Why Do Employees Resist Change?

by Paul Strebel

Harvard Business Review

Reprint 96310

Organizations have personal compacts with their employees. Change efforts will fail unless those compacts are revised.

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Change management isn't working as it should. In a telling statistic, leading practitioners of radical corporate reengineering report that success rates in *Fortune* 1,000 companies are well below 50%; some say they are as low as 20%. The scenario is all too familiar. Company leaders talk about total quality management, downsizing, or customer value. Determined managers follow up with plans for process improvements in customer service, manufacturing, and supply chain management, and for new organizations to fit the new processes. From subordinates, management looks for enthusiasm, acceptance, and commitment. But it gets something less. Communication breaks down, implementation plans miss their mark, and results fall short. This happens often enough that we have to ask why, and how we can avoid these failures.

In the Change Program at IMD, in which executives tackle actual change problems from their own companies, I have worked with more than 200 managers from 32 countries, all of whom are struggling to respond to the shocks of rapidly evolving markets and technology. Although each company's particular circumstances account for some of the problems, the widespread difficulties have at least one common root: Managers and employees view change differently. Both groups know that vision and leadership drive successful change, but far too few leaders recognize the ways in which individuals commit to change to bring it about. Top-level managers see change as an opportunity to strengthen the business by aligning operations with strategy, to take on new professional challenges and risks, and to advance their careers. For many employees, however, including middle managers, change is neither sought after nor welcomed. It is disruptive and intrusive. It upsets the balance.

Senior managers consistently misjudge the effect of this gap on their relationships with subordinates and on the effort required to win acceptance of change. To close the gap, managers at all levels

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DRAWINGS BY MICHAEL WITTE

must learn to see things differently. They must put themselves in their employees' shoes to understand how change looks from that perspective and to examine the terms of the "personal compacts" between employees and the company.

What Is a Personal Compact?

Employees and organizations have reciprocal obligations and mutual commitments, both stated and implied, that define their relationship. Those agreements are what I call personal compacts, and corporate change initiatives, whether proactive or reactive, alter their terms. Unless managers define new terms and persuade employees to accept them, it is unrealistic for managers to expect employees fully to buy into changes that alter the status quo. As results all too often prove, disaffected employees will undermine their managers' credibility and well-designed plans. However, I have observed initiatives in which personal compacts were successfully revised to support major change – although the revision process was not necessarily explicit or deliberate. Moreover, I have identified three major dimensions shared by compacts in all companies. These common dimensions are *formal*, *psychological*, and *social*.

The *formal* dimension of a personal compact is the most familiar aspect of the relationship between employees and their employers. For an employee, it captures the basic tasks and performance requirements for a job as defined by company documents such as job descriptions, employment contracts, and performance agreements. Business or budget plans lay out expectations of financial performance. In return for the commitment to perform, managers convey the authority and resources each individual needs to do his or her job. What isn't explicitly committed to in writing is usually agreed to orally. From an employee's point of view, personal commitment to the organization comes from understanding the answers to the following series of questions:

□ What am I supposed to do for the organization?
□ What help will I get to do the job?
□ How and when will my performance be evaluated, and what form will the feedback take?
□ What will I be paid, and how will pay relate to my performance evaluation?

Companies may differ in their approach to answering those questions, but most have policies and procedures that provide direction and guidelines to managers and employees. Nevertheless, a clear, accurate formal compact does not ensure that employees will be satisfied with their jobs or that they will make the personal commitment managers expect. Unfortunately, many managers stop here when anticipating how change will affect employees. In fact, performance along this dimension is tightly linked to the other two.

The *psychological* dimension of a personal compact addresses aspects of the employment relationship that are mainly implicit. It incorporates the elements of mutual expectation and reciprocal commitment that arise from feelings like trust and dependence between employee and employer. Though often unwritten, the psychological dimension underpins an employee's personal commitment to individual and company objectives. Managers expect employees to be loyal and willing to do whatever it takes to get the job done, and they routinely make observations and assumptions about the kind of commitment their employees display. The terms of a job description rarely capture the importance of commitment, but employees' behavior reflects their awareness of it. Employees determine their commitment to the organization along the psychological dimension of their personal compact by asking:

☐ How hard will I really have to work?
☐ What recognition, financial reward, or other personal satisfaction will I get for my efforts?
☐ Are the rewards worth it?

