The Flattened Firm -Not as Advertised

Julie Wulf, Harvard Business School
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For decades, management consultants and the popular business press have urged large firms to flatten their hierarchies. The economic logic for flattening seems sound: to remain competitive in the face of increased competition from globalized markets, for instance, firms must pursue a streamlined, efficient organization that can respond more quickly to customers. While flattening (or delayering, as it is also known) is said to reduce costs, its alleged benefits flow primarily from changes in internal governance: by pushing decisions downward, firms not only enhance customer and market responsiveness, but also improve accountability and morale.

Have large firms flattened their hierarchies? And, if so, has flattening delivered on its promise and pushed decisions down to empowered, autonomous managers? What has flattening meant in reality? Surprisingly, no one has addressed these questions rigorously and empirically.

Accordingly, I set out to investigate the flattening phenomenon using a variety of methods, including quantitative analysis of large datasets and more qualitative, field-based research involving executive interviews and company surveys on executive time use (see the sidebar on research methods). Using a large-scale panel data set of reporting relationships, job descriptions, and compensation structures in a sample of over 300 large U.S. firms over roughly a 20-year period, my co-authors and I began by characterizing the shifting “shape” of each company’s hierarchy. We focused on the top of the pyramid: after all, it is the CEO and other members of senior management who make the resource-allocation decisions that ultimately determine firm strategy and performance. Then, to dig deeper into how decisions are made in flattened firms today, we complemented the historical data analysis with executive interviews - what CEOs say - and analysis of data on executive time use – what CEOs do.

We discovered that flattening has occurred, but it is not what it is widely assumed to be. In line with the conventional view of flattening, we find that firms eliminated layers in the middle-management ranks, and they changed pay structures in ways suggesting some decisions were in fact delegated to lower levels. But, using multiple methods of analysis, we find other evidence sharply at odds with the prevailing view of flattening. In fact, flattened firms exhibited more control and decision-making at the top. Not only did they centralize more functions, such that a greater number of functional managers reported directly to the CEO; firms also paid the higher-level functional managers more and lower-level division managers less, suggesting more decisions at the top. Furthermore, CEOs report in interviews that they flattened to “get closer to the businesses” and more involved, not less, in internal operations and subordinate activities. Our analysis of time use confirms that CEOs of flattened firms did in fact allocate more time to internal interactions. Thus, flattening transferred decision rights from lower-level division managers up to higher-level functional managers. And flattening also moved decision rights
from the CEO’s direct reports—the second level of top management—up to the CEO at the pinnacle of the hierarchy.

Why should managers care? Firms may flatten structure to push decisions down, but in fact it can have opposite effects. Managers take note. There are also broader lessons with respect to flattening. First, when you change structure, you need to think about other aspects of internal governance which affect decision-making. That is, incentive design and managerial skills/preferences. Second, when you change structure, it has implications, not only for the location of decision rights, but also the way in which decisions are made. Flatter structures involve a different role for the CEO.

This article will document the results of the flattening phenomenon at the top of the corporate hierarchy, defining what it is and describing what it means for internal governance and decision-making.