

Analysis of the Organizational Reorientation of the ABB Group



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Analysis of the Organizational Reorientation of the ABB Group

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- C** Strategic orientation for the 21st century
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A

Economic development

- Description of economic development
- Income situation
- Finance situation
- Employment situation
- Trends for ABB shares and capital market reactions

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Description of economic development I

Turnover for the year 2000 came to \$ 22.97 billion, down 6% from 1999. The **decline in sales** hit every sector except financial services, and was due to the strong US dollar, in the view of CEO Centerman. Sales broke down as follows: 55% for Europe, 25% for the Americas, 8% for the Middle East and Africa, and a scant 12%, notwithstanding all efforts to the contrary.

Although **operating profits** (earnings before interest and taxes – EBIT) were up 23% to \$ 1.39 billion, it should be noted that part of this result came from companies sold off.

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Description of economic development II

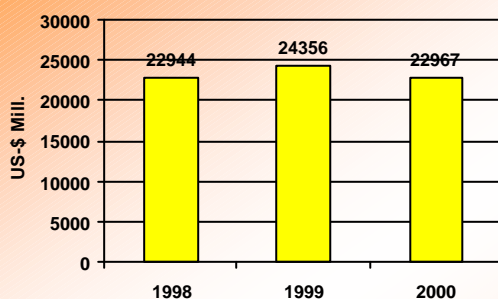
ABB recorded a sharp drop in operating **cash flow**, which fell more than 35% from \$ 1.58 billion to \$ 1.20 billion. This was primarily due to an expansion of current assets, which could reflect unsatisfactory capital management and management problems.

In the financial year 2000, the **number of employees** of the ABB Group fell only slightly. However, significant shifts occurred (e.g. from wage-earners to salary-earners) and trends varied widely within the individual sectors.

All in all, ABB recorded **mediocre results** for the year 2000. However, the Group's management is forecasting strong growth for the future.

Earnings situation I

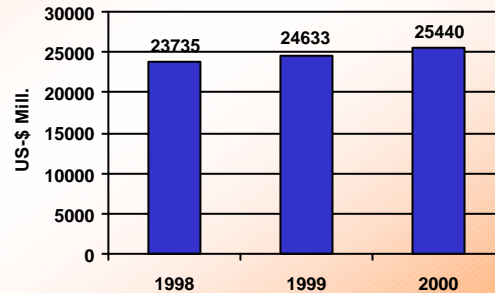
Revenues



⇒ **2000: 5.7% drop in revenue**

- „9.4% drop in company sectors
 - Automation technology
 - Oil, gas and petrochemicals“

Orders received

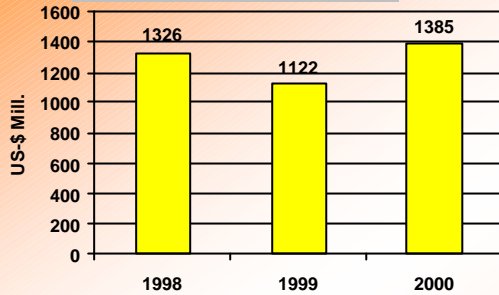


⇒ **2000: 3.3% rise in orders received**

„26.4% increase in the USA“

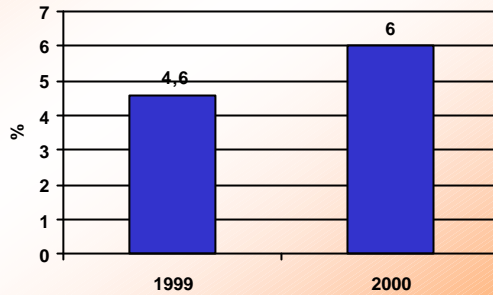
Earnings situation II

Earnings before interest and taxes / EBIT



⇒ 2000: 23.4% increase in earnings before interest and taxes

EBIT margin



⇒ 2000: Rise in EBIT margin

*) Earnings before interest and taxes
..... * 100
Turnover

Earnings situation III

Key figures for sectors in 2000

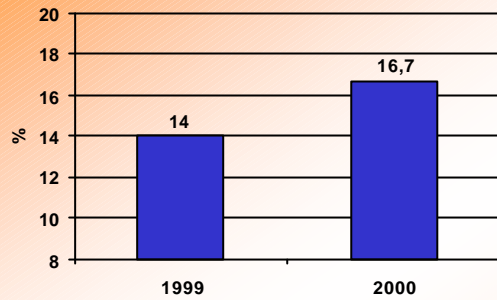
(Amounts in \$ mill.)