Individuals formulate responses to those questions in large part by evaluating their relationship with their boss. Their loyalty and commitment is closely connected to their belief in their manager's willingness to recognize a job well done, and not just with more money. In the context of a major change program, a manager's sensitivity to this dimension of his or her relationship with subordinates is crucial to gaining commitment to new goals and performance standards.

Employees gauge an organization's culture through the *social* dimension of their personal compacts. They note what the company says about its values in its mission statement and observe the interplay between company practices and management's attitude toward them. Perceptions about the company's main goals are tested when employees evaluate the balance between financial and nonfinancial objectives, and when they determine whether management practices what it preaches. They translate those perceptions about values into beliefs about how the company really works–about the unspoken rules that apply to career development, promotions, decision making, conflict resolution, resource allocation, risk sharing, and layoffs. Along the social dimension, an employee tries to answer these specific questions:

☐ Are my values similar to those of others in the organization?
☐ What are the real rules that determine who gets what in this company?

Employees often misunderstand or, worse, ignore the implications of change for their individual commitments to the company.

Alignment between a company's statements and management's behavior is the key to creating a context that evokes employee commitment along the social dimension. It is often the dimension of a personal compact that is undermined most in a change initiative when conflicts arise and communication breaks down. Moreover, it is the dimension along which management's credibility, once lost, is most difficult to recover.

Unrevised Personal Compacts Block Change

Looking through the lens of unrevised personal compacts, employees often misunderstand or, worse, ignore the implications of change for their individual commitments. At Philips Electronics, based in the Netherlands, employees' failure to understand changing circumstances drove the organization to the brink of bankruptcy.

In the early 1980s, Philips's reputation for engineering excellence and financial strength was unparalleled, and it was a prestigious company to work for. The company – which pioneered the development of the audio cassette, the video recorder, and the compact disc – recruited the best electrical engineers in the Netherlands.

Like many multidomestic European companies, Philips had a matrix structure in which strong country managers ran the international sales and marketing subsidiaries like fiefdoms. Local product divisions were organized separately, and competition for resources among the different business units was vigorous. Central control was anathema, but the size and complexity of headquarters in Eindhoven grew nevertheless.

At the same time, competition was intensifying. Despite its continued excellence in engineering innovation, Philips was having trouble getting new products to market in a timely way. Margins were squeezed as manufacturing costs slipped out of line in comparison with Sony's and Panasonic's, and market share started falling even in the company's northern European heartland, where Sony was rapidly taking over the leading position. During the 1980s, two successive CEOs, Wisse Dekkers and Cor van der Klugt, tried to redirect the company. Each, in his time, hammered home the problems that needed correcting: the pace and quality of product development, slow time to market, and high manufacturing costs. The two men communicated vigorously, reorganized, and set up task forces on change. In Philips's 1989 annual report, van der Klugt reported that he had redefined management responsibilities to give product divisions greater freedom to respond to competitive and market pressures. Yet the projected improvements in costs and market share did not materialize quickly enough. At the end of van der Klugt's tenure, Philips was facing the biggest operating loss in the company's history.

Why couldn't either of those seasoned professional managers deal with the changes in the competitive environment? They understood the problems, articulated the plans, and undertook the initiatives that we associate with change leadership. Yet each failed in his attempt to redirect the company in time because widespread employee support was missing. In fact, personal compacts in place at the time actually blocked change because there was little alignment between senior managers' statements and the practice and attitude of lower-level managers and their subordinates.

But the problem could have been predicted. During Philips's prosperous years, a tradition of lifelong employment was part of the company culture. Job security came in exchange for loyalty to the company and to individual managers. Informal rules and personal relationships dominated formal systems for performance evaluations and career advancement. Managers' job descriptions and position in the hierarchy set limits on their responsibilities, and operating outside those boundaries was discouraged. Subordinates weren't encouraged any differently. People weren't trying to meet challenges facing the company or even looking for personal growth. Position and perceived power in the company network determined who got what. And because seniority so directly affected an employee's career growth and level of compensation, workers had no incentive to work harder than people just above them or to exceed their boss's minimum expectations for performance.

