to analyze the multiple dimensions of management control systems (Widener, 2007; Tessier and Otley, 2012). This framework argues for the coordinated design of four different types of control systems. Belief systems communicate the values, purpose, and direction of the organization; they play a central role in inspiring effort and providing people with decision criteria when facing unexpected situations. Boundary systems limit the opportunity space for executing existing strategies and exploring new ones; they are typically worded as opportunities to avoid and

initiatives the company will not pursue. Diagnostic control systems are performance measurement systems that track the implementation of the current strategy. Targets derived from planning processes become benchmarks to evaluate actual performance. Powered by formal incentives, they are essential tools of management-by-exception. In contrast, top managers use some systems interactively to regularly and personally involve themselves in discussions with subordinates about the strategic uncertainties that can threaten the current strategy (Simons, 1991, 1994, 1995: 95).

The use of diagnostic control systems as monitoring devices for strategy implementation is closely related to the controllability principle: authority over resources equal, or align with, responsibility for performance (Arrow, 1974; Merchant, 1985). This principle dates back to the founding of American railroads. Charles E. Perkins, president of the Chicago, Burlington, and Quincy Railroad, wrote in 1885: “It is obvious that to hold a manager responsible for results it is necessary to give him pretty full power over the property which he must use to produce those results.” (Chandler, McCraw, and Tedlow, 1995: 36).

The applicability and limits of the controllability principle has been studied using agency-based analytical models (Holmström, 1979; Antle and Demski, 1988; Datar, Kulp, and Lambert, 2001). These models consider trade-offs between the effort and characteristics of the agent and the risks that incentive systems impose. The signal-to-noise ratio of performance measures determines the optimal trade-off between information and risk allocation. Performance measures that reflect the actions of the agent show a better signal-to-noise ratio, while measures mostly outside the agent’s control receive a marginal weight on the incentive contract.

The controllability principle combines two concepts that are at the heart of this study: span of control and span of accountability. Span of control describes the formal decision rights over the tangible and intangible assets as well as formal authority over subordinates. Thus, for any

individual job, span of control can be either wide, indicating control of a wide range of resources, or narrow, indicating that a manager has direct control of relatively few resources.

Accountability refers to the expectations about what a manager “should be able and obliged to explain, justify and take responsibility” (Messner, 2009: 918). Diagnostic control systems define the accountability structure of an organization through the design of performance measurement, evaluation, and reward systems. Span of accountability represents the range of tradeoffs inherent in the measure(s) for which a manager is accountable (Simons, 2005). Again, this can range from narrow to wide. **Figure 2** shows a hierarchy of span of accountability for financial and non-financial measures. At the bottom of the funnel, measures such as headcount and line-item expense budgets allow few tradeoffs. Managers accountable for these measures have relatively few degrees of freedom and, therefore, a narrow span of accountability. The measures at the top of the funnel, such as competitive position and market value, are much broader allowing many tradeoffs and creating a wide span of accountability.<sup>6</sup>

*Insert Figure 2 here*

Diagnostic control systems are typically conceptualized as mechanisms to identify deviations from plans as early-warning signals that can trigger remedial action. Not surprisingly, the focus on such top-down programming to achieve pre-set standards and goals has led researchers to conclude that diagnostic systems can stifle entrepreneurial behavior, search, and innovation within organizations (Davila, Foster and Oyon, 2009).

However, this interpretation of diagnostic control systems ignores the organizational context within which these systems operate. In particular, the interaction between span of accountability

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<sup>6</sup> The number of measures for which a manager is accountable can also affect span of accountability. Span of accountability is widest when a manager is accountable for a small number of broad measures, such as ROA or market share. Span of accountability narrows as managers are held accountable for an increasing number of measures—especially those lower in the funnel—as each additional measure constrains the ability to make tradeoffs.

and span of control shape managers' behavior. When span of accountability is narrower than span of control (i.e, a manager controls resources for which he or she is not fully accountable), the result will likely be organizational slack and waste. Alternatively, a span of accountability wider than span of control leads to managers' stress, dissatisfaction and turnover as managers feel unable to meet their objectives (see Fischer, 2010 for a summary of over forty studies). But setting span of accountability wider than span of control can also have positive consequences if it forces managers to be entrepreneurial (Stevenson and Jarillo, 1990). Vancil provided an early glimpse of the effects of this purposeful misalignment:

Corporate managers use the calculation of profit to influence the behavior of each profit center manager, and the message they are sending to him in deciding to assign costs of shared resources is that the scope of his initiative should not be restricted solely to the resources for which he has functional authority. ... his responsibility includes trying to influence the management of those shared resources. (1979: 105, 118)

This perspective suggests that senior managers may sometimes wish to purposefully set span of accountability wider than span of control. When faced with accountability for broad measures and a shortage of resources, managers—at least those who are so inclined—will respond as entrepreneurs do: by building interpersonal networks to gain access to needed resources and activating search routines to build new approaches to achieve their objectives.<sup>7</sup>

Empirical studies provide some evidence to support this interpretation. Organizations benefit from relaxing the controllability principle to encourage managers to pay attention to variables outside their control (Merchant, 1985) and influence others to address interdependencies (Frow, Marginson, and Ogden, 2005). Holding managers accountable for measures broader than the resources they control promotes flexible, proactive work behavior in complex, dynamic settings (Burkert, Fischer, and Hoos, 2013).

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<sup>7</sup> The results of these search activities can then remain localized or make it to top management through interactive systems. This interaction is most relevant during episodes of strategic change; in contrast to periods of strategic stability where search routines are much less relevant.

## Research Design

The longitudinal in-depth case study reported in this paper tracked the implementation of a new strategy at Henkel, a consumer products and industrial goods company headquartered in Germany from 2008 through 2013, starting with the appointment of a new CEO. During the period of study, the company went through a profound process of strategic change turning a comfortable organization into one emphasizing entrepreneurial orientation and industry-leading performance. Fifty-five thousand employees around the globe had to change their management approach from an exploitation mentality to integrate exploration activities into their work. As in any process of strategic change, Henkel had to seamlessly transition from one strategy to the next without faltering in the delivery of consistent performance.<sup>8</sup>

We use an exploratory longitudinal case study to document the evolution of Henkel during this period (Yin, 2003). The use of a longitudinal research design over an extended time period has been used in prior studies on strategic change.<sup>9</sup> Collecting real-time data as the phenomenon unfolds offers a unique research opportunity, minimizing potential recollection biases associated with memory loss, sense making, and ex-post rationalizations. Data was gathered through interviews with senior executives, board members and managers across the hierarchy, observation of top management meetings, and review of a variety of documents on the strategy change process ranging from top management presentations to internal communication memos. In addition, we collected information available to the public typical of a large, publicly-traded company.

Because we were interested in the process of strategic change, we used a longitudinal rather than a cross-sectional design to document the evolution of the company and its practices. We had access

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<sup>8</sup> Henkel created contextual ambidexterity needed to simultaneously implement the current strategy and build the new one (Raisch et al., 2009).