	Sales	Changes as a %	Operating result	Operating margin *)
Automation technology	7465	-9	486	6.5
Electricity transmission	3315	-11	262	7.9
Electricity distribution	2830	-2	182	6.4
Oil, gas, petrochemicals	2796	-9	169	6.0
Building technology	5889	-7	456	7.7
Financial services	1966	17	349	--

*) Profit on sales

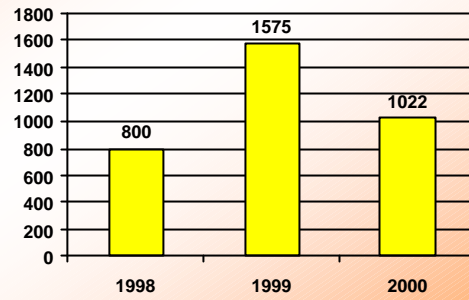
Financial situation

Equity ratio



⇒ 2000: Slight rise in equity ratio

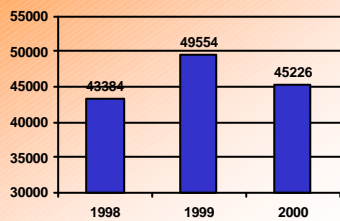
Cash-flow



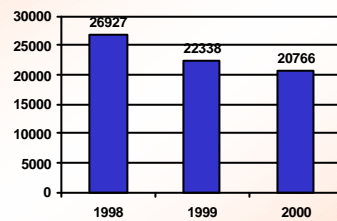
⇒ 2000: 35.1% drop in operating cash-flow

Employment I

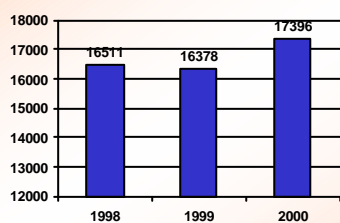
Automation technology / 2000: - 8.7%



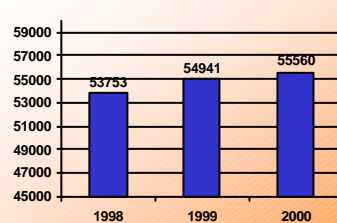
Electricity transmission / 2000: - 7.0%



Electricity distribution / 2000: + 6.2%

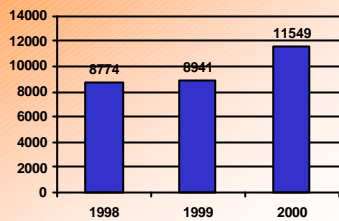


Building technology / 2000: + 1.1%



Employment II

Oil, gas and petrochemicals / 2000: + 29.2%



Financial services / 2000: +7.2%

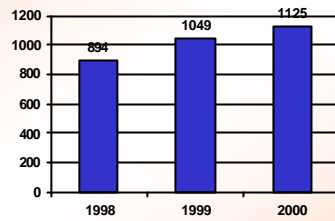


ABB Group overall / 2000: -0.4%

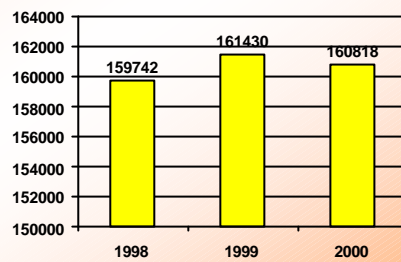


ABB: Press Release, 13.02.2001

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Trends for ABB shares and capital market reactions

- ⇒ „Stock market disappointed by results for ABB Group“ (FAZ, 14.02.01)
- ⇒ „Weak last quarter causes shares to plummet by up to 7.5%“ (Handelsblatt, 14.02.01)
- ⇒ „ABB hard to read“ (NZZ, 14.02.01)



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B Organizational development: The matrix organization and its change

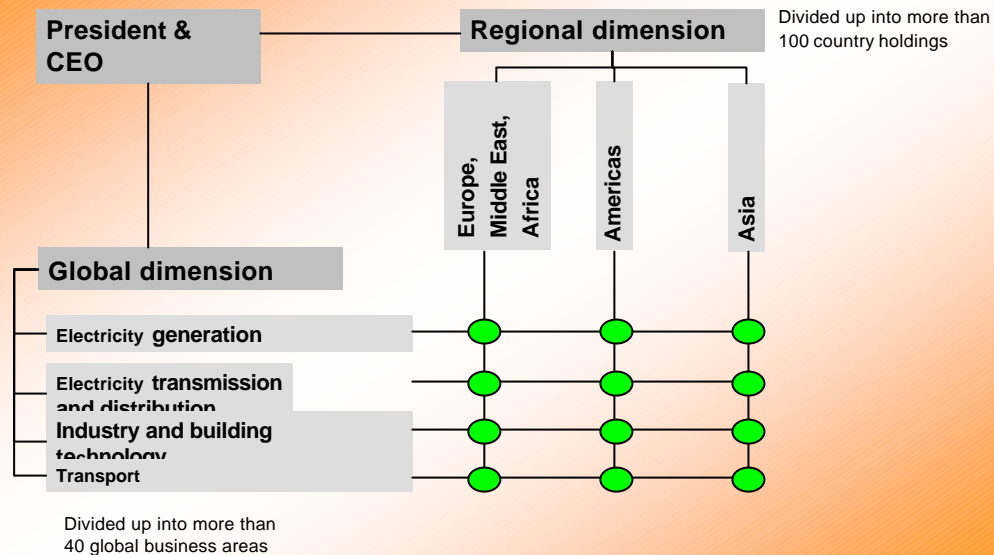
Milestones in organizational development

- Matrix organization 1988
- Strong decentralization 1990
- Move towards a continental organization in 1993
- Sector-based organization 1998 (product-oriented)
- Sector-based organization 2001 (customer-oriented)

Milestones in organizational development



Global matrix organization 1993-1998 - Representation



Taken from: Barham/Heimer: ABB- der tanzende Riese, p. 304 f.