Moreover, even when costs were demonstrably out of line and operating margins were declining, Philips had no effective mechanism for holding managers accountable for failing to achieve financial targets. Budget-to-actual variances were attributed to events outside the control of unit managers. And because of the limitations of financial reporting systems and a culture that encouraged loyalty over performance, no one was able to challenge this mind-set effectively.

None of that changed under Dekkers or van der Klugt. Managers and subordinates were not forced to understand how the changes essential to turning the company around would require them to take a fundamentally different view of their obligations. Neither Dekkers nor van der Klugt drove the process far enough to alter employees' perceptions and bring about revised personal compacts.

By the time Jan Timmer took over at Philips in May 1990, the company faced a crisis. Net operating income in the first quarter of 1990 was 6 million guilders compared with 223 million guilders the previous year, and the net operating loss for the year was projected by analysts at 1.2 billion guilders. Timmer was an insider from the consumer electronics division, where he had successfully stopped mounting operating losses. But the scale of Timmer's challenge to turn the company around was matched by the pressure on him to deal quickly and effectively with the potentially crippling losses.

Orchestrating the Revision of Compacts

The revision of personal compacts occurs in three phases. First, leaders draw attention to the need to change and establish the context for revising compacts. Second, they initiate a process in which employees are able to revise and buy into new compact terms. Finally, they lock in commitments with new formal and informal rules. By approaching these phases systematically and creating explicit links between employees' commitments and the company's necessary change outcomes, managers dramatically improve the probability of hitting demanding targets. To lead Philips out of its crisis, Jan Timmer had to steer the company through those phases.

Shock Treatment at Philips. Although the competitive landscape around Philips had changed, the company and its employees had not. Employees' personal compacts favored maintaining the status quo, so resistance to change was imbedded in the culture. To achieve a turnaround, Timmer was going to have to reach deep into the organization and not only lead the initiative but also closely manage it. Getting people's attention was merely the first step. Persuading them to revise the terms of their personal compacts was a much bigger challenge.

Timmer's approach was a dramatic one; in fact, it was shock treatment. Shortly after becoming CEO in mid-1990, he invited the company's top 100 managers to an off-site retreat at Philips's training center in De Ruwenberg. There he explained the company's situation in stark terms: Its survival was in jeopardy. To reinforce the message, he handed out a hypothetical press release stating that Philips was bankrupt. It was up to the group in the room to bring the company back. Everyone would have to contribute. Operation Centurion had begun and, with it, the end of life in the company as all those in the room had known it.

From the start, Timmer's terms for change were tough and unambiguous, and those who didn't like them were encouraged to leave. In Operation Centurion, Timmer captured the mind-set he wanted and created the process he would use to focus managers' attention on the new goals. Extending the metaphor, Timmer offered his managers new personal contracts, which were like the assignments given officers by their superiors in the Roman army. In the ensuing Centurion Sessions, the terms of these new compacts would begin to take shape.

Drawing on benchmarking data on best-in-class productivity, Timmer called for an across-the-board 20% reduction in head count. He also stipulated that resources for essential new initiatives would have to come from within, despite deep cuts in expenses throughout the company. The meeting broke up to allow managers from each product division to come to grips with what they had been presented and to consider how they would respond. Before this initial session with Timmer ended, each of the division managers had orally agreed on targets for reductions in head count and operating costs. In subsequent discussions, those plans became formal budget agreements between Timmer and his Centurion managers: Each plan was signed by the presenting manager to signify his personal commitment to the terms. Performance would be measured against achievement of the targets and linked to individual bonuses and career opportunities. Personal commitments, binding agreements, and standards for performance would form the basis for the new personal compacts at Philips.

Personal commitments, binding agreements, and performance standards formed the basis for new compacts at Philips.

The De Ruwenberg meeting has become part of Philips's company lore. It underscored the urgency of the company's situation and set the stage for the compact-revision process that followed. In the days and weeks thereafter, Timmer maintained a high profile as he spread the message of Operation Centurion and the significance of the new personal compacts. Regular budget reviews gave him opportunities to reinforce his message about personal commitments to current goals. Ongoing meetings with Philips's top 100 managers were the forum for discussing long-term plans.

