Escaping the silo effect

A new book argues that internal divisions pose very real risks for businesses – including private equity.

Words *Hannah Langworth*

Gillian Tett, US managing editor of the *Financial Times*, is telling a cautionary tale, using Japanese conglomerate Sony as an example. She asks the audience how many of them had Sony Walkmans as children or teenagers. She was glued to hers and "couldn't imagine a world without it" when she was growing up. "But," Tett continues, "the reality is today that you probably don't even know where your once prized Sony Walkman is." Whatever happened to the Sony Walkman, she asks. Why was it so triumphant, only to then almost completely disappear?

One answer might be the rise of the iPod, whose digital technology totally eclipsed the Walkman's analogue capabilities. But that is not the whole story. Sony, she says, had everything needed to develop its own market-leading digital music player: hardware expertise, software expertise, top-level product design capabilities and an outstanding music catalogue. The problem was that it could not bring them all together.

Sony was riven with political, cultural and physical divisions between the people working in these departments. For this reason, Tett explains in her recently published book *The Silo Effect* (see page 10), Sony fell victim to the negative effects that too rigid divisions, and the barriers between them, can have on an organisation's ability to identify risks and innovate, which ultimately meant Sony failed to develop an effective competitor to the iPod. This is what she describes as the silo effect.

The lessons to be learnt from Sony and the other case studies used in her book are applicable to organisations across the business world, says Tett. She is speaking at Second Home, an innovative office building in Shoreditch that describes itself as "a place where entrepreneurs and creative businesses come together, in the pursuit of great work". With its plentiful co-working spaces, promotion of collaborative projects between different teams, and communal lunches, Second Home has clearly bought into the idea that getting rid of silos can bring business success.

It appears, however, that private equity is moving in the opposite direction. In recent decades, an industry that was once known as a niche, free-wheeling and flexible source of capital has grown massively. This has brought with it increasing institutionalisation and formalisation of functions and roles. So how can private equity escape the silo effect?

ONLY CONNECT

With returns declining and competition more intense than ever, the rise of specialists has been a favoured path for private equity firms in recent years. "There is tremendous temptation for private equity firms to become more focused because you want to give specialists a chance to use their expertise," says Tett. However, doing so presents "silo effect" risks.

"Specialising runs out of steam when you can't connect the dots on patterns of risk or opportunity, which is really what private equity is all about," says Andros Payne, founder and managing partner of organisational performance consultancy Humatica. While Tett does not use an example from the private equity world in her book (though she says Steven Schwarzman has apparently tried to put similar ideas into practice at Blackstone), she does discuss how siloed specialist teams at both the Bank of England and UBS failed to spot risks in the run-up to the financial crisis, alongside the story of Sony's failure to fulfil its creative potential, despite its experts, at the dawn of the digital music era.

But, as Payne's comments and these examples suggest, the real problem with specialisation is not the presence of specialists itself but a lack of communication between them. Tett acknowledges that "we need to have specialists in the twenty-first century world to create order in the face of extreme complexity and an ever-swelling deluge of data". One of her key examples of a "silo-busting" organisation is hedge fund Blue Mountain, which prospered not by replacing its various asset class specialists with generalists, but by encouraging them to share information and work together. "Dividing people into small groups with specialist expertise can be productive, but effort is needed to make sure they communicate, collaborate and co-operate," agrees Payne.

As an example of these principles working in practice in private equity, look to Inflexion, one of the most successful firms in the European mid-market of recent years by just about any given yardstick. Inflexion is made up, managing partner Simon Turner told *Real Deals* last year, of "diverse and highly skilled people...highly respected in their various sector areas" and "thrives on interaction and sharing ideas and information".

5 WAYS TO ESCAPE SILOS

GILLIAN TETT'S ADVICE FOR BUSINESSES THAT WANT TO AVOID THE DAMAGING EFFECTS OF SILOS.

