Richard L. Daft, Ph.D., is the Brownlee O. Currey, Jr., Professor of Management in the Owen Graduate School of Management at Vanderbilt University. Professor Daft specializes in the study of organization theory and leadership. Professor Daft is a Fellow of the Academy of Management and has served on the editorial boards of Academy of Management Journal, Administrative Science Quarterly, and Journal of Management Education. He was the Associate Editor-in-Chief of Organization Science and served for three years as associate editor of Administrative Science Quarterly.

Professor Daft has authored or co-authored twelve books, including Management (Cengage/South-Western, 2010), The Leadership Experience (Cengage/South-Western, 2008), and What to Study: Generating and Developing Research Questions (Sage, 1982). He also published Fusion Leadership: Unlocking the Subtle Forces That Change People and Organizations (Berrett-Koehler, 2000, with Robert Lengel). He has authored dozens of scholarly articles, papers, and chapters. His work has been published in Administrative Science Quarterly, Academy of Management Journal, Academy of Management Review, Organizational Dynamics, Strategic Management Journal, Journal of Management, Accounting Organizations and Society, Management Science, MIS Quarterly, California Management Review, and Organizational Behavior Teaching Review. Professor Daft has been awarded several government research grants to pursue studies of organization design, organizational innovation and change, strategy implementation, and organizational information processing.

Professor Daft is also an active teacher and consultant. He has taught management, leadership, organizational change, organizational theory, and organizational behavior. He has been involved in management development and consulting for many companies and government organizations, including Allstate Insurance, American Banking Association, Bell Canada, Bridgestone, National Transportation Research Board, NL Baroid, Nortel, TVA, Pratt & Whitney, State Farm Insurance, Tenneco, Tennessee Emergency Pediatric Services, the United States Air Force, the United States Army, J. C. Bradford & Co., Central Parking System, USAA, United Methodist Church, Entergy Sales and Service, Bristol-Myers Squibb, First American National Bank, and the Vanderbilt University Medical Center.
This page intentionally left blank
<table>
<thead>
<tr>
<th>Part 1: Introduction to Organizations</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Organizations and Organization Theory</td>
<td>2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 2: Organizational Purpose and Structural Design</th>
<th>55</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Strategy, Organization Design, and Effectiveness</td>
<td>56</td>
</tr>
<tr>
<td>3. Fundamentals of Organization Structure</td>
<td>88</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 3: Open System Design Elements</th>
<th>137</th>
</tr>
</thead>
<tbody>
<tr>
<td>4. The External Environment</td>
<td>138</td>
</tr>
<tr>
<td>5. Interorganizational Relationships</td>
<td>174</td>
</tr>
<tr>
<td>6. Designing Organizations for the International Environment</td>
<td>208</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 4: Internal Design Elements</th>
<th>251</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. Manufacturing and Service Technologies</td>
<td>252</td>
</tr>
<tr>
<td>8. Using IT for Coordination and Control</td>
<td>294</td>
</tr>
<tr>
<td>9. Organization Size, Life Cycle, and Decline</td>
<td>332</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 5: Managing Dynamic Processes</th>
<th>371</th>
</tr>
</thead>
<tbody>
<tr>
<td>10. Organizational Culture and Ethical Values</td>
<td>372</td>
</tr>
<tr>
<td>11. Innovation and Change</td>
<td>410</td>
</tr>
<tr>
<td>12. Decision-Making Processes</td>
<td>450</td>
</tr>
<tr>
<td>13. Conflict, Power, and Politics</td>
<td>371</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Integrative Cases</th>
<th>529</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0 Rondell Data Corporation</td>
<td>531</td>
</tr>
<tr>
<td>2.0 It Isn’t So Simple: Infrastructure Change at Royce Consulting</td>
<td>539</td>
</tr>
<tr>
<td>3.0 Custom Chip, Inc.</td>
<td>544</td>
</tr>
<tr>
<td>4.0 “Ramrod” Stockwell</td>
<td>551</td>
</tr>
<tr>
<td>5.0 W. L. Gore &amp; Associates, Inc. Entering 1998</td>
<td>554</td>
</tr>
<tr>
<td>6.0 Dick Spencer</td>
<td>569</td>
</tr>
<tr>
<td>7.0 The Plaza Inn</td>
<td>574</td>
</tr>
<tr>
<td>8.0 Dowling Flexible Metals</td>
<td>578</td>
</tr>
<tr>
<td>9.0 The Donor Services Department</td>
<td>582</td>
</tr>
<tr>
<td>10.0 Empire Plastics</td>
<td>586</td>
</tr>
</tbody>
</table>
Brief Contents

11.1 Littleton Manufacturing (A) 589
11.2 Littleton Manufacturing (B) 601
12.0 Hartland Memorial Hospital (A): An Inbox Exercise 603

Glossary 613
Name Index 623
Corporate Name Index 634
Subject Index 639
Part 1: Introduction to Organizations

Chapter 1: Organizations and Organization Theory 2

Organization Theory in Action
- Topics, 6 • Current Challenges, 7 • Purpose of This Chapter, 10

What is an Organization?
- Definition, 11 • From Multinationals to Nonprofits, 11 • Importance of Organizations, 12

BookMark 1.0: The Company: A Short History of a Revolutionary Idea 13

Dimensions of Organization Design
- Structural Dimensions, 15 • Contextual Dimensions, 17

In Practice: Ternary Software Inc. 18
- Performance and Effectiveness Outcomes, 20

In Practice: Federal Bureau of Investigation 22
- The Evolution of Organization Theory and Design
- Historical Perspectives, 23

How Do You Fit the Design? Evolution of Style
- Don’t Forget the Environment, 26

Organizational Configuration
- Mintzberg’s Organizational Types, 26 • Contemporary Design Ideas, 30

Efficient Performance versus the Learning Organization
- From Vertical to Horizontal Structure, 31 • From Routine Tasks to Empowered Roles, 31 • From Formal Control Systems to Shared Information, 33 • From Competitive to Collaborative Strategy, 33 • From Rigid to Adaptive Culture, 33

In Practice: Cementos Mexicanos 34

Framework for the Book 35
- Levels of Analysis, 35 • Plan of the Book, 37 • Plan of Each Chapter, 37

Design Essentials 39

Chapter 1 Workbook: Measuring Dimensions of Organizations 40

Case for Analysis: Perdue Farms Inc.: Responding to 21st Century Challenges 41

Part 2: Organizational Purpose and Structural Design 55

Chapter 2: Strategy, Organization Design, and Effectiveness 56

Purpose of This Chapter, 57

The Role of Strategic Direction in Organization Design 58

Organizational Purpose
- Strategic Intent, 60

In Practice: Walgreens 61
- Operative Goals, 62 • The Importance of Goals, 64
## Contents

A Framework for Selecting Strategy and Design  | 65

*Porter’s Competitive Forces and Strategies, 65*

### How Do You Fit the Design? Your Strategy/Performance Strength  | 66

**In Practice:** Apple  | 68

*Miles and Snow’s Strategy Typology, 70*

**BookMark 2.0:** The Strategy Paradox: Why Committing to Success Leads to Failure (And What to Do About It)  | 71

*How Strategies Affect Organization Design, 72 * Other Factors Affecting Organization Design, 73*

Assessing Organizational Effectiveness  | 74

Traditional Effectiveness Approaches  | 75

*Goal Indicators, 75 * Resource-based Indicators, 76 * Internal Process Indicators, 77*

The Balanced Scorecard Approach to Effectiveness  | 77

Design Essentials  | 79

**Chapter 2 Workbook:** Identifying Company Strategies and Effectiveness Criteria  | 81

**Case for Analysis:** The University Art Museum  | 81

**Case for Analysis:** Airstar Inc.  | 84

**Chapter 2 Workshop:** The Balanced Scorecard and Organizational Effectiveness  | 85

**Chapter 3: Fundamentals of Organization Structure**  | 88

*Purpose of This Chapter, 90*

Organization Structure  | 90

**BookMark 3.0:** The Future of Management  | 92

Information-Sharing Perspective on Structure  | 92

**In Practice:** Textron Inc.  | 94

*Vertical Information Sharing, 94 * Horizontal Information Sharing, 95*

**How Do You Fit the Design?** The Pleasure/Pain of Working on a Team  | 100

Organization Design Alternatives  | 101

*Required Work Activities, 101 * Reporting Relationships, 102 * Departmental Grouping Options, 102*

Functional, Divisional, and Geographic Designs  | 104

*Functional Structure, 104*

**In Practice:** Blue Bell Creameries, Inc.  | 105

*Functional Structure with Horizontal Linkages, 105 * Divisional Structure, 106 * Geographic Structure, 109*

Matrix Structure  | 110

*Conditions for the Matrix, 110 * Strengths and Weaknesses, 112*

**In Practice:** Englander Steel  | 113

Horizontal Structure  | 115

*Characteristics, 116*

**In Practice:** GE Salisbury  | 117

*Strengths and Weaknesses, 118*

Virtual Networks and Outsourcing  | 119

*How the Structure Works, 120*

**In Practice:** TiVo Inc.  | 120

*Strengths and Weaknesses, 121*

Hybrid Structure  | 122

Applications of Structural Design  | 123

*Structural Alignment, 125 * Symptoms of Structural Deficiency, 125*

Design Essentials  | 127

**Chapter 3 Workbook:** You and Organization Structure  | 128

**Case for Analysis:** C & C Grocery Stores Inc.  | 129

**Case for Analysis:** Aquarius Advertising Agency  | 132

---

### Part 3: Open System Design Elements

**Chapter 4: The External Environment**  | 138

*Purpose of This Chapter, 140*

The Organization’s Environment  | 140

*Task Environment, 140 * General Environment, 142 * International Environment, 143*

**In Practice:** Univision  | 144

The Changing Environment  | 144

*Simple–Complex Dimension, 145 * Stable–Unstable Dimension, 146*

**BookMark 4.0:** Confronting Reality: Doing What Matters to Get Things Right  | 146

*Framework, 147*
Adapting to a Changing Environment
Adding Positions and Departments, 149

In Practice: Wal-Mart
Building Relationships, 150
Differentiation and Integration, 152
Organic versus Mechanistic Management Processes, 153
Planning, Forecasting, and Responsiveness, 155

How Do You Fit the Design? Mind and Environment
Framework for Responses to Environmental Change
Dependence on External Resources
Influencing External Resources
Establishing Formal Relationships, 159

In Practice: AT&T
Influencing Key Sectors, 162

In Practice: eBay
Organization–Environment Integrative Framework, 164

Design Essentials

Chapter 4 Workbook: Organizations You Rely On
Case for Analysis: The Paradoxical Twins: Acme and Omega Electronics

Chapter 5: Interorganizational Relationships
Purpose of This Chapter, 176
Organizational Ecosystems
Is Competition Dead?, 177

In Practice: Sony Corporation and Samsung Electronics Company
The Changing Role of Management, 179
Interorganizational Framework, 180

Resource Dependence
Supply Chain Relationships, 181
Power Implications, 182

In Practice: Amazon.com
Collaborative Networks
Why Collaboration?, 183

How Do You Fit the Design? Personal Networking
From Adversaries to Partners, 185

BookMark 5.0: Managing Strategic Relationships: The Key to Business Success
Organizational Form and Niche, 189
Process of Ecological Change, 189

Chapter 6: Designing Organizations for the International Environment
Purpose of This Chapter, 210
Entering the Global Arena
Motivations for Global Expansion, 211

BookMark 6.0: The World Is Flat: A Brief History of the Twenty-First Century
Stages of International Development, 214
Global Expansion through International Strategic Alliances, 215

Designing Structure to Fit Global Strategy
Model for Global versus Local Opportunities, 216
Global Division Structure, 218
Global Geographic Division Structure, 221

In Practice: Colgate-Palmolive Company
Global Matrix Structure, 223

In Practice: Asea Brown Boveri Ltd. (ABB)
Building Global Capabilities
The Global Organizational Challenge, 226

In Practice: IBM
Global Coordination Mechanisms, 230
Cultural Differences in Coordination and Control
National Value Systems, 233

How Do You Fit the Design? Are You Ready to Fill an International Role?
Three National Approaches to Coordination and Control, 235

The Transnational Model of Organization
Design Essentials

Chapter 6 Workbook: Made in the U.S.A.? Case for Analysis: TopDog Software
Case for Analysis: Rhodes Industries
Chapter 6 Workshop: Comparing Cultures
Part 4: Internal Design Elements

Chapter 7: Manufacturing and Service Technologies

Purpose of This Chapter, 255
Core Organization Manufacturing Technology 256
Manufacturing Firms, 256 * Strategy, Technology, and Performance, 258
In Practice: Printronix 259
BookMark 7.0: Inviting Disaster: Lessons from the Edge of Technology 260
Contemporary Applications 261
Flexible Manufacturing Systems, 261 * Lean Manufacturing, 263
In Practice: Matsushita Electric Industrial Company 263
Performance and Structural Implications, 264
Core Organization Service Technology 266
Service Firms, 267
How Do You Fit the Design? Manufacturing vs. Service 269
Designing the Service Organization, 270
In Practice: Home Depot Inc. 271
Non-Core Departmental Technology 272
Variety, 272 * Analyzability, 272 * Framework, 273
Department Design 275
Workflow Interdependence Among Departments 277
Types, 277
In Practice: Great Ormond Street Hospital for Children 279
Structural Priority, 280 * Structural Implications, 280
In Practice: Athletic Teams 281
Impact of Technology on Job Design 282
Job Design, 282 * Sociotechnical Systems, 283
Design Essentials 285
Chapter 7 Workbook: Bistro Technology 287
Case for Analysis: Acetate Department 288

Chapter 8: Using IT for Coordination and Control

Purpose of This Chapter, 296
Information Technology Evolution 296
Information for Decision Making and Control 298
Organizational Decision-Making Systems, 298 * Feedback Control Model, 299 * Management Control Systems, 300
How Do You Fit the Design? Is Goal-Setting Your Style? 301
In Practice: eBay 302
The Level and Focus of Control Systems 305
Organization Level: The Balanced Scorecard, 305
BookMark 8.0: Five Key Principles of Corporate Performance Management 306
Department Level: Behavior versus Outcome Control, 308
In Practice: Best Buy 310
Adding Strategic Value: Strengthening Internal Coordination 311
Intranets, 311 * Web 2.0 Tools, 312 * Knowledge Management, 312
In Practice: ExactTarget Inc. 314
Enterprise Resource Planning, 314
Adding Strategic Value: Strengthening External Coordination 315
The Integrated Enterprise, 315
In Practice: Corrugated Supplies 316
Customer Relationships, 318
E-Business Organization Design 319
In-House Division, 319 * Spin-Off, 319 * Strategic Partnership, 320
It Impact on Organization Design 321
Design Essentials 323
Chapter 8 Workbook: Balanced Scorecard Exercise 325
Case for Analysis: Century Medical 327
Case for Analysis: Product X 328

Chapter 9: Organization Size, Life Cycle, and Decline

Purpose of This Chapter, 334
Organization Size: Is Bigger Better? 334
Pressures for Growth, 334
BookMark 9.0: Small Giants: Companies That Choose to Be Great Instead of Big 335
Dilemmas of Large Size, 336
How Do You Fit the Design? What Size Organization for You? 338
### Part 5: Managing Dynamic Processes

#### Chapter 10: Organizational Culture and Ethical Values

**Purpose of This Chapter, 374**

Organizational Culture

- **What Is Culture?**, 374
- Emergence and Purpose of Culture, 376

**BookMark 10.0:** Good to Great: Why Some Companies Make the Leap . . . And Others Don’t

Interpreting Culture, 377

Organization Design and Culture

- The Adaptability Culture, 382

**In Practice:** Google

- The Mission Culture, 383
- The Clan Culture, 384
- The Bureaucratic Culture, 384

**How Do You Fit the Design?** Corporate Culture Preference

- Culture Strength and Organizational Subcultures, 385

**In Practice:** Pitney Bowes Credit Corporation

Organizational Culture, Learning, and Performance

**In Practice:** Genentech

Ethical Values and Social Responsibility

- Sources of Individual Ethical Principles, 389
- Managerial Ethics, 390
- Corporate Social Responsibility, 392
- Does It Pay to Be Good?, 392

How Leaders Shape Culture and Ethics

- Values-Based Leadership, 394
- Formal Structure and Systems, 395

**Chapter 10 Workbook:** Shop ’til You Drop: Corporate Culture in the Retail World

**Case for Analysis:** Implementing Change at National Industrial Products

**Case for Analysis:** Does This Milksheke Taste Funny?

**Chapter 10 Workshop:** The Power of Ethics

---

#### Chapter 11: Innovation and Change

**Purpose of This Chapter, 411**

The Strategic Role of Change

- Innovate or Perish, 412
- Strategic Types of Change, 413

Elements for Successful Change

Technology Change

**How Do You Fit the Design?** Are You Innovative?

- The Ambidextrous Approach, 418
- Techniques for Encouraging Technology Change, 419

**BookMark 11.0:** Innovation: The Five Disciplines for Creating What Customers Want

New Products and Services

- New Product Success Rate, 423
- Reasons for New Product Success, 424

**In Practice:** Threadless

Achieving Competitive Advantage:

- The Need for Speed, 427
## Integrative Cases

<table>
<thead>
<tr>
<th>Case</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0</td>
<td>Rondell Data Corporation</td>
<td>531</td>
</tr>
<tr>
<td>2.0</td>
<td>It Isn’t So Simple: Infrastructure Change at Royce Consulting</td>
<td>539</td>
</tr>
<tr>
<td>3.0</td>
<td>Custom Chip, Inc.</td>
<td>544</td>
</tr>
<tr>
<td>4.0</td>
<td>“Ramrod” Stockwell</td>
<td>551</td>
</tr>
<tr>
<td>5.0</td>
<td>W. L. Gore &amp; Associates, Inc. Entering 1998</td>
<td>554</td>
</tr>
<tr>
<td>6.0</td>
<td>Dick Spencer</td>
<td>569</td>
</tr>
<tr>
<td>7.0</td>
<td>The Plaza Inn</td>
<td>574</td>
</tr>
<tr>
<td>8.0</td>
<td>Dowling Flexible Metals</td>
<td>578</td>
</tr>
<tr>
<td>9.0</td>
<td>The Donor Services Department</td>
<td>582</td>
</tr>
<tr>
<td>10.0</td>
<td>Empire Plastics</td>
<td>586</td>
</tr>
<tr>
<td>11.1</td>
<td>Littleton Manufacturing (A)</td>
<td>589</td>
</tr>
<tr>
<td>11.2</td>
<td>Littleton Manufacturing (B)</td>
<td>601</td>
</tr>
<tr>
<td>12.0</td>
<td>Hartland Memorial Hospital (A): An Inbox Exercise</td>
<td>603</td>
</tr>
</tbody>
</table>

Glossary: 613  
Name Index: 623  
Corporate Name Index: 634  
Subject Index: 639
This page intentionally left blank
My vision for the Tenth Edition of Organization Theory and Design is to integrate contemporary problems about organization design with classic ideas and theories in a way that is engaging and enjoyable for students. Significant changes in this edition include two new features—“Managing by Design Questions” and “How Do You Fit the Design?”—along with updates to every chapter that incorporate the most recent ideas, new case examples, new book reviews, and new end-of-book integrative cases. The research and theories in the field of organization studies are rich and insightful and will help students and managers understand their organizational world and solve real-life problems. My mission is to combine the concepts and models from organizational theory with changing events in the real world to provide the most up-to-date view of organization design available.

DISTINGUISHING FEATURES OF THE TENTH EDITION

Many students in a typical organization theory course do not have extensive work experience, especially at the middle and upper levels, where organization theory is most applicable. Moreover, word from the field is that many students today often do not read the chapter opening examples or boxed examples, preferring instead to focus on chapter content. To engage students in the world of organizations, the Tenth Edition adds two significant features. First, “Managing by Design Questions” start each chapter to engage students in thinking and expressing their beliefs and opinions about organization design concepts. Second, a new in-chapter feature, “How Do You Fit the Design?” engages students in how their personal style and approach will fit into an organization. Other student experiential activities that engage students in applying chapter concepts are new “Book Marks,” new “In Practice” examples, and new integrative cases for student analysis. The total set of features substantially expands and improves the book’s content and accessibility. These multiple pedagogical devices are used to enhance student involvement in text materials.

**How Do You Fit the Design?** The “How Do You Fit the Design?” feature presents a short questionnaire in each chapter about the student’s own style and preferences to quickly provide feedback about how they fit particular organizations or situations. For example, questionnaire topics include: “What Size Organization for You?” “Are You Ready to Fill an International Role?” “The Pleasure/Pain of Working on a Team,” “How Innovative Are You?” and “How Do You Make
Important Decisions?” These short feedback questionnaires connect the student’s personal preferences to chapter material to heighten interest and show relevance of the concepts.

**Managing by Design Questions** Each chapter now opens with three short opinion questions that engage students in clarifying their thoughts about upcoming material and concepts. These questions are based on the idea that when students express their opinions first, they are more open to and interested in receiving material relevant to the questions. Example questions, which ask students to agree or disagree, include:

*The primary role of managers in business organizations is to achieve maximum efficiency.*
*Managers should use the most objective, rational process possible when making a decision.*
*If management practices and coordination techniques work well for a company in its home country, they probably will be successful in the company’s international divisions as well.*
*A certain amount of conflict is good for an organization.*

As a follow-up to the three “Managing by Design” questions, each chapter contains three “Assess Your Answer” inserts that allow students to compare their original opinions with the “correct” or most appropriate answers based on chapter concepts. Students learn whether their mental models and beliefs about organizations align with the world of organizations.

**Book Marks** “Book Marks,” a unique feature of this text, are book reviews that reflect current issues of concern for managers working in real-life organizations. These reviews describe the varied ways companies are dealing with the challenges of today’s changing environment. New “Book Marks” in the Tenth Edition include *Five Key Principles of Corporate Performance Management; The World Is Flat: A Brief History of the Twenty-First Century; The Strategy Paradox: Why Committing to Success Leads to Failure (And What to Do About It); The Future of Management; Small Giants: Companies That Choose to Be Great Instead of Big;* and *Innovation: The Five Disciplines for Creating What Customers Want.*

**In Practice** This edition contains many new “In Practice” examples that illustrate theoretical concepts in organizational settings. Many examples are international, and all are based on real organizations. New “In Practice” cases used within chapters include Samsung Electronics, eBay, the Salvation Army, Axiom Global, Univision, Google, Semco, AT&T, the World Bank, Threadless, Carilion Health System, Apple, Matsushita Electric, Herman Miller, and Great Ormand Street Hospital for Children.

**Manager’s Briefcase** Located in the chapter margins, this feature tells students how to use concepts to analyze cases and manage organizations.

**Text Exhibits** Frequent exhibits are used to help students visualize organizational relationships, and the artwork has been redone to communicate concepts more clearly.
**Design Essentials**  This summary and interpretation section tells students how the essential chapter points are important in the broader context of organization theory.

**Case for Analysis**  These cases are tailored to chapter concepts and provide a vehicle for student analysis and discussion.

**Integrative Cases**  The integrative cases at the end of the text have been expanded and positioned to encourage student discussion and involvement. The new cases include Rondell Data Corporation; The Plaza Inn; and Hartland Memorial Hospital (A): An Inbox Exercise. Previous cases that have been retained include Royce Consulting; Custom Chip Inc.; W. L. Gore & Associates; Empire Plastics; and Littleton Manufacturing.

**NEW CONCEPTS**

Many concepts have been added or expanded in this edition. New material has been added on organizational configuration and Mintzberg’s organization forms; strategic intent, core competence and competitive advantage; Porter’s competitive forces and strategies; using the balanced scorecard to measure effectiveness; using strategy maps; the trend toward outsourcing; supply chain management; intelligence teams; collaborative versus operations management roles; applying Web 2.0 tools for internal and external coordination; behavior versus outcome control; executive dashboards; interpreting and shaping culture through organization structures, control systems, and power systems; corporate social responsibility; values-based leadership; collaborative teams for innovation; prospect theory; groupthink; overcoming cognitive biases in decision making; and the power of empowerment. Many ideas are aimed at helping students learn to design organizations for an environment characterized by uncertainty; a renewed emphasis on innovation; public demands for stronger ethics and social responsibility; and the need for a speedy response to change, crises, or shifting customer expectations. In addition, coping with the complexity of today’s global environment is explored thoroughly in Chapter 6.

**CHAPTER ORGANIZATION**

Each chapter is highly focused and is organized into a logical framework. Many organization theory textbooks treat material in sequential fashion, such as “Here’s View A, Here’s View B, Here’s View C,” and so on. *Organization Theory and Design* shows how they apply in organizations. Moreover, each chapter sticks to the essential point. Students are not introduced to extraneous material or confusing methodological squabbles that occur among organizational researchers. The body of research in most areas points to a major trend, which is reported here. Several chapters develop a framework that organizes major ideas into an overall scheme.

This book has been extensively tested on students. Feedback from students and faculty members has been used in the revision. The combination of organization theory concepts, book reviews, examples of leading organizations, self-insight questionnaires, case illustrations, experiential exercises, and other teaching devices is designed to meet student learning needs, and students have responded favorably.
SUPPLEMENTS


PowerPoint Lecture Presentation  Available on the Instructor’s Resource CD-ROM and the Web site, the PowerPoint Lecture Presentation enables instructors to customize their own multimedia classroom presentations. Prepared in conjunction with the text and instructor’s resource guide, the package contains approximately 150 slides. It includes figures and tables from the text, as well as outside materials to supplement chapter concepts. Material is organized by chapter and can be modified or expanded for individual classroom use. PowerPoint presentations are also easily printed to create customized transparency masters.

ExamView  A computerized version of the Test Bank is available on the Instructor’s Resource CD-ROM. ExamView contains all of the questions in the printed test bank. This program is easy-to-use test creation software. Instructors can add or edit questions, instructions, and answers and can select questions (randomly or numerically) by previewing them on the screen. Instructors can also create and administer quizzes online, whether over the Internet, a local area network (LAN), or a wide area network (WAN).

Instructor’s Resource CD-ROM (ISBN: 0-324-59905-6)  Key instructor ancillaries (Instructor’s Manual, Test Bank, ExamView, and PowerPoint slides) are provided on CD-ROM, giving instructors the ultimate tool for customizing lectures and presentations.

WebTutor™ Toolbox  WebTutor is an interactive, Web-based student supplement on WebCT and/or BlackBoard that harnesses the power of the Internet to deliver innovative learning aids that actively engage students. The instructor can incorporate WebTutor as an integral part of the course, or the students can use it on their own as a study guide.

Web Site (www.cengage.com/management/daft)  The Daft Web site is a comprehensive, resource-rich location for both instructors and students to find pertinent information. The Instructor Resources section contains an Instructor’s Manual download, Test Bank download, and PowerPoint download.

Premium Web Site (www.cengage.com/login)  This new optional Premium Web site features text-specific resources that enhance student learning by bringing concepts to life. Dynamic interactive learning tools include online quizzes, flashcards, PowerPoint slides, learning games, and more.

Video/DVD (ISBN: 0-324-59906-4)  This DVD includes video segments related to organization design concepts. They’re designed to visually reinforce key concepts.

Tailored to the table of contents in Daft’s *Organization Theory and Design*, Tenth Edition, the core purpose of *Experiential Exercises in Organization Theory and Design* is to provide courses in organizational theory with a set of classroom exercises that will help students better understand and internalize the basic principles of the course. The chapters of the book cover the most basic and widely covered concepts in the field. Each chapter focuses on a central topic, such as organizational power, production technology, or organizational culture, and provides all necessary materials to fully participate in three different exercises. Some exercises are intended to be completed by individuals, others in groups, and still others can be used either way. The exercises range from instrumentation-based and assessment questionnaires to actual creative production activities.

**ACKNOWLEDGMENTS**

Textbook writing is a team enterprise. The Tenth Edition has integrated ideas and hard work from many people to whom I am grateful. Reviewers and focus group participants made an especially important contribution. They praised many features, were critical of things that didn’t work well, and offered valuable suggestions.

David Ackerman  
*University of Alaska, Southeast*

Michael Bourke  
*Houston Baptist University*

Suzanne Clinton  
*Cameron University*

Jo Anne Duffy  
*Sam Houston State University*

Cheryl Duvall  
*Mercer University*

Patricia Feltes  
*Missouri State University*

Robert Girling  
*Sonoma State University*

John A. Gould  
*University of Maryland*

Ralph Hanke  
*Pennsylvania State University*

Bruce J. Hanson  
*Pepperdine University*

Guiseppe Labianca  
*Tulane University*

Jane Lemaster  
*University of Texas–Pan American*

Steven Maranville  
*University of Saint Thomas*

Rick Martinez  
*Baylor University*

Janet Near  
*Indiana University*

Julie Newcomer  
*Texas Woman’s University*

Asbjorn Osland  
*George Fox University*

Laynie Pizzolatto  
*Nicholls State University*

Samantha Rice  
*Abilene Christian University*

Richard Saaverda  
*University of Michigan*

W. Robert Sampson  
*University of Wisconsin, Eau Claire*

Amy Sevier  
*University of Southern Mississippi*

W. Scott Sherman  
*Pepperdine University*

Thomas Terrell  
*Coppin State College*

Jack Tucci  
*Southeastern Louisiana University*

Judith White  
*Santa Clara University*

Jan Zahrly  
*University of North Dakota*
Among my professional colleagues, I am grateful to my friends and colleagues at Vanderbilt’s Owen School—Bruce Barry, Ray Friedman, Neta Moye, Rich Oliver, David Owens, Ranga Ramanujam, and Bart Victor—for their intellectual stimulation and feedback. I also owe a special debt to Dean Jim Bradford and Associate Deans Bill Christie and Dawn Iocabucci for providing the time and resources for me to stay current on the organization design literature and develop the revisions for the text.

I want to extend special thanks to my editorial associate, Pat Lane. She skillfully wrote materials on a variety of topics and special features, found resources, and did an outstanding job with the copyedited manuscript and page proofs. Pat’s personal enthusiasm and care for the content of this text enabled the Tenth Edition to continue its high level of excellence.

The team at South-Western also deserves special mention. Joe Sabatino did a great job of designing the project and offering ideas for improvement. Erin Guendelsberger and Emma Guttler were superb to work with during their respective turns as Developmental Editor, keeping the people and project on schedule while solving problems creatively and quickly. Colleen Farmer, Senior Content Project Manager, provided superb project coordination and used her creativity and management skills to facilitate the book’s on-time completion. Clint Kernen, Marketing Manager, provided additional support, creativity, and valuable market expertise.

Finally, I want to acknowledge the love and contributions of my wife, Dorothy Marcic. Dorothy has been very supportive of my textbook projects and has created an environment in which we can grow together. She helped the book take a giant step forward with her creation of the Workbook and Workshop student exercises. I also want to acknowledge the love and support of my daughters, Danielle, Amy, Roxanne, Solange, and Elizabeth, who make my life special during our precious time together.

Richard L. Daft

Nashville, Tennessee

March 2009
Chapter 1

Organizations and Organization Theory

Organization Theory in Action
Topics • Current Challenges • Purpose of This Chapter

What Is an Organization?
Definition • From Multinationals to Nonprofits • Importance of Organizations

Dimensions of Organization Design
Structural Dimensions • Contextual Dimensions • Performance and Effectiveness Outcomes

The Evolution of Organization Theory and Design
Historical Perspectives • Don’t Forget the Environment

Organizational Configuration
Mintzberg’s Organizational Types • Contemporary Design Ideas

Efficient Performance versus the Learning Organization
From Vertical to Horizontal Structure • From Routine Tasks to Empowered Roles • From Formal Control Systems to Shared Information • From Competitive to Collaborative Strategy • From Rigid to Adaptive Culture

Framework for the Book
Levels of Analysis • Plan of the Book • Plan of Each Chapter

Design Essentials
Before reading this chapter, please circle your opinion below for each of the following statements:

1. An organization can be understood primarily by understanding the people who make it up.

   1  2  3  4  5
   STRONGLY AGREE STRONGLY DISAGREE

2. The primary role of managers in business organizations is to achieve maximum efficiency.

   1  2  3  4  5
   STRONGLY AGREE STRONGLY DISAGREE

3. A CEO’s top priority is to make sure the organization is designed correctly.

   1  2  3  4  5
   STRONGLY AGREE STRONGLY DISAGREE

A LOOK INSIDE

XEROX CORPORATION

On the eve of the twenty-first century, Xerox Corporation seemed on top of the world, with fast-rising earnings, a soaring stock price, and a new line of computerized copier-printers that were technologically superior to rival products. Less than two years later, many considered Xerox a has-been, destined to fade into history. Consider the following events:

- Sales and earnings plummeted as rivals caught up with Xerox’s high-end digital machines, offering comparable products at lower prices.
- Xerox’s losses for the opening year of the twenty-first century totaled $384 million, and the company continued to bleed red ink. Debt mounted to $18 billion.
- The stock fell from a high of $64 to less than $4, amid fears that the company would file for federal bankruptcy protection. Over an 18-month period, Xerox lost $38 billion in shareholder wealth.
- Twenty-two thousand Xerox workers lost their jobs, further weakening the morale and loyalty of remaining employees. Major customers were alienated, too, by a restructuring that threw salespeople into unfamiliar territories and tied billing up in knots, leading to mass confusion and billing errors.
- The company was fined a whopping $10 million by the Securities and Exchange Commission (SEC) for accounting irregularities and alleged accounting fraud.

What went wrong at Xerox? The company’s deterioration is a classic story of organizational decline. Although Xerox appeared to fall almost overnight, the organization’s problems were connected to a series of organizational blunders over a period of many years.

BACKGROUND

Xerox was founded in 1906 as the Haloid Company, a photographic supply house that developed the world’s first xerographic copier, introduced in 1959. Without a doubt, the 914 copier was a money-making machine. By the time it was retired in the early 1970s, the 914 was the best-selling industrial product of all time, and the new name of the company, Xerox, was listed in the dictionary as a synonym for photocopying.
Joseph C. Wilson, Haloid’s longtime chairman and president, created a positive, people-oriented culture continued by his successor, David Kearns, who steered Xerox until 1990. The Xerox culture and its dedicated employees (sometimes called “Xeroids”) were the envy of the corporate world. In addition to values of fairness and respect, Xerox’s culture emphasized risk taking and employee involvement. Wilson wrote the following for early recruiting materials: “We seek people who are willing to accept risk, willing to try new ideas and have ideas of their own…who are not afraid to change what they are doing from one day to the next, and from one year to the next…” Xerox continued to use these words in its recruiting efforts, but the culture the words epitomize had eroded.

“BUROX” TAKES HOLD
Like many profitable organizations, Xerox became a victim of its own success. Leaders no doubt knew that the company needed to move beyond copiers to sustain its growth, but they found it difficult to look beyond the 70 percent gross profit margins of the 914 copier.

Xerox’s Palo Alto Research Center (PARC), established in 1970, became known around the world for innovation—many of the most revolutionary technologies in the computer industry, including the personal computer, graphical user interface, Ethernet, and laser printer, were invented at PARC. But the copier bureaucracy, or Burox as it came to be known, blinded Xerox leaders to the enormous potential of these innovations. While Xerox was plodding along selling copy machines, younger, smaller, and hungrier companies were developing PARC technologies into tremendous money-making products and services.

The dangers of Burox became dramatically clear when the company’s xerography patents began expiring. Suddenly, Japanese rivals such as Canon and Ricoh were selling copiers at the cost it took Xerox to make them. Market share declined from 95 percent to 13 percent by 1982. And with no new products to make up the difference, the company had to fight hard to cut costs and reclaim market share by committing to Japanese-style techniques and total quality management. Through the strength of his leadership, CEO Kearns was able to rally the troops and rejuvenate the company by 1990. However, he also set Xerox on a path to future disaster. Seeing a need to diversify, Kearns moved the company into insurance and financial services on a large scale. When he turned leadership over to Paul Allaire in 1990, Xerox’s balance sheet was crippled by billions of dollars in insurance liabilities.

ENTERING THE DIGITAL AGE
Allaire wisely began a methodical, step-by-step plan for extricating Xerox from the insurance and financial services business. At the same time, he initiated a mixed strategy of cost cutting and new-product introductions to get the stodgy company moving again. Xerox had success with a line of digital presses and new high-speed digital copiers, but it fumbled again by underestimating the threat of the inkjet printer. By the time Xerox introduced its own line of desktop printers, the game was already over.

Desktop printers, combined with increasing use of the Internet and e-mail, cut heavily into Xerox’s sales of copiers. People didn’t need to make as many photocopies, but there was a huge increase in the number of documents being created and shared. Rebranding Xerox as “The Document Company,” Allaire pushed into the digital era, hoping to remake Xerox in the image of the rejuvenated IBM, offering not just “boxes (machines)” but complete document management solutions.

As part of that strategy, Allaire picked Richard Thoman, who was then serving as Louis Gerstner’s right-hand man at IBM, as his successor. Thoman came to Xerox as president, chief operating officer, and eventually CEO, amid high hopes that the company could regain the stature of its glory years. Only 13 months later, as revenues and the stock price continued to slide, he was fired by Allaire, who had remained as Xerox chairman.

PLAYING POLITICS
Allaire and Thoman blamed each other for the failure to successfully implement the digital strategy. Outsiders, however, believe the failure had much more to do with Xerox’s dysfunctional culture. The culture was already slow to adapt, and some say that under Allaire it became almost totally paralyzed by politics. Thoman was brought in to shake things up, but when he tried, the old guard rebelled. A management struggle developed, with the outsider Thoman and a few allies on one side lined up against Allaire and his group of insiders who were accustomed to doing things the Xeroid way. Recognized for his knowledge, business experience, and intensity, Thoman was also considered to be somewhat haughty
and unapproachable. He was never able to exert substantial influence with key managers and employees, nor to gain the support of board members, who continued to rally behind Allaire.

The failed CEO succession illustrates the massive challenge of reinventing a century-old company. By the time Thoman arrived, Xerox had been going through various rounds of restructuring, cost cutting, rejuvenating, and reinventing for nearly two decades, but little had really changed. Many believe Thoman tried to do too much too soon. He saw the urgency for change but was unable to convey that urgency to others within the company and inspire them to take the difficult journey real transformation requires.

Others doubted that anyone could fix Xerox, because the culture had become too dysfunctional and politicized. “There was always an in-crowd and an out-crowd,” says one former executive. “They change the branches, but when you look closely, the same old monkeys are sitting in the trees.”

THE INSIDER’S INSIDER
Enter Anne Mulcahy, the consummate insider. In August 2001, Allaire turned over the CEO reins to the popular twenty-four-year veteran, who had started at Xerox as a copier saleswoman and worked her way up the hierarchy. Despite her insider status, Mulcahy proved that she was more than willing to challenge the status quo at Xerox. Since she took over, Mulcahy has surprised skeptical analysts, stockholders, and employees by engineering one of the most extraordinary business turnarounds in recent history.

How did she do it? One key success factor was giving people vision and hope. Mulcahy wrote a fictitious Wall Street Journal article describing Xerox five years in the future, outlining the things Xerox wanted to accomplish as if they had already been achieved and presenting the company as a thriving, forward-thinking organization. And although few people thought Mulcahy would take the tough actions Xerox needed to survive, she turned out to be a strong decision maker. She quickly launched a turnaround plan that included massive cost cutting and closing of several money-losing operations, including the division she had previously headed. She was brutally honest about “the good, the bad, and the ugly” of the company’s situation, as one employee put it, but she also showed that she cared about what happened to employees. After major layoffs, she walked the halls to tell people she was sorry and let them vent their anger. She personally negotiated the settlement of a long investigation into fraudulent accounting practices, insisting that her personal involvement was necessary to signal a new commitment to ethical business practices and corporate social responsibility. She appealed directly to creditors begging them not to pull the plug until a new management team could make needed changes.

Mulcahy transferred much of production to outside contractors and refocused Xerox on innovation and service. Two areas she refused to cut were research and development and customer contact. Since 2005, Xerox has introduced more than 100 new products and moved into high-growth areas such as document management services, IT consulting, and digital press technology. A series of acquisitions enabled the company to enter new markets and expand its base of small- and medium-sized business customers. Sales in 2007 rose to more than $17 billion, and in November of that year, Xerox announced its first quarterly cash dividend in six years. Mulcahy has also responded to global stakeholders with a firm commitment to human rights and sustainable business practices. “By doing the right thing for our stakeholders and the global community, we’re also doing what is right for our business,” she said.

Mulcahy was belittled in the press when she took over as CEO, but she has proved the pundits wrong and regularly shows up on various “best manager” lists. In 2008, she became the first woman CEO selected by her peers to receive Chief Executive magazine’s “CEO of the Year” award, which she promptly declared to “represent the impressive accomplishments of Xerox people around the world.” But Mulcahy knows Xerox can’t afford to rest on its laurels. The technology industry is tough, and she has to keep her management team focused on growth while also maintaining the cost controls that stabilized the company.

Eight years after this American icon almost fell, Xerox is once again admired in the corporate world. Has the “perfect storm” of troubles been replaced with a “perfect dawn”? Mulcahy and her top management team believe Xerox is positioned to be resilient in the face of the current economic slowdown, but in the rapidly changing world of organizations, nothing is ever certain.¹
Welcome to the real world of organization theory. The shifting fortunes of Xerox illustrate organization theory in action. Xerox managers were deeply involved in organization theory each day of their working lives—but many never realized it. Company managers didn’t fully understand how the organization related to the environment or how it should function internally. Organization theory concepts have helped Anne Mulcahy and her management team analyze and diagnose what is happening and the changes needed to keep the company competitive. Organization theory gives us the tools to explain the decline of Xerox and understand Mulcahy’s turnaround.

Similar problems have challenged numerous organizations. Consider the dramatic organizational missteps illustrated by the 2008 crises in the mortgage industry and finance sector in the United States. Lehman Brothers Holdings, a pillar in the investment banking industry for more than 150 years, filed for Chapter 11 bankruptcy, unable to weather the storm sweeping through the industry. American International Group (AIG) sought a bailout from the U.S. government. And another icon, Merrill Lynch, was saved by becoming part of Bank of America, which had already snapped up struggling mortgage lender Countrywide Financial Corporation. The Merrill Lynch acquisition gave Bank of America a vast reach into nearly every part of the finance industry, from credit cards and auto loans to stock underwriting, wealth management, and merger advice. Power in the industry took a decided shift away from huge investment firms back toward the basic business of commercial banking, making companies such as Bank of America and Wells Fargo & Company in the United States, Germany’s Deutsche Bank AG, and Banco Santander SA of Spain key players in a new financial landscape. The 2008 crisis in the U.S. financial sector represented change and uncertainty on an unprecedented scale, and it would, to some extent, affect managers in all types of organizations and industries around the world.

**ORGANIZATION THEORY IN ACTION**

Organization theory gives us the tools to analyze and understand how a huge, powerful firm like Lehman Brothers can die and a company like Bank of America can emerge almost overnight as a giant in the industry. It enables us to comprehend how a band like the Rolling Stones, which operates like a highly sophisticated global business organization, can enjoy phenomenal success for nearly half a century, while some musical groups with equal or superior talent don’t survive past a couple of hit songs. Organization theory helps us explain what happened in the past, as well as what may happen in the future, so that we can manage organizations more effectively.

**Topics**

Each of the topics to be covered in this book is illustrated in the Xerox case. Indeed, managers at companies such as Xerox, Lehman Brothers, Bank of America, and even the Rolling Stones are continually faced with a number of challenges. For example:

- How can the organization adapt to or control such external elements as competitors, customers, government, and creditors in a fast-paced environment?
- What strategic and structural changes are needed to help the organization attain effectiveness?
• How can the organization avoid management ethical lapses that could threaten its viability?
• How can managers cope with the problems of large size and bureaucracy?
• What is the appropriate use of power and politics among managers?
• How should internal conflict be managed?
• What kind of corporate culture is needed to enhance rather than stifle innovation and change, and how can that culture be shaped by managers?