But Timmer knew that he could not accomplish his goals unless managers and subordinates throughout the company were also committed to change. Employees' concerns about this corporate initiative had to be addressed. Therefore, as the objectives for Operation Centurion came into focus at senior levels, plans to extend its reach emerged. Senior managers negotiated Centurion contracts with their business unit directors, and that group then took the initiative to the product-group and country-management teams. At workshops and training programs, employees at all levels talked about the consequences and objectives of change. Timmer reached out via company "town meetings" to answer questions and talk about the future. His approach made people feel included, and his direct style encouraged them to support him. It soon became clear that employees were listening and the company was changing.

By the end of 1991, the workforce had been cut by 22% – 68,000 people. Those who didn't meet the terms of their contracts were gone, including Timmer's successor in the consumer electronics division. Even at the top, the culture of patronage, social networking, and lifetime employment in exchange for loyalty became things of the past. When no one inside qualified, Timmer hired top managers from outside. As a result, by mid-1994, only 4 members of the original senior-management committee remained, and only 5 of the 14 were Dutch. A company survey in 1994 confirmed that employees had responded favorably to the changes and the new atmosphere: Morale and feelings of empowerment had soared. After fluctuating during the early nineties, Philips's financial performance recovered strongly in 1993 and 1994; operating income rose from (4.3%) of sales in 1990 to 6.2% in 1994 and the share price moved from 20.30 guilders to 51.40 guilders.

Of course, not every case is like Philips's. You do not need a crisis to revise personal compacts and get greater commitment. The contrasting example of Eisai, a Japanese health-care company, shows how far the understanding of personal compacts can take you when change is proactive.

Creating the Context for Change at Eisai. A small, family-owned company, Eisai was one of the original manufacturers of vitamin E, and it maintained a strong research commitment to natural pharmaceuticals. Over the years, it developed drugs for the treatment of cardiovascular, respiratory, and neurological diseases; by the end of the 1980s, such drugs comprised 60% of the company's sales. The company experienced steady, modest growth during that decade, and in 1989 sales reached 197 billion yen and profits approached 13 billion yen. But there were signs of potential trouble ahead. Eisai was spending a hefty 13% of sales on R&D – compared with an average of 8.5% in other companies – and between 1982 and 1991, only 12 of the company's 295 patent applications in Japan had been approved by regulatory authorities. Although it was the sixth-largest Japanese pharmaceutical company, Eisai was a relatively small player in an industry in which global competition was increasing while growth in the domestic market was slowing down.

In 1988, Haruo Naito took over as CEO and president from his father. Before that, he had chaired Eisai's five-year strategic planning committee. During that time, he had become convinced that the company's focus on the discovery and manufacture of pharmaceuticals was not sustainable for long-term growth against large, global competitors. In the absence of either a real or a perceived crisis, however, and in the face of deeply felt cultural traditions, changing direction at Eisai would require unusual leadership.

In the tradition of Japanese family companies, Eisai had few formal rules of employment. Among the 4,000 employees, lifelong employment was the norm and career advancement and authority were based on seniority. Groups made decisions because failure by an individual would mean loss of face. And employees were not encouraged to step outside established roles to take on assignments beyond the scope and structure of the existing organization. Individuals were loyal both to their managers and to group norms, so they did not seek personal recognition or accomplishment. And because other Japanese companies operated in similar ways, there was no external competitive pressure to be different. To accomplish strategic transformation, Naito would have to create a compelling context for change and an inducement for employees to try something new – without disrupting the entire organization.

Several years after becoming CEO, Naito formulated a radical new vision for Eisai that he called Human Health Care (HHC). It extended the company's focus from manufacturing drug treatments for specific illnesses to improving the overall quality of life, especially for elderly sick people. To accomplish that mission, Eisai would have to develop a wide array of new products and services. And that, in turn, would require broad employee involvement and commitment. Although Naito did not explicitly characterize Eisai employees' commitments as personal compacts, he clearly understood that individuals would have to accept new terms and performance standards that he could not simply mandate. He had to encourage entrepreneurial and innovative activity and create an environment in which such efforts would be accepted and rewarded. Indeed, for his vision of HHC to become reality, Naito knew that employees themselves would ultimately have to take the lead in designing the formal terms of their personal compacts.