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The global matrix organization 1993-1998 - Description I

In 1993, the Group was organized on the one hand on a **product-oriented basis** into **four corporate divisions** with a total of some 50 business areas and on the other hand on a **area-oriented basis** into **three geographic regions** with 1,300 **legally independent** companies and a total of some 5,000 autonomous local units.

The local units are set up as so-called **profit centers** with their own balance sheets and profit and loss accounting. The companies and profit centers are tailored to fit local conditions, whereas worldwide coordination is handled through the two **matrix dimensions** (regional and global dimension).

Vgl. Schulte-Zurhausen: Organisation, 2. Auflage, München, 1999, S. 262.

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The global matrix organization 1993-1998 - Description II

The regional dimensions are primarily responsible for **sales** and optimum satisfaction of the **needs of local customers**, whereas the global dimensions are responsible for **strategic orientation** and **distribution** of products as well as **research & development**.

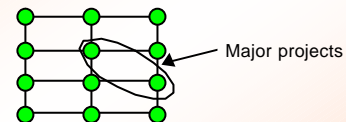
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Vgl. Barham/Heimer: ABB- der tanzende Riese, S. 304 f.

Changing or completing the matrix organization

Major projects

- Major projects as the third dimension in the matrix
- Increase in scope, range and complexity of major projects
- Major projects concern both the global and the regional dimension
- Development of permanent project structures



Financial services

- growing customer interest in complete solutions – from feasibility studies to financing
- frequent resource shortages for financing major projects in developing countries

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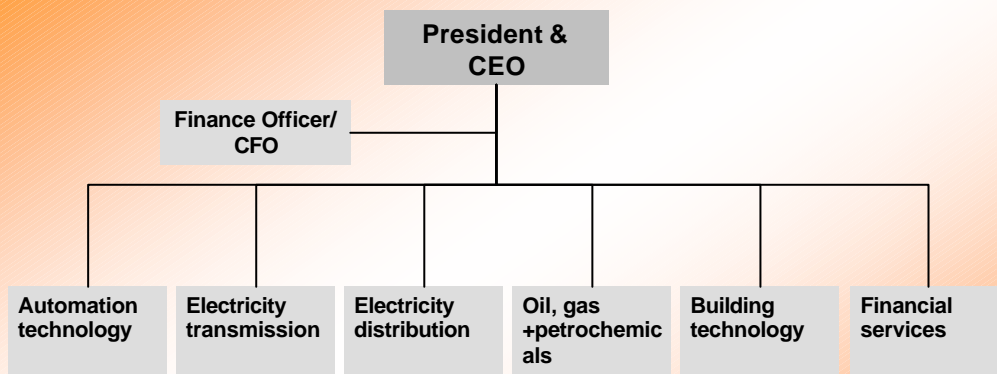
Reasons for changing over from a matrix organization to a sector-based organization

In response to needs, ABB turned the matrix organization into a sector-based organization.

- Simplification of management structure
- Reaction to new market trends / ongoing globalization
- Expectations regarding better project and works coordination
- Expansion coordination provided through the regional dimension
 - ⇒ Possibility of dissolving the regional organizations' structures
- Global aspects require highest priority (Group earnings before earnings on the national level)

In a matrix organization, there is the general problem of overlapping jurisdictions (provinces/sector) which causes financial problems. ABB is restructuring in an effort to settle such issues.

The sector-based organization 1998-2001 - Depiction



As of September 2000

Source: ABB

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Organization by sector 1998-2001 - Description

The Group consists of the President and CEO, the CFO and the heads of global company segments. The regional (continental) dimension was dissolved in order to enable the Group to focus more closely on exploiting the potential for applying **more global** processes and programs throughout the Group.

Several business areas have been established under each corporate area.

The organization at the national level has been retained in order to further expand the multilocal presence on local markets.

C Strategic orientation for the 21st century

- Goals for the 21st century and their impact on growth strategy
- Sub-strategy: Expand supply in the field of industrial IT
- Sub-strategy: Expand into new high-growth markets
- Sub-strategy: Introduce a customer-based organizational reorientation
- Further grounds for the customer-based organizational reorientation

The goals of the 21st century and their impact on the growth strategy

Material goals (up to 2005)

- Increase sales by 6% annually
- Increase operating profit by 15% annually
- Increase operating margin by 12%

Immaterial goals

- Customer-based orientation
- Commitment to sustainability
- Become a value-adder for customers, employees, shareholders and the company



Growth strategy to increase sales and earnings

Sub-strategies:

- Increase supply in field of industrial IT
- Expand into new high-growth markets
- Introduce customer-based organizational reorientation

Growth strategy to increase sales and earnings

Sub-strategy: Expand in field of industrial IT

Industrial IT refers to an electronic architecture encompassing the gamut of the company's technologies and services.