These are the topics with which organization theory is concerned. Organization theory concepts apply to all types of organizations in all industries. Managers at Burger King revitalized the once-floundering fast-food chain by revising its menu and marketing approach based on customer analysis. Nokia underwent a major reorganization to improve the organization’s flexibility and adaptability. Hewlett-Packard acquired Electronic Data Systems Corporation to move H-P more aggressively into the technology services industry. All of these companies are using concepts based in organization theory. Organization theory also applies to nonprofit organizations such as the United Way, the American Humane Association, local arts organizations, colleges and universities, and the Make-A-Wish Foundation, which grants wishes to terminally ill children.

Organization theory draws lessons from organizations such as Xerox, Bank of America, and United Way and makes those lessons available to students and managers. As our opening example of Xerox shows, even large, successful organizations are vulnerable, lessons are not learned automatically, and organizations are only as strong as their decision makers. Organizations are not static; they continuously adapt to shifts in the external environment. Today, many companies are facing the need to transform themselves into dramatically different organizations because of new challenges in the environment.

Current Challenges

Research into hundreds of organizations provides the knowledge base to make Xerox and other organizations more effective. For example, challenges facing organizations today are different from those of the past, and thus the concept of organizations and organization theory is evolving. The world is changing more rapidly than ever before, and managers are responsible for positioning their organizations to adapt to new needs. Some specific challenges today’s managers and organizations face are globalization, intense competition, rigorous ethical scrutiny, the need for rapid response, the digital workplace, and increasing diversity.

Globalization. The cliché that the world is getting smaller is dramatically true for today’s organizations. With rapid advances in technology and communications, the time it takes to exert influence around the world from even the most remote locations has been reduced from years to only seconds. Markets, technologies, and organizations are becoming increasingly interconnected. Today’s successful organizations feel “at home” anywhere in the world. Companies can locate different parts of the organization wherever it makes the most business sense: top leadership in one country, technical brainpower and production in other locales.

Related trends are global outsourcing, or contracting out some functions to organizations in other countries, and strategic partnering with foreign firms to gain a global advantage. In Bain & Company’s 2007 survey of managers, nearly
50 percent said they saw cross-border acquisitions as crucial to their future competitiveness. Moreover, U.S. managers believe developing relationships in India and China will be vital to business success. Already, numerous companies from all over the world, including Home Depot, CNA Life, and Sony, use India’s Wipro Ltd. to develop sophisticated software applications, design semiconductors, and manage back-office solutions. Other companies turn to China, which is the world’s largest maker of consumer electronics and is rapidly and expertly moving into biotechnology, computer manufacturing, and semiconductors.

Intense Competition. This growing global interdependence creates new advantages, but it also means that the environment for companies is becoming extremely competitive. Customers want low prices for goods and services. Outsourcing firms in low-wage countries can often do work for 50 to 60 percent less than companies based in the United States, for instance, so U.S. firms that provide similar services have to search for new ways to compete or go into new lines of business. In recent years, though, rising fuel costs cut into the cost advantage many manufacturers enjoyed from what has been called the “China price.” The higher cost of shipping goods from China or other low-wage countries counteracted the lower cost of production, leaving U.S. manufacturers searching for ways to make up the difference without exorbitant price increases.

Companies in all industries are feeling pressure to drive down costs and keep prices low, yet at the same time they are compelled to invest in research and development or get left behind in the global drive for innovation. In the United States, high oil prices, the housing slump, mortgage meltdown, crisis in the financial sector, and the soaring costs of materials and supplies created a tough environment for companies in all industries. Consider McDonald’s. Even as managers were seeking ways to expand the menu and draw in new customers, McDonald’s labs were testing how to cut the cost of making basic items on the Dollar Menu. With the price of ingredients such as cheese, beef, and buns going up, McDonald’s had to cut internal costs or lose money on its dollar-menu items. Auto insurers searched for new ways to compete as drivers faced with steep gas prices looked for ways to cut their transportation costs. Casual restaurant chains battled to draw in customers as people cut back on eating out. Grocers, too, felt the sting. Managers at Supervalu, the second largest supermarket company in the United States, quickly learned that they couldn’t just pass on their higher costs to shoppers. Sales and profits plunged in early 2008 before managers adjusted their strategy to promote cheaper store brands, work with manufacturers to design innovative promotions and coupons, and introduce new lines of products at lower prices.

Ethics and Social Responsibility. Today’s managers face tremendous pressure from the government and the public to hold their organizations and employees to high ethical and professional standards. Following widespread moral lapses and corporate financial scandals, organizations are under scrutiny as never before. The pervasiveness of ethical lapses in the early 2000s was astounding. Once-respected firms such as Enron, Arthur Andersen, Tyco, and HealthSouth became synonymous with greed, deceit, and financial chicanery. No wonder a public poll found that 79 percent of respondents in the United States believe questionable business practices are widespread. Fewer than one-third said they think most CEOs are honest. The sentiment is echoed in other countries. Recent investigations of dozens of top executives in Germany for tax evasion, bribery, and other forms of corruption have destroyed the high level of public trust business leaders there once enjoyed, with just
15 percent of respondents in Germany now saying they consider business leaders trustworthy.\textsuperscript{14}

The climate of suspicion has spread to nonprofit organizations and colleges and universities as well. For example, the student loan industry has come under close scrutiny after an investigation found that Student Loan Xpress paid financial aid directors at three universities a total of $160,000 in consulting fees, personal tuition reimbursement, and other payments as a gateway to being placed on the universities’ preferred lenders lists. Investigators are seeking to determine whether lenders are being recommended to students because of the hidden payments university officials are receiving rather than the fact that they offer the best lending terms to students.\textsuperscript{15}

\textbf{Speed and Responsiveness}. A third significant challenge for organizations is to respond quickly and decisively to environmental changes, organizational crises, or shifting customer expectations. For much of the twentieth century, organizations operated in a relatively stable environment, so managers could focus on designing structures and systems that kept the organization running smoothly and efficiently. There was little need to search for new ways to cope with increased competition, volatile environmental shifts, or changing customer demands. Today, globalization and advancing technology have accelerated the pace at which organizations in all industries must roll out new products and services to stay competitive. Today’s customers want products and services tailored to their exact needs, and they want them \textit{now}. Manufacturing firms that relied on mass production and distribution techniques must be prepared with new computer-aided systems that can produce one-of-a-kind variations and streamlined distribution systems that deliver products directly from the manufacturer to the consumer. Service firms, as well, are searching for new ways to provide value. Allstate Insurance, for example, enhanced responsiveness to customers with its Your Choice Auto program, which gives drivers the opportunity to choose the insurance perks they want. Allstate managers recognize that what appeals to drivers can change quickly as gasoline prices shift.\textsuperscript{16}

Considering the turmoil and flux inherent in today’s world, the mindset needed by organizational leaders is to expect the unexpected and be prepared for rapid change and potential crises. Crisis management has moved to the forefront in light of devastating natural disasters and terrorist attacks all over the world; a tough economy, rocky stock market, growing unemployment, and weakening consumer confidence; widespread ethical scandals; and, in general, an environment that may shift dramatically at a moment’s notice.

\textbf{The Digital Workplace}. Many traditional managers feel particularly awkward in today’s technology-driven workplace. Organizations have been engulfed by information technology that affects how they are designed and managed. In today’s workplace, many employees perform much of their work on computers and may work in virtual teams, connected electronically to colleagues around the world. In addition, rather than competing as independent entities, organizations are becoming enmeshed in electronic networks. More and more of today’s business takes place by digital processes over a computer network rather than in physical space. Some companies have taken e-business to very high levels to achieve amazing performance. The use of end-to-end digital supply-chain networks to keep in touch with customers, take orders, buy components from suppliers, coordinate with manufacturing partners, and ship customized products directly to consumers has spread to all industries.\textsuperscript{17}

These advances mean that organizational leaders not only need to be technologically
savvy but are also responsible for managing a web of relationships that reaches far beyond the boundaries of the physical organization, building flexible e-links between a company and its employees, suppliers, contract partners, and customers.18

**Diversity.** As organizations increasingly operate on a global playing field, the workforce—as well as the customer base—grows increasingly diverse. Many of today’s leading organizations have an international face. Look at the makeup of consulting firm McKinsey & Company. In the 1970s, most consultants were American, but by the turn of the century, McKinsey’s chief partner was a foreign national (Rajat Gupta from India), only 40 percent of consultants were American, and the firm’s foreign-born consultants came from forty different countries.19

In addition to coping with global diversity, managers in the United States realize the nation’s domestic population is changing dramatically. The minority population of the United States is now more than 100 million, making about one in three U.S. residents a minority. Roughly 32 million people speak Spanish at home, and nearly half of these people say they don’t speak English very well.20 Today’s average employee is older, and many more women, people of color, and immigrants are seeking job and advancement opportunities. By 2050, it is estimated that 85 percent of entrants into the workforce will be women and people of color. Already, white males, the majority of workers in the past, represent less than half of the workforce.21 This growing diversity brings a variety of challenges, such as maintaining a strong corporate culture while supporting diversity, balancing work and family concerns, and coping with the conflict brought about by varying cultural styles.

**Purpose of This Chapter**

The purpose of this chapter is to explore the nature of organizations and organization theory today. Organization theory has developed from the systematic study of organizations by scholars. Concepts are obtained from living, ongoing organizations. Organization theory has a practical application, as illustrated by the Xerox case. It helps managers understand, diagnose, and respond to emerging organizational needs and problems.

The next section begins with a formal definition of organization and then explores introductory concepts for describing and analyzing organizations. Next, the scope and nature of organization theory are discussed more fully. Succeeding sections examine the history of organization theory and design, a framework for understanding organizational forms, the development of new organizational forms in response to changes in the environment, and how organization theory can help people manage complex organizations in a rapidly changing world. The chapter closes with a brief overview of the themes to be covered in this book.

**WHAT IS AN ORGANIZATION?**

Organizations are hard to see. We see outcroppings, such as a tall building, a computer workstation, or a friendly employee, but the whole organization is vague and abstract and may be scattered among several locations, even around the world. We know organizations are there because they touch us every day. Indeed, they are so common that we take them for granted. We hardly notice that we are born in a
hospital, have our birth records registered in a government agency, are educated in schools and universities, are raised on food produced on corporate farms, are treated by doctors engaged in a joint practice, buy a house built by a construction company and sold by a real estate agency, borrow money from a bank, turn to police and fire departments when trouble erupts, use moving companies to change residences, and receive an array of benefits from various government agencies. Most of us spend many of our waking hours working in an organization of one type or another.

**Definition**

Organizations as diverse as a bank, a corporate farm, a government agency, and Xerox Corporation have characteristics in common. The definition used in this book to describe organizations is as follows: organizations are (1) social entities that (2) are goal-directed, (3) are designed as deliberately structured and coordinated activity systems, and (4) are linked to the external environment.

The key element of an organization is not a building or a set of policies and procedures; organizations are made up of people and their relationships with one another. An organization exists when people interact with one another to perform essential functions that help attain goals. Recent trends in management recognize the importance of human resources, with most new approaches designed to empower employees with greater opportunities to learn and contribute as they work together toward common goals.

Managers deliberately structure and coordinate organizational resources to achieve the organization’s purpose. However, even though work may be structured into separate departments or sets of activities, most organizations today are striving for greater horizontal coordination of work activities, often using teams of employees from different functional areas to work together on projects. Boundaries between departments, as well as those between organizations, are becoming more flexible and diffuse as companies face the need to respond to changes in the external environment more rapidly. An organization cannot exist without interacting with customers, suppliers, competitors, and other elements of the external environment. Today, some companies are even cooperating with their competitors, sharing information and technology to their mutual advantage.

**From Multinationals to Nonprofits**

Some organizations are large, multinational corporations, others are small, family-owned businesses, and still others are nonprofit organizations or governmental agencies. Some manufacture products such as automobiles, flat-panel televisions, or lightbulbs, whereas others provide services such as legal representation, Internet and telecommunications services, mental health resources, or car repair. Later in this text, Chapter 7 will look at the distinctions between manufacturing and service technologies. Chapter 9 discusses size and life cycle and describes some differences between small and large organizations.

Another important distinction is between for-profit businesses and nonprofit organizations. All of the topics in this text apply to nonprofit organizations such as the Salvation Army, the World Wildlife Fund, the Save the Children Foundation, and Chicago’s La Rabida Hospital, which is dedicated to serving the poor, just as they do to such businesses as Xerox, Sirius XM Radio, Dunkin’ Donuts, and Nintendo. However, there are some important dissimilarities to keep in mind. The primary difference is that managers in businesses direct their activities toward earning money for the company,
whereas managers in nonprofits direct their efforts toward generating some kind of social impact. The unique characteristics and needs of nonprofit organizations created by this distinction present unique challenges for organizational leaders.  

Financial resources for nonprofits typically come from government appropriations, grants, and donations rather than from the sale of products or services to customers. In businesses, managers focus on improving the organization’s products and services to increase sales revenues. In nonprofits, however, services are typically provided to nonpaying clients, and a major problem for many organizations is securing a steady stream of funds to continue operating. Nonprofit managers, committed to serving clients with limited funds, must focus on keeping organizational costs as low as possible and demonstrating a highly efficient use of resources. Another problem is that, since nonprofit organizations do not have a conventional “bottom line,” managers often struggle with the question of what constitutes organizational effectiveness. It is easy to measure dollars and cents, but nonprofits have to measure intangible goals such as “improve public health,” “make a difference in the lives of the disenfranchised,” or “enhance appreciation of the arts.”

Managers in nonprofit organizations also deal with many diverse stakeholders and must market their services to attract not only clients (customers) but also volunteers and donors. This can sometimes create conflict and power struggles among organizations, as illustrated by the Make-A-Wish Foundation, which is butting heads with small, local wish-granting groups as it expands to cities across the United States. The more kids a group can count as helping, the easier it is to raise funds. Local groups don’t want Make-A-Wish invading their turf, particularly at a time when charitable donations in general are declining with the slowing economy. Small groups are charging that Make-A-Wish is abusing the power of its national presence to overwhelm or absorb the smaller organizations. “We should not have to compete for children and money,” says the director of the Indiana Children’s Wish Fund. “They [Make-A-Wish] use all their muscle and money to get what they want.”

Thus, the organization design concepts discussed throughout this book, such as dealing with issues of power and conflict, setting goals and measuring effectiveness, coping with environmental uncertainty, implementing effective control mechanisms, and satisfying multiple stakeholders, apply to nonprofit organizations such as the Indiana Children’s Wish Fund just as they do to businesses such as Xerox. These concepts and theories are adapted and revised as needed to fit the unique needs and problems of various small, large, profit, or nonprofit organizations.

Importance of Organizations

It may seem hard to believe today, but organizations as we know them are relatively recent in the history of humankind. Even in the late nineteenth century there were few organizations of any size or importance—no labor unions, no trade associations, and few large businesses, nonprofit organizations, or governmental agencies. What a change has occurred since then! The development of large organizations transformed all of society, and, indeed, the modern corporation may be the most significant innovation of the past 100 years. This chapter’s Book Mark examines the rise of the corporation and its significance in our society.

Organizations are all around us and shape our lives in many ways. But what contributions do organizations make? Why are they important? Exhibit 1.1 lists seven reasons organizations are important to you and to society. First, organizations bring together resources to accomplish specific goals. Consider Northrup
Chapter 1: Organizations and Organization Theory

The limited liability corporation is the greatest single discovery of modern times,” is one conclusion of the concise and readable book The Company: A Short History of a Revolutionary Idea by John Micklethwait and Adrian Wooldridge. Companies are so ubiquitous today that we take them for granted, so it may come as a surprise that the company as we know it is a relatively recent innovation. Although people have joined together in groups for commercial purposes since ancient Greek and Roman times, the modern company has its roots in the late nineteenth century. The idea of a limited liability company that was legally an “artificial person” began with the Joint Stock Companies Act, enacted by the London Board of Trade in 1856. Today the company is seen as “the most important organization in the world.” Here are a few reasons why:

- The corporation was the first autonomous legal and social institution that was within society yet independent of the central government.
- The concept of a limited liability company unleashed entrepreneurs to raise money because investors could lose only what they invested. Increasing the pool of entrepreneurial capital spurred innovation and generally enriched the societies in which companies operated.
- The company is the most efficient creator of goods and services that the world has ever known. Without a company to harness resources and organize activities, the cost to consumers for almost any product we know today would be impossible to afford.
- Historically, the corporation has been a force for civilized behavior and provided people with worthwhile activities, identity, and community, as well as a paycheck.
- The Virginia Company, a forerunner of the limited liability corporation, helped introduce the revolutionary concept of democracy to the American colonies.
- The modern multinational corporation began in Britain in the third quarter of the 1800s with the railroads, which built rail networks throughout Europe by shipping into each country the managers, materials, equipment, and labor needed.

During the past few years, it seems that large corporations have been increasingly in conflict with societies’ interests. Yet large companies have been reviled throughout modern history—consider the robber barons at the beginning of the twentieth century—and the authors suggest that recent abuses are relatively mild compared to some incidents from history. Everyone knows that corporations can be scoundrels, but overall, Micklethwait and Wooldridge argue, their force has been overwhelmingly for the cumulative social and economic good.

The Company: A Short History of a Revolutionary Idea, by John Micklethwait and Adrian Wooldridge, is published by The Modern Library.

Grumman Newport News (formerly Newport News Shipbuilding), which builds nuclear-powered, Nimitz-class aircraft carriers. Putting together an aircraft carrier is an incredibly complex job involving 47,000 tons of precision-welded steel, more than 1 million distinct parts, 900 miles of wire and cable, and more than seven years of hard work by 17,800 employees. How could such a job be accomplished without an organization to acquire and coordinate these varied resources?

Organizations also produce goods and services that customers want at competitive prices. Bill Gates, who built Microsoft into a global powerhouse, asserts that the modern organization “is one of the most effective means to allocate resources we’ve ever seen. It transforms great ideas into customer benefits on an unimaginably large scale.” Companies look for innovative ways to produce and distribute desirable goods and services more efficiently. Two ways are through e-business and through the use of computer-based manufacturing technologies. Redesigning organizational structures and management practices can also contribute to increased efficiency. Organizations create a drive for innovation rather than a reliance on standard products and outmoded approaches to management and organization design.
Organizations adapt to and influence a rapidly changing environment. Consider Google, provider of the Internet’s most popular search engine, which continues to adapt and evolve along with the evolving Internet. Rather than being a rigid service, Google is continually adding technological features that create a better service by accretion. At any time, Google’s site features several technologies in development so that engineers can get ideas and feedback from users. Some large businesses have entire departments charged with monitoring the external environment and finding ways to adapt to or influence that environment.

Through all of these activities, organizations create value for their owners, customers, and employees. Managers analyze which parts of the operation create value and which parts do not; a company can be profitable only when the value it creates is greater than the cost of resources. Vizio Inc., a growing force in the flat-panel television industry, for example, creates value by using existing LCD technology and developing an equity partnership with a contract manufacturer rather than producing televisions in-house. By keeping its costs low, the California-based company has been able to sell flat-panel TVs at about half the cost of those sold by major electronics manufacturers.

Finally, organizations have to cope with and accommodate today’s challenges of workforce diversity and growing concerns over ethics and social responsibility, as well as find effective ways to motivate employees to work together to accomplish organizational goals.

**DIMENSIONS OF ORGANIZATION DESIGN**

Organizations shape our lives, and well-informed managers can shape organizations. The first step for understanding organizations is to look at dimensions that describe specific organizational design traits. These dimensions describe organizations in much the same way that personality and physical traits describe people.

---

**EXHIBIT 1.1**

Importance of Organizations

<table>
<thead>
<tr>
<th>Organizations exist to do the following:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bring together resources to achieve desired goals and outcomes</td>
</tr>
<tr>
<td>2. Produce goods and services efficiently</td>
</tr>
<tr>
<td>3. Facilitate innovation</td>
</tr>
<tr>
<td>4. Use modern manufacturing and information technologies</td>
</tr>
<tr>
<td>5. Adapt to and influence a changing environment</td>
</tr>
<tr>
<td>6. Create value for owners, customers, and employees</td>
</tr>
<tr>
<td>7. Accommodate ongoing challenges of diversity, ethics, and the motivation and coordination of employees</td>
</tr>
</tbody>
</table>
Organizational dimensions fall into two types: structural and contextual, as illustrated in Exhibit 1.2. **Structural dimensions** provide labels to describe the internal characteristics of an organization. They create a basis for measuring and comparing organizations. **Contextual dimensions** characterize the whole organization, including its size, technology, environment, and goals. They describe the organizational setting that influences and shapes the structural dimensions. Contextual dimensions can be confusing because they represent both the organization and the environment. Contextual dimensions can be envisioned as a set of overlapping elements that underlie an organization’s structure and work processes. To understand and evaluate organizations, one must examine both structural and contextual dimensions. These dimensions of organization design interact with one another and can be adjusted to accomplish the purposes listed earlier in Exhibit 1.1.

**Structural Dimensions**

1. **Formalization** pertains to the amount of written documentation in the organization. Documentation includes procedures, job descriptions, regulations, and policy manuals. These written documents describe behavior and activities. Formalization is often measured by simply counting the number of pages of documentation within the organization. Large state universities, for example, tend to be high on formalization because they have several volumes of written rules for such things as registration, dropping and adding classes, student associations, dormitory governance, and financial assistance. A small, family-owned business, in contrast, may have almost no written rules and would be considered informal.
EXHIBIT 1.3
Organization Chart
Illustrating the Hierarchy of Authority for a Community Job Training Program
2. **Specialization** is the degree to which organizational tasks are subdivided into separate jobs. If specialization is extensive, each employee performs only a narrow range of tasks. If specialization is low, employees perform a wide range of tasks in their jobs. Specialization is sometimes referred to as the division of labor.

3. **Hierarchy of authority** describes who reports to whom and the span of control for each manager. The hierarchy is depicted by the vertical lines on an organization chart, as illustrated in Exhibit 1.3. The hierarchy is related to span of control (the number of employees reporting to a supervisor). When spans of control are narrow, the hierarchy tends to be tall. When spans of control are wide, the hierarchy of authority will be shorter.

4. **Centralization** refers to the hierarchical level that has authority to make a decision. When decision making is kept at the top level, the organization is centralized. When decisions are delegated to lower organizational levels, it is decentralized. Examples of organizational decisions that might be centralized or decentralized include purchasing equipment, establishing goals, choosing suppliers, setting prices, hiring employees, and deciding marketing territories.

5. **Professionalism** is the level of formal education and training of employees. Professionalism is considered high when employees require long periods of training to hold jobs in the organization. Professionalism is generally measured as the average number of years of education of employees, which could be as high as twenty in a medical practice and less than ten in a construction company.

6. **Personnel ratios** refer to the deployment of people to various functions and departments. Personnel ratios include the administrative ratio, the clerical ratio, the professional staff ratio, and the ratio of indirect to direct labor employees. A personnel ratio is measured by dividing the number of employees in a classification by the total number of organizational employees.

### Contextual Dimensions

1. **Size** can be measured for the organization as a whole or for specific components, such as a plant or division. Because organizations are social systems, size is typically measured by the number of employees. Other measures such as total sales or total assets also reflect magnitude, but they do not indicate the size of the human part of the system.

2. **Organizational technology** refers to the tools, techniques, and actions used to transform inputs into outputs. It concerns how the organization actually produces the products and services it provides for customers and includes such things as flexible manufacturing, advanced information systems, and the Internet. An automobile assembly line, a college classroom, and an overnight package delivery system are technologies, although they differ from one another.

3. The **environment** includes all elements outside the boundary of the organization. Key elements include the industry, government, customers, suppliers, and the financial community. The environmental elements that affect an organization the most are often other organizations.

4. The organization’s **goals and strategy** define the purpose and competitive techniques that set it apart from other organizations. Goals are often written down as an enduring statement of company intent. A strategy is the plan of action that describes resource allocation and activities for dealing with the environment and for reaching the organization’s goals. Goals and strategies define the scope of operations and the relationship with employees, customers, and competitors.
5. An organization’s *culture* is the underlying set of key values, beliefs, understandings, and norms shared by employees. These underlying values and norms may pertain to ethical behavior, commitment to employees, efficiency, or customer service, and they provide the glue to hold organization members together. An organization’s culture is unwritten but can be observed in its stories, slogans, ceremonies, dress, and office layout.

The eleven contextual and structural dimensions discussed here are interdependent. For example, large organization size, a routine technology, and a stable environment all tend to create an organization that has greater formalization, specialization, and centralization. More detailed relationships among the dimensions are explored in later chapters of this book.

---

**Assess Your Answer**

1. An organization can be understood primarily by understanding the people who make it up.

**Answer:** Disagree. An organization has distinct characteristics that are independent of the nature of the people who make it up. All the people could be replaced over time while an organization’s structural and contextual dimensions would remain similar.

---

These dimensions provide a basis for measuring and analyzing characteristics that cannot be seen by the casual observer, and they reveal significant information about an organization. Consider, for example, the dimensions of Ternary Software compared with those of Wal-Mart and a governmental agency.

---

**IN PRACTICE**

Brian Robertson is one of the founders of Ternary Software and holds the title of CEO. But as for having the power and authority typically granted to a top executive, forget about it. Consider a recent strategy meeting where a programmer criticized Robertson’s plan to replace the company’s profit sharing program with an ad hoc bonus system based on performance. After much discussion, the CEO’s plan was soundly rejected in favor of keeping the profit sharing program and using monthly bonus incentives.

At Ternary, a company that writes software on contract for other organizations, everyone has a voice in making important decisions. A seven-member policy-setting team that includes two frontline workers elected by their peers consults with other teams throughout the company, ultimately giving every employee a chance to participate in decision making. Meetings are highly informal and people are invited to share feelings as well as business ideas. Any time a new item on the agenda is brought up for discussion, each person is asked for his or her gut reaction. Then, people get to state objections, offer alternative ideas, rework proposals, and perhaps throw out management’s suggestions and plans.

Contrast Ternary’s approach to that of Wal-Mart, which achieves its competitive edge through internal cost efficiency. A standard formula is used to build each store, with uniform displays and merchandise. Wal-Mart’s administrative expenses are the lowest of any chain. The distribution system is a marvel of efficiency. Goods can be delivered to any store in less than two days after an order is placed. Stores are controlled from the top, although store
managers have some freedom to adapt to local conditions. Employees follow standard procedures set by management and have little say in decision making. However, performance is typically high, and most employees consider that the company treats them fairly.

An even greater contrast is seen in many government agencies or nonprofit organizations that rely heavily on public funding. Most state humanities and arts agencies, for example, are staffed by a small number of highly trained employees, but workers are overwhelmed with rules and regulations and swamped by paperwork. Employees who have to implement rule changes often don’t have time to read the continuous stream of memos and still keep up with their daily work. Employees must require extensive reporting from their clients in order to make regular reports to a variety of state and federal funding sources. Agency workers are frustrated and so are the community-based organizations they seek to serve.32

Exhibit 1.4 illustrates several structural and contextual dimensions of Ternary Software, Wal-Mart, and the state arts agency. Ternary is a small organization that ranks very low with respect to formalization and centralization and has a medium degree of specialization. Professionalism is high, with a number of staff assigned to nonworkflow activities to do the R&D needed to stay abreast of changes in the software and information technology industries. Wal-Mart is much more formalized, specialized, and centralized. Efficiency is more important than new products, so most activities are guided by standard regulations. Professionalism is low, and the percentage of nonworkflow personnel is kept to a minimum. The arts agency, in contrast to the other organizations, reflects its status as a small part of a large government bureaucracy. The agency is overwhelmed with rules and standard procedures. Rules are dictated from the top. Most employees are assigned to workflow

![Exhibit 1.4 Characteristics of Three Organizations](image)
activities, although in normal times a substantial number of people are devoted to administration and clerical support.

Structural and contextual dimensions can thus tell a lot about an organization and about differences among organizations. Organization design dimensions are examined in more detail in later chapters to determine the appropriate level of each dimension needed to perform effectively in each organizational setting.

**Performance and Effectiveness Outcomes**

The whole point of understanding structural and contextual dimensions is to design the organization in such a way as to achieve high performance and effectiveness. Managers adjust structural and contextual dimensions to most efficiently and effectively transform inputs into outputs and provide value. Efficiency refers to the amount of resources used to achieve the organization’s goals. It is based on the quantity of raw materials, money, and employees necessary to produce a given level of output. Effectiveness is a broader term, meaning the degree to which an organization achieves its goals.

To be effective, organizations need clear, focused goals and appropriate strategies for achieving them. Strategy, goals, and approaches to measuring effectiveness will be discussed in detail in Chapter 2. Many organizations are using new technology to improve efficiency and effectiveness. For example, the health care industry is striving to increase efficiency by using information technology to reduce paperwork and streamline procedures. With new technology, one physician’s office in Philadelphia says it can now handle more patients with three fewer office employees. Information technology also helps the staff locate information more quickly and reduce mistakes, leading to a higher quality of care and better customer service.33

Achieving effectiveness is not always a simple matter because different people want different things from the organization. For customers, the primary concern is high-quality products and services at a reasonable price, whereas employees are mostly concerned with adequate pay, good working conditions, and job satisfaction. Managers carefully balance the needs and interests of various stakeholders in setting goals and striving for effectiveness. This is referred to as the stakeholder approach, which integrates diverse organizational activities by looking at various organizational stakeholders and what they want from the organization. A stakeholder is any group within or outside of the organization that has a stake in the organization’s performance. The satisfaction level of each group can be assessed as an indication of the organization’s performance and effectiveness.34

**2 The primary role of managers in business organizations is to achieve maximum efficiency.**

**ANSWER: Disagree.** Efficiency is important, but organizations must respond to a variety of stakeholders, who may want different things from the organization. Managers strive for both efficiency and effectiveness in trying to meet the needs and interests of stakeholders. Effectiveness is often considered more important than efficiency.
Exhibit 1.5 illustrates various stakeholders and what each group wants from the organization. Stakeholder interests sometimes conflict, and organizations often find it difficult to simultaneously satisfy the demands of all groups. A business might have high customer satisfaction, but the organization might have difficulties with creditors or supplier relationships might be poor. Consider Wal-Mart. Customers love its efficiency and low prices, but the low-cost emphasis has caused friction with suppliers. Some activist groups argue that Wal-Mart’s tactics are unethical because they force suppliers to lay off workers, close factories, and outsource to manufacturers from low-wage countries. One supplier said clothing is being sold at Wal-Mart so cheaply that many U.S. companies couldn’t compete even if they paid their workers nothing. The challenges of managing such a huge organization have also led to strains in relationships with employees and other stakeholder groups, as evidenced by recent gender discrimination suits and complaints about low wages and poor benefits.35

Research has shown that the assessment of multiple stakeholder groups is an accurate reflection of organizational effectiveness, especially with respect to organizational adaptability.36 Moreover, both profit and nonprofit organizations care about their reputations and attempt to shape stakeholders’ perceptions of their performance.37

In reality, it is unreasonable to assume that all stakeholders can be equally satisfied, but if an organization fails to meet the needs of several stakeholder groups, it is probably not meeting its effectiveness goals. Managers strive to at least minimally satisfy the interests of all stakeholders. When any one group becomes seriously dissatisfied, it may withdraw its support and hurt future organizational performance. Satisfying multiple stakeholders can be challenging, particularly as goals and priorities change, as illustrated by the following example.

---

**Exhibit 1.5**

Major Stakeholder Groups and What They Expect

- **OWNERS AND STOCKHOLDERS**
  - Financial return

- **SUPPLIERS**
  - Satisfactory transactions
  - Revenue from purchases

- **COMMUNITY**
  - Good corporate citizen
  - Contribution to community affairs

- **UNION**
  - Worker pay
  - Benefits

- **GOVERNMENT**
  - Obedience to laws and regulations
  - Fair competition

- **MANAGEMENT**
  - Efficiency
  - Effectiveness

- **CUSTOMERS**
  - High-quality goods, services
  - Service
  - Value

- **CREDITORS**
  - Creditworthiness
  - Fiscal responsibility
Few people deny that homeland security should be a top priority for the United States, and since the attacks of September 11, 2001, the Federal Bureau of Investigation (FBI) has channeled more and more resources into the domestic war on terrorism. Consider the seven-year investigation into the anthrax attacks that occurred weeks after September 11 and killed five people in the United States. The investigation culminated in mid-2008 by identifying the alleged culprit as an Army biological weapons scientist at Fort Detrick in Frederick, Maryland. The suspect committed suicide after being told he would be charged with murder.

Combatting terrorism sounds good, right? The only problem is, the agency’s new priority means hundreds of agents have been pulled off their regular beats, where they investigated everything from drug smuggling to kidnapping to white collar crime. “Just about everyone here is involved in terror cases, one way or another,” says agent Ron Buckley. “Everything else is on the back burner.”

The FBI’s new focus is putting a heavy burden on police departments and other law enforcement agencies around the country. These organizations don’t have the personnel, investigative resources, or know-how to fight the kinds of crime FBI agents once handled. For example, even when local departments have adequate manpower, crimes often go unsolved because of lack of access to the FBI’s high-tech forensic labs. Local communities are also distressed because they fear more drugs in their neighborhoods and more violent crime on their streets. Although the U.S. public is worried about terrorism, they also want their own little piece of the world protected from criminal activity.

Some FBI agents aren’t particularly happy about the change either. An agent who has spent most of his 25-year career poring over financial statements investigating fraud, for example, has to make a huge mental shift to feel comfortable traveling around town in an unmarked car with submachine guns, stun grenades, body armor—and a toothbrush—prepared for the next long stakeout.38 

This example provides a glimpse of how difficult it can be for managers to satisfy multiple stakeholders. In all organizations, managers have to evaluate stakeholder concerns and establish goals that can achieve at least minimal satisfaction for major stakeholder groups.

THE EVOLUTION OF ORGANIZATION THEORY AND DESIGN

Organization theory is not a collection of facts; it is a way of thinking about organizations. Organization theory is a way to see and analyze organizations more accurately and deeply than one otherwise could. The way to see and think about organizations is based on patterns and regularities in organizational design and behavior. Organization scholars search for these regularities, define them, measure them, and make them available to the rest of us. The facts from the research are not as important as the general patterns and insights into organizational functioning. Insights from organization design research can help managers improve organizational efficiency and effectiveness, as well as strengthen the quality of organizational life.39 One area of insight is how organization design and management practices have varied over time in response to changes in the larger society.
Historical Perspectives

You may recall from an earlier management course that the modern era of management theory began with the classical management perspective in the late nineteenth and early twentieth century. The emergence of the factory system during the Industrial Revolution posed problems that earlier organizations had not encountered. As work was performed on a much larger scale by a larger number of workers, people began thinking about how to design and manage work in order to increase productivity and help organizations attain maximum efficiency. The classical perspective, which sought to make organizations run like efficient, well-oiled machines, is associated with the development of hierarchy and bureaucratic organizations and remains the basis of much of modern management theory and practice. In this section, we will examine the classical perspective, with its emphasis on efficiency and organization, as well as other perspectives that emerged to address new concerns, such as employee needs and the role of the environment. Elements of each perspective are still used in organization design, although they have been adapted and revised to meet changing needs. These different perspectives can also be associated with different ways in which managers think about and view the organization, called manager frame of reference. Complete the questionnaire in the “How Do You Fit the Design?” box on page 24 to understand your frame of reference.

Efficiency Is Everything. Pioneered by Frederick Winslow Taylor, scientific management emphasizes scientifically determined jobs and management practices as the way to improve efficiency and labor productivity. Taylor proposed that workers “could be retooled like machines, their physical and mental gears recalibrated for better productivity.” He insisted that management itself would have to change and emphasized that decisions based on rules of thumb and tradition should be replaced with precise procedures developed after careful study of individual situations. To use this approach, managers develop precise, standard procedures for doing each job, select workers with appropriate abilities, train workers in the standard procedures, carefully plan work, and provide wage incentives to increase output.

Taylor’s approach is illustrated by the unloading of iron from railcars and reloading finished steel for the Bethlehem Steel plant in 1898. Taylor calculated that with correct movements, tools, and sequencing, each man was capable of loading 47.5 tons per day instead of the typical 12.5 tons. He also worked out an incentive system that paid each man $1.85 per day for meeting the new standard, an increase from the previous rate of $1.15. Productivity at Bethlehem Steel shot up overnight. These insights helped to establish organizational assumptions that the role of management is to maintain stability and efficiency, with top managers doing the thinking and workers doing what they are told.

The ideas of creating a system for maximum efficiency and organizing work for maximum productivity are deeply embedded in our organizations. A recent *Harvard Business Review* article discussing innovations that shaped modern management put scientific management at the top of its list of twelve influential innovations.

How to Get Organized. Another subfield of the classical perspective took a broader look at the organization. Whereas scientific management focused primarily on the technical core—on work performed on the shop floor—administrative principles looked at the design and functioning of the organization as a whole. For example, Henri Fayol proposed fourteen principles of management, such as “each subordinate
This questionnaire asks you to describe yourself. For each item, give the number “4” to the phrase that best describes you, “3” to the item that is next best, and on down to “1” for the item that is least like you.

1. My strongest skills are:
   ___a. Analytical skills
   ___b. Interpersonal skills
   ___c. Political skills
   ___d. Flair for drama

2. The best way to describe me is:
   ___a. Technical expert
   ___b. Good listener
   ___c. Skilled negotiator
   ___d. Inspirational leader

3. What has helped me the most to be successful is my ability to:
   ___a. Make good decisions
   ___b. Coach and develop people
   ___c. Build strong alliances and a power base
   ___d. Inspire and excite others

4. What people are most likely to notice about me is my:
   ___a. Attention to detail
   ___b. Concern for people
   ___c. Ability to succeed in the face of conflict and opposition
   ___d. Charisma

5. My most important leadership trait is:
   ___a. Clear, logical thinking
   ___b. Caring and support for others
   ___c. Toughness and aggressiveness
   ___d. Imagination and creativity

6. I am best described as:
   ___a. An analyst
   ___b. A humanist
   ___c. A politician
   ___d. A visionary

Scoring: Compute your scores according to the following rater. The higher score represents your way of viewing the organization and will influence your management style.

Structure = 1a + 2a + 3a + 4a + 5a + 6a = _______
Human Resource = 1b + 2b + 3b + 4b + 5b + 6b = _______
Political = 1c + 2c + 3c + 4c + 5c + 6c = _______
Symbolic = 1d + 2d + 3d + 4d + 5d + 6d = _______

**Interpretation:** Organization managers typically view their world through one or more mental frames of reference. (1) The **structural frame** of reference sees the organization as a machine that can be economically efficient with vertical hierarchy and routine tasks that give a manager the formal authority to achieve goals. This manager way of thinking became strong during the era of scientific management when efficiency was everything. (2) The **human resource frame** sees the organization as its people, with manager emphasis given to support, empowerment, and belonging. This manager way of thinking gained importance after the Hawthorne studies. (3) The **political frame** sees the organization as a competition for scarce resources to achieve goals, with manager emphasis on building agreement among diverse groups. This frame of reference reflects the need for organizations to share information, have a collaborative strategy, and to have all parts working together. (4) The **symbolic frame** sees the organization as theater, with manager emphasis on symbols, vision, culture, and inspiration. This manager frame of reference is important for managing an adaptive culture in a learning organization.

Which frame reflects your way of viewing the world? The first two frames of reference—structural and human resource—are important for newer managers at the lower and middle levels of an organization. These two frames usually are mastered first. As managers gain experience and move up the organization, they should acquire political and collaborative skills (Chapter 13) and also learn to use symbols to shape cultural values (Chapter 10). It is important for managers not to be stuck in one way of viewing the organization because their progress may be limited.

receives orders from only one superior” (unity of command) and “similar activities in an organization should be grouped together under one manager” (unity of direction). These principles formed the foundation for modern management practice and organization design.

The scientific management and administrative principles approaches were powerful and gave organizations fundamental new ideas for establishing high productivity and increasing prosperity. Administrative principles in particular contributed to the development of bureaucratic organizations, which emphasized designing and managing organizations on an impersonal, rational basis through such elements as clearly defined authority and responsibility, formal recordkeeping, and uniform application of standard rules. Although the term bureaucracy has taken on negative connotations in today’s organizations, bureaucratic characteristics worked extremely well for the needs of the Industrial Age. One problem with the classical perspective, however, is that it failed to consider the social context and human needs.

What about People? Early work on industrial psychology and human relations received little attention because of the prominence of scientific management. However, a major breakthrough occurred with a series of experiments at a Chicago electric company, which came to be known as the Hawthorne Studies. Interpretations of these studies at the time concluded that positive treatment of employees improved their motivation and productivity. The publication of these findings led to a revolution in worker treatment and laid the groundwork for subsequent work examining treatment of workers, leadership, motivation, and human resource management. These human relations and behavioral approaches added new and important contributions to the study of management and organizations.

However, the hierarchical system and bureaucratic approaches that developed during the Industrial Revolution remained the primary approach to organization design and functioning well into the 1970s and early 1980s. In general, this approach worked well for most organizations until the past few decades. However, during the 1980s, it began to lead to problems. Increased competition, especially on a global scale, changed the playing field. North American companies had to find a better way.

Can Bureaucracies Be Flexible? The 1980s produced new corporate cultures that valued lean staff, flexibility and learning, rapid response to the customer, engaged employees, and quality products. Organizations began experimenting with teams, flattened hierarchies, and participative management approaches. For example, in 1983, a DuPont plant in Martinsville, Virginia, cut management layers from eight to four and began using teams of production employees to solve problems and take over routine management tasks. The new design led to improved quality, decreased costs, and enhanced innovation, helping the plant be more competitive in a changed environment. Rather than relying on strict rules and hierarchy, managers began looking at the entire organizational system, including the external environment.

Over the past twenty-five years organizations have undergone even more profound and far-reaching changes. More flexible approaches to organization design have become prevalent. Recent influences on the shifting of organization design include the Internet and other advances in communications and information technology; globalization and the increasing interconnection of organizations; the rising educational level of employees and their growing quality-of-life expectations; and the growth of knowledge- and information-based work as primary organizational activities.
Don’t Forget the Environment

Many problems occur when all organizations are treated as similar, which was the case with scientific management and administrative principles that attempted to design all organizations alike. The structures and systems that work in the retail division of a conglomerate will not be appropriate for the manufacturing division. The organization charts and financial procedures that are best for an entrepreneurial Internet firm like Google will not work for a large food processing plant at Kraft or Nabisco.

Contingency means that one thing depends on other things, and for organizations to be effective, there must be a “goodness of fit” between their structure and the conditions in their external environment. What works in one setting may not work in another setting. There is no “one best way.” Contingency theory means it depends. For example, some organizations experience a certain environment, use a routine technology, and desire efficiency. In this situation, a management approach that uses bureaucratic control procedures, a hierarchical structure, and formal communication would be appropriate. Likewise, free-flowing management processes work best in an uncertain environment with a nonroutine technology. The correct management approach is contingent on the organization’s situation.

Today, almost all organizations operate in highly uncertain environments. Thus, we are involved in a significant period of transition, in which concepts of organization theory and design are changing as dramatically as they did with the dawning of the Industrial Revolution.

ORGANIZATIONAL CONFIGURATION

Another important insight from organization design researchers is how organizations are configured—that is, what makes up an organization’s parts and how do the various parts fit together?

Mintzberg’s Organizational Types

One framework proposed by Henry Mintzberg suggests that every organization has five parts. These parts, illustrated in Exhibit 1.6, include the technical core, top management, middle management, technical support, and administrative support.

Technical Core. The technical core includes people who do the basic work of the organization. This part actually produces the product and service outputs of the organization. This is where the primary transformation from inputs to outputs takes place. The technical core is the production department in a manufacturing firm, the teachers and classes in a university, and the medical activities in a hospital.