<sup>9</sup> Some prominent examples include Rosenbloom's (2000) study at NCR, Tripsas and Gavetti's (2000) study at Polaroid, and Danneels's (2010) study of Smith Corona.

to the decision-making processes leading to changes in strategy, information about diagnostic control systems and the associated span of accountability, and organizational structures with special attention to span of control. We also gathered data on how these changes were enacted across business units and headquarters. While the variables of interest shaped our data collection process, we let informants and other data sources describe and interpret the events as they unfolded.

In analyzing the data, we started from the two anchoring formal organizational design variables for strategy implementation: organizational structure and diagnostic control systems. The data was then organized using these two variables and their interaction, clustering observations, data, and managers' interpretations around these themes. The study was designed to be inductive, theory-building. This grounded approach (Strauss and Corbin, 1990) put as little theoretical structure as possible, yet a clear research theme gave coherence to data collection.

Over time, we identified four main phases of the change process. The first phase began with the communication of the new strategy and four-year stretch targets both internally and to public markets. During this initial phase, the CEO divested assets and centralized resources to narrow span of control for operating managers. In the second stage, top managers changed the belief systems of the organization by adopting a new mission and values that supported entrepreneurial behavior and a new customer-focus. In the third stage, performance measures were changed. Span of accountability was widened by making managers accountable for measures that required more tradeoffs. This widening of span of accountability, coupled with the narrowing of span of control, created an entrepreneurial gap. During the fourth and final stage, managers began to use performance evaluation systems in a highly interactive way to identify and invest in those people best aligned with the new strategy of the company.

During the five-year period of the study, we interviewed members of the executive committee (board of directors, CEO, CFO, and division heads), most of them several times. We also

interviewed subordinate functional managers across various regions. In addition to one-on-one interviews, we attended top-management meetings and formal presentations on strategy implementation and performance evaluation. The appendix describes the data gathered during the period. In selecting who to interview, we looked for the perspective of a broad range of board members and top managers who were responsible for the strategic change effort, but also for diversity of experiences across the hierarchy to map the evolution of the various managerial levels of the company as it implemented the new strategy.

Interviews typically lasted one to one-and-one-half hours. These face-to-face interviews were complemented with telephone interviews and e-mails queries. During interviews and meetings, the research team took detailed notes that we annotated after each meeting.<sup>10</sup> Interviews were open-ended starting with a broad perspective into the manager's experience and views on the company and progressively becoming more detailed to the level of stories and examples that illustrated the process of strategic change, organizational design, and diagnostic control systems.

The capacity to interview managers repeatedly over time facilitated an understanding of the longitudinal change process. Discussions focused on the different external and internal dimensions of the new strategy, managers' perceptions of the contrasting strategies pre- and post-2008, changes to the organizational design of the business units and how they demanded people to adapt and emphasize new skills, and the evolution of accountability systems across the hierarchy. As in any open-ended interview, other themes emerged that gave additional context for interpreting the data.

We also observed several top management meetings on the topic of strategy, strategy implementation, and performance evaluation. We had access to internal documents and reports that gave us an additional source of data to better understand the intent and evolution of organizational

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<sup>10</sup> Confidentiality policies at the company precluded taping interviews.



design and routines during the period. Throughout the period we collected public information on the company to further understand the process. This diverse database across sources of information and over time allowed for triangulation across informants and the same informants over time to create a rich understanding of the evolution of the phenomenon of interest.

The data analysis progressed in parallel to data collection. Managers' descriptions and event observation were organized into four categories: organizational structure, diagnostic control systems, strategic implications, and other organizational aspects. Within each category, we identified sub-categories to better track the evolution of the different parts that conform each variable. For organizational structure, we identified components such as decision rights, resources controlled by the manager, supervisor changes, and changes to the job description. For diagnostic control systems, we tracked the composition and difficulty of targets, types of performance measures, evolution of incentive systems, performance evaluation, promotion decisions, and budgets. Strategic implications included changes to behavior, evolution of performance, and new strategic initiatives.<sup>11</sup> Other organizational aspects include topics that did not fit clearly within one of the previous three categories; most of these aspects referred to cultural changes, although they also include references to competitors, customers, and economic conditions.

## **Henkel's Use of Structure and Systems to Drive Strategic Change**

### ***Company background***

Henkel AG & Company dates back to 1876 when Fritz Henkel founded the company to manufacture a new laundry detergent. Today the Henkel family still holds a significant part of the company's equity. The company grew to become one of the most important consumer products in Germany. After World War II, the company had to rebuild most of its infrastructure. It grew during

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<sup>11</sup> These changes encompass a broad set of organizational aspects such as financial performance, new products, employee rotation or aspects associated with the culture of Henkel.

this period through innovation (it was the first company to use television advertising) and acquisitions. By 2008, the company competed in 125 countries with €14 billion in sales and 55,000 employees. The company was organized into three business units: adhesive technologies, laundry and home care, and cosmetics and toiletries. All of these business segments faced highly competitive markets although with different characteristics. In the adhesive business, the company was the market leader, facing tough competitors like 3M. Henkel was a relatively small player in the laundry, home care, and beauty segments, competing against much larger companies like Procter & Gamble and L’Oreal.

We organize the strategic change process documented in the study into four main stages. In the first stage, the company redefined its strategy and made changes to its mix of resources such as facilities and brands, reducing the resources under managers’ control. In the second stage, the company changed “soft” aspects with a new set of beliefs and values. The third stage involved pushing down accountability across the hierarchy and, at the same time, widening span of accountability for individual managers. Together with the narrowed span of control, the new design of diagnostic systems broadened managers’ entrepreneurial gap. The final stage was defined by top managers use of performance evaluation systems as interactive systems to identify and promote those people best aligned with then new demands of the company. These stages are consistent with prior evidence on the patterns of newly-appointed top managers in situations of strategic turnaround (Simons, 1994).<sup>12</sup>

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<sup>12</sup> Simons (1994) identifies five stages in turnaround settings. The first one is the definition of new boundaries. Then the top manager defines the new strategy and new beliefs and values. Third, targets are defined and pushed down the organization through diagnostic systems. Fourth, incentives are linked subjectively to strategy. Finally, use one system interactively to signal priorities. At Henkel, the first stage that we identify includes a new strategy and span of control. The second stage defines and communicates a new set of belief systems. Then accountability is pushed down the organization. The last stage sees the use of performance evaluation as an interactive system to promote those people aligned with the new strategy.

### ***Stage 1: Announce the new strategy and narrow span of control***

Kasper Rorsted, who joined the company in 2005, became CEO in April 2008. For many years, the company had been reporting adequate, but unimpressive, growth and profit figures (8% revenue growth and an EBIT margin of 10.3% in 2008). Competitors 3M, P&G, and L'Oréal consistently outshone Henkel on measures such as revenue growth, gross margin and profitability. Analysts perceived that Henkel suffered from complacency and employees lacked a strong competitive spirit. A senior executive at the time described the company as “a happy underperformer, always number two or number three, but we didn't care.”