In conjunction with its growth strategy, ABB has introduced a program to expand use of Internet and information. This is being introduced on a Group-wide basis.

ABB incorporates industrial IT in all its own products in order to combine the entire product range and meet customers' needs.

The aim of this strategy is to link the business processes of ABB's manufacturers, suppliers and customers, thus making it possible to meet individual customers' needs.

Growth strategy to increase sales and earnings

Sub-strategy: Expand supply in field of industrial IT

„Some other renowned companies, such as SAP, have already got going in this field. As a result, ABB will have a hard time positioning itself successfully.“

Growth strategy to increase sales and earnings

Sub-strategy: Expand into new high-growth markets

ABB is trying to boost growth in the manufacturing and consumer goods branches, in telecommunications, logistics automation, liberalized public utilities markets and in alternative technologies.

In conjunction with this strategy, the business area New Ventures Ltd. was founded. This area is designed to identify and invest in new technologies, business innovations and new partnerships.

New Ventures Ltd. is intended to accelerate product and business development for ABB and ensure rapid product roll-out.

Growth strategy to increase sales and earnings

Sub-strategy: Expand into new high-growth markets

„ABB is trying to boost growth in new markets and thus increase capital yields. However, it is not yet clear how and with what tools ABB plans to conquer these new markets and fit them into the organization.“

Growth strategy to increase sales and earnings

Sub-strategy: Introduce customer-based organizational reorientation

With this strategy and the resultant fundamental restructuring of the entire group, ABB is trying to focus on the customer and organize itself entirely around customers and sales channels.

In the new organization, customers will no longer be serviced by various ABB product areas. Rather, each customer will be looked after by a single area.

This reorientation is designed to make ABB's products and services more transparent for customers. ABB's aim is to have customers enhance its ability to compete.

Growth strategy to increase sales and earnings

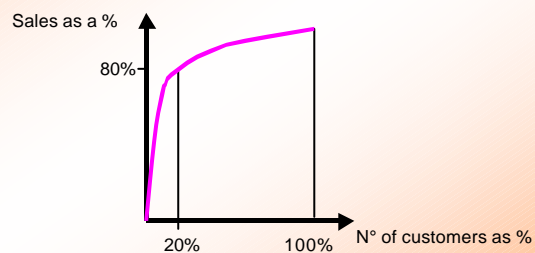
Sub-strategy: Introduce customer-based organization reorientation

„Today, all companies are striving to achieve a customer-based orientation, but few have geared themselves to customers as radically and completely as ABB.“

Further grounds for the customer-based organizational reorientation

200 customers account for 30% of total sales. Out of these 200 customers, 180 are serviced by a single business segment of the ABB Group. This shows clearly that as far as large customers are concerned, ABB still has great potential to expand business relations; consequently, it is focusing more closely on achieving this goal.

The background for this approach is the 20-80 rule „discovered“ by Centerman (whereby 20% of customer account for 80% of sales).

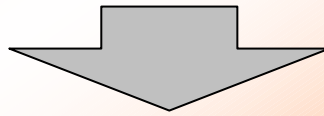


Further grounds for the customer-based organizational reorientation

The company wants to make it easier for customers to do business with ABB. Instead of 10 interlocutors, customers will only have to deal with one.

The aim of the strategic reorientation is to enhance ABB's relations with customers, thereby boosting growth.

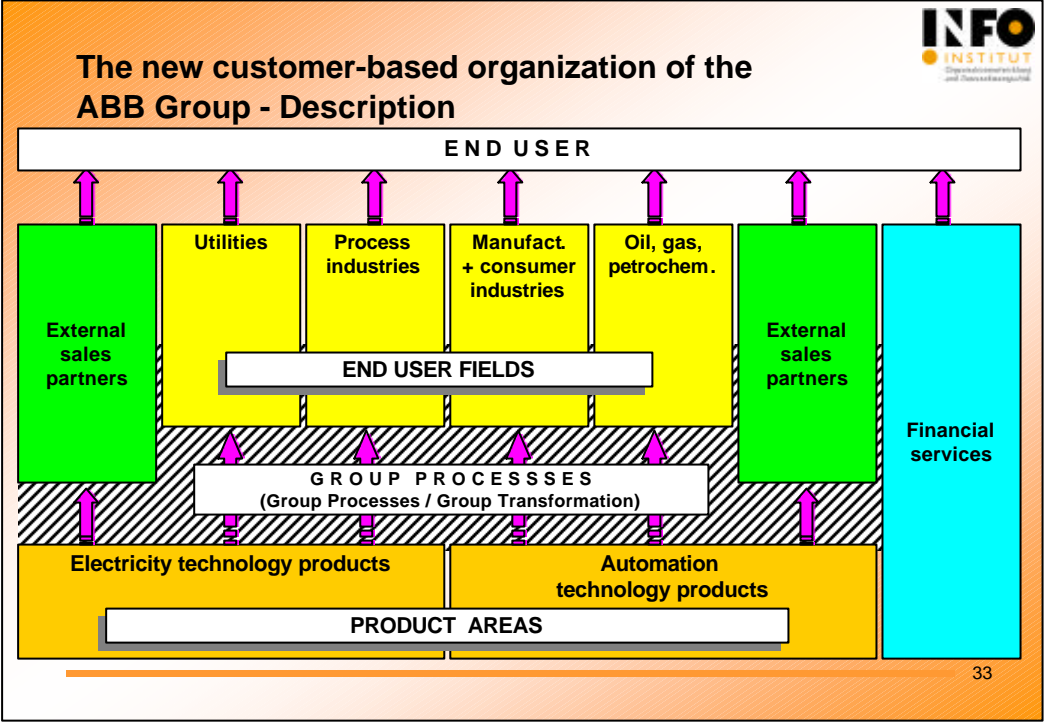
ABB is pursuing a concept that aims at enhancing customers' benefits by focusing on customers' needs.