Technical Support. The technical support function helps the organization adapt to the environment. Technical support employees such as engineers, researchers, and information technology professionals scan the environment for problems, opportunities, and technological developments. Technical support is responsible for creating innovations in the technical core, helping the organization change and adapt.
EXHIBIT 1.6

Five Basic Parts of an Organization


Administrative Support. The administrative support function is responsible for the smooth operation and upkeep of the organization, including its physical and human elements. This includes human resource activities such as recruiting and hiring, establishing compensation and benefits, and employee training and development, as well as maintenance activities such as cleaning of buildings and service and repair of machines.

Management. Management is a distinct function, responsible for directing and coordinating other parts of the organization. Top management provides direction, planning, strategy, goals, and policies for the entire organization or major divisions. Middle management is responsible for implementation and coordination at the departmental level. In traditional organizations, middle managers are responsible for mediating between top management and the technical core, such as implementing rules and passing information up and down the hierarchy.

A CEO’s top priority is to make sure the organization is designed correctly.

ANSWER: Agree. Top managers have many responsibilities, but one of the most important is making sure the organization is designed correctly. Organization design organizes and focuses people’s work and shapes their response to customers and other stakeholders. Managers consider both structural and contextual dimensions as well as make sure the various parts of the organization work together to achieve important goals.

In real-life organizations, the five parts are interrelated and often serve more than one function. For example, managers coordinate and direct parts of the organization, but they may also be involved in administrative and technical support.

Mintzberg proposed that the five parts could fit together in five basic types of organization, as illustrated in Exhibit 1.7. The five configurations are entrepreneurial structure, machine bureaucracy, professional bureaucracy, diversified form, and adhocracy. The five organizational parts vary in size and importance in each type.
EXHIBIT 1.7
Mintzberg’s Five Organization Types

- a. Entrepreneurial Structure
- b. Machine Bureaucracy
- c. Professional Bureaucracy
- d. Diversified Form
- e. Adhocracy

This difference is related to the differences in size, goals, and other characteristics of the organization.

1. **Entrepreneurial Structure.** The organization with an entrepreneurial structure, as shown in Exhibit 1.7(a), is typically a new, small start-up company. It consists mainly of a top manager and workers in the technical core. The organization is managed and coordinated by direct supervision from the top rather than by middle managers or support departments. Top management is the key part of the structure. Few support staff are needed. The primary goal of the organization is to survive and become established in its industry. There is little formalization or specialization. This form is suited to a dynamic environment because the simplicity and flexibility enable it to maneuver quickly and compete successfully with larger, less adaptable organizations.

2. **Machine Bureaucracy.** The machine bureaucracy in Exhibit 1.7(b) is very large, typically mature, and the technical core is often oriented to mass production. It has fully elaborated technical and administrative departments, including engineers, market researchers, and financial analysts who scrutinize, routinize, and formalize work in the high-volume production center. The narrow middle management area reflects the tall hierarchy for control. This form reflects extensive formalization and specialization, with a primary goal of efficiency. This form is suited to a simple, stable environment. It would not do well in a dynamic environment because the bureaucracy is not adaptable.

3. **Professional Bureaucracy.** The distinguishing feature of the professional bureaucracy in Exhibit 1.7(c) is the size and power of the technical core, which is made up of highly skilled professionals, such as in hospitals, universities, law firms, and consulting firms. The technical support staff is small or nonexistent, because professionals make up the bulk of the organization. A large administrative support staff is needed to support the professionals and handle the organization’s routine administrative activities. The primary goals are quality and effectiveness, and although there is some specialization and formalization, professionals in the technical core have autonomy. Professional organizations typically provide services rather than tangible goods, and they exist in complex environments.

4. **Diversified Form.** Organizations with a diversified form are mature firms that are extremely large and are subdivided into product or market groups, as shown in Exhibit 1.7(d). There is a relatively small top management and a small technical support group for the top level. There is a larger administrative support staff to handle paperwork to and from the divisions. In the exhibit, four independent divisions are shown below the headquarters, and the bulge across the middle indicates that middle management is key. Each of the independent divisions illustrates a machine bureaucracy with its own technical and administrative support staff, but on occasion a division may resemble the entrepreneurial structure, professional bureaucracy, or even adhocracy. The diversified form helps to solve the problem of inflexibility experienced by a too-large machine bureaucracy by dividing it into smaller parts.

5. **Adhocracy.** The adhocracy develops in a complex, rapidly changing environment. The design goal is frequent innovation and meeting continually changing needs, as in the aerospace and defense industries. Exhibit 1.7(e) shows the various parts (middle management, technical, and administrative support) merged together into an amorphous mass in the middle. The main structure consists of many overlapping teams rather than a vertical hierarchy. Adhocracies are...
usually young or middle-aged and can grow quite large. The organization has professional employees, and the technical and administrative support staff are part of the mix of ongoing innovation teams and projects rather than being placed in separate departments. Employees are engaged in the administration and support of their own teams. The production center, illustrated with dashed lines, is separate from the fluid and innovative core above it. If standardized production is done within the organization, it would occur in this operating core quite separate from the ongoing innovation in the professional center above it. In the professional center, the adhocracy is decentralized.

**Contemporary Design Ideas**

Each of the forms outlined by Mintzberg can be found among today’s organizations. To some extent, organizations are still imprinted with the hierarchical, bureaucratic, formalized approach that arose in the nineteenth century. Yet the challenges presented by today’s dynamic environment require greater flexibility and adaptability for most organizations. Thus, organizations and managers may be seen as shifting from a mindset based on rigid mechanical systems to one based on flexible natural systems.

For most of the twentieth century, Newtonian science, which suggests that the world functions as a well-ordered machine, continued to guide managers’ thinking about organizations. The environment was perceived as orderly and predictable and the role of managers was to maintain stability. This mindset worked quite well for the Industrial Age. Growth was a primary criterion for organizational success.

Organizations became large and complex, and boundaries between functional departments and between organizations were distinct. Internal structures grew more complex, vertical, and bureaucratic. Leadership was based on solid management principles and tended to be autocratic; communication was primarily through formal memos, letters, and reports. Managers did all the planning and “thought work,” while employees did the manual labor in exchange for wages and other compensation.

The environment for today’s companies, however, is anything but stable. With the turbulence of recent years, managers can no longer maintain an illusion of order and predictability. The science of chaos theory suggests that relationships in complex, adaptive systems—including organizations—are nonlinear and made up of numerous interconnections and divergent choices that create unintended effects and render the whole unpredictable. The world is full of uncertainty, characterized by surprise, rapid change, and confusion. Managers can’t measure, predict, or control in traditional ways the unfolding drama inside or outside the organization. However, chaos theory also recognizes that this randomness and disorder occurs within certain larger patterns of order. The ideas of chaos theory suggest that organizations should be viewed more as natural systems than as well-oiled, predictable machines.

**EFFICIENT PERFORMANCE VERSUS THE LEARNING ORGANIZATION**

The new mindset has spurred many organizations to shift from strict vertical hierarchies to flexible, decentralized structures that emphasize horizontal collaboration, widespread information sharing, and adaptability. This shift can clearly be seen in the U.S. Army, once considered the ultimate example of a rigid, top-down organization.
Today’s army is fighting a new kind of war that demands a new approach to how it trains, equips, and uses soldiers. Fighting a fluid, fast-moving, and fast-changing terrorist network means that junior officers in the field who are experts on the local situation have to make quick decisions, learning through trial and error and sometimes departing from standard Army procedures.51

Although the stakes might not be as high, business and nonprofit organizations today also need greater fluidity and adaptability. Many managers are redesigning their companies toward something called the learning organization. The learning organization promotes communication and collaboration so that everyone is engaged in identifying and solving problems, enabling the organization to continuously experiment, improve, and increase its capability.

Exhibit 1.8 compares organizations designed for efficient performance with those designed for continuous learning by looking at five elements of organization design: structure, tasks, systems, culture, and strategy. As shown in the exhibit, all of these elements are interconnected and influence one another.

From Vertical to Horizontal Structure

Traditionally, the most common organizational structure has been one in which activities are grouped together by common work from the bottom to the top of the organization. Generally little collaboration occurs across functional departments, and the whole organization is coordinated and controlled through the vertical hierarchy, with decision-making authority residing with upper-level managers. This structure can be quite effective. It promotes efficient production and in-depth skill development, and the hierarchy of authority provides a sensible mechanism for supervision and control in large organizations. However, in a rapidly changing environment, the hierarchy becomes overloaded. Top executives are not able to respond rapidly enough to problems or opportunities.

In the learning organization, the vertical structure that creates distance between managers at the top of the organization and workers in the technical core is disbanded. Structure is created around horizontal workflows or processes rather than departmental functions. The vertical hierarchy is dramatically flattened, with perhaps only a few senior executives in traditional support functions such as finance or human resources. Self-directed teams are the fundamental work unit in the learning organization. Boundaries between functions are practically eliminated because teams include members from several functional areas.

From Routine Tasks to Empowered Roles

A task is a narrowly defined piece of work assigned to a person. In traditional organizations, tasks are broken down into specialized, separate parts, as in a machine. Knowledge and control of tasks are centralized at the top of the organization, and employees are expected to do as they are told. A role, in contrast, is a part in a dynamic social system. A role has discretion and responsibility, allowing the person to use his or her discretion and ability to achieve an outcome or meet a goal. In learning organizations, employees play a role in the team or department and roles may be continually redefined or adjusted. There are few rules or procedures, and knowledge and control of tasks are located with workers rather than with supervisors or top executives. Employees are encouraged to take care of problems by working with one another and with customers.
EXHIBIT 1.8
Two Organization Design Approaches

Mechanical System Design
- Vertical Structure
- Rigid Culture
- Formal Systems
- Competitive Strategy
- Routine Tasks

Natural System Design
- Horizontal Structure
- Empowered Roles
- Adaptive Culture
- Collaborative Strategy
- Shared Information

Organizational Change in the Service of Performance

Stable Environment
Efficient Performance

Turbulent Environment
Learning Organization

Source: Adapted from David K. Hurst, Crisis and Renewal: Meeting the Challenge of Organizational Change (Boston, Mass.: Harvard Business School Press, 1995).
From Formal Control Systems to Shared Information

In young, small organizations (Mintzberg’s entrepreneurial structure), communication is generally informal and face-to-face. There are few formal control and information systems because the top leaders of the company usually work directly with employees in the day-to-day operation of the business. However, when organizations grow large and complex, the distance between top leaders and workers in the technical core increases. Formal systems are often implemented to manage the growing amount of complex information and to detect deviations from established standards and goals.52

In learning organizations, information serves a very different purpose. The widespread sharing of information keeps the organization functioning at an optimum level. The learning organization strives to return to the condition of a small, entrepreneurial firm in which all employees have complete information about the company so they can act quickly. Ideas and information are shared throughout the organization. In addition, learning organizations maintain open lines of communication with customers, suppliers, and even competitors to enhance learning capability.

From Competitive to Collaborative Strategy

In traditional organizations designed for efficient performance, strategy is formulated by top managers and imposed on the organization. Top executives think about how the organization can best respond to competition, efficiently use resources, and cope with environmental changes. In the learning organization, in contrast, the accumulated actions of an informed and empowered workforce contribute to strategy development. Since all employees are in touch with customers, suppliers, and new technology, they help identify needs and solutions and participate in strategy making. In addition, strategy emerges from partnerships with suppliers, customers, and other firms. Consider IBM, where top managers used to do all the strategic planning. Now the company invites customers as well as people from nonprofit, business, government, and academic organizations to help, then makes the results public through conferences and reports.53 Learning companies are willing to share their best ideas. Organizations become collaborators as well as competitors, experimenting to find the best way to learn and adapt. Boundaries between organizations become diffuse, with companies often forming partnerships to compete globally, sometimes joining in modular or virtual network organizations that are connected electronically.

From Rigid to Adaptive Culture

A danger for many organizations is that the corporate culture becomes fixed, as if set in concrete. Organizations that were highly successful in stable environments often become victims of their own success when the environment begins to change dramatically, as we saw illustrated in the opening case of Xerox Corporation. The cultural values, ideas, and practices that helped attain success can be detrimental to effective performance in a rapidly changing environment.

In a learning organization, the culture encourages openness, equality, continuous improvement, and change. People in the organization are aware of the whole system, how everything fits together, and how the various parts of the organization interact with one another and with the environment. This whole-system mindset
minimizes boundaries within the organization and with other companies. In addition, activities and symbols that create status differences, such as executive dining rooms or reserved parking spaces, are discarded. Each person is a valued contributor and the organization becomes a place for creating a web of relationships that allows people to develop and apply their full potential. Consider QuikTrip, a chain of convenience stores, where most of the top managers started out at the store level, and everyone is considered a vital part of the chain’s success. “The purpose of QuikTrip,” says CEO Chester Cadieux II, “is to give our employees the opportunity to grow and succeed.” The emphasis on treating everyone with care and respect creates a climate in which people feel safe to experiment, take risks, and make mistakes, all of which encourage learning.

No company represents a perfect example of a learning organization, although many of today’s most competitive organizations have shifted toward ideas and forms based on the concept of a living, dynamic system. As illustrated in Exhibit 1.8, today’s managers are involved in a struggle as they attempt to change their companies into learning organizations. The challenge for managers is to maintain some level of stability as they actively promote change toward a new way of thinking, to navigate between order and chaos.

One organization that reflects many of the qualities of a learning organization is Mexico’s Cementos Mexicanos (Cemex).

Cementos Mexicanos (Cemex), based in Monterrey, Mexico, has been making and delivering concrete for nearly a century. But the organization is on the cutting edge of organization design, a model of what it takes to succeed in the complex environment of the twenty-first century.

Cemex specializes in delivering concrete in developing areas of the world, places where anything can, and usually does, go wrong. Even in Monterrey, Cemex copes with unpredictable weather and traffic conditions, spontaneous labor disruptions, building permit snafus, and arbitrary government inspections of construction sites. In addition, more than half of all orders are changed or canceled by customers, usually at the last minute. Considering that a load of concrete is never more than ninety minutes from spoiling, those chaotic conditions mean high costs, complex scheduling, and frustration for employees, managers, and customers.

To help the organization compete in this environment, managers looked for both technological and organizational innovations. Leaders call their new approach “living with chaos.” Rather than trying to change the customers, Cemex resolved to do business on the customers’ own terms and design a system in which last-minute changes and unexpected problems are routine.

A core element of this approach is a sophisticated information technology system, including a global positioning satellite system and onboard computers in all delivery trucks, which is fed with streams of day-to-day data on customer orders, production schedules, traffic problems, weather conditions, and so forth. Now Cemex trucks head out every morning to cruise the streets. When a customer order comes in, an employee checks the customer’s credit status, locates a nearby truck, and relays directions for delivery. If the order is canceled, computers automatically direct the plant to scale back production.

Cemex also made managerial and organizational changes to support the new approach. The company enrolled all its drivers, who had an average of six years of formal schooling, in
weekly secondary-education classes and began training them in delivering not just cement but quality service. In addition, many strict and demanding work rules were abolished so that workers had more discretion and responsibility for identifying and rapidly responding to problems and customer needs. As a result, each Cemex truck now operates as a self-organizing business unit, run by well-trained employees who think like businesspeople. According to Francisco Perez, operations manager at Cemex in Guadalajara, “They used to think of themselves as drivers. But anyone can deliver concrete. Now our people know that they’re delivering a service that the competition cannot deliver.”

Like most organizations in the construction industry, Cemex has been devastated by the recent housing collapse and credit crisis. Yet the company is poised for adaptation to the changing environment due to the combination of extensive networking technology and a new management approach that taps into the mind-power of everyone in the company. People at Cemex are constantly learning—on the job, in training classes, and through visits to other organizations. As a result, the company has a startling capacity to anticipate customer needs, solve problems, and innovate quickly. In addition, Cemex freely shares what it knows with other organizations, even competitors, believing the widespread sharing of knowledge and information is the best way to keep the organization thriving in a world of complexity and rapid change.

**FRAMEWORK FOR THE BOOK**

How does a course in organization theory differ from a course in management or organizational behavior? The answer is related to the concept called *level of analysis*.

**Levels of Analysis**

Each organization is a system that is composed of subsystems. Organization systems are nested within systems, and one *level of analysis* has to be chosen as the primary focus. Four levels of analysis normally characterize organizations, as illustrated in Exhibit 1.9. The individual human being is the basic building block of organizations. The human being is to the organization what a cell is to a biological system. The next higher system level is the group or department. These are collections of individuals who work together to perform group tasks. The next level of analysis is the organization itself. An organization is a collection of groups or departments that combine into the total organization.

Organizations themselves can be grouped together into the next higher level of analysis, which is the interorganizational set and community. The interorganizational set is the group of organizations with which a single organization interacts. Other organizations in the community make up an important part of an organization’s environment.

Organization theory focuses on the organizational level of analysis but with concern for groups and the environment. To explain the organization, one should look not only at its characteristics but also at the characteristics of the environment and of the departments and groups that make up the organization. The focus of this book is to help you understand organizations by examining their specific characteristics,
the nature of and relationships among groups and departments that make up the organization, and the collection of organizations that make up the environment.

Are individuals included in organization theory? Organization theory does consider the behavior of individuals, but in the aggregate. People are important, but they are not the primary focus of analysis. Organization theory is distinct from organizational behavior.

**Organizational behavior** is the micro approach to organizations because it focuses on the individuals within organizations as the relevant units of analysis. Organizational behavior examines concepts such as motivation, leadership style, and personality and is concerned with cognitive and emotional differences among people within organizations.

**Organization theory** is a macro examination of organizations because it analyzes the whole organization as a unit. Organization theory is concerned with people aggregated into departments and organizations and with the differences in structure and behavior at the organization level of analysis. Organization theory might be considered the sociology of organizations, while organizational behavior is the psychology of organizations.

A new approach to organization studies is called **meso theory**. Most organizational research and many management courses specialize in either organizational behavior or organization theory. **Meso theory** (meso means “in between”) concerns the integration of both micro and macro levels of analysis. Individuals and groups affect the organization, and the organization in return influences individuals and groups. To thrive in organizations, managers and employees need to understand multiple levels simultaneously. For example, research may show that employee diversity enhances innovation. To facilitate innovation, managers need to understand how structure and context (organization theory) are related to interactions among diverse employees (organizational behavior) to foster innovation, because both macro and micro variables account for innovations.56

For its part, organization theory is directly relevant to top- and middle-management concerns and partly relevant to lower management. Top managers are responsible for the entire organization and must set goals, develop strategy, interpret the external environment, and decide organization structure and design.
Middle management is concerned with major departments, such as marketing or research, and must decide how the department relates to the rest of the organization. Middle managers must design their departments to fit work-unit technology and deal with issues of power and politics, intergroup conflict, and information and control systems, each of which is part of organization theory. Organization theory is only partly concerned with lower management because this level of supervision is concerned with employees who operate machines, input data, teach classes, and sell goods. Organization theory is concerned with the big picture of the organization and its major departments.

**Plan of the Book**

The topics within the field of organization theory are interrelated. Chapters are presented so that major ideas unfold in logical sequence. The framework that guides the organization of the book is shown in Exhibit 1.10. Part 1 introduces the basic idea of organizations as social systems and the nature of organization theory. This discussion provides the groundwork for Part 2, which is about strategic management, goals and effectiveness, and the fundamentals of organization structure. Organizations are open systems that exist for a purpose. This section examines how managers help the organization achieve its purpose, including the design of an appropriate structure, such as a functional, divisional, matrix, or horizontal structure. Part 3 looks at the various open system elements that influence organization structure and design, including the external environment, interorganizational relationships, and the global environment.

Parts 4 and 5 look at processes inside the organization. Part 4 describes how organization design is related to such factors as manufacturing and service technology, organizational size and life cycle, and information and control systems. Part 5 shifts to dynamic processes that exist within and between major organizational departments and includes topics such as innovation and change, culture and ethical values, decision-making processes, managing intergroup conflict, and power and politics.

**Plan of Each Chapter**

Each chapter begins with opening questions to immediately engage the student in the chapter content. Theoretical concepts are introduced and explained in the body of the chapter. Several *In Practice* segments are included in each chapter to illustrate the concepts and show how they apply to real organizations. Each chapter also contains a *How Do You Fit the Design?* questionnaire that draws students more deeply into a particular topic and enables them to experience organization design issues in a personal way. A *Book Mark* is included in each chapter to present organizational issues that managers face right now. These short book reviews discuss current concepts and applications to deepen and enrich the student’s understanding of organizations. The examples and book reviews illustrate the dramatic changes taking place in management thinking and practice. Key points for designing and managing organizations are highlighted in the *Briefcase* items throughout the chapter. Each chapter closes with a *Design Essentials* section that reviews and explains important theoretical concepts.
EXHIBIT 1.10
Framework for the Book

Part 1: Introduction to Organizations

CHAPTER 1
Organizations and Organization Theory

Part 2: Organizational Purpose and Structural Design

CHAPTER 2
Strategy, Organization Design, and Effectiveness

CHAPTER 3
Fundamentals of Organization Structure

Part 3: Open System Design Elements

CHAPTER 4
The External Environment

CHAPTER 5
Interorganizational Relationships

CHAPTER 6
Designing Organizations for the International Environment

Part 4: Internal Design Elements

CHAPTER 7
Manufacturing and Service Technologies

CHAPTER 8
Using IT for Coordination and Control

CHAPTER 9
Organizational Size, Life Cycle, and Decline

Part 5: Managing Dynamic Processes

CHAPTER 10
Organizational Culture and Ethical Values

CHAPTER 11
Innovation and Change

CHAPTER 12
Decision-Making Processes

CHAPTER 13
Conflict, Power, and Politics
Turbulence and complexity have replaced stability and predictability as defining traits for today’s organizations. Some of the specific challenges managers and organizations face include globalization, intense competition, rigorous ethical scrutiny, the need for rapid response, the digital workplace, and increasing diversity.

Organizations are highly important, and managers are responsible for shaping organizations to perform well and meet the needs of society. The structural dimensions of formalization, specialization, hierarchy of authority, centralization, professionalism, and personnel ratios, and the contextual dimensions of size, organizational technology, environment, goals and strategy, and culture provide labels for measuring and analyzing organizations. These dimensions vary widely from organization to organization. Subsequent chapters provide frameworks for analyzing organizations with these concepts.

Many types of organizations exist. One important distinction is between for-profit businesses, in which managers direct their activities toward earning money for the company, and nonprofit organizations, in which managers direct their efforts toward generating some kind of social impact. Managers strive to design organizations to achieve both efficiency and effectiveness. Effectiveness is complex because different stakeholders have different interests and needs that they want satisfied by the organization.

Organization design perspectives have varied over time. Managers can understand organizations better by gaining a historical perspective and by understanding basic organizational configurations. Five parts of the organization are the technical core, top management, middle management, technical support, and administrative support. Different configurations of these parts result in five basic organization types: entrepreneurial structure, machine bureaucracy, professional bureaucracy, diversified form, and adhocracy.

Challenges in today’s environment are leading to changes in organization design and management practices. The trend is away from highly structured systems based on a mechanical model toward looser, more flexible systems based on a natural, biological model. Many managers are redesigning companies toward the learning organization, which is characterized by a horizontal structure, empowered employees, shared information, collaborative strategy, and an adaptive culture.

Finally, most concepts in organization theory pertain to the top- and middle-management levels of the organization. This book is concerned more with the topics of those levels than with the operational-level topics of supervision and motivation of employees, which are discussed in courses on organizational behavior.

**Key Concepts**

- adhocracy
- administrative principles
- bureaucratic organizations
- chaos theory
- contextual dimensions
- contingency
- diversified form
- effectiveness
- efficiency
- entrepreneurial structure
- Hawthorne Studies
- learning organization
- level of analysis
- machine bureaucracy
- meso theory
- organization theory
- organizational behavior
- organizations
- professional bureaucracy
- role
- scientific management
- stakeholder
- stakeholder approach
- structural dimensions
- task
Discussion Questions

1. What is the definition of organization? Briefly explain each part of the definition.

2. Explain how Mintzberg’s five basic parts of the organization (Exhibit 1.6) fit together to perform needed functions. If an organization had to give up one of these five parts, such as during a severe downsizing, which one could it survive the longest without? Discuss.

3. A handful of companies on the Fortune 500 list are more than 100 years old, which is rare. What organizational characteristics do you think might explain 100-year longevity?

4. Based on what you know about the following organizations, how would you categorize them according to Mintzberg’s Five Organizational Types (Exhibit 1.7): General Electric? Facebook? Toyota Motor Corporation? Your college or university? A local consulting firm?

5. What is the difference between formalization and specialization? Do you think an organization high on one dimension would also be high on the other? Discuss.

6. What does contingency mean? What are the implications of contingency theory for managers?

7. What are the primary differences between an organization designed for efficient performance and one designed for learning and change? Which type of organization do you think would be easier to manage? Discuss.

8. Why is shared information so important in a learning organization as compared to an efficient-performance organization? Discuss how an organization’s approach to information sharing might be related to other elements of organization design, such as structure, tasks, strategy, and culture.

9. What are some differences one might expect among stakeholder expectations for a nonprofit organization versus a for-profit business? Do you think nonprofit managers have to pay more attention to stakeholders than do business managers? Discuss.

10. Early management theorists believed that organizations should strive to be logical and rational, with a place for everything and everything in its place. Discuss the pros and cons of this approach for today’s organizations.

Chapter 1 Workbook: Measuring Dimensions of Organizations*

Analyze two organizations along the following dimensions. Indicate where you think each organization would fall on each of the scales. Use an X to indicate the first organization and an * to show the second.

You may choose any two organizations you are familiar with, such as your place of work, the university, a student organization, your church or synagogue, or your family.

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Scale</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formalization</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>Many written rules</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Few rules</td>
</tr>
<tr>
<td>Specialization</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>Separate tasks and roles</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Overlapping tasks</td>
</tr>
<tr>
<td>Hierarchy</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>Tall hierarchy of authority</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Flat hierarchy of authority</td>
</tr>
<tr>
<td>Technology</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>Product</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Service</td>
</tr>
<tr>
<td>External Environment</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>Stable</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Unstable</td>
</tr>
<tr>
<td>Culture</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>Clear norms and values</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ambiguous norms and values</td>
</tr>
<tr>
<td>Professionalism</td>
<td>1 2 3 4 5 6 7 8 9 10</td>
<td>High professional training</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Low professional training</td>
</tr>
</tbody>
</table>
Chapter 1: Organizations and Organization Theory

### Case for Analysis: Perdue Farms Inc.: Responding to 21st Century Challenges*

#### Background and Company History

“I have a theory that you can tell the difference between those who have inherited a fortune and those who have made a fortune. Those who have made their own fortune forget not where they came from and are less likely to lose touch with the common man.” (Bill Sterling, Just Browsin’ column in Eastern Shore News, March 2, 1988)

The history of Perdue Farms is dominated by seven themes: quality, growth, geographic expansion, vertical integration, innovation, branding, and service. Arthur W. Perdue, a Railway Express agent and descendent of a French Huguenot family named Perdeaux, founded the company in 1920 when he left his job with Railway Express and entered the egg business full-time near the small town of Salisbury, Maryland. Salisbury is located in a region immortalized in James Michener’s *Chesapeake* that is alternately known as “the Eastern Shore” or “the DelMarVa Peninsula.” It includes parts of Delaware, Maryland and Virginia. Arthur Perdue’s only child, Franklin Parsons Perdue, was born in 1920.

A quick look at Perdue Farms’ mission statement (Exhibit 1.11) reveals the emphasis the company has always put on quality. In the 1920s, “Mr. Arthur,” as he was called, bought leghorn breeding stock from Texas to improve the quality of his flock. He soon expanded his egg market and began shipments to New York. Practicing small economies such as mixing his own chicken feed and using leather from his old shoes to make hinges for his chicken coops, he stayed out of debt and prospered. He tried to add a new chicken coop every year.

By 1940, Perdue Farms was already known for quality products and fair dealing in a tough, highly competitive market. The company began offering chickens for sale when Mr. Arthur realized that the future lay in selling chickens, not eggs. In 1944, Mr. Arthur made his son Frank a full partner in A.W. Perdue & Son Inc.

In 1950, Frank took over leadership of the company, which employed forty people. By 1952, revenues were $6 million from the sale of 2,600,000 broilers. During this period, the company began to vertically integrate, operating its own hatchery, starting to mix its own feed formulations, and operating its own feed mill. Also, in the 1950s, Perdue Farms began to contract with others to grow chickens for them. By furnishing the growers with peeps (baby chickens) and feed, the company was better able to control quality.

In the 1960s, Perdue Farms continued to vertically integrate by building its first grain receiving and storage facilities and Maryland’s first soybean processing plant. By 1967, annual sales had increased to about $35 million. But, it became clear to Frank that profits lay in processing chickens. Frank recalled in an interview for *BusinessWeek* (September 15, 1972) “processors were paying us 10¢ a live pound for what cost us 14¢ to produce. Suddenly, processors were making as much as 7¢ a pound.”

A cautious, conservative planner, Arthur Perdue had not been eager for expansion, and Frank Perdue was reluctant to enter poultry processing. But, economics forced his hand and, in 1968, the company bought its first processing plant, a Swift & Company operation in Salisbury.

From the first batch of chickens that it processed, Perdue’s standards were higher than those of the federal government. The state grader on the first batch has often told the story of how he was worried that he had rejected too many chickens as not Grade A. As he finished his inspections for that first day, he saw Frank Perdue headed his way and he could tell that Frank was not happy. Frank started inspecting the birds and never argued over one that was rejected. Next, he saw Frank start to go through the

#### Questions

1. What are the main differences between the two organizations you evaluated?

2. Would you recommend that one or both of the organizations have different ratings on any of the scales? Why?

---

*Copyright 1996 by Dorothy Marcic. All rights reserved.*
Stand on Tradition
Perdue was built upon a foundation of quality, a tradition described in our Quality Policy...

Our Quality Policy
“We shall produce products and provide services at all times which meet or exceed the expectations of our customers.”
“We shall not be content to be of equal quality to our competitors.”
“Our commitment is to be increasingly superior.”
“Contribution to quality is a responsibility shared by everyone in the Perdue organization.”

Focus on Today
Our mission reminds us of the purpose we serve...

Our Mission
“Enhance the quality of life with great food and agricultural products.”
While striving to fulfill our mission, we use our values to guide our decisions...

Our Values
• Quality: We value the needs of our customers. Our high standards require us to work safely, make safe food and uphold the Perdue name.
• Integrity: We do the right thing and live up to our commitments. We do not cut corners or make false promises.
• Trust: We trust each other and treat each other with mutual respect. Each individual’s skill and talent are appreciated.
• Teamwork: We value a strong work ethic and ability to make each other successful. We care what others think and encourage their involvement, creating a sense of pride, loyalty, ownership and family.

Look to the Future
Our vision describes what we will become and the qualities that will enable us to succeed...

Our Vision
“To be the leading quality food company with $20 billion in sales in 2020.”

Perdue in the Year 2020
• To our customers: We will provide food solutions and indispensable services to meet anticipated customer needs.
• To our consumers: A portfolio of trusted food and agricultural products will be supported by multiple brands throughout the world.
• To our associates: Worldwide, our people and our workplace will reflect our quality reputation, placing Perdue among the best places to work.
• To our communities: We will be known in the community as a strong corporate citizen, trusted business partner and favorite employer.
• To our shareholders: Driven by innovation, our market leadership and our creative spirit will yield industry-leading profits.
ones that the state grader had passed and began to toss some of them over with the rejected birds. Finally, realizing that few met his standards, Frank put all of the birds in the reject pile. Soon, however, the facility was able to process 14,000 Grade A broilers per hour.

From the beginning, Frank Perdue refused to permit his broilers to be frozen for shipping, arguing that it resulted in unappetizing black bones and loss of flavor and moistness when cooked. Instead, Perdue chickens were (and some still are) shipped to market packed in ice, justifying the company’s advertisements at that time that it sold only “fresh, young broilers.” However, this policy also limited the company’s market to those locations that could be serviced overnight from the Eastern Shore of Maryland. Thus, Perdue chose for its primary markets the densely populated towns and cities of the East Coast, particularly New York City, which consumes more Perdue chicken than all other brands combined.

Frank Perdue’s drive for quality became legendary both inside and outside the poultry industry. In 1985, Frank and Perdue Farms were featured in the book, A Passion for Excellence, by Tom Peters and Nancy Austin.

In 1970, Perdue established its primary breeding and genetic research programs. Through selective breeding, Perdue developed a chicken with more white breast meat than the typical chicken. Selective breeding has been so successful that Perdue Farms chickens are desired by other processors. Rumors have even suggested that Perdue chickens have been stolen on occasion in an attempt to improve competitor flocks.

In 1971, Perdue Farms began an extensive marketing campaign featuring Frank Perdue. In his early advertisements, he became famous for saying things like “If you want to eat as good as my chickens, you’ll just have to eat my chickens.” He is often credited with being the first to brand what had been a commodity product. During the 1970s, Perdue Farms also expanded geographically to areas north of New York City such as Massachusetts, Rhode Island, and Connecticut.

In 1977, “Mr. Arthur” died at the age of 91, leaving behind a company with annual sales of nearly $200 million, an average annual growth rate of 17 percent compared to an industry average of 1 percent a year, the potential for processing 78 thousand broilers per hour, and annual production of nearly 350 million pounds of poultry per year. Frank Perdue said of his father simply “I learned everything from him.”

In 1981, Frank Perdue was in Boston for his induction into the Babson College Academy of Distinguished Entrepreneurs, an award established in 1978 to recognize the spirit of free enterprise and business leadership. Babson College President Ralph Z. Sorenson inducted Perdue into the academy, which, at that time, numbered eighteen men and women from four continents. Perdue had the following to say to the college students:

“There are none, nor will there ever be, easy steps for the entrepreneur. Nothing, absolutely nothing, replaces the willingness to work earnestly, intelligently towards a goal. You have to be willing to pay the price. You have to have an insatiable appetite for detail, have to be willing to accept constructive criticism, to ask questions, to be financially responsible, to surround yourself with good people and, most of all, to listen.” (Frank Perdue, speech at Babson College, April 28, 1981)

The early 1980s saw Perdue Farms expand southward into Virginia, North Carolina, and Georgia. It also began to buy out other producers such as Carroll’s Foods, Purvis Farms, Shenandoah Valley Poultry Company, and Shenandoah Farms. The latter two acquisitions diversified the company’s markets to include turkey. New products included value-added items such as “Perdue Done It!,” a line of fully cooked fresh chicken products.

James A. (Jim) Perdue, Frank’s only son, joined the company as a management trainee in 1983 and became a plant manager. The late 1980s tested the mettle of the firm. Following a period of considerable expansion and product diversification, a consulting firm recommended that the company form several strategic business units, responsible for their own operations. In other words, the firm should decentralize. Soon after, the chicken market leveled off and then declined for a period. In 1988, the firm experienced its first year in the red. Unfortunately, the decentralization had created duplication and enormous administrative costs. The firm’s rapid plunge into turkeys and other food processing, where it had little experience, contributed to the losses. Characteristically, the company refocused, concentrating on efficiency of operations, improving communications throughout the company, and paying close attention to detail.

On June 2, 1989, Frank celebrated fifty years with Perdue Farms. At a morning reception in downtown Salisbury, the governor of Maryland proclaimed it “Frank Perdue Day.” The governors of Delaware and Virginia did the same. In 1991, Frank was named chairman of the Executive Committee and Jim Perdue became chairman of the board. Quieter, gentler, and more formally educated, Jim Perdue focused on operations, infusing the company with an even stronger devotion to quality control and a bigger commitment to strategic planning. Frank Perdue continued to do advertising and public relations. As Jim Perdue matured as the company leader, he took over the role of company spokesperson and began to appear in advertisements.

Under Jim Perdue’s leadership, the 1990s were dominated by market expansion south into Florida and west to Michigan and Missouri. In 1992, the international business segment was formalized, serving customers in Puerto Rico, South America, Europe, Japan, and China. By fiscal year 1998, international sales were $180 million per year. International markets are beneficial for the firm because U.S. customers prefer white meat, whereas customers in most other countries prefer dark meat.

Food-service sales to commercial customers has also become a major market. New retail product lines focus on value-added items, individually quick-frozen items, home-meal replacement items, and products for the delicatessen.
The “Fit & Easy” label continues as part of a nutrition campaign, using skinless, boneless chicken and turkey products.

The 1990s also saw the increased use of technology and the building of distribution centers to better serve the customer. For example, all over-the-road trucks were equipped with satellite two-way communications and geographic positioning, allowing real-time tracking, rerouting if needed, and accurately informing customers when to expect product arrival.

Currently, nearly 20,000 associates have increased revenues to more than $2.5 billion.

Management and Organization

“From 1950 until 1991, Frank Perdue was the primary force behind Perdue Farms growth and success. During Frank’s years as the company leader, the industry entered its high growth period. Industry executives had typically developed professionally during the industry’s infancy. Many had little formal education and started their careers in the barnyard, building chicken coops and cleaning them out. They often spent their entire careers with one company, progressing from supervisor of grow-out facilities to management of processing plants to corporate executive positions. Perdue Farms was not unusual in that respect. An entrepreneur through and through, Frank lived up to his marketing image of “it takes a tough man to make a tender chicken.” He mostly used a centralized management style that kept decision-making authority in his own hands or those of a few trusted, senior executives whom he had known for a lifetime. Workers were expected to do their jobs.

In later years, Frank increasingly emphasized employee (or “associates” as they are currently called) involvement in quality issues and operational decisions. This emphasis on employee participation undoubtedly eased the transfer of power in 1991 to his son, Jim, which appears to have been unusually smooth. Although Jim grew up in the family business, he spent almost fifteen years earning an undergraduate degree in biology from Wake Forest University, a master’s degree in marine biology from the University of Massachusetts at Dartmouth, and a doctorate in fisheries from the University of Washington in Seattle. Returning to Perdue Farms in 1983, he earned an EMBA from Salisbury State University and was assigned positions as plant manager, divisional quality control manager, and vice president of Quality Improvement Process (QIP) prior to becoming chairman.

Jim has a people-first management style. Company goals center on the three Ps: People, Products, and Profitability. He believes that business success rests on satisfying customer needs with quality products. It is important to put associates first, he says, because “If [associates] come first, they will strive to assure superior product quality—and satisfied customers.” This view has had a profound impact on the company culture, which is based on Tom Peters’s view that “Nobody knows a person’s 20 square feet better than the person who works there.” The idea is to gather ideas and information from everyone in the organization and maximize productivity by transmitting these ideas throughout the organization.

Key to accomplishing this “employees first” policy is workforce stability, a difficult task in an industry that employs a growing number of associates working in physically demanding and sometimes stressful conditions. A significant number of associates are Hispanic immigrants who may have a poor command of the English language, are sometimes undereducated, and often lack basic health care. In order to increase these associates’ opportunity for advancement, Perdue Farms focuses on helping them overcome these disadvantages.

For example, the firm provides English-language classes to help non-English-speaking associates assimilate. Ultimately associates can earn the equivalent of a high school diploma. To deal with physical stress, the company has an ergonomics committee in each plant that studies job requirements and seeks ways to redesign those jobs that put workers at the greatest risk. The company also has an impressive wellness program that currently includes clinics at ten plants. The clinics are staffed by professional medical people working for medical practice groups under contract to Perdue Farms. Associates have universal access to all Perdue-operated clinics and can visit a doctor for anything from a muscle strain to prenatal care to screening tests for a variety of diseases. Dependent care is available. While benefits to the employees are obvious, the company also benefits through a reduction in lost time for medical office visits, lower turnover, and a happier, healthier, more productive and stable work force.

Marketing

In the early days, chicken was sold to butcher shops and neighborhood groceries as a commodity; that is, producers sold it in bulk and butchers cut and wrapped it. The customer had no idea which firm grew or processed the chicken. Frank Perdue was convinced that higher profits could be made if the firm’s products could be sold at a premium price. But, the only reason a product can command a premium price is if customers ask for it by name—and that means the product must be differentiated and “branded.” Hence, the emphasis over the years on superior quality, broader-breasted chickens, and a healthy golden color (actually the result of adding marigold petals in the feed to enhance the natural yellow color that corn provided).

Today, branded chicken is ubiquitous. The new task for Perdue Farms is to create a unified theme to market a wide variety of products (e.g., both fresh meat and fully prepared and frozen products) to a wide variety of customers (e.g., retail, food service, and international). Industry experts believe that the market for fresh poultry has peaked while sales of value-added and frozen products continue to grow at a healthy rate. Although domestic retail sales accounted for about 60 percent of Perdue Farms’ revenues
in the 2000 fiscal year, food service sales now account for 20 percent, international sales account for 5 percent, and grain and oilseed contribute the remaining 15 percent. The company expects food service, international, and grain and oilseed sales to continue to grow as a percentage of total revenues.

**Domestic Retail**

Today’s retail grocery customer is increasingly looking for ease and speed of preparation; that is, value-added products. The move toward value-added products has significantly changed the meat department in the modern grocery store. There are now five distinct meat outlets for poultry:

1. The fresh meat counter—traditional, fresh meat—includes whole chicken and parts
2. The delicatessen—processed turkey, rotisserie chicken
3. The frozen counter—individually quick-frozen items such as frozen whole chickens, turkeys, and Cornish hens
4. Home meal replacement—fully prepared entrees such as Perdue brand “Short Cuts” and Deluca brand entrees (the Deluca brand was acquired and is sold under its own name) that are sold along with salads and desserts so that you can assemble your own dinner
5. Shelf stable—canned products

Because Perdue Farms has always used the phrase “fresh young chicken” as the centerpiece of its marketing, value-added products and the retail frozen counter create a possible conflict with past marketing themes. Are these products compatible with the company’s marketing image, and, if so, how does the company express the notion of quality in this broader product environment? To answer that question, Perdue Farms has been studying what the term “fresh young chicken” means to customers who consistently demand quicker and easier preparation and who admit that they freeze most of their fresh meat purchases once they get home. One view is that the importance of the term “fresh young chicken” comes from the customer’s perception that “quality” and “freshness” are closely associated. Thus, the real issue may be trust; that is, the customer must believe that the product, whether fresh or frozen, is the freshest, highest quality possible, and future marketing themes must develop that concept.

**Operations**

Two words sum up the Perdue approach to operations—quality and efficiency—with emphasis on the first over the latter. Perdue, more than most companies, represents the Total Quality Management (TQM) slogan, “Quality, a journey without end.” Some of the key events in Perdue’s quality improvement process are listed in Exhibit 1.12.