The new CEO had little tolerance for this perceived market position stating: “staying where we are is no longer an option. We either move up or move down: we either become relevant or we will be made irrelevant.” A manager with a 12-year tenure at the company described the situation that Rorsted inherited: “many employees have been with Henkel for 20, 30, and even 40 years; the company has been able to show stable performance over many years, so people were generally content with the way things were.” Another manager put it as follows: “from 2000 to 2008, Henkel missed every single target. We had a 12% market share target, 80% of the organization didn't know we had a target. We had a tradition in the past that if we had a bad year, it was all crisis, it was recession, it was competition or it was flooding in Thailand. When the year was good, it was because we were fantastic.”

The new CEO quickly announced an aggressive new agenda. During a November 2008 press conference to announce a 58% drop in third quarter profit (due to the effects of the 2007/8 financial crisis), he committed publicly to a 3% to 5% yearly organic growth through 2012, an EBIT margin of 14% by that same year, and a 10% growth in earnings per share.

Analysts were skeptical about whether the company could reach these targets. One analyst stated, “We don't have a clue on how they can be reached.” The following comments were typical:

“the listeners of the London analyst conference could not believe their ears” (Wertpapier, 27.11.2008); “14% seems too ambitious” (Thomas Joekel Union Investments; Mark Oliver Caspari, Bankhaus Lampe; Societe Generale); “As for the recently announced 2012 margin targets of 14%, we frankly think it has little credibility” (Credit Suisse, 27.11.2008).

The CEO reflected on the reaction to his announcement: “In 2008, we said that we would get EBIT margins up 14% by 2012. Not one analyst believed we could do it. In 2009, most of the financial community came and said, why are you not dropping the number, you have the largest financial crisis since WWII, and internally it was pretty much the same. By 2010, we had EBIT up from 10% to 12%, so people could see that it was possible. And we are now providing a guidance for a 13% margin target for 2011. We are not backing down, even with the current financial crisis. I keep reminding everyone, ‘the target is the target.’”

Managers described the new stretch target and compared it to the more comfortable situation that existed prior to the appointment of the new CEO: “We always set long-term targets, but they never seemed to be our first priority. Some teams would plan annual targets, which they would achieve within 10 months. Because of this type of behavior, we never achieved the full potential of the company. Now, the tension is unprecedented. We have set what I call ‘vicious targets.’ The 14% EBIT margin is just a number, but this number will transform the company in the way we set out ambitions and how we go after them.” The announcement sent a message throughout the company that a process of significant strategic change had begun.

To achieve the target communicated to the financial markets, the company structured the new strategy around three strategic priorities: (1) “achieve our full business potential,” (2) “focus more on our customers,” and (3) “strengthen our global team” (**Figure 3**). The CEO described it as: “we took our triangle and if you ask our organization today, every single person knows it. They know the three strategic priorities and the 14%.”

*Insert Figure 3 here*

As part of the first strategic priority “achieve our full business potential,” the company implemented a variety of structural initiatives starting in 2008. According to the CEO: “we tackled the hard things before attempting the soft ones. For the first part, I expected that people in the organization would feel uncomfortable, but we had to implement these changes to secure our future. We closed 60 plants worldwide and shifted functions such as purchasing, finance, and human resources into centralized shared-services. For the second part I needed to have everybody on board... I needed emotional buy-in.”

These structural initiatives included divesting underperforming brands (the number of brands declined from 900 to less than 500), reinvesting in growing brands (its Dial brand moved to the top of U.S. body wash market), making a \$3.7 billion acquisition in the adhesives’ business (U.S.-based National Starch) to consolidate its leadership position, and shifting its focus to emerging markets. On the cost side, initiatives included increasing production capacity in emerging markets, searching for cost efficiencies on the administrative and procurement sides, closing uncompetitive plants, reducing headcount by fifteen percent, and consolidating administrative functions into shared-service centers in low-cost countries. These early events reinforced the message of dramatic strategic change.

As part of achieving “full business potential,” operating managers in all divisions saw their resources reduced and, as a result, their spans of control narrowed. The fifteen percent headcount reduction meant that fewer people were available to achieve the newly-announced stretch goals. Resources for administration, procurement, finance, and human resources were moved out of operating divisions and centralized in shared service centers. Division managers now had to call upon and coordinate with central functions to get the support resources they needed. With the closing of 60 plants, manufacturing was also centralized into shared production facilities. Division

managers no longer controlled production directly, but rather had to coordinate across regions to allocate production capacity.

These events had the effect of drastically narrowing span of control for most business managers.

A company executive described the effects:

“Before the reorganization, local general managers (GMs) had direct control of key functions in their business units such as controlling and supply chain management. Now, with the implementation of global standards and policies, many of these functions have been centralized. The GMs are still responsible for business results and operations, but they have drastically fewer resources under their direct control ... often only the sales and marketing functions report directly to them. This is a big change and big challenge for local management.”

### ***Stage 2: Redefine values through beliefs systems***

The new strategy hinged on the creation of a “winning culture” that reflected an entrepreneurial mindset throughout the business. To achieve this goal, the new CEO believed that he had to change the beliefs system of the business to support the type of entrepreneurial culture he envisioned.<sup>13</sup>

CEO Rorsted described the move into reshaping the culture as follows:

“After two years of fixing the hardware issues, we moved into culture. A lot of companies do not have a culture. When they get a new employee on board, they tell he or she what the job is, what the email account is, how you submit expense claims, how you get into SAP; very few companies actually sit you down and say here is what we are about. We want to be very transparent about who we want to have in the organization. People have a choice: either I want to be part of this team or I don’t want to be part of this team.”

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<sup>13</sup> Other aspects of creating a winning culture included four principles: (1) everyone wants the Henkel team to win, (2) everyone is eager to beat the competition, (3) everyone is proud of and motivated by the common success, and (4) everyone delivers at his/her best. Its implementation happened around three themes: (1) management competencies, (2) leadership principles, and (3) organizational climate.

New competencies included: can-do-mentality and optimism; customer focus; willingness to drive change; competitive mindset; strategic and visionary thinking; passion to win; conflict handling; cultural awareness; developing; building organizational capability; and act as a role model.

Leadership principles highlighted accountability; optimism and passion for business and performance; drive change and question status quo; empower teams and strengthen their capabilities; dynamic team diversity; open, direct, and consistent communication; generate trust and focus on empathy; develop and coach top talents; give and ask for feedback; and entrepreneurial role models.

Organizational climate was articulated across the following dimensions: clarity and commitment; accountability and discipline; encouragement and delegation; team spirit; rewards and appreciation; passion for excellence and desire to win.