Structure follows Strategy

D Organizational reorientation of the Group: The customer-based organization

- Description of the new organization
- Description of the new organization - Overview
- End buyer areas
- Channel partner areas (product areas)
- Financial services areas
- Group process areas
- Business areas
- Impact of the new organization at the local level
- Group functions



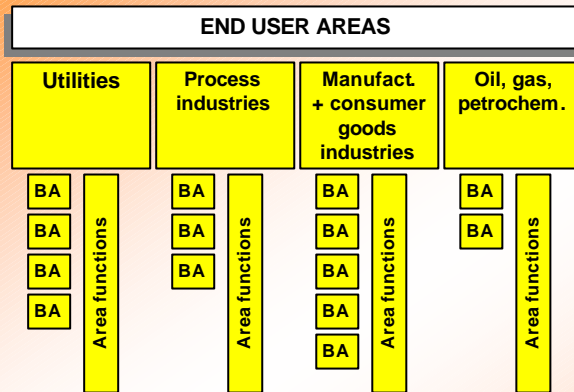
INFO
INSTITUT
Organisationsentwicklung
und Personalmanagement

Description of the new organization - Overview

The new organization of the ABB Group will consist of nine areas, seven customer areas and two areas for optimum performance (Group Transformation and Group Processes). The customer areas are subdivided into four areas geared directly towards end users, two Channel Partner areas (product areas) as well as the Financial Services field.

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The four end user areas



Group areas are sub-divided into business areas and area functions.

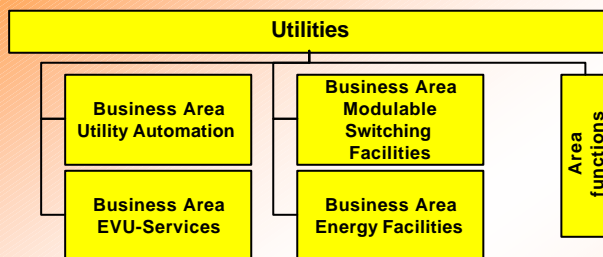
In general, area functions may be broken down as follows:

- Controlling
- Personnel
- Communication
- Business development
- Marketing
- Group Processes
- E-Business
- Technology
- etc.

Task:

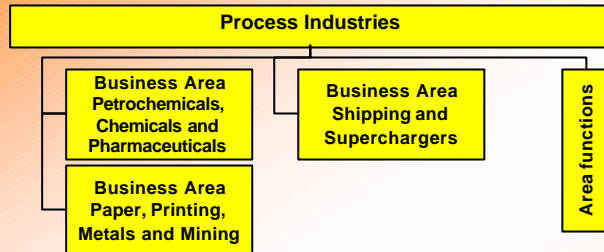
Service industrial customers quickly and easily with ABB products, solutions and services.

The four end user areas - Group area Utilities -



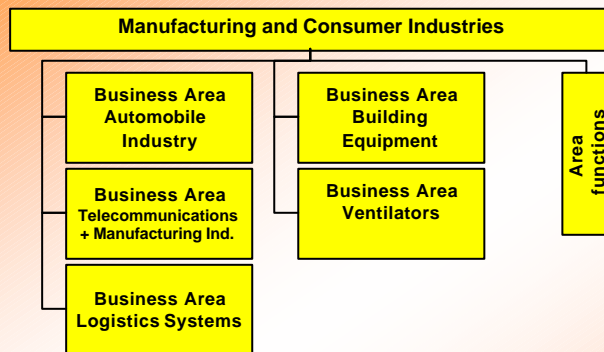
Responsible for electricity, gas and water utility companies

**The four end user areas
- Group area Process Industries -**



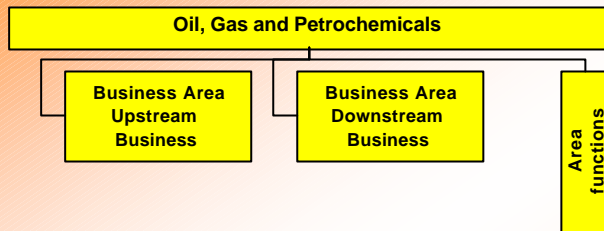
Responsible for customers in the branches of Pulp, Paper, Printing, Mining, Metals, Cement, Petrochemicals, Refineries, Pharmaceuticals and Shipping