**EXHIBIT 1.12**

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1924</td>
<td>Arthur Perdue bought leghorn roosters for $25</td>
</tr>
<tr>
<td>1950</td>
<td>Adopted the company logo of a chick under a magnifying glass</td>
</tr>
<tr>
<td>1984</td>
<td>Frank Perdue attended Philip Crosby’s Quality College</td>
</tr>
<tr>
<td>1985</td>
<td>Perdue recognized for its pursuit of quality in <em>A Passion for Excellence</em></td>
</tr>
<tr>
<td></td>
<td>— 200 Perdue managers attended Quality College</td>
</tr>
<tr>
<td></td>
<td>— Adopted the Quality Improvement Process (QIP)</td>
</tr>
<tr>
<td>1986</td>
<td>Established Corrective Action Teams (CAT’s)</td>
</tr>
<tr>
<td>1987</td>
<td>Established Quality Training for all associates</td>
</tr>
<tr>
<td></td>
<td>— Implemented Error Cause Removal Process (ECR)</td>
</tr>
<tr>
<td>1988</td>
<td>Steering Committee formed</td>
</tr>
<tr>
<td>1989</td>
<td>First Annual Quality Conference held</td>
</tr>
<tr>
<td></td>
<td>— Implemented Team Management</td>
</tr>
<tr>
<td>1990</td>
<td>Second Annual Quality Conference held</td>
</tr>
<tr>
<td></td>
<td>— Codified Values and Corporate Mission</td>
</tr>
<tr>
<td>1991</td>
<td>Third Annual Quality Conference held</td>
</tr>
<tr>
<td></td>
<td>— Customer Satisfaction defined</td>
</tr>
<tr>
<td>1992</td>
<td>Fourth Annual Quality Conference held</td>
</tr>
<tr>
<td></td>
<td>— How to implement Customer Satisfaction explained to team leaders and</td>
</tr>
<tr>
<td></td>
<td>Quality Improvement Teams (QIT)</td>
</tr>
<tr>
<td></td>
<td>— Created Quality Index</td>
</tr>
<tr>
<td></td>
<td>— Created Customer Satisfaction Index (CSI)</td>
</tr>
<tr>
<td></td>
<td>— Created “Farm to Fork” quality program</td>
</tr>
<tr>
<td>1999</td>
<td>Launched Raw Material Quality Index</td>
</tr>
<tr>
<td>2000</td>
<td>Initiated High Performance Team Process</td>
</tr>
</tbody>
</table>
Both quality and efficiency are improved through the management of details. Exhibit 1.13 depicts the structure and product flow of a generic, vertically integrated broiler company. A broiler company can choose which steps in the process it wants to accomplish in-house and which it wants suppliers to provide. For example, the broiler company could purchase all grain, oilseed, meal, and other feed products. Or it could contract with hatcheries to supply primary breeders and hatchery supply flocks.

Perdue Farms chose maximum vertical integration to control every detail. It breeds and hatches its own eggs (19 hatcheries), selects its contract growers, builds Perdue-engineered chicken houses, formulates and manufactures its own feed (12 poultry feedmills, 1 specialty feedmill, 2 ingredient-blending operations), oversees the care and feeding of the chicks, operates its own processing plants (21 processing and further processing plants), distributes via its own trucking fleet, and markets the products (see Exhibit 1.13). Total process control formed the basis for Frank Perdue’s early claims that Perdue Farms poultry is, indeed, higher quality than other poultry. When he stated in his early ads that “A chicken is what it eats...I store my own grain and mix my own feed...and give my Perdue chickens nothing but well water to drink...,” he knew that his claim was honest and he could back it up.

Total process control also enables Perdue Farms to ensure that nothing goes to waste. Eight measurable items—hatchability, turnover, feed conversion, livability, yield, birds per man-hour, utilization, and grade—are tracked routinely.

Perdue Farms continues to ensure that nothing artificial is fed to or injected into the birds. No shortcuts are taken. A chemical-free and steroid-free diet is fed to the chickens. Young chickens are vaccinated against disease. Selective breeding is used to improve the quality of the chicken stock. Chickens are bred to yield more white breast meat because that is what the consumer wants.

To ensure that Perdue Farms poultry continues to lead the industry in quality, the company buys and analyzes competitors’ products regularly. Inspection associates grade these products and share the information with the highest levels of management. In addition, the company’s Quality Policy is displayed at all locations and taught to all associates in quality training (Exhibit 1.14).

**Research and Development**

Perdue is an acknowledged industry leader in the use of research and technology to provide quality products and service to its customers. The company spends more on research as a percent of revenues than any other poultry processor. This practice goes back to Frank Perdue’s focus on finding ways to differentiate his products based on quality and value. It was research into selective breeding that resulted in the broader breast, an attribute of Perdue Farms chicken that was the basis of his early advertising. Although other processors have also improved their stock, Perdue Farms believes that it still leads the industry. A list of some of Perdue Farms technological accomplishments is given in Exhibit 1.15.

As with every other aspect of the business, Perdue Farms tries to leave nothing to chance in R&D. The company employs specialists in avian science, microbiology, genetics, nutrition, and veterinary science. Because of its R&D capabilities, Perdue Farms is often involved in United States Drug Administration (USDA) field tests with pharmaceutical suppliers. Knowledge and experience gained from these tests can lead to a competitive advantage. For example, Perdue has the most extensive and expensive vaccination program in the industry. Currently, the company is working with and studying the practices of several European producers who use completely different methods.

The company has used research to significantly increase productivity. For example, in the 1950s, it took fourteen weeks to grow a 3 pound chicken. Today, it takes only seven weeks to grow a 5 pound chicken. This gain in efficiency is due principally to improvements in the conversion rate of feed to chicken. Feed represents about 65 percent of the cost of growing a chicken. Thus, if additional research can further improve the conversion rate of feed to chicken by just 1 percent, it would represent estimated additional income of $2.5–3 million per week or $130–156 million per year.

**Environment**

Environmental issues present a constant challenge to all poultry processors. Growing, slaughtering, and processing poultry is a difficult and tedious process that demands absolute efficiency to keep operating costs at an acceptable level. Inevitably, detractors argue that the process is dangerous to workers, inhumane to the poultry, hard on the environment, and results in food that may not be safe. Thus, media headlines such as “Human Cost of Poultry Business Bared,” “Animal Rights Advocates Protest Chicken Coop Conditions,” “Processing Plants Leave Toxic Trail,” or “EPA Mandates Poultry Regulations” are routine.

Perdue Farms tries to be proactive in managing environmental issues. In April 1993, the company created an Environmental Steering Committee. Its mission is “...to provide all Perdue Farms work sites with vision, direction, and leadership so that they can be good corporate citizens from an environmental perspective today and in the future.” The committee is responsible for overseeing how the company is doing in such environmentally sensitive areas as waste water, storm water, hazardous waste, solid waste, recycling, bio-solids, and human health and safety.

For example, disposing of dead birds has long been an industry problem. Perdue Farms developed small composters for use on each farm. Using this approach,
Chapter 1: Organizations and Organization Theory

Perdue Farms
Integrated Operations

EXHIBIT 1.13
Perdue Farms’ Integrated Operations
WE SHALL not be content to be of equal quality to our competitors.

OUR COMMITMENT is to be increasingly superior.

CONTRIBUTION TO QUALITY is a responsibility shared by everyone in the Perdue organization.

CONDUCTS more research than all competitors combined

Breeds chickens with consistently more breast meat than any other bird in the industry

First to use digital scales to guarantee weights to customers

First to package fully-cooked chicken products in microwaveable trays

First to have a box lab to define quality of boxes from different suppliers

First to test both its chickens and competitors’ chickens on 52 quality factors every week

Improved on-time deliveries 20% between 1987 and 1993

Built state of the art analytical and microbiological laboratories for feed and end product analysis

First to develop best management practices for food safety across all areas of the company

First to develop commercially viable pelletized poultry litter

carcasses are reduced to an end-product that resembles soil in a matter of a few days. The disposal of hatchery waste is another environmental challenge. Historically, manure and unhatched eggs were shipped to a landfill. However, Perdue Farms developed a way to reduce the waste by 50 percent by selling the liquid fraction to a pet-food processor that cooks it for protein. The other 50 percent is recycled through a rendering process. In 1990, Perdue Farms spent $4.2 million to upgrade its existing treatment facility with a state-of-the-art system at its Accomac, Virginia, and Showell, Maryland, plants. These facilities use forced hot air heated to 120 degrees to cause the microbes to digest all traces of ammonia, even during the cold winter months.

More than ten years ago, North Carolina’s Occupational Safety and Health Administration cited Perdue Farms for an unacceptable level of repetitive stress injuries at its Lewiston and Robersonville, North Carolina, processing plants. This sparked a major research program in which Perdue Farms worked with Health and Hygiene Inc. of Greensboro, North Carolina, to learn more about ergonomics, the repetitive movements required to accomplish specific jobs. Results have been dramatic. Launched in 1991 after two years of development, the program videotapes employees at all of Perdue Farms’ plants as they work in order to describe and place stress values on various tasks. Although the cost to Perdue Farms has been significant, results have been dramatic with workers’ compensation claims down 44 percent, lost-time recordables just 7.7 percent of the industry average, an 80 percent decrease in serious repetitive stress cases, and a 50 percent reduction in lost time for surgery for back injuries (Shelley Reese, “Helping Employees get a Grip,” Business and Health, August 1998).

Despite these advances, serious problems continue to develop. Some experts have called for conservation measures that might limit the density of chicken houses in a given area or even require a percentage of existing chicken houses to be taken out of production periodically. Obviously this would be very hard on the farm families who own existing chicken houses and could result in fewer acres devoted to agriculture. Working with AgriRecycle Inc. of Springfield, Missouri, Perdue Farms has developed a possible solution. The plan envisions the poultry companies processing excess manure into pellets for use as fertilizer. This would permit sales outside the poultry growing region, better balancing the input of grain. Spokesmen estimate that as much as 120,000 tons, nearly one-third of the surplus nutrients from manure produced each year on the DelMarVa Peninsula, could be sold to corn growers in other parts of the country. Prices would be market driven but could be $25 to $30 per ton, suggesting a potential, small profit. Still, almost any attempt to control the problem potentially raises the cost of growing chickens, forcing...
poultry processors to look elsewhere for locations where the chicken population is less dense.

In general, solving industry environmental problems presents at least five major challenges to the poultry processor:

- How to maintain the trust of the poultry consumer
- How to ensure that the poultry remain healthy
- How to protect the safety of the employees and the process
- How to satisfy legislators who need to show their constituents that they are taking firm action when environmental problems occur
- How to keep costs at an acceptable level

Jim Perdue sums up Perdue Farms’ position as follows: “...we must not only comply with environmental laws as they exist today, but look to the future to make sure we don’t have any surprises. We must make sure our environmental policy statement [see Exhibit 1.16] is real, that there’s something behind it and that we do what we say we’re going to do.”

**Logistics and Information Systems**

The explosion of poultry products and increasing number of customers during recent years placed a severe strain on the existing logistics system, which was developed at a time when there were far fewer products, fewer delivery points, and lower volume. Hence, the company had limited ability to improve service levels, could not support further growth, and could not introduce innovative services that might provide a competitive advantage.

In the poultry industry, companies are faced with two significant problems—time and forecasting. Fresh poultry has a limited shelf life—measured in days. Thus forecasts must be extremely accurate and deliveries must be timely. On one hand, estimating requirements too conservatively results in product shortages. Mega-customers such as Wal-Mart will not tolerate product shortages that lead to empty shelves and lost sales. On the other hand, if estimates are overstated, the result is outdated products that cannot be sold and losses for Perdue Farms. A common expression in the poultry industry is “you either sell it or smell it.”

Forecasting has always been extremely difficult in the poultry industry because the processor needs to know approximately eighteen months in advance how many broilers will be needed in order to size hatchery supply flocks and contract with growers to provide live broilers. Most customers (e.g., grocers and food-service buyers) have a much shorter planning window. Additionally, there is no way for Perdue Farms to know when rival poultry processors will put a particular product on special, reducing Perdue Farms sales, or when bad weather and other uncontrollable problems may reduce demand.

In the short run, information technology (IT) has helped by shortening the distance between the customer and Perdue Farms. As far back as 1987, personal computers (PCs) were placed directly on each customer-service associate’s desk, allowing the associate to enter customer orders directly. Next, a system was developed to put dispatchers in direct contact with every truck in the system so that they would have accurate information about product inventory and truck location at all times. Now, IT is moving to further shorten the distance between the customer and the Perdue Farms service representative by putting a PC on the customer’s desk. All of these steps improve communication and shorten the time from order to delivery.

To control the entire supply chain management process, Perdue Farms purchased a multi-million-dollar information technology system that represents the biggest nontangible asset expense in the company’s history. This integrated, state-of-the-art information system required total process re-engineering, a project that took eighteen months and required training 1,200 associates. Major goals of the system were to (1) make it easier and more desirable for the customer to do business with Perdue Farms, (2) make it easier for Perdue Farms associates to get the job done, and (3) take as much cost out of the process as possible.

**Industry Trends**

The poultry industry is affected by consumer, industry, and governmental regulatory trends. Currently, chicken is the number one meat consumed in the United States, with a 40 percent market share. The typical American consumes about 81 pounds of chicken, 69 pounds of beef, and 52 pounds of pork annually (USDA data). Additionally, chicken is becoming the most popular meat in the world. In 1997, poultry set an export record of $2.5 billion. Although exports fell 6 percent in 1998, the decrease was attributed to Russia’s and Asia’s financial crisis, and food-industry experts expected this to be only a temporary setback. Hence, the world market is clearly a growth opportunity for the future.

Government agencies whose regulations impact the industry include the Occupational Safety and Health Administration (OSHA) for employee safety and the Immigration and Naturalization Service (INS) for undocumented workers. OSHA enforces its regulations via periodic inspections, and levies fines when noncompliance is found. For example, a Hudson Foods poultry plant was fined more than a million dollars for alleged willful violations causing ergonomic injury to workers. The INS also uses periodic inspections to find undocumented workers. It estimates that undocumented aliens working in the industry vary from 3 to 78 percent of the workforce at individual plants. Plants that are found to use undocumented workers, especially those that are repeat offenders, can be heavily fined.
Perdue Farms is committed to environmental stewardship and shares that commitment with its farm family partners. We’re proud of the leadership we’re providing our industry in addressing the full range of environmental challenges related to animal agriculture and food processing. We’ve invested—and continue to invest—millions of dollars in research, new technology, equipment upgrades, and awareness and education as part of our ongoing commitment to protecting the environment.

- Perdue Farms was among the first poultry companies with a dedicated Environmental Services department. Our team of environmental managers is responsible for ensuring that every Perdue facility operates within 100 percent compliance of all applicable environmental regulations and permits.

- Through our joint venture, Perdue AgriRecycle, Perdue Farms is investing $12 million to build in Delaware a first-of-its-kind pellet plant that will convert surplus poultry litter into a starter fertilizer that will be marketed internationally to nutrient deficient regions. The facility, which will serve the entire DelMarVa region, is scheduled to begin operation in April, 2001.

- We continue to explore new technologies that will reduce water usage in our processing plants without compromising food safety or quality.

- We invested thousands of man-hours in producer education to assist our family farm partners in managing their independent poultry operations in the most environmentally responsible manner possible. In addition, all our poultry producers are required to have nutrient management plans and dead-bird composters.

- Perdue Farms was one of four poultry companies operating in Delaware to sign an agreement with Delaware officials outlining our companies’ voluntary commitment to help independent poultry producers dispose of surplus chicken litter.

- Our Technical Services department is conducting ongoing research into feed technology as a means of reducing the nutrients in poultry manure. We’ve already achieved phosphorous reductions that far exceed the industry average.

- We recognize that the environmental impact of animal agriculture is more pronounced in areas where development is decreasing the amount of farmland available to produce grain for feed and to accept nutrients. That is why we view independent grain and poultry producers as vital business partners and strive to preserve the economic viability of the family farm.

At Perdue Farms, we believe that it is possible to preserve the family farm; provide a safe, abundant and affordable food supply; and protect the environment. However, we believe that can best happen when there is cooperation and trust between the poultry industry, agriculture, environmental groups and state officials. We hope Delaware’s effort will become a model for other states to follow.
The Future
The marketplace for poultry in the twenty-first century will be very different from that of the past. Understanding the wants and needs of generation Xers and echo-boomers will be key to responding successfully to these differences.

Quality will continue to be essential. In the 1970s, quality was the cornerstone of Frank Perdue’s successful marketing program to “brand” his poultry. However, in the twenty-first century, quality will not be enough. Today’s customers expect—even demand—all products to be high quality. Thus, Perdue Farms plans to use customer service to further differentiate the company. The focus will be on learning how to become indispensable to the customer by taking cost out of the product and delivering exactly the way the customer wants it, where and when the customer wants it. In short, as Jim Perdue says, “Perdue Farms wants to become so easy to do business with that the customer will have no reason to do business with anyone else.”

Acknowledgements: The authors are indebted to Frank Perdue, Jim Perdue, and the numerous associates at Perdue Farms, who generously shared their time and information about the company. In addition, the authors would like to thank the anonymous librarians at Blackwell Library, Salisbury State University, who routinely review area newspapers and file articles about the poultry industry—the most important industry on the DelMarVa Peninsula. Without their assistance, this case would not be possible.

*Adapted from George C. Rubenson and Frank M. Shipper, Department of Management and Marketing, Franklin P. Perdue School of Business, Salisbury University. Copyright 2001 by the authors.

Notes


36. Tusi, “A Multiple-Constituency Model of Effectiveness.”

37. Fombrun and Shanley, “What’s in a Name?”


45. Dunbar and Starbuck, “Learning to Design Organizations.”
48. This discussion is based in part on Toby J. Tetenbaum, “Shifting Paradigms: From Newton to Chaos,” *Organizational Dynamics* (Spring 1998), 21–32.
Part 2
Organizational Purpose and Structural Design

Chapter 2
Strategy, Organization Design, and Effectiveness

Chapter 3
Fundamentals of Organization Structure
Chapter 2

Strategy, Organization Design, and Effectiveness

The Role of Strategic Direction in Organization Design

Organizational Purpose
  - Strategic Intent • Operative Goals • The Importance of Goals

A Framework for Selecting Strategy and Design
  - Porter’s Competitive Forces and Strategies • Miles and Snow’s Strategy Typology • How Strategies Affect Organization Design • Other Factors Affecting Organization Design

Assessing Organizational Effectiveness

Traditional Effectiveness Approaches
  - Goal Indicators • Resource-based Indicators • Internal Process Indicators

The Balanced Scorecard Approach to Effectiveness

Design Essentials
One of the primary responsibilities of managers is to position their organizations for success by establishing goals and strategies that can keep the organization competitive. Consider MySpace. It started as a social networking site, but managers’ new goal is to make it a “social portal,” of which networking is only a part. MySpace has plenty of users, but revenues haven’t been rolling in as quickly as top executives at parent company Fox Interactive Media (owned by News Corporation) would like. To meet tough revenue goals, the company’s co-founders, CEO Chris DeWolfe and President Tom Anderson, are expanding MySpace into user-generated videos, global marketing partnerships with big-name brands such as McDonald’s, Harley-Davidson, and State Farm Insurance, and a joint venture with major music companies. Other goals include beefing up the company’s mobile business and revamping the website to make it both easier to use and more hospitable to advertising. Yet, even as this text is being written, goals and strategic direction might be changing at MySpace. “We are a company that needs to move fast,” says Anderson. 1

Purpose of This Chapter

Top managers give direction to organizations. They set goals and develop the plans for their organization to attain them. The purpose of this chapter is to help you understand the types of goals that organizations pursue and some of the competitive strategies managers use to reach those goals. We will provide an overview of strategic management, examine two significant frameworks for determining strategic action, and look at how strategies affect organization design. The chapter also describes the most popular approaches to measuring the effectiveness of organizational efforts. To manage organizations well, managers need a clear sense of how to measure effectiveness.
THE ROLE OF STRATEGIC DIRECTION
IN ORGANIZATION DESIGN

An organizational goal is a desired state of affairs that the organization attempts to reach.\(^2\) A goal represents a result or end point toward which organizational efforts are directed. The choice of goals and strategy influences how the organization should be designed.

Top executives decide the end purpose the organization will strive for and determine the direction it will take to accomplish it. It is this purpose and direction that shapes how the organization is designed and managed. Indeed, the primary responsibility of top management is to determine an organization’s goals, strategy, and design, therein adapting the organization to a changing environment.\(^3\) Middle managers do much the same thing for major departments within the guidelines provided by top management. Exhibit 2.1 illustrates the relationships through which top managers provide direction and then design.

The direction-setting process typically begins with an assessment of the opportunities and threats in the external environment, including the amount of change, uncertainty, and resource availability, which we discuss in more detail in Chapter 4. Top managers also assess internal strengths and weaknesses to define the company’s distinctive competence compared with other firms in the industry. This competitive analysis of the internal and external environments is one of the central concepts in strategic management.\(^4\)

1 A company’s strategic intent or direction reflects managers’ systematic analysis of organizational and environmental factors.

**ANSWER:** Agree. The best strategies come from systematic analysis of organizational strengths and weaknesses combined with analysis of opportunities and threats in the environment. Careful study combined with experience enable top managers to decide on specific goals and strategies.

The next step is to define and articulate the organization’s strategic intent. This includes defining an overall mission and official goals based on the correct fit between external opportunities and internal strengths. Leaders then formulate specific operational goals and strategies that define how the organization is to accomplish its overall mission. In Exhibit 2.1, organization design reflects the way goals and strategies are implemented so that the organization’s attention and resources are consistently focused toward achieving the mission and goals.

Organization design is the administration and execution of the strategic plan. Organization direction is implemented through decisions about structural form, including whether the organization will be designed for a learning or an efficiency orientation, as discussed in Chapter 1, as well as choices about information and control systems, the type of production technology, human resource policies, culture, and linkages to other organizations. Changes in structure, technology, human resource policies, culture, and interorganizational linkages will be discussed in subsequent chapters. Also note the arrow in Exhibit 2.1 running from organization design back to strategic intent. This means that strategies are often made within the
current structure of the organization, so that current design constrains, or puts limits on, goals and strategy. More often than not, however, the new goals and strategy are selected based on environmental needs, and then top management attempts to redesign the organization to achieve those ends.

Finally, Exhibit 2.1 illustrates how managers evaluate the effectiveness of organizational efforts—that is, the extent to which the organization realizes its goals. This chart reflects the most popular ways of measuring performance, each of which is discussed later in this chapter. It is important to note here that performance measurements feed back into the internal environment, so that past performance of the organization is assessed by top management in setting new goals and strategic direction for the future.

The role of top management is important because managers can interpret the environment differently and develop different goals. For example, a new CEO at Borders Group believed the book retailer was missing an opportunity by emphasizing its bricks and mortar stores while paying little attention to the online world of book retailing. When George Jones took over as CEO, he quickly saw e-commerce as “a necessary component of our business.” Borders ended its alliance with Amazon.com and reopened its own branded website. This gave Borders Rewards members the chance to earn benefits online, which they weren’t able to do through Amazon. Aiming to become a force in online bookselling, Borders abandoned its strategy of

---

expanding the book superstore concept, selling off most of its overseas stores and closing numerous stores in the United States.\(^5\)

The choices top managers make about goals, strategies, and organization design have a tremendous impact on organizational effectiveness. Remember that goals and strategy are not fixed or taken for granted. Top managers and middle managers must select goals for their respective units, and the ability to make good choices largely determines firm success. Organization design is used to implement goals and strategy and also determines organization success.

**ORGANIZATIONAL PURPOSE**

All organizations, including MySpace, Johnson & Johnson, Google, Harvard University, the Catholic Church, the U.S. Department of Agriculture, the local laundry, and the neighborhood deli, exist for a purpose. This purpose may be referred to as the overall goal, or mission. Different parts of the organization establish their own goals and objectives to help meet the overall goal, mission, or purpose of the organization.

**Strategic Intent**

Many types of goals exist in organizations, and each type performs a different function. However, to achieve success, organizational goals and strategies are focused with strategic intent. **Strategic intent** means that all the organization’s energies and resources are directed toward a focused, unifying, and compelling overall goal.\(^6\) Examples of ambitious goals that demonstrate strategic intent are Komatsu’s vision to “Encircle Caterpillar,” Canon’s to “Beat Xerox,” and Coca-Cola’s “To put a Coke within ‘arm’s reach’ of every consumer in the world.”\(^7\) Strategic intent provides a focus for management action. Three aspects related to strategic intent are the mission, core competence, and competitive advantage.

**Mission.** The overall goal for an organization is often called the **mission**—the organization’s reason for existence. The mission describes the organization’s shared values and beliefs and its reason for being. The mission is sometimes called the **official goals,** which refers to the formally stated definition of business scope and outcomes the organization is trying to achieve. Official goal statements typically define business operations and may focus on values, markets, and customers that distinguish the organization. Whether called a mission statement or official goals, the organization’s general statement of its purpose and philosophy is often written down in a policy manual or the annual report. The mission statement for State Farm is shown in Exhibit 2.2 Note how the overall mission, values, and vision are all defined.

One of the primary purposes of a mission statement is to serve as a communication tool.\(^8\) The **mission statement** communicates to current and prospective employees, customers, investors, suppliers, and competitors what the organization stands for and what it is trying to achieve. A mission statement communicates legitimacy to internal and external stakeholders, who may join and be committed to the organization because they identify with its stated purpose and vision. Most top leaders want employees, customers, competitors, suppliers, investors, and the local community to look on them in a favorable light, and the concept of legitimacy plays a critical role.\(^9\) In today’s corporate world of weakened trust, increasing regulation, and concern for the natural environment, many organizations face the need to redefine their...
mission to emphasize the firm’s purpose in more than financial terms. Companies where managers are sincerely guided by mission statements that focus on a larger social purpose, such as Medtronic’s “To restore people to full life and health” or Liberty Mutual’s “Helping people live safer, more secure lives,” typically attract better employees, have better relationships with external parties, and perform better in the marketplace over the long term.

**Competitive Advantage.** The overall aim of strategic intent is to help the organization achieve a sustainable competitive advantage. Competitive advantage refers to what sets the organization apart from others and provides it with a distinctive edge for meeting customer or client needs in the marketplace. Strategy necessarily changes over time to fit environmental conditions, and good managers pay close attention to trends that might require changes in how the company operates. Managers analyze competitors and the internal and external environments to find potential competitive openings and learn what new capabilities the organization needs to gain the upper hand against other companies in the industry. Consider how managers at Walgreens are shifting their goals and strategy to maintain a competitive advantage.

For decades, Walgreens has succeeded with strategic goals of opening conveniently located stores faster than competitors and filling more prescriptions than any other drugstore chain. Recently, though, faced with the increased competitiveness of rivals and a weakened U.S. economy, the chain’s managers began looking for competitive openings that could keep the company growing.

Rather than just selling prescriptions, Walgreens is redefining its strategic intent to become a broad health care provider. It began by opening pharmacies in hospitals and (continued)
assisted living facilities and by offering flu shots and other immunizations in its stores. Then, the company established Take Care Health Clinics to provide basic health services inside 136 Walgreens stores. Now, managers are moving aggressively into the health care industry by buying firms that operate health care centers at large corporations. These centers provide everything from treating simple illnesses to counseling employees on managing chronic diseases. Walgreens’ managers see a tremendous opportunity. “In the U.S., there are more than 7,600 office sites with 1,000 or more employees that could support a health-care center,” CEO Jeffrey Rein said.

Rein envisions Walgreens bringing together its various operations—basic prescription services, in-store clinics, specialty pharmaceuticals, and workplace health care centers—using electronic prescriptions and medical records, so that the company will meet a broad range of customers’ health care needs.13

Strong customer service and top-notch pharmacist knowledge have always been key strengths for Walgreens. Now these competencies are being applied on a broader scale as the company moves into the larger health care industry. As at Walgreens, managers strive to develop strategies that focus on their core competencies in order to attain a competitive advantage.

Core Competence. A company’s core competence is something the organization does especially well in comparison to its competitors. A core competence may be in the area of superior research and development, expert technological know-how, process efficiency, or exceptional customer service.14 At VF, a large apparel company that owns Vanity Fair, Nautica, Wrangler, and The North Face, strategy focuses on the company’s core competencies of operational efficiency and merchandising know-how. When VF bought The North Face, for example, its distribution systems were so poor that stores were getting ski apparel at the end of winter and camping gear at the end of summer. The company’s operating profit margin was minus 35 percent. Managers at VF revamped The North Face’s sourcing, distribution, and financial systems and within five years doubled sales to $500 million and improved profit margins to a healthy 13 percent.15 Gaylord Hotels, which has large hotel and conference centers in several states as well as the Opryland complex near Nashville, Tennessee, thrives based on a core competence of providing exceptional service for large group meetings.16 Robinson Helicopter succeeds through superior technological know-how for building small, two-seater helicopters used for everything from police patrols in Los Angeles to herding cattle in Australia.17 In each case, leaders identified what their company does especially well and built the strategy around it.

Operative Goals

The organization’s mission and overall goals provide a basis for developing more specific operative goals. Operative goals designate the ends sought through the actual operating procedures of the organization and explain what the organization is actually trying to do.18 Operative goals describe specific measurable outcomes and are often concerned with the short run. Operative goals typically pertain to the primary tasks an organization must perform.19 Specific goals for each primary task provide direction for the day-to-day decisions and activities within departments. Typical operative goals include performance goals, resource goals, market goals, employee development goals, productivity goals, and goals for innovation and change.
Overall Performance. Profitability reflects the overall performance of for-profit organizations. Profitability may be expressed in terms of net income, earnings per share, or return on investment. Other overall performance goals are growth and output volume. Growth pertains to increases in sales or profits over time. Volume pertains to total sales or the amount of products or services delivered. For example, Jelly Belly Candy Company, which practically created the market for gourmet jelly beans, has a goal of increasing sales by 25 percent to $200 million by 2010. Related goals include introducing new lines of candies as well as getting Jelly Belly beans into more retail outlets.20

Government and nonprofit organizations such as social service agencies or labor unions do not have goals of profitability, but they do have goals that attempt to specify the delivery of services to clients or members within specified expense levels. The Internal Revenue Service has a goal of providing accurate responses to 85 percent of taxpayer questions about new tax laws. Growth and volume goals also may be indicators of overall performance in nonprofit organizations. Expanding their services to new clients is a primary goal for many social service agencies, for example.

Resources. Resource goals pertain to the acquisition of needed material and financial resources from the environment. They may involve obtaining financing for the construction of new plants, finding less expensive sources for raw materials, or hiring top-quality technology graduates. Resource goals for Stanford University include attracting top-notch professors and students. Auto manufacturers such as Honda Motor Company and Toyota Motor Corporation have resource goals of obtaining high-quality auto parts at low cost. For nonprofit organizations, resource goals might include recruiting dedicated volunteers and expanding the organization’s funding base.

Market. Market goals relate to the market share or market standing desired by the organization. Market goals are largely the responsibility of marketing, sales, and advertising departments. In the toy industry, Canada’s Mega Bloks Inc. achieved its market goal of doubling its share of the toy building block market to 30 percent. The giant of the industry, Denmark’s LEGO Group, is reevaluating strategies to try to regain the market share it has lost.21 Market goals can also apply to nonprofit organizations. Cincinnati Children’s Hospital Medical Center, not content with a limited regional role in health care, has gained a growing share of the national market by developing expertise in the niche of treating rare and complex conditions and relentlessly focusing on quality.22

Employee Development. Employee development pertains to the training, promotion, safety, and growth of employees. It includes both managers and workers. Strong employee development goals are one of the characteristics common to organizations that regularly show up on Fortune magazine’s list of “100 Best Companies to Work For.” For example, family-owned Wegmans Food Markets, which has appeared on the list every year since its inception and was voted the nation’s top supermarket chain by the Food Network in 2007, has a motto of “Employees First, Customers Second,” reflecting the company’s emphasis on employee development goals.23

Productivity. Productivity goals concern the amount of output achieved from available resources. They typically describe the amount of resource inputs required to
reach desired outputs and are thus stated in terms of “cost for a unit of production,” “units produced per employee,” or “resource cost per employee.” Managers at Akamai Technologies, which sells Web content delivery services, keep a close eye on sales per employee to see if the company is meeting productivity goals. Akamai’s chief financial officer, Timothy Weller, sees this statistic as “the single easiest measure of employee productivity."24

**Innovation and Change.** Innovation goals pertain to internal flexibility and readiness to adapt to unexpected changes in the environment. Innovation goals are often defined with respect to the development of specific new services, products, or production processes. Procter & Gamble is taking a new approach to innovation that brings in ideas from outside entrepreneurs and researchers. Managers set a goal of getting 50 percent of the company’s innovation from outside the organization by 2010, up from about 35 percent in 2004 and only 10 percent in 2000.25

Successful organizations use a carefully balanced set of operative goals. Although profitability goals are important, some of today’s best companies recognize that a single-minded focus on bottom-line profits may not be the best way to achieve high performance. Innovation and change goals are increasingly important, even though they may initially cause a decrease in profits. Employee development goals are critical for helping to maintain a motivated, committed workforce.

**The Importance of Goals**

Both official goals and operative goals are important for the organization, but they serve very different purposes. Official goals and mission statements describe a value system for the organization and set an overall purpose and vision; operative goals represent the primary tasks of the organization. Official goals legitimize the organization; operative goals are more explicit and well defined.

Operative goals serve several specific purposes, as outlined in Exhibit 2.3. For one thing, goals provide employees with a sense of direction, so that they know what they are working toward. This can help to motivate employees toward specific targets and important outcomes. Numerous studies have shown that specific high goals can significantly increase employee performance.26 People like having a focus for their activities and efforts. Consider Guitar Center, a fast-growing retailer in the United States. Managers establish specific goals for sales teams at every Guitar Center store each morning, and employees do whatever they need to, short of losing the company money, to meet the targets. Guitar Center’s unwritten mantra of “Take the deal” means that salespeople are trained to take any profitable deal, even at razor-thin margins, to meet daily sales goals.27
Another important purpose of goals is to act as guidelines for employee behavior and decision making. Appropriate goals can act as a set of constraints on individual behavior and actions so that employees behave within boundaries that are acceptable to the organization and larger society.28 They help to define the appropriate decisions concerning organization structure, innovation, employee welfare, or growth. Finally, goals provide a standard for assessment. The level of organizational performance, whether in terms of profits, units produced, degree of employee satisfaction, level of innovation, or number of customer complaints, needs a basis for evaluation. Operative goals provide this standard for measurement.

A FRAMEWORK FOR SELECTING STRATEGY AND DESIGN

To support and accomplish the organization’s strategic intent and keep people focused in the direction determined by organizational mission, vision, and operative goals, managers have to select specific strategy and design options that can help the organization achieve its purpose and goals within its competitive environment. In this section, we examine a couple of practical approaches to selecting strategy and design. The questionnaire in this chapter’s “How Do You Fit the Design?” box on page 66 will give you some insight into your own strategic management competencies.

A strategy is a plan for interacting with the competitive environment to achieve organizational goals. Some managers think of goals and strategies as interchangeable, but for our purposes, goals define where the organization wants to go and strategies define how it will get there. For example, a goal might be to achieve 15 percent annual sales growth; strategies to reach that goal might include aggressive advertising to attract new customers, motivating salespeople to increase the average size of customer purchases, and acquiring other businesses that produce similar products. Strategies can include any number of techniques to achieve the goal. The essence of formulating strategies is choosing whether the organization will perform different activities than its competitors or will execute similar activities more efficiently than its competitors do.29

Two models for formulating strategies are the Porter model of competitive strategies and Miles and Snow’s strategy typology. Each provides a framework for competitive action. After describing the two models, we will discuss how the choice of strategies affects organization design.

Porter’s Competitive Forces and Strategies

One popular and effective model for formulating strategy is Porter’s competitive forces and strategies. Michael E. Porter studied a number of business organizations and proposed that managers can formulate a strategy that makes the organization more profitable and less vulnerable if they understand five forces in the industry environment.30 Porter found the following forces determine a company’s position vis-à-vis competitors in the industry:

- **The Threat of New Entrants.** The threat of new entrants to an industry can create pressure for established organizations, which might need to hold down prices or increase their level of investment. For example, when managers at Nike
learned that fast-growing athletic apparel company Under Armour planned to get into the business of selling athletic footwear, they quickly invested in reviving their company’s long-dead cross-training category by designing the new SPARQ trainer.\textsuperscript{31}
The threat of entry in an industry depends largely on the amount and extent of potential barriers, such as cost. It is far more costly to enter the auto manufacturing industry, for instance, than to start a specialty coffee shop.

- **The Power of Suppliers.** Large, powerful suppliers can charge higher prices, limit services or quality, and shift costs to their customers, keeping more of the value for themselves. The concentration of suppliers and the availability of substitute suppliers are significant factors in determining supplier power. The sole supplier of materials or information to a company will have great power, for example. The Nielsen Company has wielded tremendous power with television networks because it has until recently been the sole source of ratings data that network executives use to make advertising and programming decisions. Nielsen’s power has recently waned due to quality control problems, as well as the threat presented by TiVo, a provider of digital video recorders, which has begun offering its own detailed audience and ratings data to the networks. 32

- **The Power of Buyers.** Powerful customers, the flip side of powerful suppliers, can force down prices, demand better quality or service, and drive up costs for the supplying organization. Wal-Mart, for example, is so powerful that it can easily put the screws to manufacturers who supply goods for sale at its stores.

- **The Threat of Substitutes.** The power of alternatives and substitutes for a company’s product or service may be affected by changes in cost, new technologies, social trends that will deflect buyer loyalty, and other environmental changes. Large pharmaceutical companies are under intense pressure from generic competition as patents on numerous popular drugs have expired in recent years. 33 Providers of conventional long-distance telephone services have suffered from the introduction of inexpensive Internet-based phone services.

- **Rivalry among Existing Competitors.** Rivalry among competitors is influenced by the preceding four forces, as well as by cost and product differentiation. Porter has referred to the “advertising slugfest” when describing the scrambling and jockeying for position that occurs among fierce rivals within an industry. The rivalry between Coke and Pepsi is a famous example. Recently, Coke scored big with its sponsorship of the Beijing Olympics, but Pepsi’s creative marketing had many Chinese consumers thinking it was an official sponsor too. 34

In finding its competitive edge within these five forces, Porter suggests that a company can adopt one of three strategies: differentiation, low-cost leadership, or focus. 35 The focus strategy, in which the organization concentrates on a specific market or buyer group, is further divided into focused low cost and focused differentiation. This yields four basic strategies, as illustrated in Exhibit 2.4. To use this model, managers evaluate two factors, competitive advantage and competitive scope. With respect to advantage, managers determine whether to compete through lower costs or through the ability to offer unique or distinctive products and services that can command a premium price. Managers then determine whether the organization will compete on a broad scope (competing in many customer segments) or a narrow scope (competing in a selected customer segment or group of segments). These choices determine the selection of strategies, as illustrated in Exhibit 2.4.

**Differentiation.** In a differentiation strategy, organizations attempt to distinguish their products or services from others in the industry. An organization may use advertising, distinctive product features, exceptional service, or new technology to achieve a product perceived as unique. This strategy usually targets customers who are not particularly concerned with price, so it can be quite profitable.
### A differentiation strategy can reduce rivalry with competitors and fight off the threat of substitute products because customers are loyal to the company’s brand. However, companies must remember that successful differentiation strategies require a number of costly activities, such as product research and design and extensive advertising. Companies that pursue a differentiation strategy need strong marketing abilities and creative employees who are given the time and resources to seek innovations. One good illustration of a company that benefits from a differentiation strategy is Apple. Apple has never tried to compete on price and likes being perceived as an “elite” brand. Its personal computers, for example, can command significantly higher prices than other PCs because of their distinctiveness. The company has built a loyal customer base by providing innovative, stylish products and creating a prestigious image. Consider the launch of the iPhone.

---

**EXHIBIT 2.4**
Porter’s Competitive Strategies

<table>
<thead>
<tr>
<th>COMPETITIVE SCOPE</th>
<th>COMPETITIVE ADVANTAGE</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad</td>
<td>Low Cost</td>
<td>Low-cost leadership</td>
</tr>
<tr>
<td>Narrow</td>
<td>Uniqueness</td>
<td>Differentiation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Focused low-cost leadership</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Focused differentiation</td>
</tr>
</tbody>
</table>

Although Apple is still a small player in the broader cell phone market, the innovative technology of the iPhone, combined with creative marketing and the cachet of Apple, convinced many consumers that they needed a phone that gives them easy access to the Internet, digital music and video, and mobile social networks. So-called “smartphones” have been used for years by business professionals, with Research in Motion’s BlackBerry being the leader. But it took Apple to build a strong consumer market for them.

Apple is now aiming directly at the BlackBerry, opening the door to third-party software applications that can make the iPhone more compatible with the needs of business users. The BlackBerry has a huge head start in this market, but as one IT professional said, “The iPhone is the coolest thing you’ll touch.”

Service firms can use a differentiation strategy as well. Umpqua Bank, based in Portland, Oregon, for instance, wants to become a “lifestyle brand,” rather than just a financial institution. Many branches have free wi-fi access, spacious seating areas with big-screen televisions, and Umpqua branded coffee. The company recently released its first CD—not a “certificate of deposit,” but the kind with music on it. The bank worked with music marketing firm Rumblefish to put together a collection of songs by new or undiscovered artists in the markets where Umpqua operates. Over the past dozen or so years, Umpqua’s differentiation strategy has helped it grow from about $150 million in deposits to more than $7 billion.

**Low-Cost Leadership.** The low-cost leadership strategy tries to increase market share by keeping costs low compared to competitors. With a low-cost leadership strategy, the organization aggressively seeks efficient facilities, pursues cost reductions, and uses tight controls to produce products or services more efficiently than its competitors. Low-cost doesn’t necessarily mean low-price, but in many cases, low-cost leaders provide goods and services to customers at cheaper prices. For example, the CEO of Irish airline Ryanair said of the company’s strategy: “It’s the oldest, simplest formula: Pile ’em high and sell ’em cheap... We want to be the Wal-Mart of the airline business. Nobody will beat us on price. EVER.” Ryanair can offer low fares because it keeps costs at rock bottom, lower than anyone else in Europe. The company’s watchword is cheap tickets, not customer care or unique services.

The low-cost leadership strategy is concerned primarily with stability rather than taking risks or seeking new opportunities for innovation and growth. A low-cost position means a company can achieve higher profits than competitors because of its efficiency and lower operating costs. Low-cost leaders such as Ryanair or Wal-Mart can undercut competitors’ prices and still earn a reasonable profit. In addition, if substitute products or potential new competitors enter the picture, the low-cost producer is in a better position to prevent loss of market share.

2 The best business strategy is to make products and services as distinctive as possible to gain an edge in the marketplace.

**ANSWER:** Disagree. Differentiation, making the company’s products or services distinctive from others in the market, is one effective strategic approach. A low-cost leadership approach can be equally or even more effective depending on the organization’s strengths and the nature of competition in the industry.
Focus. With Porter’s third strategy, the focus strategy, the organization concentrates on a specific regional market or buyer group. The company will try to achieve either a low-cost advantage or a differentiation advantage within a narrowly defined market. One good example of a focused low-cost strategy is Edward Jones, a St. Louis–based brokerage house. The firm has succeeded by building its business in rural and small-town America and providing investors with conservative, long-term investments. An example of a focused differentiation strategy is Puma, the German athletic-wear manufacturer. In the mid-1990s, Puma was on the brink of bankruptcy. CEO Jochen Zeitz, then only 30 years old, revived the brand by targeting selected customer groups, especially armchair athletes, and creating stylish shoes and clothes that are setting design trends. Puma is “going out of its way to be different,” says analyst Roland Könen.

Porter found that companies that did not consciously adopt a low-cost, differentiation, or focus strategy achieved below-average profits compared to those that used one of the three strategies. Many Internet companies have failed because managers did not develop competitive strategies that would distinguish them in the marketplace. On the other hand, Google became highly successful with a coherent differentiation strategy that distinguished it from other search engines. The ability of managers to devise and maintain a clear competitive strategy is considered one of the defining factors in an organization’s success. However, in today’s tumultuous environment, some scholars and consultants emphasize that managers also need to maintain flexibility in their strategic thinking, as further discussed in this chapter’s Book Mark.

Miles and Snow’s Strategy Typology

Another strategy typology was developed from the study of business strategies by Raymond Miles and Charles Snow. The Miles and Snow typology is based on the idea that managers seek to formulate strategies that will be congruent with the external environment. Organizations strive for a fit among internal organization characteristics, strategy, and the external environment. The four strategies that can be developed are the prospector, the defender, the analyzer, and the reactor.

Prospector. The prospector strategy is to innovate, take risks, seek out new opportunities, and grow. This strategy is suited to a dynamic, growing environment, where creativity is more important than efficiency. Nike, which innovates in both products and internal processes, exemplifies the prospector strategy. Nike’s new Air Jordan XX3, for example, is the first in a program of shoes based on designs that can be produced using recycled materials and limited amounts of toxic chemical-based glues. CEO Mark Parker says Nike’s growth strategy is based on both outward expansion and inward redesign of operations. Online companies such as Facebook, Google, and MySpace also reflect a prospector strategy.