To accomplish strategic transformation, Eisai's CEO had to create a context for change.

In 1989, Naito announced his new strategic vision and initiated a training program for 103 "innovation managers" who were to become the agents for change in the company. The training program consisted of seminars on trends in health care and concepts of organizational change. It also gave employees a firsthand look at patient-care practices by having them spend several days in both traditional and nontraditional health-care facilities where they performed actual nursing activities. At the end of the program, Naito charged the innovation managers with turning the insights from their experiences into proposals for new products and services. Each proposal was brought before Naito and Eisai's executive management to gain high-level corporate support and, as important to Naito, to secure indi-

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vidual managers' public commitment to the achievement of their HHC projects' goals.

This training program and the subsequent HHC product-development efforts set the stage for the creation of a dramatically different set of personal compacts at Eisai. The innovation managers operated outside both the normal organizational structure and the company's traditional cultural boundaries. They designed new products and programs, put together multidisciplinary teams to develop their ideas, and drew new participants of their own choice into the change initiative. They reported to Naito, and he personally evaluated their performance and the contribution of individual projects to the HHC vision. As a result, junior people had a chance to break out of the seniority system and to shape the development of the company's new strategy as well as the terms of their own personal compacts. These were opportunities previously unheard of in Eisai or in other Japanese pharmaceutical companies.

The visibility and senior-management support for the first projects generated widespread enthusiasm for participating in the new movement at Eisai. The cross-functional teams established employee ownership of the HHC vision, which rapidly took on a life of its own. Soon there were proposals for 130 additional HHC projects involving 900 people, and by the end of 1993, 73 projects were under way. New services offered by the company included a 24-hour telephone line to assist people taking Eisai medications. Another brought consumers and medical professionals together at conferences to discuss health care needs. New attention to consumer preferences led to improvements in the packaging and delivery of medications.

Although personal compacts at Eisai are still dominated by traditional cultural norms, Naito's ability to lead his employees through a process in which they examined and revised the old terms enabled them to accomplish major strategic change. The effects of the new strategy are visible in Eisai's product mix. By the end of 1993, the company had moved from sixth to fifth place in the Japanese domestic pharmaceutical industry, and today Eisai's customers and competitors view the company as a leader in health care.

Culture and Personal Compacts

The extent to which personal compacts are written or oral varies with the organization's culture and, in many cases, the company's home country. In general, the more homogeneous the culture, the more implicit the formal dimension of personal compacts is likely to be. The same is true along psychological and social dimensions in homogeneous environments, because employers and employees share similar perspectives and expectations. For example, in Japan and continental Europe, the legal systems for settling disputes are based on a civil code documented in statutes. Those systems carry over to the underlying principles in legal contracts and to the assumptions that support employer-employee relationships. Indeed, when a compact is laid out too explicitly in Japan, it is taken as an affront and a sign that one party doesn't understand how things work.

Personal compacts will need to be more explicit as companies become truly multinational.

By contrast, in countries like the United States, personal compacts tend to be supported by formal systems to ensure objectivity in the standards for performance evaluation. And more structure exists to support employee-employer relations, both in the form of company policies and procedures and in the role that human resource departments play. Similarly, as companies become more truly multinational, the importance of making the terms of personal compacts explicit increases, as does the requirement to support them formally. In my experience, this is true whether companies are implementing change to meet the needs of a culturally diverse workforce or to respond to market opportunities and threats.

Regardless of the cultural context, unless the revision of personal compacts is treated as integral to the change process, companies will not accomplish their goals. In one way or another, leaders must take charge of the process and address each dimension. Jan Timmer and Haruo Naito revised their employees' personal compacts using different approaches and for different reasons. But each drove successful corporate change by redefining his employees' commitment to new goals in terms that everyone could understand and act on. Without such leadership, employees will remain skeptical of the vision for change and distrustful of management, and management will likewise be frustrated and stymied by employees' resistance.

Reprint 96310