**The four end user areas
- Group area Manufacturing and Consumer Industries -**



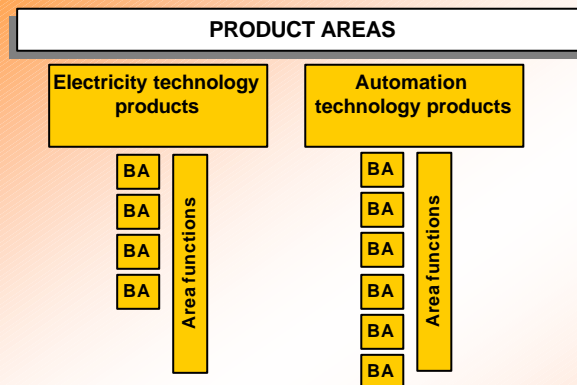
Responsible for customers in the Automobile and Consumer Goods Industry and the infrastructure area (Telecommunications, Airports, Post, Distribution and Building Technology)

The four end user areas - Group area Oil, Gas and Petrochemicals -



Responsible for delivery of products, systems and turnkey installations

The two product area (channel partner areas)



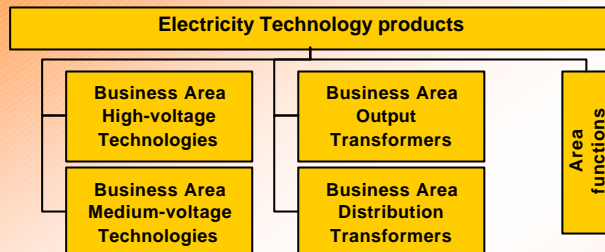
Group areas are sub-divided into Business Areas and Area Functions. In general, the area functions are sub-divided as follows:

- Controlling
- Personnel
- Communications
- Business Development
- Marketing
- Group Processes
- E-Business
- Technology
- etc.

Tasks:

- Service external sales partners like wholesalers, sales companies and distributors directly
- Service industrial customers from the four end user areas
- Develop and make all generic products inside ABB

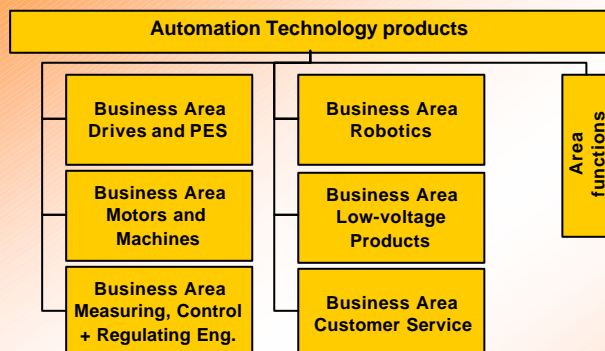
The two product areas - Product area Electricity Technology -



Range of power-related products:

Power generators, switching facilities, devices, cables and other products and technologies for high-voltage and medium-voltage applications

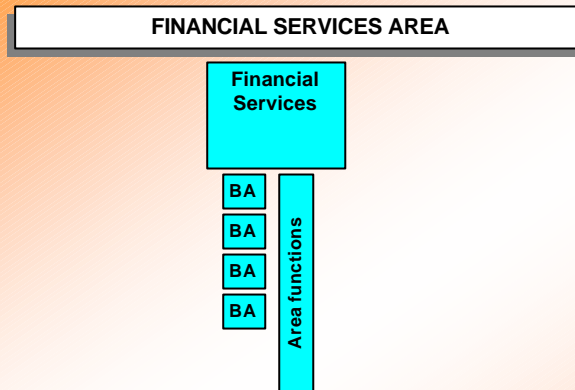
The two product areas - Product area Automation Technology -



Service range:

Complete spectrum of automation and control products, robotics, measuring products, drive electronics, motors, switching facilities and accessories as well as other low-voltage products

The Financial Services area



The Group area is broken down into business areas und area functions.

Area functions are sub-divided as follows:

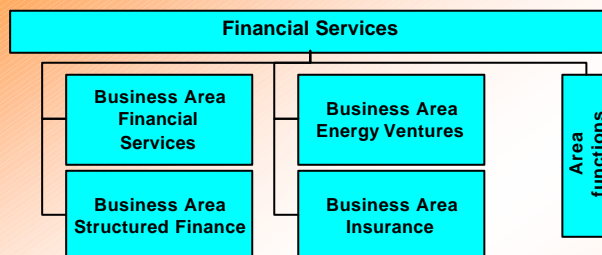
- Controlling
- Personnel
- Communication
- Business Development
- Group Processes
- IS
- Legal Affairs
- Credit Management

Task:

Offer a comprehensive range of financial services and support projects for all ABB fields and for outside customers.