Defender. The defender strategy is almost the opposite of the prospector. Rather than taking risks and seeking out new opportunities, the defender strategy is concerned with stability or even retrenchment. This strategy seeks to hold on to current customers, but it neither innovates nor seeks to grow. The defender is concerned primarily with internal efficiency and control to produce reliable, high-quality products for steady customers. This strategy can be successful when the organization exists in a declining industry or a stable environment. Paramount Pictures has been using a defender strategy for several years. Paramount turns out a steady stream of reliable
Strategies that have the greatest chance of success, says author, professor, and Deloitte consultant Michael Raynor, also have the highest probability of failure. Why? Because key uncertainties in the environment can break either for or against managers’ best-laid plans. In his book, The Strategy Paradox, Raynor says the strategic choices of differentiation or low-cost enable companies to become highly successful when environmental circumstances favor the strategy, but they can lead to failure when market conditions shift in an unpredictable way.

RESOLVING THE PARADOX
So is business just a crapshoot? Despite uncertainty, Raynor says managers can implement strategies that deliver superior results while minimizing exposure to the vagaries of fate. He offers a set of tools based on a framework used by Johnson & Johnson:

- **Anticipate the Future and Formulate Strategic Options.** First managers anticipate the future by building as many different scenarios of the future as they can imagine. Each scenario describes possible future shifts in critical environmental forces affecting the company, which might include a radical change in the price of oil, a game-changing technology shift, or an economic recession. Next, they develop long-range strategic options for each of the scenarios. For example, managers at Alliant Energy, a $3 billion Wisconsin-based energy-utility holding company, were considering whether to invest in nonregulated generating assets. Rather than committing heavily to a particular strategy, they considered a series of scenarios that captured the full range of possible futures over a ten-year period and devised strategic options targeted to each set of competitive conditions.

- **Decide on Strategic Actions and Manage Chosen Options.** The next step is to translate analysis into action. Once senior managers have defined a range of alternative strategic options, they can determine which actions are appropriate as the future unfolds. Managing the options is the job of line managers once senior executives identify and commit to strategic options. The cycle continues as senior managers focus on the future while lower level managers implement strategic commitments for the short-term.

A RECIPE FOR AVOIDING DISASTER?
Raynor developed his ideas of the strategy paradox after studying winning companies and conducting postmortems on losing ones. He suggests that what separates the two is often poor timing or unforeseen changes in the environment rather than inferior strategies or flawed execution. Instead of a traditional strategic planning approach that treats environmental uncertainty as an afterthought, this approach puts uncertainty at the center of the strategic decision-making process, helping managers maintain strategic flexibility as the future unfolds.

initiatives such as a digital book service, an online DVD rental business, and a digital music store to compete with Apple’s iTunes.\(^4^5\)

**Reactor.** The reactor strategy is not really a strategy at all. Rather, reactors respond to environmental threats and opportunities in an ad hoc fashion. In a reactor strategy, top management has not defined a long-range plan or given the organization an explicit mission or goal, so the organization takes whatever actions seem to meet immediate needs. Although the reactor strategy can sometimes be successful, it can also lead to failed companies. Some large, once highly successful companies are struggling because managers failed to adopt a strategy consistent with consumer trends. In recent years, managers at Dell, long one of the most successful and profitable makers of personal computers in the world, have been floundering to find the appropriate strategy. Dell had a string of disappointing quarterly profits as the company reached the limits of its “make PCs cheap and build them to order” strategy. Competitors caught up, and Dell had failed to identify new strategic directions that could provide a new edge.\(^4^6\)

The Miles and Snow typology has been widely used, and researchers have tested its validity in a variety of organizations, including hospitals, colleges, banking institutions, industrial products companies, and life insurance firms. In general, researchers have found strong support for the effectiveness of this typology for organization managers in real-world situations.\(^4^7\)

**How Strategies Affect Organization Design**

Choice of strategy affects internal organization characteristics. Organization design characteristics need to support the firm’s competitive approach. For example, a company wanting to grow and invent new products looks and “feels” different from a company that is focused on maintaining market share for long-established products in a stable industry. Exhibit 2.5 summarizes organization design characteristics associated with the Porter and Miles and Snow strategies.

With a low-cost leadership strategy, managers take an efficiency approach to organization design, whereas a differentiation strategy calls for a learning approach. Recall from Chapter 1 that organizations designed for efficiency have different characteristics from those designed for learning. A low-cost leadership strategy (efficiency) is associated with strong, centralized authority and tight control, standard operating procedures, and emphasis on efficient procurement and distribution systems. Employees generally perform routine tasks under close supervision and control and are not empowered to make decisions or take action on their own. A differentiation strategy, on the other hand, requires that employees be constantly experimenting and learning. Structure is fluid and flexible, with strong horizontal coordination. Empowered employees work directly with customers and are rewarded for creativity and risk taking. The organization values research, creativity, and innovativeness over efficiency and standard procedures.

The prospector strategy requires characteristics similar to a differentiation strategy, and the defender strategy takes an efficiency approach similar to low-cost leadership. Because the analyzer strategy attempts to balance efficiency for stable product lines with flexibility and learning for new products, it is associated with a mix of characteristics, as listed in Exhibit 2.5. With a reactor strategy, managers have left the organization with no direction and no clear approach to design.
Porter’s Competitive Strategies

<table>
<thead>
<tr>
<th>Strategy: Differentiation</th>
<th>Miles and Snow’s Strategy Typology</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organization Design:</strong></td>
<td><strong>Strategy:</strong> Prospector</td>
</tr>
<tr>
<td>- Learning orientation; acts in a flexible</td>
<td><strong>Organization Design:</strong> Low Cost</td>
</tr>
<tr>
<td>loosely knit way, with strong horizontal</td>
<td>Leadership</td>
</tr>
<tr>
<td>coordination</td>
<td>- Efficiency orientation;</td>
</tr>
<tr>
<td>- Strong capability in research</td>
<td>centralized authority and tight</td>
</tr>
<tr>
<td>- Values and builds in mechanisms for</td>
<td>cost control</td>
</tr>
<tr>
<td>customer intimacy</td>
<td>- Emphasis on production efficiency;</td>
</tr>
<tr>
<td>- Rewards employee creativity, risk</td>
<td>low overhead</td>
</tr>
<tr>
<td>taking, and innovation</td>
<td>- Close supervision; little employee</td>
</tr>
<tr>
<td></td>
<td>empowerment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Strategy: Low-Cost Leadership</th>
<th><strong>Organization Design:</strong> Prospector</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organization Design:</strong></td>
<td>- Efficiency orientation;</td>
</tr>
<tr>
<td>- Efficiency orientation; strong central</td>
<td>centralized authority and tight</td>
</tr>
<tr>
<td>authority; tight cost control, with</td>
<td>cost control</td>
</tr>
<tr>
<td>frequent, detailed control reports</td>
<td>- Emphasis on production efficiency;</td>
</tr>
<tr>
<td>- Standard operating procedures</td>
<td>low overhead</td>
</tr>
<tr>
<td>- Highly efficient procurement and</td>
<td>- Close supervision; little employee</td>
</tr>
<tr>
<td>distribution systems</td>
<td>empowerment</td>
</tr>
<tr>
<td>- Close supervision; routine tasks;</td>
<td>- No clear organizational approach;</td>
</tr>
<tr>
<td>limited employee empowerment</td>
<td>design characteristics may shift</td>
</tr>
<tr>
<td></td>
<td>abruptly, depending on current</td>
</tr>
<tr>
<td></td>
<td>needs</td>
</tr>
</tbody>
</table>


Other Factors Affecting Organization Design

Strategy is one important factor that affects organization design. Ultimately, however, organization design is a result of numerous contingencies, which will be discussed throughout this book. The emphasis given to efficiency and control versus learning and flexibility is determined by the contingencies of strategy, environment, size and life cycle, technology, and organizational culture. The organization is designed to “fit” the contingency factors, as illustrated in Exhibit 2.6.

For example, in a stable environment, the organization can have a traditional structure that emphasizes vertical control, efficiency, specialization, standard procedures, and centralized decision making. However, a rapidly changing environment...
may call for a more flexible structure, with strong horizontal coordination and collaboration through teams or other mechanisms. Environment will be discussed in detail in Chapters 4 and 5. In terms of size and life cycle, young, small organizations are generally informal and have little division of labor, few rules and regulations, and ad hoc budgeting and performance systems. Large organizations such as Coca-Cola, Sony, or General Electric, on the other hand, have an extensive division of labor, numerous rules and regulations, and standard procedures and systems for budgeting, control, rewards, and innovation. Size and stages of the life cycle will be discussed in Chapter 9.

Design must also fit the workflow technology of the organization. For example, with mass production technology, such as a traditional automobile assembly line, the organization functions best by emphasizing efficiency, formalization, specialization, centralized decision making, and tight control. An e-business, on the other hand, would need to be more informal and flexible. Technology’s impact on design will be discussed in detail in Chapters 7 and 8. A final contingency that affects organization design is corporate culture. An organizational culture that values teamwork, collaboration, creativity, and open communication, for example, would not function well with a tight, vertical structure and strict rules and regulations. The role of culture is discussed in Chapter 10.

One responsibility of managers is to design organizations that fit the contingency factors of strategy, environment, size and life cycle, technology, and culture. Finding the right fit leads to organizational effectiveness, whereas a poor fit can lead to decline or even the demise of the organization.

**ASSESSING ORGANIZATIONAL EFFECTIVENESS**

Understanding organizational goals and strategies, as well as the concept of fitting design to various contingencies, is a first step toward understanding organizational effectiveness. Organizational goals represent the reason for an organization’s existence and the outcomes it seeks to achieve. The next few sections of the chapter explore the topic of effectiveness and how effectiveness is measured in organizations.
Recall from Chapter 1 that organizational effectiveness is the degree to which an organization realizes its goals.\textsuperscript{48} Effectiveness is a broad concept. It implicitly takes into consideration a range of variables at both the organizational and departmental levels. Effectiveness evaluates the extent to which multiple goals—whether official or operative—are attained.

Efficiency is a more limited concept that pertains to the internal workings of the organization. Organizational efficiency is the amount of resources used to produce a unit of output.\textsuperscript{49} It can be measured as the ratio of inputs to outputs. If one organization can achieve a given production level with fewer resources than another organization, it would be described as more efficient.\textsuperscript{50}

Sometimes efficiency leads to effectiveness, but in other organizations, efficiency and effectiveness are not related. An organization may be highly efficient but fail to achieve its goals because it makes a product for which there is no demand. Likewise, an organization may achieve its profit goals but be inefficient. Efforts to increase efficiency, particularly through severe cost cutting, can also sometimes make the organization less effective. One regional fast food chain wanting to cut costs decided to reduce food waste by not cooking any food until it was ordered. The move reduced the chain’s costs, but it also led to delayed service, irritated customers, and lower sales.\textsuperscript{51}

Overall effectiveness is difficult to measure in organizations. Organizations are large, diverse, and fragmented. They perform many activities simultaneously, pursue multiple goals, and generate many outcomes, some intended and some unintended.\textsuperscript{52} Managers determine what indicators to measure in order to gauge the effectiveness of their organizations. Studies and surveys have found that many managers have a difficult time with the concept of evaluating effectiveness based on characteristics that are not subject to hard, quantitative measurement.\textsuperscript{53} However, top executives at some of today’s leading companies are finding new ways to measure effectiveness, including the use of such “soft” indications as customer loyalty and employee engagement.

First, we will discuss several traditional approaches to measuring effectiveness that focus on which indicators managers consider most important to track. Later, we will examine an approach that integrates concern for various parts of the organization.

**TRADITIONAL EFFECTIVENESS APPROACHES**

Organizations bring resources in from the environment, and those resources are transformed into outputs delivered back into the environment, as shown in Exhibit 2.7. Traditional approaches to measuring effectiveness look at different parts of the organization and measure indicators connected with outputs, inputs, or internal activities.

**Goal Indicators**

The goal approach to effectiveness consists of identifying an organization’s output goals and assessing how well the organization has attained those goals.\textsuperscript{54} This is a logical approach because organizations do try to attain certain levels of output, profit, or client satisfaction. The goal approach measures progress toward
attainment of those goals. For example, an important measure for the Women’s National Basketball Association is number of tickets sold per game. During the league’s first season, President Val Ackerman set a goal of 4,000 to 5,000 tickets per game. The organization actually averaged nearly 9,700 tickets per game, indicating that the WNBA was highly effective in meeting its goal for attendance.55

The important goals to consider are operative goals, because official goals (mission) tend to be abstract and difficult to measure.56 Indicators tracked with the goal approach include:

- Profitability—the positive gain from business operations or investments after expenses are subtracted
- Market share—the proportion of the market the firm is able to capture relative to competitors
- Growth—the ability of the organization to increase its sales, profits, or client base over time
- Social responsibility—how well the organization serves the interests of society as well as itself
- Product quality—the ability of the organization to achieve high quality in its products or services

### Resource-based Indicators

The resource-based approach looks at the input side of the transformation process shown in Exhibit 2.7. It assumes organizations must be successful in obtaining and managing valued resources in order to be effective. From a resource-based perspective, organizational effectiveness is defined as the ability of the organization, in either absolute or relative terms, to obtain scarce and valued resources and successfully integrate and manage them.57 The resource-based approach is valuable when other indicators of performance are difficult to obtain. In many nonprofit and social welfare organizations, for example, it is hard to measure output goals or internal efficiency.
In a broad sense, resource indicators of effectiveness encompass the following dimensions:

- Bargaining position—the ability of the organization to obtain from its environment scarce and valued resources, including financial resources, raw materials, human resources, knowledge, and technology
- The abilities of the organization’s decision makers to perceive and correctly interpret the real properties of the external environment
- The abilities of managers to use tangible (e.g., supplies, people) and intangible (e.g., knowledge, corporate culture) resources in day-to-day organizational activities to achieve superior performance
- The ability of the organization to respond to changes in the environment

Internal Process Indicators

In the **internal process approach**, effectiveness is measured as internal organizational health and efficiency. An effective organization has a smooth, well-oiled internal process. Employees are happy and satisfied. Department activities mesh with one another to ensure high productivity. This approach does not consider the external environment. The important element in effectiveness is what the organization does with the resources it has, as reflected in internal health and efficiency. The best-known proponents of an internal process model are from the human relations approach to organizations. Such writers as Chris Argyris, Warren G. Bennis, Rensis Likert, and Richard Beckhard have all worked extensively with human resources in organizations and emphasize the connection between human resources and effectiveness. Results from a study of nearly 200 secondary schools showed that both human resources and employee-oriented processes were important in explaining and promoting effectiveness in those organizations.

Internal process indicators include:

- A strong, adaptive corporate culture and positive work climate
- Operational efficiency, such as using minimal resources to achieve outcomes
- Undistorted horizontal and vertical communication
- Growth and development of employees

**THE BALANCED SCORECARD APPROACH TO EFFECTIVENESS**

Business organizations have typically focused on financial measures such as profit and return on investment to assess performance. Nonprofit organizations also have to assess budgets, spending, and fund-raising income, and each of these measures is concerned with finances. Traditional approaches based on goal, resource-based, or internal process indicators all have something to offer, but each one, just like sole reliance on financial numbers, tells only part of the story. In recent years, a new approach that balances a concern for various parts of the organization rather than focusing on one aspect has become popular. The **balanced scorecard** combines several indicators of effectiveness into a single framework, balancing traditional financial measures with operational measures relating to a company’s critical success factors.
Exhibit 2.8 illustrates the four effectiveness categories considered by the balanced scorecard. Within each area of effectiveness—financial performance, customer service, internal business processes, and the organization’s capacity for learning and growth—managers identify key performance indicators the organization will track. The financial perspective reflects a concern that the organization’s activities contribute to improving short- and long-term financial performance. It includes traditional measures such as net income and return on investment. Customer service indicators measure such things as how customers view the organization, as well as customer retention and satisfaction. Business process
indicators focus on production and operating statistics, such as speed of order fulfillment and cost per order. The final component looks at the organization’s potential for learning and growth, focusing on how well resources and human capital are being managed for the company’s future. Measurements include such things as employee satisfaction and retention, amount of training people receive, business process improvements, and the introduction of new products. The components of the scorecard are designed in an integrative manner so that they reinforce one another and link short-term actions with long-term strategic goals, as illustrated in Exhibit 2.8.

3 The best measures of business performance are financial.

ANSWER: Disagree. If you can have only one type of measure of business performance, it might have to be financial. But diverse views of performance, such as using the balanced scorecard, have proven to be more effective than financials alone, because managers can understand and control the actions that cause business effectiveness. Financial numbers alone provide narrow and limited information.

The balanced scorecard helps managers assess the organization from many perspectives so they have a better understanding of total effectiveness. Successful managers keep the organization focused on data in all four components rather than relying on just one, such as finances, which tells only part of the story. Companies such as Best Buy, Wells Fargo, and Hilton Corporation, for instance, are striving to understand how they perform on all four components of effectiveness and looking at the relationships among the components. For example, how does internal efficiency relate to customer satisfaction or financial outcomes? How do measures of employee engagement, customer satisfaction, sales performance, and profitability interconnect and contribute to overall effectiveness? Hilton found that a boost in customer retention rates led to an increase in revenues. Best Buy has connected employee engagement to better store performance.62

Thus, the balanced scorecard has evolved into a system that helps managers see how organizational effectiveness results from accomplishing outcomes in four consistent and mutually supportive areas. Overall effectiveness is a result of how well these interdependent elements are aligned, so that individuals, teams, departments, and so forth are working in concert to attain specific goals that ultimately help the organization achieve high performance and fulfill its mission.63

DESIGN ESSENTIALS

- Organizations exist for a purpose. Top managers decide the organization’s strategic intent, including a specific mission to be accomplished. The mission statement, or official goals, makes explicit the purpose and direction of an organization. Operative goals designate specific ends sought through actual operating procedures. Official and operative goals are a key element in organizations because they meet these needs—establishing legitimacy with external groups,
providing employees with a sense of direction and motivation, and setting standards of performance.

- Two other aspects related to strategic intent are competitive advantage and core competence. Competitive advantage refers to what sets the organization apart from others and provides it with a distinctive edge. A core competence is something the organization does extremely well compared to competitors. Managers look for competitive openings and develop strategies based on their core competencies.

- Strategies may include any number of techniques to achieve the stated goals. Two models for formulating strategies are Porter’s competitive forces and strategies and the Miles and Snow strategy typology. Organization design needs to fit the firm’s competitive approach to contribute to organizational effectiveness.

- Assessing organizational effectiveness reflects the complexity of organizations as a topic of study. No easy, simple, guaranteed measure will provide an unequivocal assessment of performance. Organizations must perform diverse activities well—from obtaining resource inputs to delivering outputs—to be successful. Traditional approaches use output goals, resource acquisition, or internal health and efficiency as the indicators of effectiveness.

- No approach is suitable for every organization, but each offers some advantages that the others may lack. In addition, a more recent approach to measuring effectiveness is the balanced scorecard approach, which takes into consideration financial performance, customer service, internal business processes, and the organization’s capacity for learning and growth. Managers track and analyze key metrics in these four areas to see how they are interconnected and contribute to overall effectiveness.

**Key Concepts**

- analyzer
- balanced scorecard
- competitive advantage
- core competence
- defender
- differentiation strategy
- focus strategy
- goal approach
- internal process approach
- low-cost leadership strategy
- mission
- official goals
- operative goals
- organizational goal
- prospector
- reactor
- resource-based approach
- strategic intent
- strategy

**Discussion Questions**

1. Discuss the role of top management in setting organizational direction.
2. How might a company’s goals for employee development be related to its goals for innovation and change? To goals for productivity? Can you discuss ways these types of goals might conflict in an organization?
3. What is a goal for the class for which you are reading this text? Who established this goal? Discuss how the goal affects your direction and motivation.
4. What is the difference between a goal and a strategy as defined in the text? Identify both a goal and a strategy for a campus or community organization with which you are involved.
5. Discuss the similarities and differences in the strategies described in Porter’s competitive strategies and Miles and Snow’s typology.
6. Do you believe mission statements and official goal statements provide an organization with genuine legitimacy in the external environment? Discuss.
7. Suppose you have been asked to evaluate the effectiveness of the police department in a medium-sized community. Where would you begin, and how would you proceed? What effectiveness approach would you prefer?

8. What are the advantages and disadvantages of the resource-based approach versus the goal approach for measuring organizational effectiveness?

9. What are the similarities and differences between assessing effectiveness on the basis of the balanced scorecard versus the stakeholder approach described in Chapter 1? Explain.

10. A noted organization theorist once said, “Organizational effectiveness can be whatever top management defines it to be.” Discuss.
Text not available due to copyright restrictions
Text not available due to copyright restrictions
Chapter 2 Workshop: The Balanced Scorecard and Organizational Effectiveness*

1. Divide into groups of four to six members.
2. Select an organization to study for this exercise. It should be an organization for which one of you has worked, or it could be part of the university.
3. Using the exhibit “The Balanced Scorecard Approach to Effectiveness” (Exhibit 2.8), your group should list eight potential measures that show a balanced view of performance across the four categories. Use the following table.

<table>
<thead>
<tr>
<th>Effectiveness Category</th>
<th>Goal or Subgoal</th>
<th>Performance Gauge</th>
<th>How to Measure</th>
<th>Source of Data</th>
<th>What Do You Consider Effective?</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Example)</td>
<td>Equilibrium</td>
<td>Turnover rates</td>
<td>Compare percentages of workers who left</td>
<td>HRM files</td>
<td>25% reduction in first year</td>
</tr>
<tr>
<td>Financial</td>
<td>1.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customers</td>
<td>3.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Business</td>
<td>5.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Processes</td>
<td>6.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Learning and Growth</td>
<td>7.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>8.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. How will achieving these goals help the organization to become more effective? Which goals could be given more weight than others? Why?
5. Present your chart to the rest of the class. Each group should explain why it chose those particular measures and which they think are more important. Be prepared to defend your position to the other groups, which are encouraged to question your choices.

*Adapted by Dorothy Marcic from general ideas in Jennifer Howard and Larry Miller, Team Management, The Miller Consulting Group, 1994, p. 92.
48. Etzioni, Modern Organizations, 8.
Chapter 3

Fundamentals of Organization Structure

Organization Structure

Information-Sharing Perspective on Structure
  Vertical Information Sharing • Horizontal Information Sharing

Organization Design Alternatives
  Required Work Activities • Reporting Relationships • Departmental Grouping Options

Functional, Divisional, and Geographic Designs
  Functional Structure • Functional Structure with Horizontal Linkages • Divisional Structure • Geographic Structure

Matrix Structure
  Conditions for the Matrix • Strengths and Weaknesses

Horizontal Structure
  Characteristics • Strengths and Weaknesses

Virtual Networks and Outsourcing
  How the Structure Works • Strengths and Weaknesses

Hybrid Structure

Applications of Structural Design
  Structural Alignment • Symptoms of Structural Deficiency

Design Essentials
Wyeth Pharmaceuticals makes and sells some very powerful drugs, including Effexor for depression, Zosyn to treat infectious diseases, and Telazol, a combined anesthetic/tranquilizer for animals. But Wyeth no longer manages clinical testing of new drugs or vaccines. Outrageous? Shocking? No, just a new reality. In 2004, Wyeth outsourced its entire clinical testing operation—from protocol design to patient recruitment to site monitoring—to Accenture’s Health and Life Sciences Practice. Accenture also took over the management of Wyeth’s 175 or so clinical data employees and operations. An additional 400 or so people from the Accenture Global Delivery Centers assist in operations. It’s all part of Wyeth’s drive to improve quality, efficiency, speed, and innovation by outsourcing some of its operations to other firms that can handle them better and faster.

Now, you might wonder how Accenture operates. Let’s just say that even CEO Bill Green doesn’t have a permanent desk. Accenture doesn’t have a formal headquarters, no official branches, no permanent offices. The company’s chief technologist is in Germany, its head of human resources in Chicago, the chief financial officer in Silicon Valley, and most of its consultants constantly on the move.

No doubt about it, many organizations are more complex and amorphous than they used to be. Wyeth and Accenture reflect the structural trend among today’s organizations toward outsourcing, alliances, and virtual networking. Today’s companies also use other structural innovations such as teams and matrix designs to achieve the flexibility they need. Still other firms continue to be successful with traditional functional structures that are coordinated and controlled through the vertical hierarchy. Organizations use a wide variety of structural alternatives to help them achieve their purpose and goals, and nearly every firm needs to undergo reorganization at some point to help meet new challenges. Structural changes are needed to reflect new strategies or respond to changes in other contingency factors introduced in Chapter 2: environment, technology, size and life cycle, and culture.
Purpose of This Chapter

This chapter introduces basic concepts of organization structure and shows how to design structure as it appears on the organization chart. First we define structure and provide an overview of structural design. Then, an information-sharing perspective explains how to design vertical and horizontal linkages to provide needed information flow. The chapter next presents basic design options, followed by strategies for grouping organizational activities into functional, divisional, matrix, horizontal, virtual network, or hybrid structures. The final section examines how the application of basic structures depends on the organization’s situation and outlines the symptoms of structural misalignment.

Organization Structure

There are three key components in the definition of organization structure:

1. Organization structure designates formal reporting relationships, including the number of levels in the hierarchy and the span of control of managers and supervisors.
2. Organization structure identifies the grouping together of individuals into departments and of departments into the total organization.
3. Organization structure includes the design of systems to ensure effective communication, coordination, and integration of efforts across departments.

These three elements of structure pertain to both vertical and horizontal aspects of organizing. For example, the first two elements are the structural framework, which is the vertical hierarchy. The third element pertains to the pattern of interactions among organizational employees. An ideal structure encourages employees to provide horizontal information and coordination where and when it is needed.

Organization structure is reflected in the organization chart. It’s not possible to see the internal structure of an organization the way we might see its manufacturing tools, offices, or products. Although we might see employees going about their duties, performing different tasks, and working in different locations, the only way to actually see the structure underlying all this activity is through the organization chart. The organization chart is the visual representation of a whole set of underlying activities and processes in an organization. Exhibit 3.1 shows a simple organization chart for a traditional organization. The organization chart can be quite useful in understanding how a company works. It shows the various parts of an organization, how they are interrelated, and how each position and department fits into the whole.

The concept of an organization chart, showing what positions exist, how they are grouped, and who reports to whom, has been around for centuries. For example, diagrams outlining church hierarchy can be found in medieval churches in Spain. However, the use of the organization chart for business stems largely from the Industrial Revolution. As we discussed in Chapter 1, as work grew more complex and was performed by greater and greater numbers of workers, there was a pressing need to develop ways of managing and controlling organizations. The growth of the railroads provides an example. After the collision of two passenger trains in Massachusetts in 1841, the public demanded better control of the operation. As a result, the board of directors of the Western Railroad took steps to outline “definite responsibilities for
A popular form of organizing is to have employees work on what they want in whatever department they choose so that motivation and enthusiasm stay high.

**ANSWER:** Disagree. A small number of firms have tried this approach with some success, but a typical organization needs to structure its work activities, positions, and departments in a way that ensures work is accomplished and coordinated to meet organizational goals. Many managers try to give some consideration to employee choices as a way to keep enthusiasm high.
Management breakthroughs such as the principles of scientific management, divisionalized organization structure, and using brand managers for horizontal coordination have created more sustained competitive advantage than any hot new product or service innovation, says Gary Hamel in *The Future of Management*, written with Bill Breen. Wait a minute—haven’t those ideas been around since—well, forever? Exactly the point, says Hamel. In fact, he points out that many of today’s managers are running twenty-first century organizations using ideas, practices, and structural mechanisms invented a century or more ago. At that time, the principles of vertical hierarchy, specialization, bureaucratic control, and strong centralization were radical new approaches developed to solve the problem of inefficiency. They are too static, regimented, and binding today when the pace of change continues to accelerate. Today’s organizations, Hamel argues, have to become “as strategically adaptable as they are operationally efficient.”

**SOME STRUCTURAL INNOVATORS**

Hamel suggests that the practice of management must undergo a transformation akin to that which occurred with the Industrial Revolution and the advent of scientific management. Here, from *The Future of Management*, are a few examples that offer glimpses of what is possible when managers build structure around principles of community, creativity, and information sharing rather than strict hierarchy:

- **Whole Foods Market.** Teams are the basic organizational unit at Whole Foods, and they have a degree of autonomy nearly unprecedented in the retail industry. Each store is made up of eight or so self-directed teams that oversee departments such as fresh produce, prepared foods, dairy, or checkout. Teams are responsible for all key operating decisions, including pricing, ordering, hiring, and in-store promotions.
- **W. L. Gore.** W. L. Gore’s innovation was to organize work so that good things happen whether managers are “in control” or not. Gore, best known for Gore-Tex fabric, lets employees decide what they want to do. There are no management layers, few titles, and no organization charts. As at Whole Foods, the core operating units are small teams, but at Gore, people can choose which teams to work on and say no to requests from anyone. Yet Gore also builds in strong accountability—people are reviewed by at least twenty of their peers every year.
- **Visa.** Everybody’s heard of Visa, but few people know anything about the organization behind the brand. Visa is the world’s first almost-entirely virtual company. In the early 1970s, a group of banks formed a consortium which today has grown into a global network of 21,000 financial institutions and more than 1.3 billion cardholders. The organization is largely self-organizing, continually evolving as conditions change.

**HOW TO BE A MANAGEMENT INNOVATOR**

Most companies have a system for product innovation, but Hamel notes that few have a well-honed process for management innovation. *The Future of Management* provides detailed steps managers can take to increase the chances of a breakthrough in management thinking. Hamel considers the rise of modern management and organization design the most important innovation of the twentieth century. It is time now, though, for twenty-first century ideas.

to their tasks, thus reducing effectiveness. However, there is an inherent tension between vertical and horizontal mechanisms in an organization. Whereas vertical linkages are designed primarily for control, horizontal linkages are designed for coordination and collaboration, which usually means reducing control.

Organizations can choose whether to orient toward a traditional organization designed for efficiency, which emphasizes vertical communication and control, or toward a contemporary learning organization, which emphasizes horizontal communication and coordination. Exhibit 3.2 compares organizations designed for efficiency with those designed for learning and adaptation. An emphasis on efficiency and control is associated with specialized tasks, a hierarchy of authority, rules and regulations, formal reporting systems, few teams or task forces, and centralized decision making, which means problems and decisions are funneled to top levels of the hierarchy for resolution. Emphasis on learning and adaptation is associated with shared tasks, a relaxed hierarchy, few rules, face-to-face communication, many teams and task forces, and informal, decentralized decision making. Decentralized decision making means decision-making authority is pushed down to lower organizational levels.

Organizations may have to experiment to find the correct degree of centralization or decentralization to meet their needs. For example, a study by William Ouchi found that three large school districts that shifted to a more flexible, decentralized structure, giving school principals more autonomy, responsibility, and control over resources, performed better and more efficiently than large districts that were highly centralized. Top executives at New York City Transit are decentralizing the subway system to let managers of individual subway lines make almost every decision about what happens on the tracks, in the trains, and in the stations. Decentralization helps New York City Transit respond faster and more directly to customer complaints and other problems. Previously, a request to fix a leak causing slippery conditions in a station could languish for years because the centralized system slowed decision making to a crawl. On the other hand, some large decentralized companies sometimes need to build in more centralized communication and control systems to keep these huge, global corporations functioning efficiently. Consider the structural decisions that helped CEO Lewis Campbell revive Textron Inc., a $12 billion industrial conglomerate with headquarters in Providence, Rhode Island.

<table>
<thead>
<tr>
<th>Vertical Organization Designed for Efficiency</th>
<th>Horizontal Organization Designed for Learning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dominant Structural Approach</td>
<td>Horizontal structure is dominant</td>
</tr>
<tr>
<td></td>
<td>• Shared tasks, empowerment</td>
</tr>
<tr>
<td></td>
<td>• Relaxed hierarchy, few rules</td>
</tr>
<tr>
<td></td>
<td>• Horizontal communication, face-to-face</td>
</tr>
<tr>
<td></td>
<td>• Many teams and task forces</td>
</tr>
<tr>
<td></td>
<td>• Decentralized decision making</td>
</tr>
<tr>
<td>Vertical structure is dominant</td>
<td>• Specialized tasks</td>
</tr>
<tr>
<td></td>
<td>• Strict hierarchy, many rules</td>
</tr>
<tr>
<td></td>
<td>• Vertical communication and reporting systems</td>
</tr>
<tr>
<td></td>
<td>• Few teams, task forces, or integrators</td>
</tr>
<tr>
<td></td>
<td>• Centralized decision making</td>
</tr>
</tbody>
</table>
Texton CEO Lewis Campbell was a confirmed believer in decentralization, but in 2001, he took a look at the company’s situation and knew something had to change. “We were adrift,” says Campbell. “We were doing all the things we used to do but were not getting results.” An economic downturn, combined with a steep decline in the industrial and aviation markets from which Texton derived most of its profits, had left Texton in a free fall. Over a two-year period, profits declined 75 percent.

To get the company operating at peak efficiency required some dramatic changes. At the time, Texton’s many business units operated autonomously, with each unit handling its own administrative functions and managers making decisions focused on meeting their own division’s goals. Many division managers didn’t even know what other units of the company did. At the annual management summit, Campbell decreed that the various units would now be required to cooperate and share resources. The new focus would be on how the company as a whole was doing, and bonuses were linked to companywide rather than division performance. To improve efficiency, more than 1,500 payroll systems were cut down to just three, numerous health care plans across the disparate divisions were reduced to just one, and more than a hundred data centers were consolidated into a handful. Managers who had been accustomed to making all their own decisions lost some of their autonomy as companywide decisions, such as a Six Sigma quality improvement program, were centralized to headquarters level and implemented top down.

Taking Texton away from its roots as a decentralized organization to one with a single vision and more centralized decision making didn’t lead to overnight success, but the efficiencies soon began to accumulate. Within a few years, Texton’s economic health had significantly improved, and Campbell was being hailed as a turnaround artist.10

It couldn’t have been easy, bringing centralization to a company that had thrived on decentralization for its entire existence, but Campbell believed it was necessary for the current situation the company faced. Managers are always searching for the best combination of vertical control and horizontal collaboration, centralization and decentralization, for their own situations.11

**Vertical Information Sharing**

Organization design should facilitate the communication among employees and departments that is necessary to accomplish the organization’s overall task. Managers create *information linkages* to facilitate communication and coordination among organizational elements. **Vertical linkages** are used to coordinate activities between the top and bottom of an organization and are designed primarily for control of the organization. Employees at lower levels should carry out activities consistent with top-level goals, and top executives must be informed of activities and accomplishments at the lower levels. Organizations may use any of a variety of structural devices to achieve vertical linkage, including hierarchical referral, rules, plans, and formal management information systems.12

**Hierarchical Referral.** The first vertical device is the hierarchy, or chain of command, which is illustrated by the vertical lines in Exhibit 3.1. If a problem arises that employees don’t know how to solve, it can be referred up to the next level in the
hierarchy. When the problem is solved, the answer is passed back down to lower levels. The lines of the organization chart act as communication channels.

**Rules and Plans.** The next linkage device is the use of rules and plans. To the extent that problems and decisions are repetitious, a rule or procedure can be established so employees know how to respond without communicating directly with their manager. Rules and procedures provide a standard information source enabling employees to be coordinated without actually communicating about every task. At PepsiCo’s Gemesa cookie business in Mexico, for example, managers carefully brief production workers on goals, processes, and procedures so that employees themselves do most of the work of keeping the production process running smoothly, enabling the plants to operate with fewer managers. Plans also provide standing information for employees. The most widely used plan is the budget. With carefully designed and communicated budget plans, employees at lower levels can be left on their own to perform activities within their resource allotment.

**Vertical Information Systems.** A vertical information system is another strategy for increasing vertical information capacity. Vertical information systems include the periodic reports, written information, and computer-based communications distributed to managers. Information systems make communication up and down the hierarchy more efficient.

In today’s world of corporate financial scandals and ethical concerns, many top managers are considering strengthening their organization’s linkages for vertical information and control. The other major issue in organizing is to provide adequate horizontal linkages for coordination and collaboration.

**Horizontal Information Sharing**

Horizontal communication overcomes barriers between departments and provides opportunities for coordination among employees to achieve unity of effort and organizational objectives. Horizontal linkage refers to communication and coordination horizontally across organizational departments. Its importance is articulated by comments made by Lee Iacocca when he took over Chrysler Corporation in the 1980s:

*What I found at Chrysler were thirty-five vice presidents, each with his own turf … I couldn’t believe, for example, that the guy running engineering departments wasn’t in constant touch with his counterpart in manufacturing. But that’s how it was. Everybody worked independently. I took one look at that system and I almost threw up. That’s when I knew I was in really deep trouble … Nobody at Chrysler seemed to understand that interaction among the different functions in a company is absolutely critical. People in engineering and manufacturing almost have to be sleeping together. These guys weren’t even flirting!*

During his tenure at Chrysler, Iacocca pushed horizontal coordination to a high level. Everyone working on a specific vehicle project—designers, engineers, and manufacturers, as well as representatives from marketing, finance, purchasing, and even outside suppliers—worked together on a single floor so they could easily communicate.

Horizontal linkage mechanisms often are not drawn on the organization chart, but nevertheless are a vital part of organization structure. The following devices are
structural alternatives that can improve horizontal coordination and information flow. Each device enables people to exchange information.

**Information Systems.** A significant method of providing horizontal linkage in today’s organizations is the use of cross-functional information systems. Computerized information systems enable managers or frontline workers throughout the organization to routinely exchange information about problems, opportunities, activities, or decisions. For example, Siemens uses an organization-wide information system that enables 450,000 employees around the world to share knowledge and collaborate on projects to provide better solutions to customers. The information and communications division recently collaborated with the medical division to develop new products for the health care market.

Some organizations also encourage employees to use the company’s information systems to build relationships all across the organization, aiming to support and enhance ongoing horizontal coordination across projects and geographical boundaries. CARE International, one of the world’s largest private international relief organizations, enhanced its personnel database to make it easy for people to find others with congruent interests, concerns, or needs. Each person in the database has listed past and current responsibilities, experience, language abilities, knowledge of foreign countries, emergency experiences, skills and competencies, and outside interests. The database makes it easy for people working across borders to seek each other out, share ideas and information, and build enduring horizontal connections.

**Direct Contact.** A higher level of horizontal linkage is direct contact between managers or employees affected by a problem. One way to promote direct contact is to create a special liaison role. A liaison person is located in one department but has the responsibility for communicating and achieving coordination with another department. Liaison roles often exist between engineering and manufacturing departments because engineering has to develop and test products to fit the limitations of manufacturing facilities. Companies also implement other forms of direct contact. At Johnson & Johnson, top executives set up a committee made up of managers from research and development (R&D) and sales and marketing. The direct contact between managers in these two departments enables the company to establish priorities for which new drugs to pursue and market. J & J’s CEO also created a new position to oversee R&D, with an express charge to increase coordination with sales and marketing executives.

**Task Forces.** Liaison roles usually link only two departments. When linkage involves several departments, a more complex device such as a task force is required. A task force is a temporary committee composed of representatives from each organizational unit affected by a problem. Each member represents the interest of a department or division and can carry information from the meeting back to that department.

Task forces are an effective horizontal linkage device for temporary issues. They solve problems by direct horizontal coordination and reduce the information load on the vertical hierarchy. Typically, they are disbanded after their tasks are accomplished.

Organizations have used task forces for everything from organizing the annual company picnic to solving expensive and complex manufacturing problems. One
example is the Executive Automotive Committee established by Jürgen Schremp when he was CEO of DaimlerChrysler (now Daimler AG). This task force was set up specifically to identify ideas for increasing cooperation and component sharing among Mercedes, Chrysler (which was then owned by Daimler) and Mitsubishi (in which DaimlerChrysler owned a 37 percent stake). The task force started with a product road map, showing all Mercedes, Chrysler, Dodge, Jeep, and Mitsubishi vehicles to be launched over a ten-year period, along with an analysis of the components they would use, so task force members could identify overlap and find ways to share parts and cut time and costs.20

2 Committees and task forces whose members are from different departments are often worthless for getting things done.

ANSWER: Disagree. The point of cross-functional committees and task forces is to share information to coordinate their departmental activities. Meeting, talking, and disagreeing is the work of the committee. These groups should not try to “get things done” in the sense of being efficient.

Full-time Integrator. A stronger horizontal linkage device is to create a full-time position or department solely for the purpose of coordination. A full-time integrator frequently has a title, such as product manager, project manager, program manager, or brand manager. Unlike the liaison person described earlier, the integrator does not report to one of the functional departments being coordinated. He or she is located outside the departments and has the responsibility for coordinating several departments. The brand manager for Planters Peanuts, for example, coordinates the sales, distribution, and advertising for that product.

The integrator can also be responsible for an innovation or change project, such as coordinating the design, financing, and marketing of a new product. An organization chart that illustrates the location of project managers for new product development is shown in Exhibit 3.3. The project managers are drawn to the side to indicate their separation from other departments. The arrows indicate project members assigned to the new product development. New Product A, for example, has a financial accountant assigned to keep track of costs and budgets. The engineering member provides design advice, and purchasing and manufacturing members represent their areas. The project manager is responsible for the entire project. He or she sees that the new product is completed on time, is introduced to the market, and achieves other project goals. The horizontal lines in Exhibit 3.3 indicate that project managers do not have formal authority over team members with respect to giving pay raises, hiring, or firing. Formal authority rests with the managers of the functional departments, who have formal authority over subordinates.

Integrators need excellent people skills. Integrators in most companies have a lot of responsibility but little authority. The integrator has to use expertise and persuasion to achieve coordination. He or she spans the boundary between departments and must be able to get people together, maintain their trust, confront problems, and resolve conflicts and disputes in the interest of the organization.21
Teams. Project teams tend to be the strongest horizontal linkage mechanism. Teams are permanent task forces and are often used in conjunction with a full-time integrator. When activities among departments require strong coordination over a long period of time, a cross-functional team is often the solution. Special project teams may be used when organizations have a large-scale project, a major innovation, or a new product line. One good example of a special project team comes from Healthwise, a nonprofit organization that works with numerous health care organizations and online health sites like WebMD. The company put together a special project team made up of doctors, other health specialists, writers, and technical people to create a new product line called HealthMastery Campaigns. HealthMastery is a series of programs that e-mails information, surveys, and reminders to consumers on topics such as asthma, back problems, or smoking cessation, fitting with the company’s goal of providing information to help consumers make informed health-care decisions.22

Hewlett-Packard’s Medical Products Group uses virtual cross-functional teams, made up of members from various countries, to develop and market medical products and services such as electrocardiograph systems, ultrasound imaging technologies, and patient monitoring systems.23 A virtual team is one that is made up of organizationally or geographically dispersed members who are linked primarily through
advanced information and communications technologies. Members frequently use the Internet and collaboration software to work together, rather than meeting face to face. IBM’s virtual teams, for instance, collaborate primarily via internal websites using wiki technology.

An illustration of how teams provide strong horizontal coordination is shown in Exhibit 3.4. Wizard Software Company develops and markets software for various applications, from videogames to financial services. Wizard uses teams to coordinate each product line across the research, programming, and marketing departments, as illustrated by the dashed lines and shaded areas in the exhibit. Members from each
team meet at the beginning of each day as needed to resolve problems concerning customer needs, backlogs, programming changes, scheduling conflicts, and any other problem with the product line. Are you cut out for horizontal team work? Complete the questionnaire in the “How Do You Fit the Design?” box to assess your feelings about working on a team.