1 MAKE TEAM BOUNDARIES FLUID

"It pays to keep the boundaries of teams flexible and fluid," says Tett. Good ways to do this include rotational programmes and developing spaces and projects where people in different working groups can meet and work together.

2 REWARD COLLECTIVE PERFORMANCE

"When employees are rewarded purely on the basis of how their group performs, and when groups are competing with each other internally, they are unlikely to collaborate – no matter how many expensive off-sites an institution holds, or open plan offices it creates," she says.

3 SHARE INFORMATION EFFECTIVELY

It's important to not just enable information to flow freely around an organisation, but to help everyone understand that information. What Tett terms "cultural translators" come in handy here – "people who are able to move between specialist silos and explain to those sitting inside one department what is happening elsewhere".

4 CONSIDER NEW CLASSIFICATION SYSTEMS

"It pays if people can periodically try to reimagine the taxonomies they use to reorganise the world, or even experiment with alternatives." As an example, she points out that manufacturing companies often organise themselves in terms of how products were made in past decades rather than today.

5 USE TECHNOLOGY

"Computers can be programmed to rearrange information in different ways and test out different ways of organising data," she says, making them extremely useful tools for escaping silos and changing organisations for the better.

SHARED REWARDS

For Wol Kolade, managing partner of Livingbridge, increased specialisation and other types of formalisation is inevitable as the industry continues to mature and grow. "It's possible to make money as a private equity firm without being institutionalised, but it's less likely these days," he says. He adds that "to grow your business, your people have to understand what they're doing", as opposed to using what he terms "the old gunslinger model". This is because this old way of working, without scale and the "structures and systems" that come with it, struggles to deliver the consistent returns over time that LPs demand, especially in today's market characterised by far fewer easy wins when it comes to return generation and stiffer competition for targets. "Private equity is a different industry now to when people started out way back when. Consistently creating value is quite a challenge for just one or two people," he says.

At Livingbridge, the potential silo effects greater institutionalisation can pose are countered by fostering a strong, collegiate culture. Approaching remuneration and deal credit in this fashion has, Kolade says, been part of the Livingbridge way of doing things "from day one". The alternative, sometimes termed the "eat what you kill" model, is "possible to do, but harder and harder," he says. "People say to me that firms are just collections of individuals, but actually the centre, if it's doing its job right, can add value to what people are doing."

The importance of this collective accountability and reward is also stressed by Tett, who in her analysis of UBS in *The Silo Effect* shows the damage caused by an eat what you kill system at the investment bank that encouraged certain traders to maximise their own paychecks regardless of the effect of their activities on the rest of the organisation. In contrast, she also shows how rewarding overall organisational performance had significant positive effects at Blue Mountain and a large healthcare organisation.

NEW UTOPIAS

Private equity firms should remember, if they head down the path of greater institutionalisation, to make sure their specialists, and employees in general, communicate and collaborate, and to incentivise them in a way that encourages them to do so.

It is important to bear in mind, however, that while Tett maintains that small and newer organisations are as much at risk from the damaging effects of silos as corporate behemoths, private equity's youth and the entrepreneurial spirit still found when it operates at its best can work to its advantage.

Though they are becoming more formalised, even the largest private equity firms are still smaller, more flexible and more agile than many corporates or financial institutions, notes David Evans, managing director at consulting firm Alvarez & Marsal. "I have faith in the private equity model," he says, "that it is able to evolve faster than many of its counterparts" and thus see off silos to tackle risks and respond to opportunities.

Back at Second Home, where Tett gives her talk, there are plans to open a new floor, a proportion of which will be flooded to create a water garden around which workers can mingle, and to morph the business model to include an "experiential bookstore", where readers can browse books arranged by themes such as "utopia" as they sip a drink or listen to a DJ play. While no private equity firm is likely to take such dramatic steps with its way of working – or indeed its interior design – in the interests of escaping silos, some of the best performing investors have shown themselves capable of identifying the issues silos can cause and responding creatively to them. The rest would do well to do the same. ●