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The Financial Services area - Group area Financial Services -

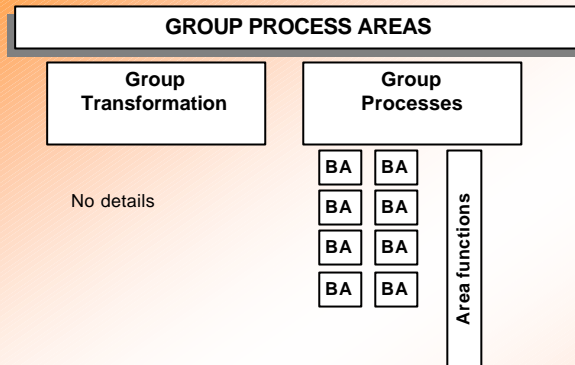


Responsible for:

- Insurance
- Structured Finance
- Development and management of private infrastructure projects
- Financial services for ABB companies

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The new Group Process - areas



The Group area Group Processes is subdivided into business areas and the following area functions:

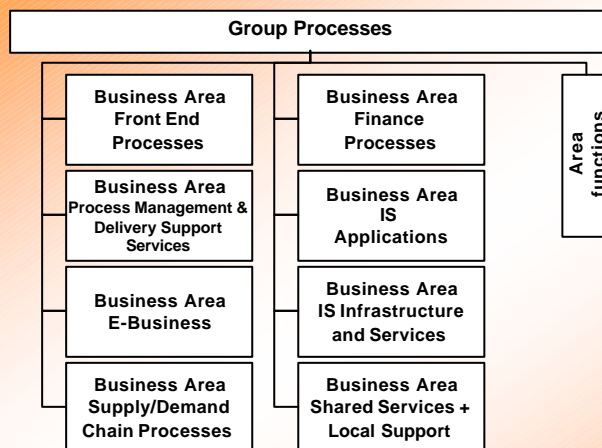
- Controlling
- Personnel
- Communication
- Group auditing
- Quality

Task:

Provide support with organization and performance optimization

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The new Group Process - area - Group area Group Processes -



- Implement the infrastructure throughout the Group in areas like quality control, supply chain management, E-Business and information systems
- Develop and introduce joint processes

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The new Group Processes - areas - Group area Group Transformation -

Group Transformation

No details on organizational structure

- Coordination of introduction worldwide of the new customer-based organizational structure
- Streamlining of the organizational structure on the basis of local and global targets set

Business Areas

Business Areas (BAs)

Each ABB Group area is composed of a host of business areas, each of which is responsible for its global business, including profit and loss accounting and balance sheets.

These business areas develop strategies for their business area units and the worldwide range of suppliers and services.

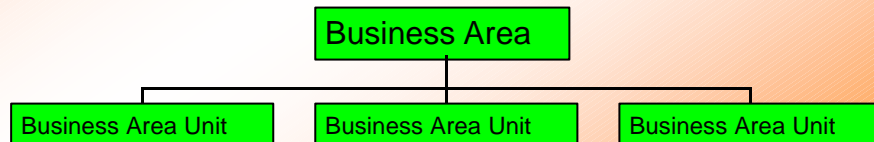
The managers of the business areas see to it that best practice solutions are applied throughout the Group above and beyond individual business areas and Group areas. They look after the practical implementation of general Group-related business procedures, shared services and possibilities for transfer of technologies within ABB.

Impact of the restructuring at the local level

Business Area Units (BAUs)

The business areas, which function on a global basis, are broken down into several business area units (BAUs). Each of these units operates in only a single country or region.

The business area units are the most important operating unit in local markets and bear full responsibility for their business, including profit and loss accounting and balance sheets. In this connection, they follow the strategic customer-based orientation.



Impact of the restructuring at the local level

Division Managers

The Group areas and business areas cannot deal with the everyday operating business throughout the world. This task is entrusted to the local Division Managers, who act as an extension of the Group areas and business areas.

Each Division Manager is responsible in the corresponding business area for profit and loss accounting and drawing up balance sheets for each individual business area unit. In addition, Division Managers see to it that the individual business area units meet local performance goals. Division Managers report thereupon to the appropriate Business Area Managers.

Impact of restructuring at the local level

Group Officer

ABB Group Officers have been appointed for each market segment. These persons are most often Division Managers who have been given additional responsibility or have proven management abilities.

Tasks of the Group Officers:

- External:**
- Represent ABB in public
 - Act as a spokesman for the Group
 - Represent ABB vis-à-vis public-sector institutions and semi-private facilities
 - Maintain contacts with trade unions

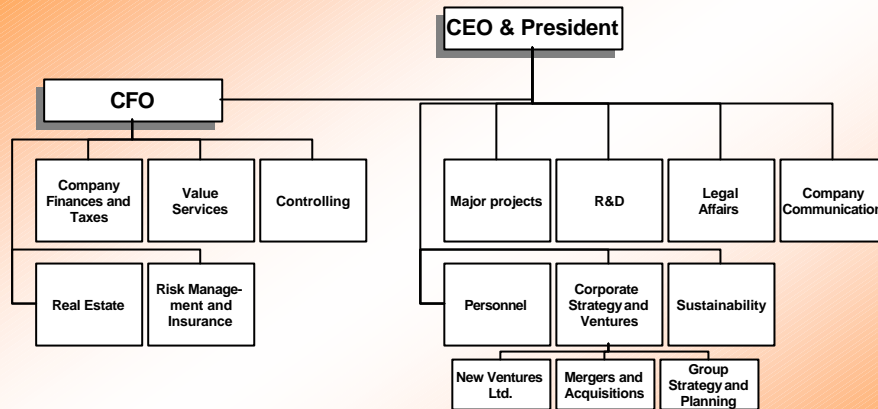
Impact of restructuring at the local level

Tasks of the Group Officers:

- Internal:**
- Overall coordination of Group initiatives
 - Overall coordination of company policy
 - Conscientious implementation of Group policy
 - Administrative director for local employees in Group functions
 - Support to Division Managers and Company Directors

The Group Officers report to the respective Group areas.