Exhibit 3.5 summarizes the mechanisms for achieving horizontal linkages. These devices represent alternatives that managers can select to increase horizontal coordination in any organization. The higher-level devices provide more horizontal information capacity, although the cost to the organization in terms of time and human resources is greater. If horizontal communication is insufficient, departments will find themselves out of synchronization and will not contribute to the overall goals of the organization. When the amount of horizontal coordination needed is high, managers should select higher-level mechanisms.
Chapter 3: Fundamentals of Organization Structure

ORGANIZATION DESIGN ALTERNATIVES

The overall design of organization structure indicates three things—required work activities, reporting relationships, and departmental groupings.

Required Work Activities

Departments are created to perform tasks considered strategically important to the company. For example, in a typical manufacturing company, work activities fall into a range of functions that help the organization accomplish its goals, such as a human resource department to recruit and train employees, a purchasing department to obtain supplies and raw materials, a production department to build products, a sales department to sell products, and so forth. As organizations grow larger and more complex, managers find that more functions need to be performed. Organizations typically define new positions, departments, or divisions as a way to accomplish new tasks deemed valuable by the organization. An interesting example comes from the United States Army, which created a small aviation unit to provide surveillance in Iraq. The new unit was to be focused on detecting and stopping insurgents planting roadside bombs. Previously, the Army had relied totally on air surveillance from the Air Force, but those resources were limited and had to be assigned by top headquarters. The Army’s new aviation unit is on call for commanders in the field and fits with the Army’s goal of being more responsive to the needs of smaller combat units in direct conflict with adversaries.26
Reporting Relationships

Once required work activities and departments are defined, the next question is how these activities and departments should fit together in the organizational hierarchy. Reporting relationships, often called the *chain of command*, are represented by vertical lines on an organization chart. The chain of command should be an unbroken line of authority that links all persons in an organization and shows who reports to whom. In a large organization such as General Electric, Bank of America, or Microsoft, 100 or more charts might be needed to identify reporting relationships among thousands of employees. The definition of departments and the drawing of reporting relationships define how employees are to be grouped into departments.

Departmental Grouping Options

Options for departmental grouping, including functional grouping, divisional grouping, multifocused grouping, horizontal grouping, and virtual network grouping, are illustrated in Exhibit 3.6. **Departmental grouping** affects employees because they share a common supervisor and common resources, are jointly responsible for performance, and tend to identify and collaborate with one another.27

**Functional grouping** places together employees who perform similar functions or work processes or who bring similar knowledge and skills to bear. For example, all marketing people work together under the same supervisor, as do all manufacturing employees, all human resources people, and all engineers. For an Internet company, all the people associated with maintaining the website might be grouped together in one department. In a scientific research firm, all chemists may be grouped in a department different from biologists because they represent different disciplines.

**Divisional grouping** means people are organized according to what the organization produces. All people required to produce toothpaste—including personnel in marketing, manufacturing, and sales—are grouped together under one executive. In huge corporations, such as Time Warner Corporation, some product or service lines may represent independent businesses, such as Warner Brothers Entertainment (movies and videos), Time Inc. (publisher of magazines such as *Sports Illustrated*, *Time*, and *People*), and AOL (Internet services).

**Multifocused grouping** means an organization embraces two or more structural grouping alternatives simultaneously. These structural forms are often called *matrix* or *hybrid*. They will be discussed in more detail later in this chapter. An organization may need to group by function and product division simultaneously or might need to combine characteristics of several structural options.

**Horizontal grouping** means employees are organized around core work processes, the end-to-end work, information, and material flows that provide value directly to customers. All the people who work on a core process are brought together in a group rather than being separated into functional departments. For example, at field offices of the U.S. Occupational Safety and Health Administration, teams of workers representing various functions respond to complaints from American workers regarding health and safety issues, rather than having the work divided up among specialized employees.28

**Virtual network grouping** is the most recent approach to departmental grouping. With this grouping, the organization is a loosely connected cluster of separate components. In essence, departments are separate organizations that are electronically connected for the sharing of information and completion of tasks. Departments can be spread all over the world rather than located together in one geographic location.
EXHIBIT 3.6
Structural Design Options for Grouping Employees into Departments
The organizational forms described in Exhibit 3.6 provide the overall options within which the organization chart is drawn and the detailed structure is designed. Each structural design alternative has significant strengths and weaknesses, to which we now turn.

FUNCTIONAL, DIVISIONAL, AND GEOGRAPHIC DESIGNS

Functional grouping and divisional grouping are the two most common approaches to structural design.

Functional Structure

In a functional structure, activities are grouped together by common function from the bottom to the top of the organization. All engineers are located in the engineering department, and the vice president of engineering is responsible for all engineering activities. The same is true in marketing, R&D, and manufacturing. An example of the functional organization structure was shown in Exhibit 3.1 earlier in this chapter.

With a functional structure, all human knowledge and skills with respect to specific activities are consolidated, providing a valuable depth of knowledge for the organization. This structure is most effective when in-depth expertise is critical to meeting organizational goals, when the organization needs to be controlled and coordinated through the vertical hierarchy, and when efficiency is important. The structure can be quite effective if there is little need for horizontal coordination. Exhibit 3.7 summarizes the strengths and weaknesses of the functional structure.

One strength of the functional structure is that it promotes economy of scale within functions. Economy of scale results when all employees are located in the same place and can share facilities. Producing all products in a single plant, for example, enables the plant to acquire the latest machinery. Constructing only

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Allows economies of scale within functional departments</td>
<td>1. Slow response time to environmental changes</td>
</tr>
<tr>
<td>2. Enables in-depth knowledge and skill development</td>
<td>2. May cause decisions to pile on top; hierarchy overload</td>
</tr>
<tr>
<td>3. Enables organization to accomplish functional goals</td>
<td>3. Leads to poor horizontal coordination among departments</td>
</tr>
<tr>
<td>4. Is best with only one or a few products</td>
<td>4. Results in less innovation</td>
</tr>
<tr>
<td></td>
<td>5. Involves restricted view of organizational goals</td>
</tr>
</tbody>
</table>

one facility instead of separate facilities for each product line reduces duplication and waste. The functional structure also promotes in-depth skill development of employees. Employees are exposed to a range of functional activities within their own department.  

The main weakness of the functional structure is a slow response to environmental changes that require coordination across departments. The vertical hierarchy becomes overloaded. Decisions pile up, and top managers do not respond fast enough. Other disadvantages of the functional structure are that innovation is slow because of poor coordination, and each employee has a restricted view of overall goals.

Some organizations perform very effectively with a functional structure. Consider the case of Blue Bell Creameries, Inc.

It is the third best-selling brand of ice cream in the United States but many Americans have never heard of it. That’s because Blue Bell Creameries, with headquarters in Brenham, Texas, sells its ice cream in only seventeen, mostly southern, states. Keeping distribution limited “allows us to focus on making and selling ice cream,” says CEO and president Paul Kruse, the fourth generation of Kruses to run Blue Bell. Or, as another family slogan puts it, “It’s a cinch by the inch but it’s hard by the yard.”

The “little creamery in Brenham,” as the company markets itself, is obsessed with quality control and doesn’t let anyone outside the company touch its product from the plant to the freezer case. “We make it all, we deliver it all in our own trucks, and we maintain all the stock in retailers’ freezers,” says chairman Ed Kruse. At one time, the company was even buying packages of Oreos at retail prices, cutting open each package by hand, and dumping the cookies into the mixers to make Blue Bell’s Cookies ‘n Cream flavor. Blue Bell sells more than $400 million in ice cream a year and commands a huge percentage of the ice cream market in Texas, Louisiana, and Alabama. People outside the region often pay $89 to have four half-gallons packed in dry ice and shipped to them. Despite the demand, management refuses to compromise quality by expanding into regions that cannot be satisfactorily serviced or by growing so fast that the company can’t adequately train employees in the art of making ice cream.

Blue Bell’s major departments are sales, quality control, production, maintenance, and distribution. There is also an accounting department and a small R&D group. Most employees have been with the company for years and have a wealth of experience in making quality ice cream. The environment is stable. The customer base is well established. The only change has been the increase in demand for Blue Bell Ice Cream.

The functional structure is just right for Blue Bell Creameries. The organization has chosen to stay medium-sized and focus on making a single product—quality ice cream. However, as Blue Bell expands, it may have problems coordinating across departments, requiring stronger horizontal linkage mechanisms.

Functional Structure with Horizontal Linkages

A recent survey found that organizing by functions is still the prevalent approach to organization design. However, in today’s fast-moving world, very few companies can be successful with a strictly functional structure. Organizations compensate for
the vertical functional hierarchy by installing horizontal linkages, as described earlier in this chapter. Managers improve horizontal coordination by using information systems, direct contact between departments, full-time integrators or project managers (illustrated in Exhibit 3.3), task forces, or teams (illustrated in Exhibit 3.4). One interesting use of horizontal linkages occurred at Karolinska Hospital in Stockholm, Sweden, which had forty-seven functional departments. Even after top executives cut that down to eleven, coordination was still inadequate. The top executive team set about reorganizing workflow at the hospital around patient care. Instead of bouncing a patient from department to department, Karolinska now envisions the illness to recovery period as a process with “pit stops” in admissions, X-ray, surgery, and so forth. The most interesting aspect of the approach is the new position of nurse coordinator. Nurse coordinators serve as full-time integrators, troubleshooting transitions within or between departments. The improved horizontal coordination dramatically improved productivity and patient care at Karolinska.32 Karolinska is effectively using horizontal linkages to overcome some of the disadvantages of the functional structure.

**Briefcase**

As an organization manager, keep these guidelines in mind:

When designing overall organization structure, choose a functional structure when efficiency is important, when in-depth knowledge and expertise are critical to meeting organizational goals, and when the organization needs to be controlled and coordinated through the vertical hierarchy. Use a divisional structure in a large organization with multiple product lines and when you wish to give priority to product goals and coordination across functions.

**Divisional Structure**

The term *divisional structure* is used here as the generic term for what is sometimes called a *product structure* or *strategic business units*. With this structure, divisions can be organized according to individual products, services, product groups, major projects or programs, divisions, businesses, or profit centers. The distinctive feature of a divisional structure is that grouping is based on organizational outputs. For example, United Technologies Corporation (UTC), which is among the 50 largest U.S. industrial firms, has numerous divisions, including Carrier (air conditioners and heating), Otis (elevators and escalators), Pratt & Whitney (aircraft engines), and Sikorsky (helicopters).33

The difference between a divisional structure and a functional structure is illustrated in Exhibit 3.8. The functional structure can be redesigned into separate product groups, and each group contains the functional departments of R&D, manufacturing, accounting, and marketing. Coordination across functional departments within each product group is maximized. The divisional structure promotes flexibility and change because each unit is smaller and can adapt to the needs of its environment. Moreover, the divisional structure *decentralizes* decision making, because the lines of authority converge at a lower level in the hierarchy. The functional structure, by contrast, is *centralized*, because it forces decisions all the way to the top before a problem affecting several functions can be resolved.

Strengths and weaknesses of the divisional structure are summarized in Exhibit 3.9. The divisional organization structure is excellent for achieving coordination across functional departments. It works well when organizations can no longer be adequately controlled through the traditional vertical hierarchy, and when goals are oriented toward adaptation and change. Giant, complex organizations such as General Electric, Nestlé, and Johnson & Johnson are subdivided into a series of smaller, self-contained organizations for better control and coordination. In these large companies, the units are sometimes called divisions, businesses, or strategic business units. The structure at Johnson & Johnson includes some 250 separate operating units, including McNeil Consumer Products, makers of Tylenol; Ortho Pharmaceuticals, which makes Retin-A and birth-control pills; and J & J Consumer Products, the company that brings us...
Johnson’s Baby Shampoo and Band-Aids. Each unit is a separately chartered, autonomous company operating under the guidance of Johnson & Johnson’s corporate headquarters. Some U.S. government organizations also use a divisional structure to better serve the public. One example is the Internal Revenue Service, which wanted to be more customer oriented. The agency shifted its focus to informing, educating, and serving the public through four separate divisions serving distinct taxpayer groups—individual taxpayers, small businesses, large businesses, and tax-exempt organizations. Each division has its own budget, personnel, policies, and planning staffs that are focused on what is best for each particular taxpayer segment.

The divisional structure has several strengths. This structure is suited to fast change in an unstable environment and provides high product or service visibility. Since each product line has its own separate division, customers are able to contact the correct division and achieve satisfaction. Coordination across functions is excellent. Each product can adapt to requirements of individual customers or regions. The divisional structure typically works best in organizations that have
multiple products or services and enough personnel to staff separate functional units. Decision making is pushed down to the divisions. Each division is small enough to be quick on its feet, responding rapidly to changes in the market.

One disadvantage of using divisional structuring is that the organization loses economies of scale. Instead of fifty research engineers sharing a common facility in a functional structure, ten engineers may be assigned to each of five product divisions. The critical mass required for in-depth research is lost, and physical facilities have to be duplicated for each product line. Another problem is that product lines become separate from each other, and coordination across product lines can be difficult. As one Johnson & Johnson executive said, “We have to keep reminding ourselves that we work for the same corporation.”

Some companies that have a large number of divisions have had real problems with cross-unit coordination. Sony lost the digital media products business to Apple partly because of poor coordination. With the introduction of the iPod, Apple quickly captured 60 percent of the U.S. market versus 10 percent for Sony. The digital music business depends on seamless coordination. Sony’s Walkman didn’t even recognize some of the music sets that could be made with the company’s SonicStage software and thus didn’t mesh well with the division selling music downloads. Unless effective horizontal mechanisms are in place, a divisional structure can hurt overall performance. One division may produce products or programs that are incompatible with products sold by another division, as at Sony. Customers can become frustrated when a sales representative from one division is unaware of developments in other divisions. Task forces and other horizontal linkage devices are needed to coordinate across divisions. A lack of technical specialization is also a problem in a divisional structure. Employees identify with the product line rather than with a functional specialty. R&D personnel, for example, tend to do applied research to benefit the product line rather than basic research to benefit the entire organization.

EXHIBIT 3.9
Strengths and Weaknesses of Divisional Organization Structure

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Suited to fast change in unstable environment</td>
<td>1. Eliminates economies of scale in functional departments</td>
</tr>
<tr>
<td>2. Leads to customer satisfaction because product responsibility and</td>
<td>2. Leads to poor coordination across product lines</td>
</tr>
<tr>
<td>contact points are clear</td>
<td></td>
</tr>
<tr>
<td>3. Involves high coordination across functions</td>
<td>3. Eliminates in-depth competence and technical specialization</td>
</tr>
<tr>
<td>4. Allows units to adapt to differences in products, regions, customers</td>
<td>4. Makes integration and standardization across product lines difficult</td>
</tr>
<tr>
<td>5. Best in large organizations with several products</td>
<td></td>
</tr>
<tr>
<td>6. Decentralizes decision making</td>
<td></td>
</tr>
</tbody>
</table>

Geographic Structure

Another basis for structural grouping is the organization’s users or customers. The most common structure in this category is geography. Each region of the country may have distinct tastes and needs. Each geographic unit includes all functions required to produce and market products or services in that region. Large non-profit organizations such as the Girl Scouts of the USA, Habitat for Humanity, Make-A-Wish Foundation, and the United Way of America frequently use a type of geographic structure, with a central headquarters and semi-autonomous local units. The national organization provides brand recognition, coordinates fund-raising services, and handles some shared administrative functions, while day-to-day control and decision making is decentralized to local or regional units.39

For multinational corporations, self-contained units are created for different countries and parts of the world. Exhibit 3.10 shows a potential geographic structure for a computer company. This structure focuses managers and employees on specific geographic regions and sales targets.40 Top executives at Citigroup are considering reorganizing to a geographic structure to improve efficiency and give the giant global corporation a more unified face to local customers. The reorganization would put one top manager in charge of all the various banking operations throughout a specific region such as Asia, Europe, or North America.41

The strengths and weaknesses of a geographic divisional structure are similar to the divisional organization characteristics listed in Exhibit 3.9. The organization can adapt to the specific needs of its own region, and employees identify with regional
adapt to the specific needs of its own region, and employees identify with regional goals rather than with national goals. Horizontal coordination within a region is emphasized rather than linkages across regions or to the national office.

**MATRIX STRUCTURE**

Sometimes, an organization’s structure needs to be multifocused in that both product and function or product and geography are emphasized at the same time. One way to achieve this is through the matrix structure. The matrix can be used when both technical expertise and product innovation and change are important for meeting organizational goals. The matrix structure often is the answer when organizations find that the functional, divisional, and geographic structures combined with horizontal linkage mechanisms will not work.

The matrix is a strong form of horizontal linkage. The unique characteristic of the matrix organization is that both product divisions and functional structures (horizontal and vertical) are implemented simultaneously, as shown in Exhibit 3.11. The product managers and functional managers have equal authority within the organization, and employees report to both of them. The matrix structure is similar to the use of full-time integrators or product managers described earlier in this chapter (Exhibit 3.3), except that in the matrix structure the product managers (horizontal) are given formal authority equal to that of the functional managers (vertical).

**Conditions for the Matrix**

A dual hierarchy may seem an unusual way to design an organization, but the matrix is the correct structure when the following conditions are present:42

- **Condition 1.** Pressure exists to share scarce resources across product lines. The organization is typically medium sized and has a moderate number of product lines. It feels pressure for the shared and flexible use of people and equipment across those products. For example, the organization is not large enough to assign engineers full-time to each product line, so engineers are assigned part-time to several products or projects.

- **Condition 2.** Environmental pressure exists for two or more critical outputs, such as for in-depth technical knowledge (functional structure) and frequent new products (divisional structure). This dual pressure means a balance of power is needed between the functional and product sides of the organization, and a dual-authority structure is needed to maintain that balance.

- **Condition 3.** The environmental domain of the organization is both complex and uncertain. Frequent external changes and high interdependence between departments require a large amount of coordination and information processing in both vertical and horizontal directions.

Under these three conditions, the vertical and horizontal lines of authority must be given equal recognition. A dual-authority structure is thereby created so the balance of power between them is equal.

Referring again to Exhibit 3.11, assume the matrix structure is for a clothing manufacturer. Product A is footwear, product B is outerwear, product C is sleepwear, and so on. Each product line serves a different market and customers. As a medium-size organization, the company must effectively use people from manufacturing, design, and marketing to work on each product line. There are not enough designers
to warrant a separate design department for each product line, so the designers are shared across product lines. Moreover, by keeping the manufacturing, design, and marketing functions intact, employees can develop the in-depth expertise to serve all product lines efficiently.

The matrix formalizes horizontal teams along with the traditional vertical hierarchy and tries to give equal balance to both. However, the matrix may shift one way or the other. Many companies have found a balanced matrix hard to implement and maintain because one side of the authority structure often dominates. As a consequence, two variations of matrix structure have evolved—the functional matrix and the product matrix. In a functional matrix, the functional bosses have primary authority and the project or product managers simply coordinate product activities. In a product matrix, by contrast, the project or product managers have primary authority and functional managers simply assign technical personnel to projects and provide advisory expertise as needed. For many organizations, one of these approaches works better than the balanced matrix with dual lines of authority.43

All kinds of organizations have experimented with the matrix, including hospitals, consulting firms, banks, insurance companies, government agencies, and many
types of industrial firms. This structure has been used successfully by large, global organizations such as Procter & Gamble, Unilever, and Dow Chemical, which fine-tuned the matrix to suit their own particular goals and culture.

**Strengths and Weaknesses**

The matrix structure is best when environmental change is high and when goals reflect a dual requirement, such as for both product and functional goals. The dual-authority structure facilitates communication and coordination to cope with rapid environmental change and enables an equal balance between product and functional bosses. The matrix facilitates discussion and adaptation to unexpected problems. It tends to work best in organizations of moderate size with a few product lines. The matrix is not needed for only a single product line, and too many product lines make it difficult to coordinate both directions at once. Exhibit 3.12 summarizes the strengths and weaknesses of the matrix structure based on what we know of organizations that use it.

The strength of the matrix is that it enables an organization to meet dual demands from customers in the environment. Resources (people, equipment) can be flexibly allocated across different products, and the organization can adapt to changing external requirements. This structure also provides an opportunity for employees to acquire either functional or general management skills, depending on their interests.

One disadvantage of the matrix is that some employees experience dual authority, reporting to two bosses and sometimes juggling conflicting demands. This can be frustrating and confusing, especially if roles and responsibilities are not clearly defined by top managers. Employees working in a matrix need excellent interpersonal and conflict-resolution skills, which may require special training in human

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Achieves coordination necessary to meet dual demands from customers</td>
<td>1. Causes participants to experience dual authority, which can be frustrating and confusing</td>
</tr>
<tr>
<td>2. Flexible sharing of human resources across products</td>
<td>2. Means participants need good interpersonal skills and extensive training</td>
</tr>
<tr>
<td>3. Suited to complex decisions and frequent changes in unstable environment</td>
<td>3. Is time consuming; involves frequent meetings and conflict resolution sessions</td>
</tr>
<tr>
<td>4. Provides opportunity for both functional and product skill development</td>
<td>4. Will not work unless participants understand it and adopt collegial rather than vertical type relationships</td>
</tr>
<tr>
<td>5. Best in medium-sized organizations with multiple products</td>
<td>5. Requires great effort to maintain power balance</td>
</tr>
</tbody>
</table>

relations. The matrix also forces managers to spend a great deal of time in meet-
ings.48 If managers do not adapt to the information and power sharing required by
the matrix, the system will not work. Managers must collaborate with one another
rather than rely on vertical authority in decision making. The successful implemen-
tation of one matrix structure occurred at a steel company in Great Britain.

As far back as anyone could remember, the steel industry in England was stable
and certain. Then in the 1980s and 1990s, excess European steel capacity, an eco-
nomic downturn, the emergence of the mini mill electric arc furnace, and competition from
steelmakers in Germany and Japan forever changed the steel industry. By the turn of the
century, traditional steel mills in the United States, such as Bethlehem Steel and LTV
Corporation, were facing bankruptcy. Mittal Steel in Asia and Europe’s leading steelmaker,
Arcelor, started acquiring steel companies to become world steel titans. The survival hope
of small traditional steel manufacturers was to sell specialized products. A small company
could market specialty products aggressively and quickly adapt to customer needs. Complex
process settings and operating conditions had to be rapidly changed for each customer’s
order—a difficult feat for the titans.

Englander Steel employed 2,900 people, made 400,000 tons of steel a year (about
1 percent of Arcelor’s output), and was 180 years old. For 160 of those years, a func-
tional structure worked fine. As the environment became more turbulent and competitive,
however, Englander Steel managers realized they were not keeping up. Fifty percent of
Englander’s orders were behind schedule. Profits were eroded by labor, material, and energy
cost increases. Market share declined.

In consultation with outside experts, the president of Englander Steel saw that the com-
pany had to walk a tightrope. It had to specialize in a few high-value-added products tailored
for separate markets, while maintaining economies of scale and sophisticated technology
within functional departments. The dual pressure led to an unusual solution for a steel
company: a matrix structure.

Englander Steel had four product lines: open-die forgings, ring-mill products, wheels and
axles, and sheet steel. A business manager was given responsibility for and authority over
each line, which included preparing a business plan and developing targets for production
costs, product inventory, shipping dates, and gross profit. The managers were given author-
ity to meet those targets and to make their lines profitable. Functional vice presidents were
responsible for technical decisions. Functional managers were expected to stay abreast of
the latest techniques in their areas and to keep personnel trained in new technologies that
could apply to product lines. With 20,000 recipes for specialty steels and several hundred
new recipes ordered each month, functional personnel had to stay current. Two functional
departments—field sales and industrial relations—were not included in the matrix because
they worked independently. The final design was a hybrid matrix structure with both matrix
and functional relationships, as illustrated in Exhibit 3.13.

Implementation of the matrix was slow. Middle managers were confused. Meetings to coor-
dinate orders across functional departments seemed to be held every day. After about a year of
training by external consultants, Englander Steel was on track. Ninety percent of the orders were
now delivered on time and market share recovered. Both productivity and profitability increased
steadily. The managers thrived on matrix involvement. Meetings to coordinate product and
functional decisions provided a growth experience. Middle managers began including younger
managers in the matrix discussions as training for future management responsibility.49
EXHIBIT 3.13
Matrix Structure for Englander Steel
This example illustrates the correct use of a matrix structure. The dual pressure to maintain economies of scale and to market four product lines gave equal emphasis to the functional and product hierarchies. Through continuous meetings for coordination, Englander Steel achieved both economies of scale and flexibility.

**HORIZONTAL STRUCTURE**

A recent approach to organizing is the horizontal structure, which organizes employees around core processes. Organizations typically shift toward a horizontal structure during a procedure called reengineering. Reengineering, or business process reengineering, basically means the redesign of a vertical organization along its horizontal workflows and processes. A process refers to an organized group of related tasks and activities that work together to transform inputs into outputs that create value for customers. Examples of processes include order fulfillment, new product development, and customer service. Reengineering changes the way managers think about how work is done. Rather than focusing on narrow jobs structured into distinct functional departments, they emphasize core processes that cut horizontally across the organization and involve teams of employees working together to serve customers.

A good illustration of process is provided by claims handling at Progressive Casualty Insurance Company. In the past, a customer would report an accident to an agent, who would pass the information to a customer service representative, who, in turn, would pass it to a claims manager. The claims manager would batch the claim with others from the same territory and assign it to an adjuster, who would schedule a time to inspect the vehicle damage. Today, adjusters are organized into teams that handle the entire claims process from beginning to end. One member handles claimant calls to the office while others are stationed in the field. When an adjuster takes a call, he or she does whatever is possible over the phone. If an inspection is needed, the adjuster contacts a team member in the field and schedules an appointment immediately. Progressive now measures the time from call to inspection in hours rather than the seven to ten days it once took.

When a company is reengineered to a horizontal structure, all employees throughout the organization who work on a particular process (such as claims handling or order fulfillment) have easy access to one another so they can communicate and coordinate their efforts. The horizontal structure virtually eliminates both the vertical hierarchy and old departmental boundaries. This structural approach is largely a response to the profound changes that have occurred in the workplace and the business environment over the past fifteen to twenty years. Technological progress emphasizes computer- and Internet-based integration and coordination. Customers expect faster and better service, and employees want opportunities to use their minds, learn new skills, and assume greater responsibility. Organizations mired in a vertical mindset have a hard time meeting these challenges. Thus, numerous organizations have experimented with horizontal mechanisms such as cross-functional teams to achieve coordination across departments or task forces to accomplish temporary projects. Increasingly, organizations are shifting away from hierarchical, function-based structures to structures based on horizontal processes.
Characteristics

An illustration of a company reengineered into a horizontal structure appears in Exhibit 3.14. Such an organization has the following characteristics:\(^{52}\)

- Structure is created around cross-functional core processes rather than tasks, functions, or geography. Thus, boundaries between departments are obliterated. Ford Motor Company’s Customer Service Division, for example, has core process groups for business development, parts supply and logistics, vehicle service and programs, and technical support.

- Self-directed teams, not individuals, are the basis of organizational design and performance. Schwa, a restaurant in Chicago that serves elaborate multicourse meals, is run by a team. Members rotate jobs so that everyone is sometimes a chef, sometimes a dishwasher, sometimes a waiter, or sometimes the person who answers the phone, takes reservations, or greets customers at the door.\(^{53}\)

- Process owners have responsibility for each core process in its entirety. For Ford’s parts supply and logistics process, for example, a number of teams may work on jobs such as parts analysis, purchasing, material flow, and distribution, but a process owner is responsible for coordinating the entire process.

- People on the team are given the skills, tools, motivation, and authority to make decisions central to the team’s performance. Team members are cross-trained to perform one another’s jobs, and the combined skills are sufficient to complete a major organizational task.

• Teams have the freedom to think creatively and respond flexibly to new challenges that arise.
• Customers drive the horizontal corporation. Effectiveness is measured by end-of-process performance objectives (based on the goal of bringing value to the customer), as well as customer satisfaction, employee satisfaction, and financial contribution.
• The culture is one of openness, trust, and collaboration, focused on continuous improvement. The culture values employee empowerment, responsibility, and well-being.

General Electric’s Salisbury, North Carolina, plant shifted to a horizontal structure to improve flexibility and customer service.

General Electric’s plant in Salisbury, North Carolina, which manufactures electrical lighting panel boards for industrial and commercial purposes, used to be organized functionally and vertically. Because no two GE customers have identical needs, each panel board has to be configured and built to order, which frequently created bottlenecks in the standard production process. In the mid-1980s, faced with high product-line costs, inconsistent customer service, and a declining market share, managers began exploring new ways of organizing that would emphasize teamwork, responsibility, continuous improvement, empowerment, and commitment to the customer.

By the early 1990s, GE Salisbury had made the transition to a horizontal structure that links sets of multiskilled teams who are responsible for the entire build-to-order process. The new structure is based on the goal of producing lighting panel boards “of the highest possible quality, in the shortest possible cycle time, at a competitive price, with the best possible service.” The process consists of four linked teams, each made up of ten to fifteen members representing a range of skills and functions. A production-control team serves as process owner (as illustrated earlier in Exhibit 3.14) and is responsible for order receipt, planning, coordination of production, purchasing, working with suppliers and customers, tracking inventory, and keeping all the teams focused on meeting objectives. The fabrication team cuts, builds, welds, and paints the various parts that make up the steel box that will house the electrical components panel, which is assembled and tested by the electrical components team. The electrical components team also handles shipping. A maintenance team takes care of heavy equipment maintenance that cannot be performed as part of the regular production process. Managers have become associate advisors who serve as guides and coaches and bring their expertise to the teams as needed.

The key to success of the horizontal structure is that all the operating teams work in concert with each other and have access to the information they need to meet team and process goals. Teams are given information about sales, backlogs, inventory, staffing needs, productivity, costs, quality, and other data, and each team regularly shares information about its part of the build-to-order process with the other teams. Joint production meetings, job rotation, and cross-training of employees are some of the mechanisms that help ensure smooth integration. The linked teams assume responsibility for setting their own production targets, determining production schedules, assigning duties, and identifying and solving problems.

(continued)
Productivity and performance have dramatically improved with the horizontal structure. Bottlenecks in the workflow, which once wreaked havoc with production schedules, have been virtually eliminated. A six-week lead time has been cut to two-and-a-half days. More subtle but just as important are the increases in employee and customer satisfaction that GE Salisbury has realized since implementing its new structure.54

**Strengths and Weaknesses**

As with all structures, the horizontal structure has both strengths and weaknesses, as listed in Exhibit 3.15.

The most significant strength of the horizontal structure is enhanced coordination, which can dramatically increase the company’s flexibility and response to changes in customer needs. The structure directs everyone’s attention toward the customer, which leads to greater customer satisfaction as well as improvements in productivity, speed, and efficiency. In addition, because there are no boundaries between functional departments, employees take a broader view of organizational goals rather than being focused on the goals of a single department. The horizontal structure promotes an emphasis on teamwork and cooperation, so that team members share a commitment to meeting common objectives. Finally, the horizontal structure can improve the quality of life for employees by giving them opportunities to share responsibility, make decisions, and contribute significantly to the organization.

A weakness of the horizontal structure is that it can harm rather than help organizational performance unless managers carefully determine which core processes are critical for bringing value to customers. Simply defining the processes around

---

**EXHIBIT 3.15**

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Promotes flexibility and rapid response to changes in customer needs</td>
<td>1. Determining core processes is difficult and time consuming</td>
</tr>
<tr>
<td>2. Directs the attention of everyone toward the production and delivery of value to the customer</td>
<td>2. Requires changes in culture, job design, management philosophy, and information and reward systems</td>
</tr>
<tr>
<td>3. Each employee has a broader view of organizational goals</td>
<td>3. Traditional managers may balk when they have to give up power and authority</td>
</tr>
<tr>
<td>4. Promotes a focus on teamwork and collaboration</td>
<td>4. Requires significant training of employees to work effectively in a horizontal team environment</td>
</tr>
<tr>
<td>5. Improves quality of life for employees by offering them the opportunity to share responsibility, make decisions, and be accountable for outcomes</td>
<td>5. Can limit in-depth skill development</td>
</tr>
</tbody>
</table>

which to organize can be difficult. In addition, shifting to a horizontal structure is complicated and time consuming because it requires significant changes in culture, job design, management philosophy, and information and reward systems. Traditional managers may balk when they have to give up power and authority to serve instead as coaches and facilitators of teams. Employees have to be trained to work effectively in a team environment. Finally, because of the cross-functional nature of work, a horizontal structure can limit in-depth knowledge and skill development unless measures are taken to give employees opportunities to maintain and build technical expertise.

VIRTUAL NETWORKS AND OUTSOURCING

Recent developments in organization design extend the concept of horizontal coordination and collaboration beyond the boundaries of the traditional organization. The most widespread design trend in recent years has been the outsourcing of various parts of the organization to outside partners. Outsourcing means to contract out certain tasks or functions, such as manufacturing, human resources, or credit processing, to other companies.

Companies in almost every industry are jumping on the outsourcing bandwagon. For example, more than 1,000 law enforcement agencies across the United States have turned to PropertyRoom.com to manage the time-consuming business of cataloging and auctioning off unclaimed stolen goods such as cars, computers, jewelry, or paintings. And consider the U.S. military, which increasingly uses private military company contractors to handle just about everything except the core activity of fighting battles and securing defensive positions. Kellogg Brown & Root, a subsidiary of the Halliburton Corporation, for instance, builds and maintains military bases and provides catering and cleaning services. In the business world, Wachovia Corporation transferred administration of its human resources programs to Hewitt Associates, and British food retailer J. Sainsbury’s lets Accenture handle its entire information technology department. About 20 percent of drug manufacturer Eli Lilly & Company’s chemistry work is done in China by start-up labs such as Chem-Explorer; and companies such as India’s Wipro, France’s S.R. Teleperformance, and the U.S.-based Convergys manage call center and technical support operations for big computer and cell phone companies around the world. Fiat Auto is involved in multiple complex outsourcing relationships with other companies handling logistics, maintenance, and the manufacturing of some parts.

Once, a company’s units of operation “were either within the organization and ‘densely connected’ or they were outside the organization and not connected at all,” as one observer phrased it. Today, the lines are so blurred that it can be difficult to tell what is part of the organization and what is not. IBM handles back-office operations for many large companies, but it also outsources some of its own activities to other firms, which in turn may farm out some of their functions to still other organizations.

A few organizations carry outsourcing to the extreme to create a virtual network structure. With a virtual network structure, sometimes called a modular structure, the firm subcontracts most of its major functions or processes to separate companies and coordinates their activities from a small headquarters organization.
How the Structure Works

The virtual network organization may be viewed as a central hub surrounded by a network of outside specialists. Rather than being housed under one roof or located within one organization, services such as accounting, design, manufacturing, marketing, and distribution are outsourced to separate companies that are connected electronically to a central office. Organizational partners located in different parts of the world may use networked computers or the Internet to exchange data and information so rapidly and smoothly that a loosely connected network of suppliers, manufacturers, and distributors can look and act like one seamless company. The virtual network form incorporates a free-market style to replace the traditional vertical hierarchy. Subcontractors may flow into and out of the system as needed to meet changing needs.

With a network structure, the hub maintains control over processes in which it has world-class or difficult-to-imitate capabilities and then transfers other activities—along with the decision making and control over them—to other organizations. These partner organizations organize and accomplish their work using their own ideas, assets, and tools. The idea is that a firm can concentrate on what it does best and contract out everything else to companies with distinctive competence in those specific areas, enabling the organization to do more with less. The network structure is often advantageous for start-up companies, such as TiVo Inc., the company that introduced the digital video recorder.

The market for digital video recorders is hot, and major electronics, cable, and satellite companies are getting in on the action. The company that started it all was TiVo, a small organization based in the San Francisco Bay area.

TiVo’s founders developed a technology to allow users to record up to 80 hours of television and replay it at their convenience, without commercial interruption and minus the hassles of digital storage media or videotapes. They knew speed was of the essence if they were to take this new market by storm. The only way to do it was by outsourcing practically everything. TiVo first developed major manufacturing and marketing partnerships with large companies such as Sony, Hughes Electronics, and Royal Philips Electronics. In addition, the company outsourced distribution, public relations, advertising, and customer support. TiVo managers considered the customer support function particularly critical. Because TiVo was a new concept, ordinary call-center approaches wouldn’t work. Leaders worked closely with outsourcing partner ClientLogic to develop processes and training materials that would help customer-service agents “think like a TiVo customer.”

Using the virtual network structure enabled a small company like TiVo to get the advanced capabilities it needed without having to spend time and limited financial resources building an organization from scratch. TiVo leaders concentrated on technological innovation and developing and managing relationships with outsourcing firms. Today, TiVo has partnership agreements with numerous organizations, including a recent one with YouTube that will allow TiVo subscribers to watch user-generated videos from the website on their televisions, and one with Comcast, the nation’s number one cable operator, that will help TiVo reach a larger customer base. The deal with Comcast is critical. Without a cable partner, TiVo would find it difficult to remain a major player in the growing market for digital video recorders.
TiVo faces stiff competition, but using the virtual network structure enabled it to get established and survive in the growing industry. TiVo is marketing itself as a premium DVR service to compete with the fast-growing and less expensive options offered by satellite and cable providers. Exhibit 3.16 illustrates a simplified network structure for TiVo, showing some of the functions that are outsourced to other companies.

**Strengths and Weaknesses**

Exhibit 3.17 summarizes the strengths and weaknesses of the virtual network structure. One of the major strengths is that the organization, no matter how small, can be truly global, drawing on resources worldwide to achieve the best quality and price and then selling products or services worldwide just as easily through subcontractors. The network structure also enables a new or small company to develop products or services and get them to market rapidly without huge investments in factories, equipment, warehouses, or distribution facilities. The ability to arrange and rearrange resources to meet changing needs and best serve customers gives the network structure extreme flexibility and rapid response. New technologies can be developed quickly by tapping into a worldwide network of experts. The organization can continually redefine itself to meet changing product or market opportunities. A final strength is reduced administrative overhead. Large teams of staff specialists and administrators are not needed. Managerial and technical talent can be focused on key activities that provide competitive advantage while other activities are outsourced.
The virtual network structure also has a number of weaknesses. The primary weakness is a lack of control. The network structure takes decentralization to the extreme. Managers do not have all operations under their jurisdiction and must rely on contracts, coordination, and negotiation to hold things together. This also means increased time spent managing relationships with partners and resolving conflicts.

A problem of equal importance is the risk of failure if one organizational partner fails to deliver, has a plant burn down, or goes out of business. Managers in the headquarters organization have to act quickly to spot problems and find new arrangements. Finally, from a human resource perspective, employee loyalty can be weak in a network organization because of concerns over job security. Employees may feel that they can be replaced by contract services. In addition, it is more difficult to develop a cohesive corporate culture. Turnover may be higher because emotional commitment between the organization and employees is low. With changing products, markets, and partners, the organization may need to reshuffle employees at any time to get the correct mix of skills and capabilities.

**EXHIBIT 3.17**
Strengths and Weaknesses of Virtual Network Structure

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enables even small organizations to obtain talent and resources worldwide</td>
<td>1. Managers do not have hands-on control over many activities and employees</td>
</tr>
<tr>
<td>2. Gives a company immediate scale and reach without huge investments in factories, equipment, or distribution facilities</td>
<td>2. Requires a great deal of time to manage relationships and potential conflicts with contract partners</td>
</tr>
<tr>
<td>3. Enables the organization to be highly flexible and responsive to changing needs</td>
<td>3. There is a risk of organizational failure if a partner fails to deliver or goes out of business</td>
</tr>
<tr>
<td>4. Reduces administrative overhead costs</td>
<td>4. Employee loyalty and corporate culture might be weak because employees feel they can be replaced by contract services</td>
</tr>
</tbody>
</table>

Sources: Based on Linda S. Ackerman, “Transition Management: An In-Depth Look at Managing Complex Change,” *Organizational Dynamics* (Summer 1982), 46–66; and Frank Ostroff, *The Horizontal Organization* (New York: Oxford University Press, 1999), Fig 2.1, 34.

The virtual network structure also has a number of weaknesses. The primary weakness is a lack of control. The network structure takes decentralization to the extreme. Managers do not have all operations under their jurisdiction and must rely on contracts, coordination, and negotiation to hold things together. This also means increased time spent managing relationships with partners and resolving conflicts.

A problem of equal importance is the risk of failure if one organizational partner fails to deliver, has a plant burn down, or goes out of business. Managers in the headquarters organization have to act quickly to spot problems and find new arrangements. Finally, from a human resource perspective, employee loyalty can be weak in a network organization because of concerns over job security. Employees may feel that they can be replaced by contract services. In addition, it is more difficult to develop a cohesive corporate culture. Turnover may be higher because emotional commitment between the organization and employees is low. With changing products, markets, and partners, the organization may need to reshuffle employees at any time to get the correct mix of skills and capabilities.

**HYBRID STRUCTURE**

As a practical matter, many structures in the real world do not exist in the pure forms we have outlined in this chapter. Most large organizations, in particular, often use a hybrid structure that combines characteristics of various approaches tailored to specific strategic needs. Most companies combine characteristics of functional, divisional, geographic, horizontal, or network structures to take advantage of the strengths of various structures and avoid some of the weaknesses. Hybrid structures tend to be used in rapidly changing environments because they offer the organization greater flexibility.
One type of hybrid that is often used is to combine characteristics of the functional and divisional structures. When a corporation grows large and has several products or markets, it typically is organized into self-contained divisions of some type. Functions that are important to each product or market are decentralized to the self-contained units. However, some functions that are relatively stable and require economies of scale and in-depth specialization are also centralized at headquarters. Sun Petroleum Products Corporation (SPPC) reorganized to a hybrid structure to be more responsive to changing markets. The hybrid organization structure adopted by SPPC is illustrated in part 1 of Exhibit 3.18. Three major product divisions—fuels, lubricants, and chemicals—were created, each serving a different market and requiring a different strategy and management style. Each product-line vice president is now in charge of all functions for that product, such as marketing, planning, supply and distribution, and manufacturing. However, activities such as human resources, legal, technology, and finance were centralized as functional departments at headquarters in order to achieve economies of scale. Each of these departments provides services for the entire organization.65

A second hybrid approach that is increasingly used today is to combine characteristics of functional, divisional, and horizontal structures. Ford Motor Company’s Customer Service Division, a global operation made up of 12,000 employees serving nearly 15,000 dealers, provides an example of this type of hybrid. Beginning in 1995, when Ford launched its “Ford 2000” initiative aimed at becoming the world’s leading automotive firm in the twenty-first century, top executives grew increasingly concerned about complaints regarding customer service. They decided that the horizontal model offered the best chance to gain a faster, more efficient, integrated approach to customer service. Part 2 of Exhibit 3.18 illustrates a portion of the Customer Service Division’s hybrid structure. Several horizontally aligned groups, made up of multiskilled teams, focus on core processes such as parts supply and logistics (acquiring parts and getting them to dealers quickly and efficiently), vehicle service and programs (collecting and disseminating information about repair problems), and technical support (ensuring that every service department receives updated technical information). Each group has a process owner who is responsible for seeing that the teams meet overall objectives. Ford’s Customer Service Division retained a functional structure for its finance, strategy and communications, and human resources departments. Each of these departments provides services for the entire division.66

In a huge organization such as Ford, managers may use a variety of structural characteristics to meet the needs of the total organization. Like many large organizations, for example, Ford also outsources some of its activities to other firms. A hybrid structure is often preferred over the pure functional, divisional, horizontal, or virtual network structure because it can provide some of the advantages of each and overcome some of the disadvantages.