As a foundation for the new strategy, the company rewrote the company's longstanding values. The old values comprised a list of ten attributes that played no role in decision making or day-to-day management. They "were everywhere but had little meaning," stated one manager. They included goals ("we aspire to excellence in quality"), work principles ("we communicate openly and actively"), and history ("we preserve the tradition of an open family company") (**Table 1**). The CEO described the situation that he had inherited, "We had our ten values and we had a management team meeting in 2009 and we discussed our ten values. We asked how many of you know the ten values, all of us were incapable of writing the ten values on a board. So I joked and said either we change the values or the management team. We chose to change the values."

*Insert Table 1 here*

An internal report described the situation in 2008 as too many values, not prioritized, not clear to everyone, and a mixture of values and objectives. The same report identified the main requirements for the new set of values: (1) support people in prioritizing between customers, employees, and owners; (2) provide guidance for tough decisions (who comes first when tough decisions have to be made?); and (3) clear communication (the more decentralized a company becomes, the more employees need to know how to make value-based choices). This latter requirement highlighted the need for a clear set of belief systems as a foundation for expanding span of accountability (as discussed in the next section).

Based on a questionnaire to 126 top management level in June 2009, top management, the board, and the Henkel family designed the new vision and values: "The values were created during the management board workshops taking into account input from the family shareholders. Then, we included everyone in the company in the roll-out. We asked every employee to put the values into their own words and build personal action plans. This way everyone felt invested in the changes."

The questionnaire identified the top five priorities for strategic change to be effective: better people management, change culture, enhance customer relationships, drive innovations, and streamline portfolio. It further identified the aspects that made Henkel unique: “our family ownership/long tradition/history, our sustainability/CSR approach, our strong brands, our people, and our broad product portfolio and market presence.”<sup>14</sup>

The new values were deployed in 2010 (**Table 2**). Managers repeatedly emphasized the importance of putting customers first: “Everyday, everywhere and everyone makes sure that customers come first,” “our primary responsibility is to deliver best in class customer experience through innovative and superior products and services.” The word customer was banned from the name of any internal department to reinforce its importance.

*Insert Table 2 here*

The board member representing the family mentioned: “To (the family), the value ‘building on a family business foundation’ implies entrepreneurship and accountability. My wish is that every employee should feel like an entrepreneur—taking risks, making changes, and moving at a fast pace. The employee should be able to decide and feel like we do as owners.”

An email informing employees about the new vision and values was sent in July 2010, together with a video on the intranet, posters and leaflets on premises, and screen savers that featured fade-in of the new vision and values. A large internal communication effort starting September 2010 was put in place. It included a special edition of the internal magazine (“Henkel Life”) devoted to the topic and more than 5,000 workshops in 60 countries and 30 languages for people to understand

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<sup>14</sup> Comments in the questionnaire reinforced these aspects. “The company’s family ownership is unique versus our larger competitors in the consumer products industry,” “our sustainability heritage is an advantage that we should lever more in a uniform way moving forward,” “strong brands with clear profiles and regional strengths,” “motivation of most of the people to deliver excellent results,” and “incredible portfolio of technologies and brands—geographical spread.”



how these new guides affected their daily work: “we wanted employees to see their own contribution, and be able to put action behind words. The workshops were key to achieving this goal.” Employees were actively encouraged to communicate through various channels with quotes, ideas, and interviews their thoughts. For instance, a foreman in one of the divisions wrote: “I would like to give you some feedback that positive resonance is coming from beyond management circles, too. An active tool for transplanting the vision and values from words on paper into the hearts of the employees is a true milestone.”

The corporate’s tag line “A Brand Like a Friend” was also replaced. Its consumer focus did not apply neatly to the adhesive business, the largest division. The friendliness aspect was also at odds with the focus on competition and winning. The new vision was “A global leader in brands and technology,” the new tagline “Excellence is our passion.” This more outward looking claim was introduced in January 2011 after the new vision and values had been communicated to the entire company.

### ***Stage 3: Widen span of accountability***

At the same time that the company was working on reshaping its values, it was also redesigning its performance measurement and incentive systems, thereby expanding the span of accountability across the hierarchy. A 2009 report described the design principles of the new organization as (1) improve leadership quality; (2) increase accountability including direct reports understanding mission, strategic priorities, targets and reporting lines, everyone having their targets linked to their incentives, and making mandatory face-to-face meeting for performance evaluation signing; (3) enhance performance management including having top performers get stronger and more visible reward and recognition, active demotion of on-going underperformers, executive-level positions not for a lifetime, active exit management, success plan mandatory for promotion, and Henkel

reward ceremonies for best performance; and (4) strengthen organizational development with every business head deriving the aspiration level for the unit, establish goals for organizational development, reinforce new hire assessment after six and twelve months.

Across the board, performance measures became wider and performance targets became more difficult to achieve, even as resources under the control of managers were reduced. One senior manager recounted, “We used to set rather easy individual targets. From 2004 to 2008, 95% of employees hit their earnings even though the company as a whole didn’t reach its goals even once. It created a perception at the company that everyone is great, and yet the company as a whole was losing.”

The purpose of these new systems were described by a top manager: “In a performance-oriented company, like in sports, you select the best players, offer training and support to them, and then they need to be accountable and perform. If you want to build the best team, you must have high expectations. You cannot tolerate continued weak performance.”

The CEO mentioned: “You can only have a winning culture if you win. We had a very comfortable, very complacent culture and everybody was fulfilling their targets but the targets were wrong. It was like saying we are losing every week as a company and all the employees felt they were winning. (...) We wanted to measure ourselves against the best ones and people did not believe we could make it. We have to do this, push it through. If you cannot do it, we will help you, we will develop you, or we will let you go.”

Overall, managers saw the resources made available to achieve their goals (span of control) reduced: facilities were closed, headcount was reduced, and shared services were centralized. At the same time, building on the new values (which emphasized a customer orientation), customer-focused accountability—a wider measure than had been used previously—increased across the board.

Under the previous administration, managers were accountable for balanced scorecards containing 20 or more measures. The CEO described the situation as follows: “The balanced scorecards had too many measures. They always gave someone an excuse ... somewhere to hide. I want clear accountability for a small number of customer-focused measures. As I tell everyone: no more excuses. The target is the target.”

The new diagnostic control systems reduced the number of measures that each manager was accountable for—typically just three measures—with at least one of these measures being customer-focused. As one manager summarized, “Our prior measurement system was based on a multitude of objectives and projects. Bonus payouts were linked to complex scorecards. We ended up with a very complex system of KPIs. We have really tried to simplify things. Instead of 20 KPIs on scorecard, we now have three measures. At the same time, we have also substantially widened the measures for which we hold accountable people. For example, everyone now has some type of customer-focused measure in their targets.”

One of the operating managers stated: “The (new) strategy is more than just a frame of reference. It provides clear, measurable goals which allows every manager to assess his decisions in the light of these targets.” Another said that “the tension is now palpable.”