Group Functions



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Description of the organization of Group functions

The Group management is supported by a host of group functions.

A few Group functions (major projects, R&D, etc.) report directly to the President & CEO. Other Group functions, such as for example Controlling, report to the CFO.

The Group functions are responsible worldwide for their respective functions.

The corresponding functions in the Group areas, business areas (BAs) and business area units (BAUs) belong to their respective organizational structures. At the same time, they are incorporated into the global network of Group functions.

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E Evaluation of the impact of the restructuring on the company and on employees

Thesis 1:

„ABB wants to be a learning organization“.

In this connection, change becomes the norm, in order to ensure that the Group can adapt to constantly changing market conditions.

Accordingly, ABB has established the two new Group Process areas, Group Transformation and Group Processes. These areas are designed to facilitate skills management, accompany restructuring measures and guide and oversee corporate processes (process controlling).

➡ The danger with this approach is that the company will act erratically and get bogged down in constant cost-intensive and job-threatening restructuring.

Thesis 2:

„The customer-based orientation will become ABB’s organizational guideline “.

ABB is engaged in a radical market-based and customer-based orientation. Tied to this is a far-reaching restructuring process.

This approach is not new and has also been adopted by some of ABB’s rivals. However, ABB has pursued this strategy the most energetically and thoroughly of all.

Thesis 2 (cont.):

„The customer-based orientation has become ABB’s organizational guideline“.

One danger with this approach is that customers must agree to this concept and accept the ensuing strong dependence on ABB. Yet this trend is hard to predict. If customers are not prepared to rely on ABB, the strategy will fail.



New organizational interface and cooperation problems have emerged between product and sales areas, but their impact is not yet clear.

Thesis 3:

„Increasing shareholder value is essential for ABB“.

This can be seen from the following steps / goals:

- Repurchase and retirement of shares to the tune of some CHF 1 bn when share prices fell.
- Strict profit orientation. If appreciation is insufficient, restructuring measures are taken or the area is even sold off.
- Ambitious financial goals up to 2005 through stronger appreciation for shareholders.
- Decisions to enter new high-growth markets are taken solely on the basis of which markets offer high yields, not whether they fit into ABB's performance program.

Thesis 3 (cont.):

„Increasing shareholder value is essential for ABB“.



The danger with shareholder value orientation is that corporate policy decisions can be overly influenced by short-term profit prospects on the capital market. This approach jeopardizes the sustainable development of the company and neglects employees' contribution to the success of the company.

Thesis 4:

„Restructuring will have a significant impact on jobs“.

The statement that restructuring will have no effect on jobs is dubious. This is in all likelihood a tranquilizer for workers.

It will have both a quantitative and a qualitative impact on jobs.

- **The new organizational structure is designed to promote synergies, which lead to cost-cutting and job reductions.**

Thesis 4 (cont.):

„Restructuring will have a significant impact on jobs“.

- **There will also be changes in the structure and content of jobs, the scope of which is not yet clear.**
- **It may be assumed that the centralization of production is tied to comprehensive streamlining and concepts for increasing production.**
- **It is open to doubt whether growth alone will suffice to offset the negative effects on employment.**



There is a need to watch future development closely and critically, particularly with regard to its impact on jobs.

Thesis 5:

„The power of the head office will be considerably strengthened.“

- ABB is by and large giving its country-based structure up. Strategic decisions will be taken by the head office.
- Traditional locations will be called into question. Priority will be given to cost-oriented location policy.
- One company is to be set up per region (one or more countries).

➔ **Location consolidation will become a key negotiating area for employee representatives.**

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Thesis 6:

„The company's success depends on the workers“.

The point should be made that companies represent networks of human beings.

Changes can only be implemented with the employees, not against them.

Due consideration must be given to employees' interests.

More participation by the employees is needed.

➔ **ABB must take pains with the restructuring in order to provide timely, comprehensive explanations and take into consideration the wishes and needs of its workers.**

Time planning and information policy appear counterproductive.

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Thesis 7:

„ABB's radical restructuring poses considerable risks“.

- One of the main reasons for the organizational reorientation is corporate appreciation in the interests of the shareholders (better share prices).
- The focus on customers and markets is right in principle but entails considerable risks as far as organizational application is concerned.
- Strategic expectations, particularly with regard to growth markets, have not been defined precisely enough.
- The impact on the job situation is closely tied to reaching growth goals.

➔ **What is needed is a corporate policy which also includes the interests of employees.**