APPLICATIONS OF STRUCTURAL DESIGN

Each type of structure is applied in different situations and meets different needs. In describing the various structures, we touched briefly on conditions such as environmental stability or change and organizational size that are related to structure. Each form of structure—functional, divisional, matrix, horizontal, network, hybrid—represents a tool that can help managers make an organization more effective, depending on the demands of its situation.
Structural Alignment

Ultimately, the most important decision that managers make about structural design is to find the right balance between vertical control and horizontal coordination, depending on the needs of the organization. Vertical control is associated with goals of efficiency and stability, while horizontal coordination is associated with learning, innovation, and flexibility. Exhibit 3.19 shows a simplified continuum that illustrates how structural approaches are associated with vertical control versus horizontal coordination. The functional structure is appropriate when the organization needs to be coordinated through the vertical hierarchy and when efficiency is important for meeting organizational goals. The functional structure uses task specialization and a strict chain of command to gain efficient use of scarce resources, but it does not enable the organization to be flexible or innovative. At the opposite end of the scale, the horizontal structure is appropriate when the organization has a high need for coordination among functions to achieve innovation and promote learning. The horizontal structure enables organizations to differentiate themselves and respond quickly to changes, but at the expense of efficient resource use. The virtual network structure offers even greater flexibility and potential for rapid response by allowing the organization to add or subtract pieces as needed to adapt and meet changing needs from the environment and marketplace. Exhibit 3.19 also shows how other types of structure defined in this chapter—functional with horizontal linkages, divisional, and matrix—represent intermediate steps on the organization’s path to efficiency or innovation and learning. The exhibit does not include all possible structures, but it illustrates how organizations attempt to balance the needs for efficiency and vertical control with innovation and horizontal coordination. In addition, as described in the chapter, many organizations use a hybrid structure to combine characteristics of various structural types.

Symptoms of Structural Deficiency

Top executives periodically evaluate organization structure to determine whether it is appropriate to changing needs. Managers try to achieve the best fit between internal reporting relationships and the needs of the external environment. As a general rule, when organization structure is out of alignment...
with organization needs, one or more of the following symptoms of structural deficiency appear.\(^6^7\)

- **Decision making is delayed or lacking in quality.** Decision makers may be overloaded because the hierarchy funnels too many problems and decisions to them. Delegation to lower levels may be insufficient. Another cause of poor-quality decisions is that information may not reach the correct people. Information linkages in either the vertical or horizontal direction may be inadequate to ensure decision quality.

- **The organization does not respond innovatively to a changing environment.** One reason for lack of innovation is that departments are not coordinated horizontally. The identification of customer needs by the marketing department and the identification of technological developments in the research department must be coordinated. Organization structure also has to specify departmental responsibilities that include environmental scanning and innovation.

- **Employee performance declines and goals are not being met.** Employee performance may decline because the structure doesn’t provide clear goals, responsibilities, and mechanisms for coordination. The structure should reflect the complexity of the market environment yet be straightforward enough for employees to effectively work within.

- **Too much conflict is evident.** Organization structure should allow conflicting departmental goals to combine into a single set of goals for the entire organization. When departments act at cross-purposes or are under pressure to achieve departmental goals at the expense of organizational goals, the structure is often at fault. Horizontal linkage mechanisms are not adequate.
DESIGN ESSENTIALS

- Organization structure must accomplish two things for the organization. It must provide a framework of responsibilities, reporting relationships, and groupings, and it must provide mechanisms for linking and coordinating organizational elements into a coherent whole. The structure is reflected on the organization chart. Linking the organization into a coherent whole requires the use of information systems and linkage devices in addition to the organization chart.

- Organization structure can be designed to provide vertical and horizontal information linkages based on the information processing required to meet the organization’s overall goal. Managers can choose whether to orient toward a traditional organization designed for efficiency, which emphasizes vertical linkages such as hierarchy, rules and plans, and formal information systems, or toward a contemporary organization designed for learning and adaptation, which emphasizes horizontal communication and coordination. Vertical linkages are not sufficient for most organizations today. Organizations provide horizontal linkages through cross-functional information systems, direct contact between managers across department lines, temporary task forces, full-time integrators, and teams.

- Alternatives for grouping employees and departments into overall structural design include functional grouping, divisional grouping, multifocused grouping, horizontal grouping, and virtual network grouping. The choice among functional, divisional, and horizontal structures determines where coordination and integration will be greatest. With functional and divisional structures, managers also use horizontal linkage mechanisms to complement the vertical dimension and achieve integration of departments and levels into an organizational whole. With a horizontal structure, activities are organized horizontally around core work processes.

- A virtual network structure extends the concept of horizontal coordination and collaboration beyond the boundaries of the organization. Core activities are performed by a central hub while other functions and activities are outsourced to contract partners.

- The matrix structure attempts to achieve an equal balance between the vertical and horizontal dimensions of structure. Most organizations do not exist in these pure forms, using instead hybrid structures that incorporate characteristics of two or more types of structure.

- Ultimately, managers attempt to find the correct balance between vertical control and horizontal coordination. Signs of structural misalignment include delayed decision making, lack of innovation, poor employee performance, and excessive conflict.

- Finally, an organization chart is only so many lines and boxes on a piece of paper. The purpose of the organization chart is to encourage and direct employees into activities and communications that enable the organization to achieve its goals. The organization chart provides the structure, but employees provide the behavior. The chart is a guideline to encourage people to work together, but management must implement the structure and carry it out.
Part 2: Organizational Purpose and Structural Design

Key Concepts

centralized
decentralized
departmental grouping
divisional grouping
divisional structure
functional grouping
functional structure
horizontal grouping
horizontal linkage

horizontal structure
hybrid structure
integrator
liaison role
matrix structure
multifocused grouping
organization structure
outsourcing
process
product matrix

reengineering
symptoms of structural deficiency
task force
teams
vertical information system
vertical linkages
virtual network grouping
virtual network structure
virtual team

Discussion Questions

2. When is a functional structure preferable to a divisional structure?
3. Large corporations tend to use hybrid structures. Why?
4. What are the primary differences between a traditional organization designed for efficiency and a more contemporary organization designed for learning?
5. What is the difference between a task force and a team? Between liaison role and integrating role? Which of these provides the greatest amount of horizontal coordination?
6. What conditions usually have to be present before an organization should adopt a matrix structure?
7. The manager of a consumer products firm said, “We use the brand manager position to train future executives.” Why do you think the brand manager position is considered a good training ground? Discuss.
8. Why do companies using a horizontal structure have cultures that emphasize openness, employee empowerment, and responsibility? What do you think a manager’s job would be like in a horizontally organized company?
9. What types of organizational activities do you think are most likely to be outsourced? What types are least likely?
10. Describe the virtual network structure. What are the advantages and disadvantages of using this structure compared to performing all activities in-house within an organization?

Chapter 3 Workbook: You and Organization Structure*

To better understand the importance of organization structure in your life, do the following assignment.

Select one of the following situations to organize:

- A copy and print shop
- A travel agency
- A sports rental (such as Jet Skis or snowmobiles) in a resort area
- A bakery

Background

Organization is a way of gaining some power against an unreliable environment. The environment provides the organization with inputs, which include raw materials, human resources, and financial resources. There is a service or product to produce that involves technology. The output goes to clients, a group that must be nurtured. The complexities of the environment and the technology determine the complexity of the organization.

Planning Your Organization

1. Write down the mission or purpose of the organization in a few sentences.
2. What are the specific tasks to be completed to accomplish the mission?
3. Based on the specifics in question 2, develop an organization chart. Each position in the chart will perform a specific task or is responsible for a certain outcome.
4. You are into your third year of operation, and your business has been very successful. You want to add a second location a few miles away. What issues will you face
running the business at two locations? Draw an organization chart that includes the two business locations.

5. Five more years go by and the business has grown to five locations in two cities. How do you keep in touch with it all? What issues of control and coordination have arisen? Draw an up-to-date organization chart and explain your rationale for it.

6. Twenty years later you have seventy-five business locations in five states. What are the issues and problems that have to be dealt with through organizational structure? Draw an organization chart for this organization, indicating such factors as who is responsible for customer satisfaction, how you will know if customer needs are met, and how information will flow within the organization.


Case for Analysis: C & C Grocery Stores Inc.*

The first C & C Grocery store was started in 1947 by Doug Cummins and his brother Bob. Both were veterans who wanted to run their own business, so they used their savings to start the small grocery store in Charlotte, North Carolina. The store was immediately successful. The location was good, and Doug Cummins had a winning personality. Store employees adopted Doug’s informal style and “serve the customer” attitude. C & C’s increasing circle of customers enjoyed an abundance of good meats and produce.

By 1997, C & C had over 200 stores. A standard physical layout was used for new stores. Company headquarters moved from Charlotte to Atlanta in 1983. The organization chart for C & C is shown in Exhibit 3.20. The central offices in Atlanta handled personnel, merchandising, financial, purchasing, real estate, and legal affairs for the entire chain. For management of individual stores, the organization was divided by regions. The southern, southeastern, and northeastern regions each had about seventy stores. Each region was divided into five districts of ten to fifteen stores each. A district director was responsible for supervision and coordination of activities for the ten to fifteen district stores.

Each district was divided into four lines of authority based on functional specialty. Three of these lines reached into the stores. The produce department manager within each store reported directly to the produce specialist for the division, and the same was true for the meat department manager, who reported directly to the district meat specialist. The meat and produce managers were responsible for all activities associated with the acquisition and sale of perishable products. The store manager’s responsibility included the grocery line, front-end departments, and store operations. The store manager was responsible for appearance of personnel, cleanliness, adequate checkout service, and price accuracy. A grocery manager reported to the store manager, maintained inventories, and restocked shelves for grocery items. The district merchandising office was responsible for promotional campaigns, advertising circulars, district advertising, and attracting customers into the stores. The grocery merchandisers were expected to coordinate their activities with each store in the district.

Business for the C & C chain has dropped off in all regions in recent years—partly because of a declining economy, but mostly because of increased competition from large discount retailers such as Wal-Mart, Target, and Costco Wholesale. When these large discounters entered the grocery business, they brought a level of competition unlike any C & C had seen before. C & C had managed to hold its own against larger supermarket chains, but now even the big chains were threatened by Wal-Mart, which became no. 1 in grocery sales in 2001. C & C managers knew they couldn’t compete on price, but they were considering ways they could use advanced information technology to improve service and customer satisfaction and distinguish the store from the large discounters.

However, the most pressing problem was how to improve business with the resources and stores they now had. A consulting team from a major university was hired to investigate store structure and operations.

The consultants visited several stores in each region, talking to about fifty managers and employees. The consultants wrote a report that pinpointed four problem areas to be addressed by store executives.

1. The chain was slow to adapt to change. Store layout and structure were the same as had been designed fifteen years ago. Each store did things the same way, even though some stores were in low-income areas and other stores in suburban areas. A new computerized supply chain management system for ordering and stocking had been developed, but after two years it was only partially implemented in the stores. Other proposed information technology (IT) initiatives were still “on the back burner,” not yet even in the development stage.

2. Roles of the district store supervisor and the store manager were causing dissatisfaction. The store managers wanted to learn general management skills for potential promotion into district or regional management positions.
However, their jobs restricted them to operational activities and they learned little about merchandising, meat, and produce. Moreover, district store supervisors used store visits to inspect for cleanliness and adherence to operating standards rather than to train the store manager and help coordinate operations with perishable departments. Close supervision on the operational details had become the focus of operations management rather than development, training, and coordination.

3. **Cooperation within stores was low and morale was poor.** The informal, friendly atmosphere originally created by Doug Cummins was gone. One example of this problem occurred when the grocery merchandiser and store manager in a Louisiana store decided to promote Coke and Diet Coke as a loss leader. Thousands of cartons of Coke were brought in for the sale, but the stockroom was not prepared and did not have room. The store manager wanted to use floor area in the meat and produce sections to display Coke cartons, but those managers refused. The produce department manager said that Diet Coke did not help his sales and it was okay with him if there was no promotion at all.

4. **Long-term growth and development of the store chain would probably require reevaluation of long-term strategy.** The percent of market share going to traditional grocery stores was declining nationwide due to competition from large superstores and discount retailers. In the near future, C & C might need to introduce nonfood items into the stores for one-stop shopping, add specialty or gourmet sections within stores, and investigate how new technology could help distinguish the company, such as through targeted marketing and promotion, providing superior service and convenience, and offering their customers the best product assortment and availability.
To solve the first three problems, the consultants recommended reorganizing the district and the store structure as illustrated in Exhibit 3.21. Under this reorganization, the meat, grocery, and produce department managers would all report to the store manager. The store manager would have complete store control and would be responsible for coordination of all store activities. The district supervisor’s role would be changed from supervision to training and development. The district supervisor would head a team that included himself and several meat, produce, and merchandise specialists who would visit area stores as a team to provide advice and help for the store managers and other employees. The team would act in a liaison capacity between district specialists and the stores.

The consultants were enthusiastic about the proposed structure. With the removal of one level of district operational supervision, store managers would have more freedom and responsibility. The district liaison team would establish a cooperative team approach to management that could be adopted within stores. Focusing store responsibility on a single manager would encourage coordination within stores and adaptation to local conditions. It would also provide a focus of responsibility for storewide administrative changes.

The consultants also believed that the proposed structure could be expanded to accommodate nongrocery lines and gourmet units if these were included in C & C’s future plans. Within each store, a new department manager could be added for pharmacy, gourmet/specialty items, or other major departments. The district team could be expanded to include specialists in these lines, as well as an information technology coordinator to act as liaison for stores in the district.

The Aquarius Advertising Agency is a middle-sized firm that offered two basic services to its clients: (1) customized plans for the content of an advertising campaign (for example, slogans and layouts) and (2) complete plans for media (such as radio, TV, newspapers, billboards, and Internet). Additional services included aid in marketing and distribution of products and marketing research to test advertising effectiveness.

Its activities were organized in a traditional manner. The organization chart is shown in Exhibit 3.22. Each department included similar functions.

Each client account was coordinated by an account executive who acted as a liaison between the client and the various specialists on the professional staff of the operations and marketing divisions. The number of direct communications and contacts between clients and Aquarius specialists, clients and account executives, and Aquarius specialists and account executives is indicated in Exhibit 3.23. These sociometric data were gathered by a consultant who conducted a study of the patterns of formal and informal communication. Each intersecting cell of Aquarius personnel and the clients contains an index of the direct contacts between them.

Although an account executive was designated to be the liaison between the client and specialists within the agency, communications frequently occurred directly between clients and specialists and bypassed the account executive. These direct contacts involved a wide range of interactions, such as meetings, telephone calls, e-mail messages, and so on. A large number of direct communications occurred between agency specialists and their counterparts in the client organization. For example, an art specialist working as one member of a team on a particular client account would often be contacted directly by the client’s in-house art specialist, and agency research personnel had direct communication with research people of the client firm. Also, some of the unstructured contacts often led to more formal meetings with clients in which agency personnel made presentations, interpreted and defended agency policy, and committed the agency to certain courses of action.

Both hierarchical and professional systems operated within the departments of the operations and marketing divisions. Each department was organized hierarchically with a director, an assistant director, and several levels of authority. Professional communications were widespread and mainly concerned with sharing knowledge and techniques, technical evaluation of work, and development of professional interests. Control in each department was exercised mainly through control of promotions and supervision of work done by subordinates. Many account executives, however, felt the need for more influence, and one commented:

Creativity and art. That’s all I hear around here. It is hard as hell to effectively manage six or seven hotshots who claim they have to do their own thing. Each of them tries to sell his or her idea to the client, and most of the time I don’t know what has happened until a week later. If I were a despot, I would make all of them check with me first to get approval. Things would sure change around here.

The need for reorganization was made more acute by changes in the environment. Within a short period of time, there was a rapid turnover in the major accounts handled by the agency. It was typical for advertising agencies to gain or lose clients quickly, often with no advance warning as consumer behavior and lifestyle changes emerged and product innovations occurred.

An agency reorganization was one solution proposed by top management to increase flexibility in this unpredictable environment. The reorganization would be aimed at reducing the agency’s response time to environmental changes and at increasing cooperation and communication among specialists from different departments. The top managers are not sure what type of reorganization is appropriate. They would like your help analyzing their context and current structure and welcome your advice on proposing a new structure.

Chapter 3: Fundamentals of Organization Structure

EXHIBIT 3.22
Aquarius Advertising
Agency Organization
Chart
### EXHIBIT 3.23
Sociometric Index of Aquarius Personnel and Clients

- **F** = Frequent—daily
- **O** = Occasional—once or twice per project
- **N** = None

<table>
<thead>
<tr>
<th></th>
<th>Clients</th>
<th>Account Manager</th>
<th>Account Executives</th>
<th>TV/Radio Specialists</th>
<th>Newspaper/Magazine Specialists</th>
<th>Copy Specialists</th>
<th>Art Specialists</th>
<th>Merchandising Specialists</th>
<th>Media Specialists</th>
<th>Research Specialists</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Clients</strong></td>
<td>X</td>
<td>F</td>
<td>F</td>
<td>N</td>
<td>N</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td><strong>Account Manager</strong></td>
<td>X</td>
<td>F</td>
<td>F</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>N</td>
</tr>
<tr>
<td><strong>Account Executives</strong></td>
<td>X</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
</tr>
<tr>
<td><strong>TV/Radio Specialists</strong></td>
<td>X</td>
<td>N</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>N</td>
<td>O</td>
<td>N</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td><strong>Newspaper/Magazine Specialists</strong></td>
<td>X</td>
<td>O</td>
<td>O</td>
<td>N</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td><strong>Copy Specialists</strong></td>
<td>X</td>
<td>N</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td><strong>Art Specialists</strong></td>
<td>X</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
<td>O</td>
</tr>
<tr>
<td><strong>Merchandising Specialists</strong></td>
<td>X</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
</tr>
<tr>
<td><strong>Media Specialists</strong></td>
<td>X</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
</tr>
<tr>
<td><strong>Research Specialists</strong></td>
<td>X</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
<td>F</td>
</tr>
</tbody>
</table>

### Notes


Chapter 3: Fundamentals of Organization Structure


5. This section is based on Frank Ostroff, The Horizontal Organization: What the Organization of the Future Looks Like and How It Delivers Value to Customers (New York: Oxford University Press, 1999).


7. David Nadler and Michael Tushman, Strategic Organization Design (Glenview, Ill.: Scott Foresman, 1988).


15. Based on Galbraith, Designing Complex Organizations.


36. Based on Duncan, “What Is the Right Organization Structure?”


42. Stanley M. Davis and Paul R. Lawrence, Matrix (Reading, Mass.: Addison-Wesley, 1977), 11–24.


44. Davis and Lawrence, Matrix, 155–180.


47. Carol Hymowitz, “Managers Suddenly Have to Answer to a Crowd of Bosses” (In the Lead column), The Wall Street Journal (August 12, 2003), B1; and Michael Goold and Andrew Campbell, “Making Matrix Structures Work: Creating Clarity on Unit Roles and Responsibilities,” European Management Journal 21, no. 3 (June 2003), 351–363.


52. Based on Ostroff, The Horizontal Organization, and Anand and Daft, “What Is the Right Organization Design?”


66. Based on Ostroff, The Horizontal Organization, 29–44.

The Organization’s Environment
Task Environment · General Environment · International Environment

The Changing Environment
Simple–Complex Dimension · Stable–Unstable Dimension · Framework

Adapting to a Changing Environment
Adding Positions and Departments · Building Relationships · Differentiation and Integration · Organic versus Mechanistic Management Processes · Planning, Forecasting, and Responsiveness

Framework for Responses to Environmental Change

Dependence on External Resources

Influencing External Resources
Establishing Formal Relationships · Influencing Key Sectors · Organization–Environment Integrative Framework

Design Essentials
In the spring and summer of 2008, anyone in the United States with a car felt the effects of skyrocketing oil prices each time they had to fill the gas tank. It was a surprise change in the environment that hit consumers on a personal level, causing them to alter their buying habits, travel routes, and vacation plans. That, in turn, created even bigger headaches for organizations already struggling with higher costs. Several restaurant chains filed for bankruptcy as people stayed home to save money and reduce their gasoline use. Amusement parks such as Six Flags and Cedar Fair saw their attendance slump. Airlines suffered the double whammy of fewer customers and exorbitant fuel costs. Retailers, auto makers, food processors, trucking companies, school systems, car rental firms, and every other type of organization felt the pinch.

On the other hand, some companies also benefited from the crisis. “Four-dollar gas is the best marketing tool I have,” said Betsy Kachmar, assistant general manager of Fort Wayne Public Transportation Corporation, which saw a dramatic jump in bus ridership. Organic farmers and small companies producing food or other products for a local market became more competitive as prices of mass-produced goods increased due to transportation costs. Manufacturers of energy efficient appliances saw a rise in sales with consumers looking for ways to cut their energy use on everything from washing clothes to heating their homes. Sales at New York-based Eco Bags, which makes reusable fishnet shopping bags, doubled as grocers and customers turned away from using plastic bags made with oil.2

The rapid rise in oil prices provides a dramatic example of how shifts in the external environment create both threats and opportunities for organizations. Organizations face tremendous uncertainty in dealing with events in the external environment and often have to adapt quickly to new competition, economic turmoil, changes in consumer interests, or innovative technologies.
Purpose of This Chapter

The purpose of this chapter is to develop a framework for assessing environments and how organizations can respond to them. First, we identify the organizational domain and the sectors that influence the organization. Then, we explore two major environmental forces on the organization—the need for information and the need for resources. Organizations respond to these forces through structural design, planning systems, and attempts to adapt to and influence elements in the external environment.

THE ORGANIZATION’S ENVIRONMENT

In a broad sense the environment is infinite and includes everything outside the organization. However, the analysis presented here considers only those aspects of the environment to which the organization is sensitive and must respond to survive. Thus, organizational environment is defined as all elements that exist outside the boundary of the organization and have the potential to affect all or part of the organization.

The environment of an organization can be understood by analyzing its domain within external sectors. An organization’s domain is the chosen environmental field of action. It is the territory an organization stakes out for itself with respect to products, services, and markets served. Domain defines the organization’s niche and defines those external sectors with which the organization will interact to accomplish its goals.

The environment comprises several sectors or subdivisions that contain similar elements. Ten sectors can be analyzed for each organization: industry, raw materials, human resources, financial resources, market, technology, economic conditions, government, sociocultural, and international. The sectors and a hypothetical organizational domain are illustrated in Exhibit 4.1. For most companies, the sectors in Exhibit 4.1 can be further subdivided into the task environment and general environment.

Task Environment

The task environment includes sectors with which the organization interacts directly and that have a direct impact on the organization’s ability to achieve its goals. The task environment typically includes the industry, raw materials, and market sectors, and perhaps the human resources and international sectors.

The following examples illustrate how each of these sectors can affect organizations:

- In the industry sector, the retail landscape has begun a decided shift, with consumers rejecting huge stores for smaller shops or Internet retailers that offer greater choice, better service, or higher quality. In clothing, for instance, shoppers favor small niche retailers that offer rapid style changes. Regional grocery chains have grown more competitive by offering fresher and organic foods as well as prepared meals.

- An interesting example in the raw materials sector concerns the beverage can industry. Steelmakers owned the beverage can market until the mid-1960s, when Reynolds Aluminum Company launched a huge aluminum recycling program to
gain a cheaper source of raw materials and make aluminum cans price-competitive with steel.  

- In the market sector, makers of computer games have benefitted from a shift in consumer interest away from gaming consoles and back to lower-cost options. Today’s more powerful PCs and bigger screens are perfect for gamers, and with the tough economy, many people aren’t interested in laying out the big bucks for a console and a big screen television. After being overshadowed for several
year by consoles, PC games made a big comeback, particularly for role-playing adventure games.⁵

- The human resources sector is of significant concern to every business. At a recent CEO roundtable discussion, Steve Creamer, president and CEO of Energy Solutions, said his company’s single biggest problem is human capital. Other leaders agreed that factors such as the aging of the workforce, government limitations on visas for foreign workers, and fewer students entering fields such as engineering and science have combined to create a tremendous human resources headache for companies trying to stay competitive in a rapidly changing world.⁶

- For most companies today, the international sector is also a part of the task environment because of globalization and intense competition. China is already the world’s largest producer of raw materials for pharmaceuticals, and in 2007, for the first time, a Chinese company won permission from the Food and Drug Administration to export finished medicines to the United States. India-based companies have been exporting generics to the United States for a decade, but experts believe China’s growing firms, blessed with low costs and brilliant scientists, will quickly overtake them.⁷

**General Environment**

The general environment includes those sectors that might not have a direct impact on the daily operations of a firm but will indirectly influence it. The general environment often includes the government, sociocultural, economic conditions, technology, and financial resources sectors. These sectors affect all organizations eventually. Consider the following examples:

- In the government sector, regulations influence every phase of organizational life. One of the most prominent and far-reaching changes in the United States in recent years was the 2002 Sarbanes-Oxley Act, often referred to as SOX. SOX required several types of corporate governance reforms, including better internal monitoring to reduce the risk of fraud, certification of financial results by top executives, improved measures for internal auditing, and enhancing public financial disclosure. Additional regulations of this type are certain to follow the financial meltdown of banks and firms on Wall Street in 2008.

- Shifting demographics is a significant element in the sociocultural sector. In the United States, Hispanics have passed African Americans as the nation’s largest minority group, and their numbers are growing so fast that Hispanics (or Latinos, as some prefer to be called) are becoming a driving force in U.S. politics, economics, and culture. The growing Hispanic population is forcing gradual changes in organizations from the U.S. Labor Department to the major television networks to the local auto parts store.⁸

- General economic conditions often affect the way a company must do business. The already-struggling auto industry had an abysmal year in 2008. Sales of cars and light trucks in the United States dropped about 20 percent and sales of gas-guzzling large trucks and sport utility vehicles slowed to a crawl due to high gas prices, a weakening economy, the credit crunch, and declining consumer confidence. Auto makers had to scale back production, offer incentives to car buyers, and cut back their sales goals.⁹
• The technology sector is an area in which massive changes have occurred in recent years, from digital music and advances in mobile technology to cloning and stem-cell research. Chris DeWolfe, CEO of MySpace, believes the world has seen only the beginning of the “mobile revolution.” Mobile devices extend the phenomenal power of blogging and social networking, which are breaking down barriers to the exchange of knowledge, information, opinions, and ideas around the world. The exchange of new scientific insights, for example, now happens in hours instead of years. So, too, does the exchange of opinions about a company’s products or services.10

• All businesses have to be concerned with financial resources, and this sector is often first and foremost in the minds of entrepreneurs. Many small business owners have turned to online person-to-person (P-to-P) lending networks for small loans as banks have tightened their lending standards. Jeff Walsh, for example, borrowed around $22,000 through Prosper.com for his coin laundry business. Alex Kalempa needed $15,000 to expand his business of developing racing shift systems for motorcycles, but banks offered him credit lines of only $500 to $1,000. Kalempa went to LendingClub.com, where he got the $15,000 loan at an interest rate several points lower than the banks were offering.11

International Environment

The international sector can directly affect many organizations, and it has become extremely important in the last few years. In addition, international events can influence all domestic sectors of the environment as well. For example, adverse weather and a workers’ strike in Western Africa, which supplies about two-thirds of the world’s cocoa beans, sharply increased raw materials costs for Choco-Logo, a small maker of gourmet chocolates in Buffalo, New York.12 Farmers, fertilizer companies, food manufacturers, and grocers in the United States faced new competitive issues because of an unexpected grain shortage and rising costs related to international changes. Strong economic growth in developing countries has enabled millions of people to afford richer diets, including grain-fed meat, which directly contributed to the grain shortage in the United States.13 Countries and organizations around the world are connected as never before, and economic, political, and sociocultural changes in one part of the world eventually affect other areas.

Moreover, the distinctions between foreign and domestic operations have become increasingly irrelevant. Thomas Middelhoff of Germany’s Bertelsmann AG, which purchased U.S. publisher Random House, put it this way: “There are no German and American companies. There are only successful and unsuccessful companies.”14 U.S.-based Ford Motor Company owns Sweden’s Volvo, while the iconic American beer Miller is owned by a South African company. Toyota is a Japanese corporation, but it has manufactured millions of vehicles in North American factories. The technology behind Intel’s Centrino wireless components was born in a lab in Haifa, Israel, and Chinese researchers designed the microprocessors that control the pitch of the blade on General Electric’s giant wind turbines.15 Because of the significance of the international sector and its tremendous impact on organization design, this topic will be covered in detail in Chapter 6.

Every organization faces uncertainty domestically as well as globally. Consider a new challenge facing managers at television network Univision.
The Latino population in the United States is growing by leaps and bounds, and Univision, the giant of Spanish-language television in the United States, now challenges the major networks CBS, NBC, ABC, and Fox, especially in large cities. Univision won the loyalty of Latino audiences by keeping English out of its programs and commercials. Its prime-time lineup is based on telenovelas from Mexico, sexy soap-opera stories that attract a vast audience. Nielsen ratings indicate that Univision has 90 of the 100 most-watched Spanish-language shows in the United States.

But there’s a shift taking place that Univision managers have so far failed to respond to: the interests and tastes of viewers are changing much more rapidly than Univision’s shows. Births, not immigration, are now the main source of Latino growth, and American-born Latinos aren’t interested in the same type of programs their parents and grandparents were. “I think of [Univision] as a horse-and-buggy company,” said David R. Morse, president and CEO of New American Dimensions, which conducted a study of younger Latino viewers. Younger Latinos are more likely to speak English as their primary language, are better educated than their parents, and are more prone to marry outside their ethnic group. They want a broader variety of programs, and many prefer English-language television or bilingual programming.

Second- and third-generation bilingual Latinos are largely underserved by both Spanish and English language networks. Although they are ethnically proud, they don’t feel they have to prove themselves. They just want quality programming that addresses their interests. As Jeff Valdez, founder of SiTV, an English language cable start-up that caters to young Latinos says, “They want to see themselves on screen. They want to hear their stories.”

Can Univision transform its programming to satisfy younger Latino viewers, or is it destined to fade away as new companies like SiTV come on the scene with hip programs that attract the coveted audience of 18-to-34-year-olds? Univision is still a powerhouse, and it can succeed for years using its current formula. However, if the network doesn’t keep pace with changing demands from the environment, it could indeed go the way of the horse and buggy.

Television networks are not the only organizations that have to adapt to both subtle and massive shifts in the environment. In the following sections, we will discuss in greater detail how companies can cope with and respond to environmental uncertainty and instability.

**THE CHANGING ENVIRONMENT**

How does the environment influence an organization? The patterns and events occurring in the environment can be described along several dimensions, such as whether the environment is stable or unstable, homogeneous or heterogeneous, simple or complex; the munificence, or amount of resources available to support the organization’s growth; whether those resources are concentrated or dispersed; and the degree of consensus in the environment regarding the organization’s intended domain. These dimensions boil down to two essential ways the environment influences organizations: (1) the need for information about the environment and (2) the need for resources from the environment. The environmental conditions of complexity and change create a greater need to gather information...
and to respond based on that information. The organization also is concerned with scarce material and financial resources and with the need to ensure availability of resources.

Environmental uncertainty pertains primarily to those sectors that an organization deals with on a regular, day-to-day basis. Although sectors of the general environment—such as economic conditions, social trends, or technological changes—can create uncertainty for organizations, determining an organization’s environmental uncertainty generally means focusing on sectors of the task environment, such as how many elements the organization deals with regularly, how rapidly these elements change, and so forth. To assess uncertainty, each sector of the organization’s task environment can be analyzed along dimensions such as stability or instability and degree of complexity. The total amount of uncertainty felt by an organization is the uncertainty accumulated across environmental sectors.

Organizations must cope with and manage uncertainty to be effective. Uncertainty means that decision makers do not have sufficient information about environmental factors, and they have a difficult time predicting external changes. Uncertainty increases the risk of failure for organizational responses and makes it difficult to compute costs and probabilities associated with decision alternatives. The remainder of this section will focus on the information perspective, which is concerned with uncertainty created by the extent to which the environment is simple or complex and the extent to which events are stable or unstable. Later in the chapter, we discuss how organizations influence the environment to acquire needed resources.

**Simple–Complex Dimension**

The simple–complex dimension concerns environmental complexity, which refers to heterogeneity, or the number and dissimilarity of external elements relevant to an organization’s operations. The more external factors that regularly influence the organization and the greater number of other companies in an organization’s domain, the greater the complexity. A complex environment is one in which the organization interacts with and is influenced by numerous diverse external elements. In a simple environment, the organization interacts with and is influenced by only a few similar external elements.

Aerospace firms such as Boeing and Airbus operate in a complex environment, as do universities. Universities span a large number of technologies and are continually buffeted by social, cultural, and value changes. Universities also must cope with numerous ever-changing government regulations, competition for quality students and highly educated employees, and scarce financial resources for many programs. They deal with granting agencies, professional and scientific associations, alumni, parents, foundations, legislators, community residents, international agencies, donors, corporations, and athletic teams. This large number of external elements makes up the organization’s domain, creating a complex environment. On the other hand, a family-owned hardware store in a suburban community is in a simple environment. The store does not have to deal with complex technologies or extensive government regulations, and cultural and social changes have little impact. Human resources are not a problem because the store is run by family members and part-time help. The only external elements of real importance are a few competitors, suppliers, and customers.
Stable–Unstable Dimension

The stable–unstable dimension refers to whether elements in the environment are dynamic. An environmental domain is stable if it remains the same over a period of months or years. Under unstable conditions, environmental elements shift abruptly. Environmental domains seem to be increasingly unstable for most organizations. This chapter’s Book Mark examines the volatile nature of today’s business world and gives some tips for managing in a fast-shifting environment.

Instability may occur when competitors react with aggressive moves and countermoves regarding advertising and new products or services. For example, News Corporation’s MySpace held the crown as king of social networking until managers

The business world is changing at an increasingly rapid pace. That’s the reality that spurred Larry Bossidy, retired chairman and CEO of Honeywell International, and Ram Charan, a noted author, speaker, and business consultant, to write Confronting Reality: Doing What Matters to Get Things Right. Too many managers, they believe, are tempted to hide their heads in the sand of financial issues rather than face the confusion and complexity of the organization’s environment.

LESSONS FOR FACING REALITY

For many companies, today’s environment is characterized by global hyper-competition, declining prices, and the growing power of consumers. Bossidy and Charan offer some lessons to leaders for navigating in a fast-changing world.

• Understand the environment as it is now and is likely to be in the future, rather than as it was in the past. Relying on the past and conventional wisdom can lead to disaster. Kmart, for example, stuck to its old formula as Wal-Mart gobbled its customers and carved out a new business model. Few could have predicted in 1990, for example, that Wal-Mart would now be America’s biggest seller of groceries.

• Seek out and welcome diverse and unorthodox ideas. Managers need to be proactive and open-minded toward conversing with employees, suppliers, customers, colleagues, and anyone else they come in contact with. What are people thinking about? What changes and opportunities do they see? What worries them about the future?

• Avoid the common causes of manager failure to confront reality: filtered information, selective hearing, wishful thinking, fear, emotional overinvestment in a failing course of action, and unrealistic expectations. For example, when sales and profits fell off a cliff at data-storage giant EMC, managers displayed a bias toward hearing good news and believed the company was only experiencing a blip in the growth curve. When Joe Tucci was named CEO, however, he was determined to find out if the slump was temporary. By talking directly with top leaders at his customers’ organization, Tucci was able to face the reality that EMC’s existing business model based on high-cost technology was dead. Tucci implemented a new business model to fit that reality.

• Ruthlessly assess your organization. Understanding the internal environment is just as important. Managers need to evaluate whether their company has the talent, commitment, and attitude needed to drive the important changes. At EMC, Tucci realized his sales force needed an attitude shift to sell software, services, and business solutions rather than just expensive hardware. The arrogant, hard-driving sales tactics of the past had to be replaced with a softer, more customer-oriented approach.

STAYING ALIVE

Staying alive in today’s business environment requires that managers stay alert. Managers should always be looking at their competitors, broad industry trends, technological changes, shifting government policies, changing market forces, and economic developments. At the same time, they work hard to stay in touch with what their customers really think and really want. By doing so, leaders can confront reality and be poised for change.

at upstart Facebook began aggressively promoting the college-focused niche site as a place for everyone. The “face” of Facebook—youthful founder and CEO Mark Zuckerberg—was suddenly crowding MySpace off of magazine covers and television talk shows, and the size of Facebook’s worldwide user base surpassed MySpace before managers at MySpace even had time to react. Sometimes specific, unpredictable events—such as reports of lead-tainted paint in Mattel toys made in China, the Pakistani government’s attempt to block access to certain videos on YouTube, or the discovery of heart problems related to pain drugs such as Vioxx and Celebrex—create unstable conditions for organizations. Today, freewheeling bloggers are a tremendous source of instability for scores of companies, able to destroy a company’s reputation virtually overnight. Kryptonite’s reputation in bicycle locks plummeted after a blog noted that the locks could be opened with a Bic pen. After 10 days of blogging, Kryptonite announced a free product exchange that would cost the company about $10 million.

Although environments are more unstable for most organizations today, an example of a traditionally stable environment is a public utility. In the rural Midwest, demand and supply factors for a public utility are stable. A gradual increase in demand may occur, which is easily predicted over time. Toy companies, by contrast, have an unstable environment. Hot new toys are difficult to predict, a problem compounded by the fact that children are losing interest in toys at a younger age, their interest captured by video and computer games, electronics, and the Internet. Adding to the instability for toymakers is the shrinking retail market, with big toy retailers going out of business trying to compete with discounters such as Wal-Mart. Toymakers are trying to attract more customers in developing markets such as China, Poland, Brazil, and India to make up for the declining U.S. market, but hitting the target in those countries has proven to be a challenge. Companies such as Fisher-Price, owned by Mattel, can find their biggest products languishing on shelves as shoppers turn to less expensive locally made toys in countries where brand consciousness doesn’t come into play. As one toy analyst said, “Chinese kids have been growing for 5,000 years without the benefits of Fisher-Price.”

**Framework**

The simple–complex and stable–unstable dimensions are combined into a framework for assessing environmental uncertainty in Exhibit 4.2. In the simple, stable environment, uncertainty is low. There are only a few external elements to contend with, and they tend to remain stable. The complex, stable environment represents somewhat greater uncertainty. A large number of elements have to be scanned, analyzed, and acted upon for the organization to perform well. External elements do not change rapidly or unexpectedly in this environment.

Even greater uncertainty is felt in the simple, unstable environment. Rapid change creates uncertainty for managers. Even though the organization has few external elements, those elements are hard to predict, and they react unexpectedly to organizational initiatives. The greatest uncertainty for an organization occurs in the complex, unstable environment. A large number of elements impinge upon the organization, and they shift frequently or react strongly to organizational initiatives. When several sectors change simultaneously, the environment becomes turbulent.

A soft drink distributor functions in a simple, stable environment. Demand changes only gradually. The distributor has an established delivery route, and supplies of soft drinks arrive on schedule. State universities, appliance manufacturers, and insurance companies are in somewhat stable, complex environments. A large number of external elements are present, but although they change, changes are gradual and predictable.
Toy manufacturers are in simple, unstable environments. Organizations that design, make, and sell toys, as well as those that are involved in the clothing or music industry, face shifting supply and demand. Most Internet companies focus on a specific competitive niche and, hence, operate in simple but unstable environments as well. Although there may be few elements to contend with—e.g., technology, competitors—they are difficult to predict and change abruptly and unexpectedly.

The telecommunications industry and the airline industry face complex, unstable environments. Many external sectors are changing simultaneously. In the case
of airlines, in just a few years the major carriers were confronted with an air-traffic controller shortage, aging fleets of planes, labor unrest, soaring fuel prices, the entry of new competitors such as JetBlue and AirTran, a series of major air-traffic disasters, and a drastic decline in customer demand. Between 2001 and 2008, four large airlines and many smaller ones went through bankruptcy, and the airlines collectively laid off 170,000 employees.\textsuperscript{26}

\section*{ADAPTING TO A CHANGING ENVIRONMENT}

Once you see how environments differ with respect to change and complexity, the next question is, “How do organizations adapt to each level of environmental uncertainty?” Environmental uncertainty represents an important contingency for organization structure and internal behaviors. Recall from Chapter 3 that organizations facing uncertainty often use structural mechanisms that encourage horizontal communication and collaboration to help the company adapt to changes in the environment. In this section we discuss in more detail how the environment affects organizations. An organization in a certain environment will be managed and controlled differently from an organization in an uncertain environment with respect to positions and departments, organizational differentiation and integration, control processes, and future planning and forecasting. Organizations need to have the right fit between internal structure and the external environment.

\subsection*{Adding Positions and Departments}

As complexity and uncertainty in the external environment increase, so does the number of positions and departments within the organization, leading to increased internal complexity. This relationship is part of being an open system. Each sector in the external environment requires an employee or department to deal with it. The human resource department deals with unemployed people who want to work for the company. The marketing department finds customers. Procurement employees obtain raw materials from hundreds of suppliers. The finance group deals with bankers. The legal department works with the courts and government agencies. E-business departments handle electronic commerce, and information technology departments deal with the increasing complexity of computerized information and knowledge management systems. Adding new positions and departments is a common way for organizations to adapt to growing environmental complexity and uncertainty. Consider this example of how Wal-Mart is trying to mitigate some of the uncertainty in its environment.

Any organization with the size and power of Wal-Mart presents a large target for criticism, and the retailer has come under blistering attack for everything from its low wages and minimal health benefits to its high-pressure tactics with suppliers and its environmental policies. Much of the criticism is organized by two union-backed organizations, Wake Up Wal-Mart and Wal-Mart Watch, which have spearheaded a relentless public relations campaign against the company, including rallies, blogs, letter-writing blitzes, press conferences, and town hall meetings.

\emph{\textsuperscript{In Practice}}

\begin{itemize}
\item Wal-Mart
\end{itemize}
Wal-Mart managers went on the offensive. The company’s tiny public relations department was expanded to dozens of employees, including a “war room” where former political operatives look for ways to dispute the claims of opponents. Additionally, Wal-Mart created two high-level executive positions to act as generals in the PR war. The position of director of media relations, for instance, oversees crisis communications and manages the hundreds of phone calls a day the company receives from reporters. The director is on call 24/7 to assist with “emergency response” related to PR issues. The second new position, senior director of campaign management, includes researching the opposition, managing Wal-Mart’s relations with bloggers, and overseeing the war room.

Wal-Mart is profitable and successful, but the intense criticism has had an impact. Surveys reveal that the negative publicity has caused some shoppers to stop buying there. Wal-Mart leaders hope the new executives and expanded PR department can help turn the tide.27

Building Relationships

The traditional approach to coping with environmental uncertainty was to establish buffer departments. The purpose of buffering roles is to absorb uncertainty from the environment.28 The technical core performs the primary production activity of an organization. Buffer departments surround the technical core and exchange materials, resources, and money between the environment and the organization. They help the technical core function efficiently. The purchasing department buffers the technical core by stockpiling supplies and raw materials. The human resource department buffers the technical core by handling the uncertainty associated with finding, hiring, and training production employees.

A newer approach some organizations are trying is to drop the buffers and expose the technical core to the uncertain environment. These organizations no longer create buffers because they believe being well connected to customers and suppliers is more important than internal efficiency. For example, John Deere has assembly-line workers visiting local farms to determine and respond to customer concerns. LG Electronics pays consumers to test cell phone models, asking them to keep a journal where they jot down their feelings about features they like or don’t like and draw pictures that represent their mood when they use the phone.29 Opening up the organization to the environment by building closer relationships with external parties makes it more fluid and adaptable.