The performance evaluation process was also redesigned: “in the past nobody was low performing and managers were appreciative of everybody. Managers often delivered very positive feedback face-to-face, saving their criticism for confidential meetings when the employee was not present. It’s not that people were never let go in the past. But when they were, they would be shocked because they had never received a bad review.” The system “used to assess people on activities and efforts, but not results.” The prior system showed a disconnect between the management competence assessment and the performance evaluation. An employee mentioned: “it

was not clear whether the management competence assessment stands for performance or potential.”

The new performance evaluation system required managers to grade each of their subordinates on two scales: performance and potential (**Figure 4**). The former was defined using five criteria common to all managers: quality and quantity of results, customer orientation, teamwork and effective cooperation, people management, and leadership. A forced ranking system was then applied that required sorting individuals into four groups: top (10%), strong (60%), moderate (25%), and low (5%). Managers saw this forced curve as an important aspect of the new management system: “We have made huge progress since introducing forced differentiation,” “(There are) rigorous consequences for underperformers,” “The strength of our approach is that we apply the same criteria globally across all functions.” One of the business heads (directly reporting to the CEO) described it:

“When it comes time for evaluation, we now focus on proof: the first thing we talk about is quantity and quality of output. This is a big change from when we used to assess people on activities and efforts, but not results. .... Next, we focus on the individual’s ability to be customer-oriented in their work.”

Potential, the second dimension of the matrix, was also evaluated for all managers. This (subjective) assessment included: initiative and determination to achieve, decisiveness and risk taking, driving change and innovation, perspective and judgment, convincing and influencing, and coaching and developing people.

*Insert Figure 4 here*

The final ranking of individuals was decided in a meeting of each group’s top management to ensure comparability across units. **Figure 5** illustrates the evaluation matrix as well as the role of the calibration group and the communication of the evaluation results. The system enhanced accountability: “We felt we needed to be fair and objective, but more critical. We realized it’s better

to be honest with people, tell them how they are really doing, and give them a chance to improve.” The system “creates a tension because people who were told they were great throughout their career are suddenly being told they’re not so great anymore.” Another manager described the impact of the new performance measurement system: “Every year we raise the bar. A person who received an ‘S’ (strong rating) last year won’t necessarily earn an ‘S’ next year for the same performance. They need to keep improving. This has really changed behavior. There is more clarity about what good performance is and people are really starting to pay attention.”

*Insert Figure 5 here*

The CEO shared his perspective: “We link the pay scheme to the grid, depending on where you are. If you are more to the right side you get more, if you are more to the left you get less. The thinking is, the best employee you have in the company is the cheapest: price-performance is the lowest. And the worst is the most expensive one because you pay a lot for very little. We want to over-reward the good ones and under-reward those that don’t perform.”

Bonuses had three components: company, team, and individual performance. The company component was linked to two or three financial measures. The actual performance on these measures was compared against targets in a range between 0% and 200%. The team component was based on targets for one to three measures, commonly financial measures, specific to each unit. Again performance ranged from 0% to 200%. Company and team performance were weighted 30% and 70% respectively to create a combined score. Individual performance was an equally-weighted combination of two parts. The first part was linked to two again equally-weighted measures, often non-financial compared against targets and translated into a 0% to 150% range. The second part of the individual performance was the outcome of the subjective evaluation described above. The individual score was multiplied by the company plus team score. The target bonus (the bonus that an employee would receive if he or she performed at 100% level) was a percentage of base salary.

The actual bonus could range from 0 to 300%. The top 3,000 managers' bonus was doubled if the company met the 2012 financial goals.

One executive described the rationale for the increased emphasis on accountability and performance measurement, "We strive to balance creativity and discipline. Creativity provides freedom to blossom; accountability provides the discipline to ensure effectiveness and efficiency. With a fast and transparent decision making process, we clearly define accountability and responsibility, so that we avoid fatigue and stimulate motivation."

#### ***Stage 4: Use performance management system interactively***

With span of control narrowed across the board, a new set of customer-focused beliefs in place, and widened span of accountability for all managers, senior managers had set the stage for more entrepreneurial behavior and higher levels of performance. In the final stage of the strategic change, they began to use their performance management system in a highly interactive way.

Management control systems can either be used diagnostically (management-by-exception) or interactively. An interactive system has four attributes: the information generated by the system is an important and recurring agenda for the highest levels of management; the system demands frequent and regular attention from operating managers at all levels of the organization; data generated by the system are interpreted and discussed in face-to-face meetings of superiors, subordinates, and peers; and the system is a catalyst for the continual challenge and debate of data, assumptions, and action plans (Simons, 1995: 97).

The strategic uncertainties for Henkel emanated from the need to ensure that the company had adequate management capabilities—especially focused on the entrepreneurial mindset they were seeking—to execute the new strategy and allow the company to adapt into the future. This was especially important given the organization's history of complacency.

The performance evaluation system became a key tool for top managers to involve themselves in face-to-face discussions and decisions across the hierarchy. Managers throughout the business met on a regular basis to debate, discuss, and rank the performance and potential of all employees to identify the high performers who could lead the business into the future. Ongoing questioning from executives probed the contributions and potential of employees in all corners of the business.

The President of Middle East and Asia for Laundry & Home Care mentioned: “When you attend our performance evaluation meetings, you get some sense of the type of entrepreneurial behavior we are looking to recognize and promote.” The head of one of the major segments described the importance of identifying people who could lead the business into the future:

“Our new processes have increased the visibility of people dramatically. Senior managers now work hard to get to know top performers. When I am travelling abroad, I make it a point to meet personally with the most talented managers independent of their seniority level. The meetings make these high performers clearly visible to me and other senior management. As board members, we act as role models. When we are seen reaching out to identify high performers and getting to know them, managers at lower levels will follow in our footsteps.”

The CEO share this thoughts:

“Every single time we travel and the management team travels 160, 170 days a year, every single time we meet our high potentials. So when I went to Brazil, I called the general manager and told him I want to have a breakfast meeting with them, very easy. And then we track it every year and we regret losses when it is one of those. We are using the grid very specifically how are the people doing, how does the pipeline look like, who we do promote. We spend a lot of time—an enormous amount of time—on people development, developing the right atmosphere in the company, and getting the right set of leaders moving forward.”

### ***Performance***

In 2009, when the new CEO took over, sales were €13.5 billion. By 2013, revenues were €16.3 billion (21% increase) with 13,000 fewer employees (24% decrease). The CEO stated, “We terminated 17% of our employees, 13,000 people in three years’ time. We are 2.5 billion bigger today, and approximately 1 billion bigger in profits with 13,000 people less. We had enormous fat

in the organization. Of the top 200 leaders in 2008, 100 left. Of the six that were on the board, two are left: one guy and myself. It was not easy.”

During this same period, EBIT margin increased from 10% to 14%, and the stock price increased fourfold. **Figure 6** plots Henkel’s share price against Germany’s DAX index. **Table 3** presents financial results during the period. Net working capital as percentage of sales decreased from 11.7 in 2008 to 6.9 in 2014. The weight of emerging markets had grown to 40.6% of sales in 2010 up from 36.6% in 2008 and Henkel opened eight new plants in these markets. Despite their initial skepticism, analyst now believed that Henkel could become a world-class competitor.

*Insert Table 3 here*

The central role of recruiting, promotion, and retention or dismissal to the process of strategic change (Campbell, 2012) was evident to managers at Henkel. The President of Laundry & Home Care described the impact on performance: “We are now playing in the same league as our international competitors in terms of market share growth, revenue growth, and net profit growth. Everyone wants to be part of a winning team. We recently attracted a top person from P&G: with our new values, people want to be part of the story.”

A survey in February 2011 showed “an exceptionally high awareness, understanding and engagement with the vision and values, clearly outperforming the industry benchmarks. More than 90% of respondents know how to live the values personally in their daily work.”

The result of these changes to management approaches was an increase in entrepreneurial behavior and bottom-up innovation. By the end of 2012, management described the change in people’s behavior as follows: “The new performance management system has encouraged stronger teamwork, more collaboration, and significantly more innovation as people respond to the need to deliver results.” For example, one of the company’s major products was a premium line professional beauty products sold only in professional salons. As a result of fewer resources and



wider accountability for performance, managers developed and launched a new “affordable” professional beauty line for general retail sales. As the CEO described it, “Without the new targets and performance pressures, I doubt this innovation would have occurred.”

Early in 2013, the company unveiled its strategy through 2016. It was communicated as: “We will **outperform** our competition as a **globalized** company with **simplified** operations and a highly **inspired** team!” The four bolded words became the focus of the new strategy.

## **Discussion**

The analysis of Henkel AG illustrates the evolution of changes in formal and informal organizational design variables to effect strategic change. The study documents a myriad of changes including organizational structure, resource allocation, performance measurement and assessment, target setting, incentive and promotion systems, vision and values, and culture.

Managers at Henkel purposefully created a misalignment between span of control (a function of decision rights embedded in organizational structure) and span of accountability (determined by diagnostic control systems) that we label entrepreneurial gap. Operational managers saw their direct access to resources diminished. Yet, at the same time, their span of accountability increased. Achieving targets became a central focus of managers throughout the organization. This new, wider span of accountability was in contrast to previous periods when easy-to-achieve targets, a broad set of measures including more than 20 measures, and a promotion system heavily weighting seniority were the norm. This entrepreneurial gap widened dramatically over the period and created tension in the organization during which the strategic change process happened. Managers who were unable or unwilling to commit to the new circumstances—an expectation to do more with less and become more customer-focused—were replaced. However, those who stayed became more entrepreneurial in searching for new solutions and pursuing new initiatives.

The explicit design of an entrepreneurial gap is a potentially important variable in explaining strategic change. Various theories of organization assume the need for alignment of strategy, structure, systems, skills, staff, etc. (Darzin and Van de Ven, 1985). In contrast, this study finds that managers may seek to *destabilize* an organization through a deliberate *misalignment* of span of accountability and span of control to encourage entrepreneurial behavior (**Figure 7**). The findings also indicate how top managers can take proactive design decisions to quicken the process of strategic change.

The controllability principle argues for aligning span of control and span of accountability: by so doing, it is argued that managers are held accountable only for those actions and behaviors that they can control. Similarly, agency theory predicts performance measures aligned with the efforts of managers reduce noise and enhance the motivational properties of incentive systems. Yet, this study describes how executives purposefully reduced the span of control and increased the span of accountability to reinforce entrepreneurial behavior down the organization.

As a systems' perspective predicts, the interaction that we document in the case study is not limited to organizational structure and diagnostic systems. Rather, the evidence also describes the importance of new beliefs systems and the significant effort that the company put behind the communication of this new vision and values. These new beliefs were necessary to support the entrepreneurial culture that the new CEO wanted to create. The company also redesigned its product portfolio eliminating a significant number of brands, doing one major acquisition, and reinforced its investment in its leading brands and emerging markets.

Diagnostic control systems have typically been interpreted as traditional feedback control systems used to monitor the implementation of a particular strategy through management by exception. The Henkel case study presents a more nuanced interpretation of diagnostic systems. Their design—when considered as a complement to organizational structure—can be a powerful

mechanism to motivate entrepreneurial behavior, search activities, and innovation. The resulting entrepreneurial gap offers an important foundation for strategic change.

The concept of entrepreneurial gap gives an additional perspective on how to enact search procedures underlying organizational learning and contextual ambidexterity. Increasing span of accountability—through fewer but broader performance measures linked to rewards and promotion opportunities—while at the same time narrowing span of control—by reducing control of resources—led at Henkel to entrepreneurial behavior. This misalignment is consistent with much of the entrepreneurship literature. Entrepreneurs “pursue opportunities without regard to the resources they currently control” (Stevenson and Jarillo, 1990). In a similar way, a wide entrepreneurial gap demands this same kind of behavior. Managers facing this organizational context either leave the organization or activate search routines to achieve their accountability goals by gaining access to resources they do not fully control. To a certain extent, the findings open a piece of the black box that links organizational learning to changes in organizational outcomes.

It is also important to note that managers began using one system interactively—the performance evaluation system—to trigger debate, dialogue, and action plans cascading down through the entire organization. Starting with the CEO, top managers signaled by their personal attention and engagement how important these issues were to them and to the future success of the business. This result replicates a finding in Simons (1991) that top managers use their human development systems in a highly interactive way when they want to focus the organization on strategic uncertainties relating to leveraging skills into competitive advantage.

The case study also informs captures the interpretation of management control systems as a “package” (Malmi and Brown, 2008). Rather than picturing control as static configurations of independent systems, the central role of interactions to the change in organizational behavior speaks to the systems’ view of organizational design (Grabner and Moers, 2013).

A final aspect of the study is the effects of employee turnover associated with strategic change. Consistent with prior studies (Crossan et al., 2003), turnover does not necessarily lead to lower organizational learning. Some knowledge departs when 13,000 people leave the organization, yet most of this knowledge becomes less relevant as the new strategy replaces the old one.

## **Conclusions**

This study provides a detailed description of strategic change at Henkel. It documents how changes to formal and informal organizational design variables led to a transition from the original strategy to the new one. The findings focus on how management redesigned the interaction between decision rights and accountability to create an entrepreneurial gap—defined as the difference between span of control (defined by a manager’s decision rights) and span of accountability (defined by the manager’s accountability) and offers a powerful lens to understand how large, established companies can push entrepreneurial behavior down the hierarchy.

Henkel’s effectiveness encouraging entrepreneurial behavior using the entrepreneurial gap informs various concepts in the management literature. First, periods of strategic change are often difficult to manage and companies can easily fail (Zhang and Rajagopalan, 2010); the Henkel case study conceptualizes at least one path to success. The findings complement and reinforce existing research that has focused on cultural aspects of strategic change (Fiss and Zajac, 2006). They illustrate how changes in formal and informal aspects of organizational design reinforce each other to drive change (Simons, 2005). Second, the transition from the original strategy to the new one informs the concept of contextual ambidexterity (Raisch et al., 2009): how a company can simultaneously execute a strategy while creating a new one. Third, the findings at Henkel and the concept of entrepreneurial gap challenge the idea of fit captured in the controllability principle and agency theory’s objective to maximize the signal-to-noise ratios of performance measures. Henkel’s managers increased the noise of the performance measures to stimulate search. When

practitioners first articulated the controllability principle in the 1880s, employees were not expected to either innovate or be entrepreneurial. In this command-and-control world, work was standardized and predictable; it made perfect sense to argue that authority (span of control) should equal responsibility (span of accountability). Yet, these situations have become increasingly rare in today's highly competitive, customer-focused environments. Fourth, the entrepreneurial behavior observed at Henkel contributes to our understanding of the organizational context required for organizational learning and innovation. The widening of the entrepreneurial gap together with a demanding set of objectives and a renewed culture created an organizational setting prone to new ideas and risk taking. The case illustrates how managers can adjust the entrepreneurial gap according to the degree of innovation and independent initiative they wish to foster.

It is important to note that the results of this study do not overturn the validity of earlier work that has studied the potential for dysfunction when organizations violate the controllability principle. Forcing individuals to be entrepreneurial by holding them accountable for broad measures assumes that they can succeed in their attempts to influence colleagues and others in the business who control resources. An entrepreneur trying to start a new business who is denied access to resources is bound to fail. Similarly, an individual inside a company who cannot enlist the help of others in securing the resources needed to innovate, satisfy customer demands, or operate across complex boundaries will also likely fail (Simons, 2005, chaps. 6 and 8).

Therefore, the anxiety and frustration identified by some previous research (Merchant, 1987; Fischer, 2010) can still be expected if the institutional conditions for entrepreneurial initiative are not supported. Individuals must be able to influence others in the firm who control the resources necessary for success, and norms must exist that encourage the offering of a helping hand to those seeking new ways of achieving their goals. Without these conditions, dysfunctional behavior is

inevitable. Thus, the creation of an entrepreneurial gap per se does not mechanically lead to the outcomes observed at Henkel. Beliefs systems and context must support the approach.

Future work can explore different configurations of the entrepreneurial gap. A tight alignment between span of accountability and span of control—as the controllability principle and agency theory predict—is likely still appropriate in certain settings. In particular, we expect this alignment to be suited for stable situations where managers focus on the implementation of an existing strategy with little or any need to explore or deploy new strategies. A tight alignment between both spans does not demand the entrepreneurial behavior that exploration requires. Rather it supports a focus on executing and exploiting a top-down, well-defined strategy. Bureaucracies and mechanistic organizations would best fit this setting.

The findings from the Henkel study are limited to this company experience and can only be generalized through the theoretical concepts used in this research design. While the outcomes of the strategic change process seem to be robust in various dimensions, the case study does not identify causality nor prove optimality. As past research has argued, reality is complex and inferences between the actions of certain actors and outcomes are subject to methodological individualism (MacKay and Chia, 2013). Moreover, by construction “the identification of the microfoundations of dynamic capabilities must be necessarily incomplete, inchoate, and somewhat opaque and/or their implementation must be rather difficult” (Teece, 2007: 1321). However, we believe that the concepts and arguments offer a new way of thinking about the links between accountability and organization design that may stimulate further research in a domain that is at the heart of strategic management in today’s increasingly competitive markets.

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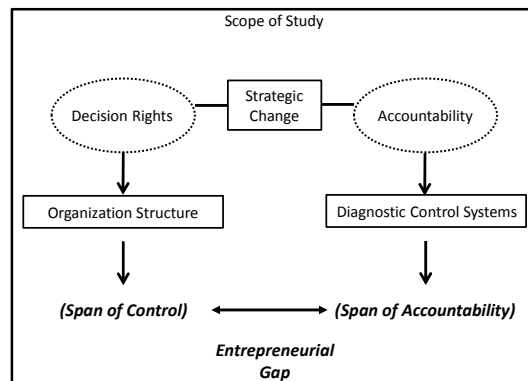
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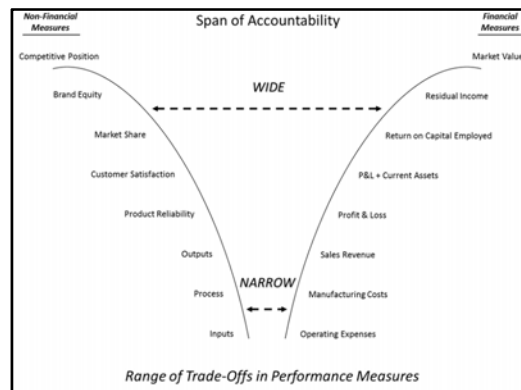
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**Figure 1: Scope of Study**



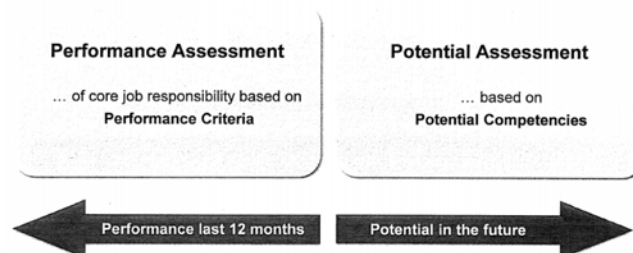
**Figure 2: Span of Accountability**



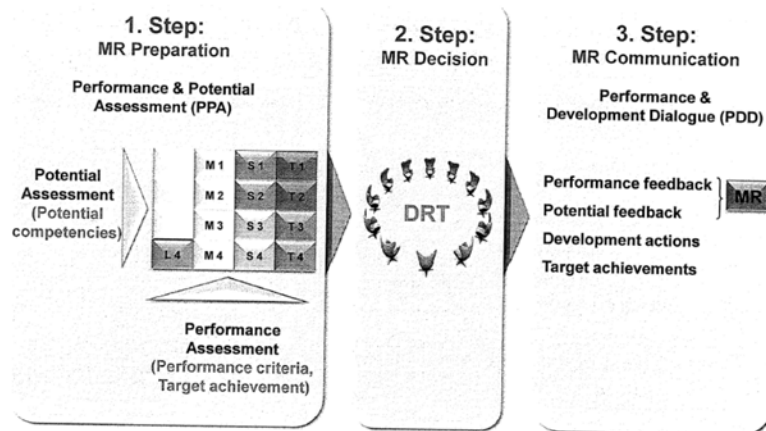
**Figure 3: Henkel's Strategy**



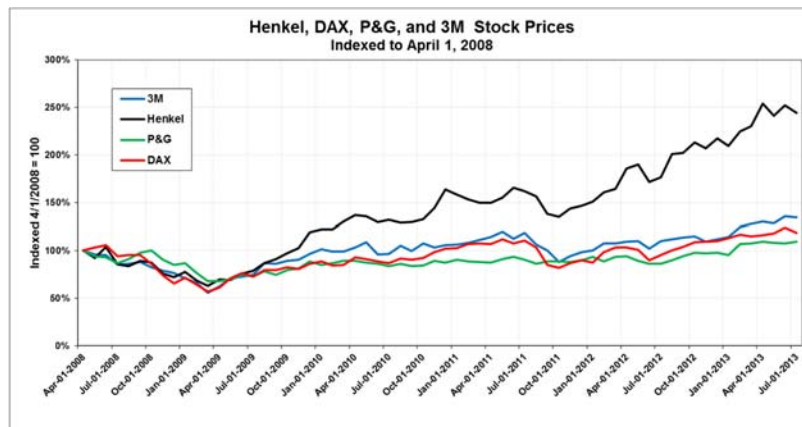
**Figure 4: The Dimensions of Performance Evaluation**



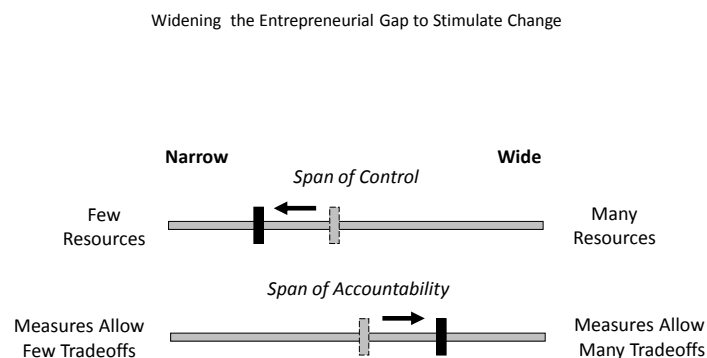
**Figure 5: The Performance Evaluation Matrix and Process**



**Figure 6: Henkel vs Germany's DAX stock price performance 2008-2013**



**Figure 7: Widening the Entrepreneurial Gap to Stimulate Entrepreneurial Behavior**



**Table 1: Henkel Vision and Values Pre-2009**

We are customer driven  
We develop superior brands and technologies  
We aspire to excellence in quality  
We strive for innovation  
We embrace change  
We are successful because of our people  
We are committed to shareholder value  
We are dedicated to sustainability and corporate social responsibility  
We communicate openly and actively  
We preserve the tradition of an open family company

**Table 2: Henkel's New Values**

We put our **customers** at the center of what we do  
We value, challenge and reward our **people**  
We drive excellent sustainable **financial** performance  
We are committed to leadership in **sustainability**  
We build our future on our **family** business foundation

**Table 3: Financial Performance**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Revenues (€millions)	12,779	13,060	9,656	9,436	10,592	11,974	12,740	13,074	14,131	13,573	15,092	15,605	16,510	16,355	16,428
Sales growth (%)	12.5%	2.2%	(26.1%)	(2.3%)	12.3%	13.0%	6.4%	2.6%	8.1%	(3.9%)	11.2%	3.4%	5.8%	(0.9%)	0.4%
EBIT margin (%)	7.7%	6.5%	7.3%	7.6%	7.7%	9.5%	9.7%	10.3%	10.3%	9.1%	12.4%	13.0%	13.8%	14.9%	15.6%

Source: Capital IQ, accessed January, 20, 2017

## Appendix: Henkel's Field Study Data Collection

Managers interviewed	Date
CEO	February 25, 2009
VP Communications	April 2, 2009
CEO, CFO, BU Heads (3)	May 13, 2009
VP Communications	June 13, 2009
VP Communications, Director Communications	June 22, 2009
CEO	June 30, 2009
BU Head, CFO	July 31, 2009
CEO	August 12, 2009
BU Head	August 13, 2009
CEO	August 17, 2009
Country Managers (3)	August 17, 2009
BU Head	August 18, 2009
Operating Manager	August 18, 2009
CEO, CFO, BU Heads (3)	August 26-27, 2009
CEO	October 31, 2009
CEO	November 3, 2009
CEO, Board Chairwoman	November 4, 2009
CEO	November 9, 2009
CEO	November 11, 2009
CEO	October 31, 2011
VP Communications, Head of HR, CFO, BU Heads (3)	December 11, 2011
CEO	December 12, 2011
Country Manager, Head of Strategy, VP Communications, Head of HR, BU Head	December 13, 2011
CEO	February 15, 2012
CEO, VP Communications, CFO	Various dates
CEO	April 17, 2013
CEO	May 1, 2013
CFO	May 13, 2013
CEO	June 10, 2013
VP Communications, Operating Managers (2)	June 26, 2013
Country Manager	July 3, 2013
VP Communications, Operating Managers (4)	July 17, 2013
CEO, CFO, Head of HR, BU Managers (3)	July 16-18, 2013
CEO	July 30, 2013
CEO	August 16, 2013
CEO	October 17, 2013
VP Communications	November 26, 2013

<b>Meetings observed</b>		
Performance Review Meetings (29)		December 13-15, 2011
Two-day meeting of CEO, CFO, Head of HR, BU Heads (3), Operating/Country Managers (6)		May 20-23, 2013
Meeting of top 40 Operating Managers		August 19-20, 2013
<b>Documents Reviewed</b>		
Henkel Life magazine	Internal elaboration	June 2008 – December 2013
Henkel Annual Reports	Internal elaboration	2008-2014
Creating a Vision-guided Value-driven Organization presentation	Internal elaboration	April 2009
Winning Culture presentation	Internal elaboration	June 2009
Survey on “The Core” summary of results	Internal elaboration	August 2009
Winning Culture @ Henkel presentation	Internal elaboration	September 2009
Henkel Values Board Conclusions presentation	Internal elaboration	October 2009
Overview and Strategic Discussion	Internal elaboration	February 2010
Evaluating People Management Competencies	Internal elaboration	June 2010
Vision and Values, CEO presentation	Internal elaboration	June 2010
Internal letter	Internal elaboration	June 2010
Introduction of New Vision and Values at Henkel	Internal elaboration	2010
The Vision and Value Story presentation	Internal elaboration	June 2011
Vision and Values Workshop follow up documents	Internal elaboration	July 2011
Status Strategic Priorities presentation	Internal elaboration	September 2011
Henkel Corporate Strategy presentation	Internal elaboration	November 2011
Action Plan Workshop Material	Internal elaboration	December 2011
Vision and Values Workshop Analysis Report I	Internal elaboration	December 2011
Vision and Values Workshop Analysis Report II	Internal elaboration	December 2011
Vision and Value Action 2011	Internal elaboration	December 2011
Milestones 2013	Internal elaboration	December 2012
Board Session and Strategy Talks 2013	Internal elaboration	April 2013
Globalization, detailed data pack	Consulting firm elaboration	June 2013
Shaping a Winning Organization	Consulting firm elaboration	June 2013