Boundary-spanning roles link and coordinate an organization with key elements in the external environment. Boundary spanning is primarily concerned with the exchange of information to (1) detect and bring into the organization information about changes in the environment and (2) send information into the environment that presents the organization in a favorable light.30

Organizations have to keep in touch with what is going on in the environment so that managers can respond to market changes and other developments. A study of high-tech firms found that 97 percent of competitive failures resulted from lack of attention to market changes or the failure to act on vital information.31 To detect and bring important information into the organization, boundary personnel scan the environment. For example, a market-research department scans and monitors trends in consumer tastes. Boundary spanners in engineering and research and development (R&D) departments scan new technological developments, innovations, and raw materials. Boundary spanners prevent the organization from stagnating by keeping top managers informed about environmental changes. Often, the
greater the uncertainty in the environment, the greater the importance of boundary spanners.32

One recent approach to boundary spanning is **business intelligence**, which refers to the high-tech analysis of large amounts of internal and external data to spot patterns and relationships that might be significant. For example, Verizon uses business intelligence to actively monitor customer interactions so that it can catch problems and fix them almost immediately.33 Tools to automate the process are a hot area of software, with companies spending billions on business-intelligence software in recent years.34

Business intelligence is related to another important area of boundary spanning, known as **competitive intelligence** (CI). Competitive intelligence gives top executives a systematic way to collect and analyze public information about rivals and use it to make better decisions.35 Using techniques that range from Internet surfing to digging through trash cans, intelligence professionals dig up information on competitors’ new products, manufacturing costs, or training methods and share it with top leaders. Intelligence teams are the newest wave of CI activities. An **intelligence team** is a cross-functional group of managers and employees, usually led by a competitive intelligence professional, who work together to gain a deep understanding of a specific business issue, with the aim of presenting insights, possibilities, and recommendations to top leaders.36 Intelligence teams can provide insights that enable managers to make more informed decisions about goals, as well as devise contingency plans and scenarios related to major competitive issues.

Many successful companies involve everyone in boundary-spanning activities. People at the grassroots level are often able to see and interpret changes or problems sooner than managers, who are typically more removed from the day-to-day work.37 At Cognos, which sells planning and budgeting programs to large corporations, any of the company’s 3,000 employees can submit scoops about competitors through an internal Web site called Street Fighter. Each day, R&D and sales managers pore over the dozens of entries. Good tips are rewarded with prizes.38

The boundary task of sending information into the environment to represent the organization is used to influence other people’s perception of the organization. In the marketing department, advertising and sales people represent the organization to customers. Purchasers may call on suppliers and describe purchasing needs. The legal department informs lobbyists and elected officials about the organization’s needs or views on political matters. Many companies set up special Web pages and blogs to present the organization in a favorable light.

**The best way for an organization to cope with a complex environment is to develop a complex structure (rather than keep it simple and uncomplicated).**

**ANSWER:** Agree. As an organization’s environment becomes more complex, the organization has to add jobs, departments, and boundary spanning roles to cope with all the elements in the environment. When environmental sectors are complex, there is no way for an organization to stay simple and uncomplicated and continue to be effective.
**Differentiation and Integration**

Another response to environmental uncertainty is the amount of differentiation and integration among departments. Organizational differentiation refers to “the differences in cognitive and emotional orientations among managers in different functional departments, and the difference in formal structure among these departments.”

When the external environment is complex and rapidly changing, organizational departments become highly specialized to handle the uncertainty in their external sector. Success in each sector requires special expertise and behavior. Employees in an R&D department thus have unique attitudes, values, goals, and education that distinguish them from employees in manufacturing or sales departments.

A study by Paul Lawrence and Jay Lorsch examined three organizational departments—manufacturing, research, and sales—in ten corporations. This study found that each department evolved toward a different orientation and structure to deal with specialized parts of the external environment. Exhibit 4.3 illustrates the market, scientific, and manufacturing subenvironments identified by Lawrence and Lorsch. As shown in the exhibit, each department interacted with different external groups. The differences that evolved among departments within the organizations are shown in Exhibit 4.4. To work effectively with the scientific subenvironment, R&D had a goal of quality work, a long time horizon (up to five years), an informal structure, and task-oriented employees. Sales was at the opposite extreme. It had a goal of customer satisfaction, was oriented toward the short term (two weeks or so), had a very formal structure, and was socially oriented.

One outcome of high differentiation is that coordination among departments becomes difficult. More time and resources must be devoted to achieving

---

**EXHIBIT 4.3**

Organizational Departments Differentiate to Meet Needs of Subenvironments

- **R & D Department**
  - Scientific Subenvironment: Scientific journals, Research centers, Professional associations

- **Manufacturing Department**
  - Manufacturing Subenvironment: Raw materials, Labor, Suppliers, Production equipment

- **Sales Department**
  - Market Subenvironment: Customers, Distribution system, Advertising agencies, Competitors

---

**President**

- **R & D Department**
- **Manufacturing Department**
- **Sales Department**
coordination when attitudes, goals, and work orientation differ so widely. **Integration** is the quality of collaboration among departments. Formal integrators are often required to coordinate departments. When the environment is highly uncertain, frequent changes require more information processing to achieve horizontal coordination, so integrators become a necessary addition to the organization structure. Sometimes integrators are called liaison personnel, project managers, brand managers, or coordinators. As illustrated in Exhibit 4.5, organizations with highly uncertain environments and a highly differentiated structure assign about 22 percent of management personnel to integration activities, such as serving on committees, on task forces, or in liaison roles. In organizations characterized by very simple, stable environments, almost no managers are assigned to integration roles. Exhibit 4.5 shows that, as environmental uncertainty increases, so does differentiation among departments; hence, the organization must assign a larger percentage of managers to coordinating roles.

Lawrence and Lorsch’s research concluded that organizations perform better when the levels of differentiation and integration match the level of uncertainty in the environment. Organizations that performed well in uncertain environments had high levels of both differentiation and integration, while those performing well in less uncertain environments had lower levels of differentiation and integration.

### Organic versus Mechanistic Management Processes

Another response to environmental uncertainty is the amount of formal structure and control imposed on employees. Tom Burns and G. M. Stalker observed twenty industrial firms in England and discovered that internal management structure was related to the external environment. When the external environment was stable, the internal organization was characterized by standard rules, procedures, and a clear hierarchy of authority. Organizations were formalized. They were also centralized, with most decisions made at the top. Burns and Stalker called this a **mechanistic** organization system.

In rapidly changing environments, the internal organization was much looser, free-flowing, and adaptive. Rules and regulations often were not written down or, if written down, were ignored. People had to find their own way through the system to figure out what to do. The hierarchy of authority was not clear. Decision-making authority was decentralized. Burns and Stalker used the term **organic** to characterize this type of management structure.
Exhibit 4.6 summarizes the differences in organic and mechanistic systems. As environmental uncertainty increases, organizations tend to become more organic, which means decentralizing authority and responsibility to lower levels, encouraging employees to take care of problems by working directly with one another, encouraging teamwork, and taking an informal approach to assigning tasks and responsibility. Thus, the organization is more fluid and is able to adapt continually to changes in the external environment. Complete the questionnaire in the “How Do You Fit the Design?” box for some insight into whether you are more suited to working in an organic organization or a mechanistic one.

The learning organization, described in Chapter 1, and the horizontal and virtual network structures, described in Chapter 3, are organic organizational forms that are used by companies to compete in rapidly changing environments. Guiltless Gourmet, which sells low-fat tortilla chips and other high-quality snack foods, provides an example. When large companies like Frito Lay entered the low-fat snack-food market, Guiltless Gourmet shifted to a flexible network structure to remain competitive. The company redesigned itself to become basically a full-time marketing organization, while production and other activities were outsourced. An 18,000-square-foot plant in

**EXHIBIT 4.5**

Environmental Uncertainty and Organizational Integrators

<table>
<thead>
<tr>
<th>Industry</th>
<th>Plastics</th>
<th>Foods</th>
<th>Container</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental uncertainty</td>
<td>High</td>
<td>Moderate</td>
<td>Low</td>
</tr>
<tr>
<td>Departmental differentiation</td>
<td>High</td>
<td>Moderate</td>
<td>Low</td>
</tr>
<tr>
<td>Percent management in integrating roles</td>
<td>22%</td>
<td>17%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: Based on Jay W. Lorsch and Paul R. Lawrence, “Environmental Factors and Organizational Integration,” *Organizational Planning: Cases and Concepts* (Homewood, Ill.: Irwin and Dorsey, 1972), 45.

**EXHIBIT 4.6**

Mechanistic and Organic Forms

<table>
<thead>
<tr>
<th>Mechanistic</th>
<th>Organic</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Tasks are broken down into specialized, separate parts.</td>
<td>1. Employees contribute to the common tasks of the department.</td>
</tr>
<tr>
<td>2. Tasks are rigidly defined.</td>
<td>2. Tasks are adjusted and redefined through employee teamwork.</td>
</tr>
<tr>
<td>3. There is a strict hierarchy of authority and control, and there are many rules.</td>
<td>3. There is less hierarchy of authority and control, and there are few rules.</td>
</tr>
<tr>
<td>4. Knowledge and control of tasks are centralized at the top of the organization.</td>
<td>4. Knowledge and control of tasks are located anywhere in the organization.</td>
</tr>
<tr>
<td>5. Communication is vertical.</td>
<td>5. Communication is horizontal.</td>
</tr>
</tbody>
</table>

Austin was closed and the workforce cut from 125 to about 10 core people who handle marketing and sales promotions. The flexible structure allowed Guiltless Gourmet to adapt quickly to changing market conditions.\textsuperscript{45}

### Planning, Forecasting, and Responsiveness

The whole point of increasing internal integration and shifting to more organic processes is to enhance the organization’s ability to quickly respond to sudden changes in an uncertain environment. It might seem that in an environment where everything is changing all the time, planning is useless. However, in uncertain environments, planning and environmental forecasting actually become \textit{more} important as a way

---

**How Do You Fit the Design?**

Does your mind best fit an organization in a certain or an uncertain environment? Think back to how you thought or behaved as a student, employee, or in a formal or informal leader position. Please answer whether each following item was Mostly True or Mostly False for you.

<table>
<thead>
<tr>
<th></th>
<th>Mostly True</th>
<th>Mostly False</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. I always offered comments on my interpretation of data or issues.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>2. I welcomed unusual viewpoints of others even if we were working under pressure.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>3. I made it a point to attend industry trade shows and company (school) events.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>4. I explicitly encouraged others to express opposing ideas and arguments.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>5. I asked “dumb” questions.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>6. I enjoyed hearing about new ideas even when working toward a deadline.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>7. I expressed a controversial opinion to bosses and peers.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
<tr>
<td>8. I suggested ways of improving my and others’ ways of doing things.</td>
<td>[ ]</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

**Scoring:** Give yourself one point for each item you marked as Mostly True. If you scored less than 5, your mindfulness level may be suited to an organization in a stable rather than unstable environment. A score of 5 or above suggests a higher level of mindfulness and a better fit for an organization in an uncertain environment.

**Interpretation:** In an organization in a highly uncertain environment everything seems to be changing. In that case, an important quality for a professional employee or manager is “mindfulness,” which includes the qualities of being open minded and an independent thinker. In a stable environment, an organization will be more “mechanistic,” and a manager without mindfulness may perform okay because much work can be done in the traditional way. In an uncertain environment, everyone needs to facilitate new thinking, new ideas, and new ways of working. A high score on this exercise suggests higher mindfulness and a better fit with an “organic” organization in an uncertain environment.

to keep the organization geared for a coordinated, speedy response. When the environment is stable, the organization can concentrate on current operational problems and day-to-day efficiency. Long-range planning and forecasting are not needed because environmental demands in the future will be the same as they are today.

With increasing environmental uncertainty, planning and forecasting become necessary. Indeed, surveys of multinational corporations have found that as environments become more turbulent, managers increase their planning activities, particularly in terms of planning exercises that encourage learning, continual adaptation, and innovation. Following the September 11, 2001, terrorist attacks in the United States, for example, there was a surge in the use of scenario and contingency planning as a way to manage uncertainty.

Planning can soften the adverse impact of external shifts. Organizations that have unstable environments often establish a separate planning department. In an unpredictable environment, planners scan environmental elements and analyze potential moves and countermoves by other organizations. Planning can be extensive and may forecast various scenarios for environmental contingencies. With scenario building, managers mentally rehearse different scenarios based on anticipating various changes that could affect the organization. Scenarios are like stories that offer alternative, vivid pictures of what the future will look like and how managers will respond. Royal Dutch/Shell Oil has long used scenario building and has been a leader in speedy response to massive changes that other organizations failed to perceive until it was too late.

Planning, however, cannot substitute for other actions, such as effective boundary spanning and adequate internal integration and coordination. The organizations that are most successful in uncertain environments are those that keep everyone in close touch with the environment so they can spot threats and opportunities, enabling the organization to respond immediately.

**FRAMEWORK FOR RESPONSES TO ENVIRONMENTAL CHANGE**

Exhibit 4.7 summarizes the ways in which environmental uncertainty influences organizational characteristics. The change and complexity dimensions are combined and illustrate four levels of uncertainty. The low uncertainty environment is simple...
and stable. Organizations in this environment can have few departments and a mechanistic structure. In a low–moderate uncertainty environment, more departments are needed, along with more integrating roles to coordinate the departments. Some planning may occur. Environments that are high–moderate uncertainty are unstable but simple. Organization structure is organic and decentralized. Planning is emphasized and managers are quick to make internal changes as needed. The high uncertainty environment is both complex and unstable and is the most difficult environment from a management perspective. Organizations are large and have many departments, but they are also organic. A large number of management
personnel are assigned to coordination and integration, and the organization uses boundary spanning, planning, and forecasting to enable a high-speed response to environmental changes.

**DEPENDENCE ON EXTERNAL RESOURCES**

Thus far, this chapter has described several ways in which organizations adapt to the lack of information and to the uncertainty caused by environmental change and complexity. We turn now to the third characteristic of the organization–environment relationship that affects organizations, which is the need for material and financial resources. The environment is the source of scarce and valued resources essential to organizational survival. Research in this area is called the resource-dependence perspective. Resource dependence means that organizations depend on the environment but strive to acquire control over resources to minimize their dependence. Organizations are vulnerable if vital resources are controlled by other organizations, so they try to be as independent as possible. Organizations do not want to become too vulnerable to other organizations because of negative effects on performance.

Although companies like to minimize their dependence, when costs and risks are high they also team up to share scarce resources and be more competitive on a global basis. Formal relationships with other organizations present a dilemma to managers. Organizations seek to reduce vulnerability with respect to resources by developing links with other organizations, but they also like to maximize their own autonomy and independence. Organizational linkages require coordination, and they reduce the freedom of each organization to make decisions without concern for the needs and goals of other organizations. Interorganizational relationships thus represent a tradeoff between resources and autonomy. To maintain autonomy, organizations that already have abundant resources will tend not to establish new linkages. Organizations that need resources will give up independence to acquire those resources. For example, DHL, the express delivery unit of Germany’s Deutsche Post AG, lost billions of dollars trying to take over the U.S. package delivery market. By 2008, the company’s boast in an early advertising campaign that “Yellow is the new Brown” (a swipe at package delivery leader UPS and its chocolate-brown trucks) was put on the shelf. DHL joined Big Brown in a strategic partnership that will have UPS handling DHL parcels in the United States. The two companies will continue to compete in overseas markets. In the face of $3 billion in losses, difficulty building a local management team in the United States, and maintenance problems at U.S. package handling facilities, Deutsche Post’s CEO Frank Appel called the partnership “a pragmatic and realistic strategy” for his company’s U.S. operations. Resource dependence will be discussed in more detail in the next chapter.

**INFLUENCING EXTERNAL RESOURCES**

In response to the need for resources, organizations try to maintain a balance between linkages with other organizations and their own independence. Organizations maintain this balance through attempts to modify, manipulate, or control other organizations. To survive, the focal organization often tries to reach out and
change or control elements in the environment. Two strategies can be adopted to influence resources in the external environment: (1) establish favorable relationships with key elements in the environment and (2) shape the environmental domain by influencing key sectors. Techniques to accomplish each of these strategies are summarized in Exhibit 4.8. As a general rule, when organizations sense that valued resources are scarce, they will use the strategies in Exhibit 4.8 rather than go it alone. Notice how dissimilar these strategies are from the responses to environmental change and complexity described in Exhibit 4.7. The dissimilarity reflects the difference between responding to the need for resources and responding to the need for information.

### Establishing Formal Relationships

Building formal relationships includes techniques such as acquiring ownership, establishing joint ventures and partnerships, developing connections with important people in the environment, recruiting key people, and using advertising and public relations.

**Acquire an Ownership Stake.** Companies use various forms of ownership to reduce uncertainty in an area important to the acquiring company. For example, a firm might buy a part of or a controlling interest in another company, giving it access to technology, products, or other resources it doesn’t currently have.

A greater degree of ownership and control is obtained through acquisition or merger. An *acquisition* involves the purchase of one organization by another so that the buyer assumes control, such as when Ford bought Volvo, Hewlett-Packard bought EDS Corporation, and Wal-Mart purchased Britain’s ASDA Group. A *merger* is the unification of two or more organizations into a single unit. Sirius Satellite Radio and XM Satellite Radio Holdings merged to become Sirius XM Radio. The merger enabled the companies to combine resources and share risks to be more competitive against digital music providers and other emerging types of music distribution. In the past few years, there has been a huge wave of acquisition and merger activity in the telecommunications industry, reflecting how these companies cope with the tremendous uncertainty they face. Consider the emergence of the “new” AT&T.

---

**EXHIBIT 4.8**

<table>
<thead>
<tr>
<th>Establishing Formal Relationships</th>
<th>Influencing Key Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Acquire an ownership stake</td>
<td>1. Change where you do business (your domain)</td>
</tr>
<tr>
<td>2. Form joint ventures and partnerships</td>
<td>2. Use political activity, regulation</td>
</tr>
<tr>
<td>3. Lock in key players</td>
<td>3. Join in trade associations</td>
</tr>
<tr>
<td>4. Recruit executives</td>
<td>4. Avoid illegitimate activities</td>
</tr>
<tr>
<td>5. Use advertising and public relations</td>
<td></td>
</tr>
</tbody>
</table>
AT&T was once all but dead, but the company has reemerged as a $165 billion giant in the global telecommunications field thanks to mergers and acquisitions. SBC Communications, which was born after the break-up of giant AT&T in 1984, went on an acquisitions spree after the Telecommunications Act of 1996 opened the door to competition, buying Pacific Telesis Group (1997), Southern New England Telecommunications (1998), and Ameritech Corporation (1999). In 2005, SBC acquired AT&T, taking the name of that iconic organization and gaining a foothold in wireless with Cingular Wireless, which was a joint venture between AT&T and BellSouth. A year later, the newly-named AT&T merged with BellSouth, giving AT&T full control of Cingular and creating a telecommunications giant not unlike the “old” AT&T of the 1980s.

However, unlike the old company, AT&T faces a pack of tough rivals, including the No. 2 telecom company, Verizon Communications, which has also been involved in many mergers and acquisitions over the past several years. Other competitors include cable companies such as Comcast and Time Warner Cable, which are bundling together television, broadband, and Internet phone service, stealing customers from AT&T all over the country. The cable providers have also formed a partnership with Sprint, enabling them to provide wireless service as well. For its part, AT&T now sells packages of wireless phone services, Internet access, and pay television, as does Verizon. The two companies have recently taken integration one step further by airing video programming—from Saturday Night Live clips to user-generated video—across all three platforms. That enables them to sell advertising as a new source of revenue as growth in wireless begins to slow. However, the risks are high, and both companies face significant uncertainty and many new rivals as they enter this new area of business.57

**Form Joint Ventures and Partnerships.** When there is a high level of complementarity between the business lines, geographical positions, or skills of two companies, the firms often go the route of a strategic alliance rather than ownership through merger or acquisition.58 Such alliances are formed through contracts and joint ventures.

Contracts and joint ventures reduce uncertainty through a legal and binding relationship with another firm. Contracts come in the form of *license agreements* that involve the purchase of the right to use an asset (such as a new technology) for a specific time and *supplier arrangements* that contract for the sale of one firm’s output to another. Contracts can provide long-term security by tying customers and suppliers to specific amounts and prices. For example, the Italian fashion house Versace forged a deal to license its primary asset—its name—for a line of designer eyeglasses. McDonald’s contracts for an entire crop of russet potatoes to be certain of its supply of french fries. McDonald’s also gains influence over suppliers through these contracts and has changed the way farmers grow potatoes and the profit margins they earn, which is consistent with the resource dependence perspective.59

*Joint ventures* result in the creation of a new organization that is formally independent of the parents, although the parents will have some control.60 Madrid-based tech startup FON has formed a joint venture with British phone carrier BT that will install FON wi-fi technology in the modems of nearly 2 million BT customers. Office Depot and Reliance Retail Limited, a division of India’s largest private-sector employer, entered into a joint venture to provide office products and services to business customers in India. Food and agricultural corporation Cargill Inc. has numerous
joint ventures around the world and recently set up a venture with Spanish cooperative Hojiblance to source, trade, and supply customers worldwide with private label and bulk olive oils. As evidenced by these short examples, many joint ventures are undertaken to share risks when companies are doing business in other countries or on a global scale.

**Lock in Key Players.** Cooptation occurs when leaders from important sectors in the environment are made part of an organization. It takes place, for example, when influential customers or suppliers are appointed to the board of directors, such as when the senior executive of a bank sits on the board of a manufacturing company. As a board member, the banker may become psychologically coopted into the interests of the manufacturing firm. An interlocking directorate is a formal linkage that occurs when a member of the board of directors of one company sits on the board of directors of another company. The individual is a communications link between companies and can influence policies and decisions. When one individual is the link between two companies, this is typically referred to as a direct interlock. An indirect interlock occurs when a director of company A and a director of company B are both directors of company C. They have access to one another but do not have direct influence over their respective companies. Research shows that, as a firm’s financial fortunes decline, direct interlocks with financial institutions increase. Financial uncertainty facing an industry also has been associated with greater indirect interlocks between competing companies.

Important business or community leaders also can be appointed to other organizational committees or task forces. By serving on committees or advisory panels, these influential people learn about the needs of the company and are more likely to include the company’s interests in their decision making. Today, many companies face uncertainty from environmental pressure groups, so organizations are trying to bring in leaders from this sector, such as when DuPont appointed environmentalists to its biotechnology advisory panel.

**Recruit Executives.** Transferring or exchanging executives also offers a method of establishing favorable linkages with external organizations. For example, the aerospace industry often hires retired generals and executives from the Department of Defense. These generals have personal friends in the department, so the aerospace companies obtain better information about technical specifications, prices, and dates for new weapons systems. They can learn the needs of the defense department and are able to present their case for defense contracts in a more effective way. Companies without personal contacts find it nearly impossible to get a defense contract. Having channels of influence and communication between organizations serves to reduce financial uncertainty and dependence for an organization.

**Get Your Side of the Story Out.** A traditional way of establishing favorable relationships is through advertising. Organizations spend large amounts of money to influence the tastes and opinions of consumers. Advertising is especially important in highly competitive industries and in industries that experience variable demand. For example, since the U.S. Food and Drug Administration loosened regulations to permit advertising of prescription drugs in the United States, the major pharmaceutical companies have spent nearly $5 billion annually on advertisements such as a cute cartoon bee pushing Nasonex spray for allergies or heart attack survivors promoting the benefits of cholesterol-fighting Lipitor.

---

**Briefcase**

As an organization manager, keep these guidelines in mind:

Reach out and control external sectors that threaten needed resources. Influence the domain by engaging in political activity, joining trade associations, and establishing favorable relationships. Establish relationships through ownership, joint ventures and strategic partnerships, cooptation, interlocking directorates, and executive recruitment. Reduce the amount of change or threat from the external environment so the organization will not have to change internally.
Public relations is similar to advertising, except that stories often are free and aimed at public opinion. Public relations people cast an organization in a favorable light in speeches, on websites, in press reports, and on television. Public relations attempts to shape the company’s image in the minds of customers, suppliers, and government officials. Blogging is an important part of public relations activities for many companies today. Randy Baseler, vice president for marketing at Boeing Commercial Airplanes, started a public blog to share the company’s view on products and marketing strategies. The open forum exposes Boeing to some stinging criticism, but it also enables the company to tell its side of the story and build better relationships with customers and the public.65

**Influencing Key Sectors**

In addition to establishing favorable linkages, organizations often try to change the environment. There are four techniques for influencing or changing a firm’s environment.

**Change Where You Do Business.** Early in this chapter, we talked about the organization’s *domain* and the ten sectors of the task environment. An organization’s domain is not fixed. Managers make decisions about which business to be in, the markets to enter, and the suppliers, banks, employees, and location to use, and this domain can be changed if necessary to keep the organization competitive.66 An organization can seek new environmental relationships and drop old ones. Managers may try to find a domain where there is little competition, no government regulation, abundant suppliers, affluent customers, and barriers to keep competitors out.

Acquisition and divestment are two techniques for altering the domain. For example, Google has acquired a number of companies to expand its domain beyond Internet search, including the $1.65 billion acquisition of YouTube.67 Divestment occurred when JC Penney sold off its chain of Eckerd drug stores to focus resources on the department store. Time Inc. is altering its domain as more readers and advertisers switch from print to online media. The company is selling off eighteen of its smaller niche magazines, including *Field & Stream* and *Parenting*, as well as cutting hundreds of employees at its other magazines—even such top sellers such as *People* and *Sports Illustrated*. Time managers made a decision to streamline publications in order to bolster the company’s presence online.68

**Get Political.** Political activity includes techniques to influence government legislation and regulation. Political strategy can be used to erect regulatory barriers against new competitors or to squash unfavorable legislation. Corporations also try to influence the appointment to agencies of people who are sympathetic to their needs.

As e-commerce continues to evolve, Internet companies such as Yahoo, Amazon, and Google have opened lobbying offices in Washington, D.C., to represent their interests. One example of their political activities is when telecom companies threatened to start charging Internet providers for speedy delivery of the Internet content the phone companies carry on their lines. The Internet firms lobbied Congress to insert language into telecom laws that would prohibit them from doing so.69 Another Internet company that has become a sophisticated and influential lobbyist is eBay.
“It is a fast-moving train, and if you get in front of it you’ll get flattened,” said an official with the state of Louisiana’s licensing agency. She was talking about eBay’s lobbying machine, which has become so powerful that it can practically make damaging or restrictive regulations disappear.

At any given time, there are approximately 90 million items for sale on eBay, and the company gets a fee for each successful transaction. Managers know that regulations on sellers would slow sales traffic, so lobbying against such regulation is a top priority for the company. In Louisiana, eBay lobbyists worked overtime to promote passage of a bill that would exempt some Internet transactions, such as those on eBay, from the state’s licensing requirements for businesses conducting auctions. When Ohio passed a law that would have regulated eBay sellers in that state, the company worked to get it reversed. Auctioning laws in both Maine and Tennessee were also changed to exempt Internet sellers after lobbying efforts from eBay. Managers know that if a law takes hold in one state, other states might follow suit.

In addition to lobbying against unfavorable legislation, eBay also pushes for legislative changes that will benefit the company. For example, eBay’s lobbying efforts in Illinois, New York, and Florida influenced those states to revise laws to allow Internet auction sites to compete with licensed ticket brokers and sell tickets for more than their face value, providing another stream of revenue for eBay.

Until recently, eBay worked primarily through a corps of local lobbyists in states all across the country. Now, though, like other major Internet firms, eBay has opened its own lobbying office in Washington, D.C. Former CEO Meg Whitman was always heavily involved in lobbying efforts. Many CEOs believe they should participate directly in lobbying. CEOs have easier access than lobbyists and can be especially effective when they do the politicking. Political activity is so important that “informal lobbyist” is an unwritten part of almost any CEO’s job description.

Managers of business organizations should not get involved in political activities.

**ANSWER:** Disagree. Smart business managers get involved in lobbying and other political activities to try to make sure the consequences of new laws and regulations are mostly positive for their own firms. Companies pay huge fees to associations and lobbyists to make sure government actions work out in their favor.

**Unite with Others.** Much of the work to influence the external environment is accomplished jointly with other organizations that have similar interests. For example, most large pharmaceutical companies belong to Pharmaceutical Research and Manufacturers of America. Manufacturing companies are part of the National Association of Manufacturers, and retailers join the Retail Industry Leaders Association. Many software companies are members of the Initiative for Software
Choice (ISC). By pooling resources, these organizations can pay people to carry out activities such as lobbying legislators, influencing new regulations, developing public relations campaigns, and making campaign contributions. The National Tooling and Machining Association (NTMA) conducts lobbying on behalf of its members on issues that affect small business, such as taxes, health insurance, or government mandates. NTMA also gives its members statistics and information that help them become more competitive in the global marketplace.  

**Don’t Fall into Illegitimate Activities.** Illegitimate activities represent the final technique companies sometimes use to control their environmental domain, but this technique typically backfires. Conditions such as low profits, pressure from senior managers, or scarce environmental resources may lead managers to adopt behaviors not considered legitimate. One study found that companies in industries with low demand, shortages, and strikes were more likely to be convicted for illegal activities, suggesting that illegal acts are an attempt to cope with resource scarcity. Some non-profit organizations have been found to use illegitimate or illegal actions to bolster their visibility and reputation as they compete with other organizations for scarce grants and donations, for example.

Types of illegitimate activities include payoffs to foreign governments, illegal political contributions, promotional gifts, and wiretapping. Bribery is one of the most frequent types of illegitimate activity, particularly in companies operating globally. Energy companies face tremendous uncertainty, for example, and need foreign governments to approve giant investments and authorize risky projects. Under pressure to win contracts in Nigeria, Albert “Jack” Stanley, a former executive at KBR (then a division of Halliburton Company), admits he orchestrated a total of about $182 million in bribes to get Nigerian officials to approve the construction of a liquified natural gas plant in that country. Stanley faces up to seven years in prison and a hefty fine after pleading guilty. In Germany, executives at both Siemens and Volkswagen have been charged with bribing labor representatives on their companies’ supervisory boards. German law requires that firms give as many as half of their supervisory board seats to labor representatives. Executives need the board’s support to carry out their plans and strategies for the company, and some resort to bribery to get the cooperation they need.

**Organization–Environment Integrative Framework**

The relationships illustrated in Exhibit 4.9 summarize the two major themes about organization–environment relationships discussed in this chapter. One theme is that the amount of complexity and change in an organization’s domain influences the need for information and hence the uncertainty felt within an organization. Greater information uncertainty is resolved through greater structural flexibility and the assignment of additional departments and boundary roles. When uncertainty is low, management structures can be more mechanistic, and the number of departments and boundary roles can be fewer. The second theme pertains to the scarcity of material and financial resources. The more dependent an organization is on other organizations for those resources, the more important it is to either establish favorable linkages with those organizations or control entry into the domain. If dependence on external resources is low, the organization can maintain autonomy and does not need to establish linkages or control the external domain.
DESIGN ESSENTIALS

- Change and complexity in the external environment have major implications for organization design and management action. Organizations are open social systems. Most are involved with hundreds of external elements. Important environmental sectors with which organizations deal are the industry, raw materials, human resources, financial resources, market, technology, economic conditions, government, sociocultural, and international.

- Organizational environments differ in terms of uncertainty and resource dependence. Organizational uncertainty is the result of the stable–unstable
and simple–complex dimensions of the environment. Resource dependence is the result of scarcity of the material and financial resources needed by the organization.

■ Organization design takes on a logical perspective when the environment is considered. Organizations try to survive and achieve efficiencies in a world characterized by uncertainty and scarcity. Specific departments and functions are created to deal with uncertainties. The organization can be conceptualized as a technical core and departments that buffer environmental uncertainty. Boundary-spanning roles bring information about the environment into the organization and send information about the organization to the external environment.

■ The concepts in this chapter provide specific frameworks for understanding how the environment influences the structure and functioning of an organization. Environmental complexity and change, for example, have specific impact on internal complexity and adaptability. Under great uncertainty, more resources are allocated to departments that will plan, deal with specific environmental elements, and integrate diverse internal activities. Moreover, organizations in rapidly changing environments typically reflect a loose, organic structure and management processes.

■ When risk is great or resources are scarce, the organization can establish linkages through acquisitions, strategic alliances, interlocking directorates, executive recruitment, or advertising and public relations that will minimize risk and maintain a supply of scarce resources. Other techniques for influencing the environment include a change of the domain in which the organization operates, political activity, participation in trade associations, and perhaps illegitimate activities.

■ Two important themes in this chapter are that organizations can learn and adapt to the environment and that organizations can change and control the environment. These strategies are especially true for large organizations that command many resources. Such organizations can adapt when necessary but can also neutralize or change problematic areas in the environment.

**Key Concepts**

- boundary-spanning roles
- buffering roles
- business intelligence
- cooptation
- differentiation
- direct interlock
- domain
- general environment
- indirect interlock
- integration
- intelligence team
- interlocking directorate
- mechanistic
- organic
- organizational environment
- resource dependence
- sectors
- simple–complex dimension
- stable–unstable dimension
- task environment
- uncertainty

**Discussion Questions**

1. Define organizational environment. Would the task environment of a new Internet-based company be the same as that of a large government agency? Discuss.

2. What are some forces that influence environmental uncertainty? Which typically has the greatest impact on uncertainty—environmental complexity or environmental change? Why?
3. Name some factors causing environmental complexity for an organization of your choice. How might this environmental complexity lead to organizational complexity? Explain.

4. Discuss the importance of the international sector for today’s organizations, compared to domestic sectors. What are some ways in which the international sector affects organizations in your city or community?

5. Describe differentiation and integration. In what type of environmental uncertainty will differentiation and integration be greatest? Least?

6. How do you think planning in today’s organizations compares to planning twenty-five years ago? Do you think planning becomes more important or less important in a world where everything is changing fast and crises are a regular part of organizational life? Why?

7. What is an organic organization? A mechanistic organization? How does the environment influence organic and mechanistic structures?

8. Why do organizations become involved in interorganizational relationships? Do these relationships affect an organization’s dependency? Performance?

9. Assume you have been asked to calculate the ratio of staff employees to production employees in two organizations—one in a simple, stable environment and one in a complex, shifting environment. How would you expect these ratios to differ? Why?

10. Is changing the organization’s domain a feasible strategy for coping with a threatening environment? Explain. Can you think of an organization in the recent news that has changed its domain?

**Chapter 4 Workbook: Organizations You Rely On**

Below, list eight organizations you somehow rely on in your daily life. Examples might be a restaurant, a clothing or CD store, a university, your family, the post office, the telephone company, an airline, a pizzeria that delivers, your place of work, and so on. In the first column, list those eight organizations. Then, in column 2, choose another organization you could use in case the ones in column 1 were not available. In column 3, evaluate your level of dependence on the organizations listed in column 1 as Strong, Medium, or Weak. Finally, in column 4, rate the certainty of that organization being able to meet your needs as High (certainty), Medium, or Low.

<table>
<thead>
<tr>
<th>Organization</th>
<th>Backup Organization</th>
<th>Level of Dependence</th>
<th>Level of Certainty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Questions

1. Do you have adequate backup organizations for those of high dependence? How might you create even more backups?

2. What would you do if an organization you rated high for dependence and high for certainty suddenly became high-dependence and low-certainty? How would your behavior relate to the concept of resource dependence?

3. Have you ever used any behaviors similar to those in Exhibit 4.8 to manage your relationships with the organizations listed in column 1?


Case for Analysis: The Paradoxical Twins: Acme and Omega Electronics*

Part 1

In 1986, Technological Products of Erie, Pennsylvania, was bought out by a Cleveland manufacturer. The Cleveland firm had no interest in the electronics division of Technological Products and subsequently sold to different investors two plants that manufactured computer chips and printed circuit boards. Integrated circuits, or chips, were the first step into microminiaturization in the electronics industry, and both plants had developed some expertise in the technology, along with their superior capabilities in manufacturing printed circuit boards. One of the plants, located in nearby Waterford, was renamed Acme Electronics; the other plant, within the city limits of Erie, was renamed Omega Electronics, Inc.

Acme retained its original management and upgraded its general manager to president. Omega hired a new president who had been a director of a large electronic research laboratory and upgraded several of the existing personnel within the plant. Acme and Omega often competed for the same contracts. As subcontractors, both firms benefited from the electronics boom and both looked forward to future growth and expansion. The world was going digital, and both companies began producing digital microprocessors along with the production of circuit boards. Acme had annual sales of $100 million and employed 550 people. Omega had annual sales of $80 million and employed 480 people. Acme regularly achieved greater net profits, much to the chagrin of Omega’s management.

Inside Acme

The president of Acme, John Tyler, was confident that, had the demand not been so great, Acme’s competitor would not have survived. “In fact,” he said, “we have been able to beat Omega regularly for the most profitable contracts, thereby
increasing our profit.” Tyler credited his firm’s greater effectiveness to his managers’ abilities to run a “tight ship.” He explained that he had retained the basic structure developed by Technological Products because it was most efficient for high-volume manufacturing. Acme had detailed organization charts and job descriptions. Tyler believed everyone should have clear responsibilities and narrowly defined jobs, which would lead to efficient performance and high company profits. People were generally satisfied with their work at Acme; however, some of the managers voiced the desire to have a little more latitude in their jobs.

**Inside Omega**

Omega’s president, Jim Rawls, did not believe in organization charts. He felt his organization had departments similar to Acme’s, but he thought Omega’s plant was small enough that things such as organization charts just put artificial barriers between specialists who should be working together. Written memos were not allowed since, as Rawls expressed it, “the plant is small enough that if people want to communicate, they can just drop by and talk things over.”

The head of the mechanical engineering department said, “Jim spends too much of his time and mine making sure everyone understands what we’re doing and listening to suggestions.” Rawls was concerned with employee satisfaction and wanted everyone to feel part of the organization. The top management team reflected Rawls’s attitudes. They also believed that employees should be familiar with activities throughout the organization so that cooperation between departments would be increased. A newer member of the industrial engineering department said, “When I first got here, I wasn’t sure what I was supposed to do. One day I worked with some mechanical engineers and the next day I helped the shipping department design some packing cartons. The first months on the job were hectic, but at least I got a real feel for what makes Omega tick.”

**Part II**

In the 1990s, mixed analog and digital devices began threatening the demand for the complex circuit boards manufactured by Acme and Omega. This “system-on-a-chip” technology combined analog functions, such as sound, graphics, and power management, together with digital circuitry, such as logic and memory, making it highly useful for new products such as cellular phones and wireless computers. Both Acme and Omega realized the threat to their futures and began aggressively to seek new customers.

In July 1992, a major photocopier manufacturer was looking for a subcontractor to assemble the digital memory units of its new experimental copier. The projected contract for the job was estimated to be $7 million to $9 million in annual sales.

Both Acme and Omega were geographically close to this manufacturer, and both submitted highly competitive bids for the production of 100 prototypes. Acme’s bid was slightly lower than Omega’s; however, both firms were asked to produce 100 units. The photocopier manufacturer told both firms that speed was critical because its president had boasted to other manufacturers that the firm would have a finished copier available by Christmas. This boast, much to the designer’s dismay, required pressure on all subcontractors to begin prototype production before the final design of the copier was complete. This meant Acme and Omega would have at most two weeks to produce the prototypes or would delay the final copier production.

**Part III**

**Inside Acme**

As soon as John Tyler was given the blueprints (Monday, July 13, 1992), he sent a memo to the purchasing department asking to move forward on the purchase of all necessary materials. At the same time, he sent the blueprints to the drafting department and asked that it prepare manufacturing prints. The industrial engineering department was told to begin methods design work for use by the production department supervisors. Tyler also sent a memo to all department heads and executives indicating the critical time constraints of this job and how he expected that all employees would perform as efficiently as they had in the past.

The departments had little contact with one another for several days, and each seemed to work at its own speed. Each department also encountered problems. Purchasing could not acquire all the parts on time. Industrial engineering had difficulty arranging an efficient assembly sequence. Mechanical engineering did not take the deadline seriously and parcelled its work to vendors so the engineers could work on other jobs scheduled previously. Tyler made it a point to stay in touch with the photocopier manufacturer to let it know things were progressing and to learn of any new developments. He traditionally worked to keep important clients happy. Tyler telephoned someone at the photocopier company at least twice a week and got to know the head designer quite well.

On July 17, Tyler learned that mechanical engineering was far behind in its development work, and he “hit the roof.” To make matters worse, purchasing had not obtained all the parts, so the industrial engineers decided to assemble the product without one part, which would be inserted at the last minute. On Thursday, July 23, the final units were being assembled, although the process was delayed several times. On Friday, July 24, the last units were finished while Tyler paced around the plant. Late that afternoon, Tyler received a phone call from the head designer of the photocopier manufacturer, who told Tyler that he had received a call on Wednesday from Jim Rawls of Omega. He explained that Rawls’s workers had found an error in the design of the connector cable and taken corrective action on their prototypes. He told Tyler that he had checked out...
the design error and that Omega was right. Tyler, a bit overwhelmed by this information, told the designer that he had all the memory units ready for shipment and that, as soon as they received the missing component on Monday or Tuesday, they would be able to deliver the final units. The designer explained that the design error would be rectified in a new blueprint he was sending over by messenger and that he would hold Acme to the Tuesday delivery date.

When the blueprint arrived, Tyler called in the production supervisor to assess the damage. The alterations in the design would call for total disassembly and the unsoldering of several connections. Tyler told the supervisor to put extra people on the alterations first thing Monday morning and to try to finish the job by Tuesday. Late Tuesday afternoon, the alterations were finished and the missing components were delivered. Wednesday morning, the production supervisor discovered that the units would have to be torn apart again to install the missing component. When John Tyler was told this, he again “hit the roof.” He called industrial engineering and asked if it could help out. The production supervisor and the methods engineer couldn’t agree on how to install the component. John Tyler settled the argument by ordering that all units be taken apart again and the missing component installed. He told shipping to prepare cartons for delivery on Friday afternoon.

On Friday, July 31, fifty prototypes were shipped from Acme without final inspection. John Tyler was concerned about his firm’s reputation, so he waived the final inspection after he personally tested one unit and found it operational. On Tuesday, August 4, Acme shipped the last fifty units.

**Inside Omega**

On Friday, July 10, Jim Rawls called a meeting that included department heads to tell them about the potential contract they were to receive. He told them that as soon as he received the blueprints, work could begin. On Monday, July 13, the prints arrived and again the department heads met to discuss the project. At the end of the meeting, drafting had agreed to prepare manufacturing prints, while industrial engineering spent Monday night redesigning the cable, and on Tuesday morning, the drafting department finalized the changes in the manufacturing prints. On Tuesday morning, Rawls was a bit apprehensive about the design changes and decided to get formal approval. Rawls received word on Wednesday from the head designer at the photocopier firm that they could proceed with the design changes as discussed on the phone. On Friday, July 24, the final units were inspected by quality control and were then shipped.

**Part IV**

Ten of Acme’s final memory units were defective, whereas all of Omega’s units passed the photocopier firm’s tests. The photocopier firm was disappointed with Acme’s delivery delay and incurred further delays in repairing the defective Acme units. However, rather than give the entire contract to one firm, the final contract was split between Acme and Omega with two directives added: (1) maintain zero defects and (2) reduce final cost. In 1993, through extensive cost-cutting efforts, Acme reduced its unit cost by 20 percent and was ultimately awarded the total contract.


---

**Notes**


34. Julie Schlosser, “Looking for Intelligence in Ice Cream,” Fortune (March 17, 2003), 114–120.


38. “Snooping on a Shoestring,” Business 2.0 (May 2003), 64–66.


60. Borys and Jemison, “Hybrid Arrangements as Strategic Alliances.”


Interorganizational Relationships

Chapter 5

Organizational Ecosystems
Is Competition Dead? · The Changing Role of Management · Interorganizational Framework

Resource Dependence
Supply Chain Relationships · Power Implications

Collaborative Networks
Why Collaboration? · From Adversaries to Partners

Population Ecology
Organizational Form and Niche · Process of Ecological Change · Strategies for Survival

Institutionalism
The Institutional View and Organization Design · Institutional Similarity

Design Essentials
SAP and Microsoft go at each other tooth-and-nail for customers, but the two called a truce to jointly develop a piece of software that allows a Microsoft spreadsheet to bring in data from an SAP accounting program. Rival Internet companies Google, Yahoo!, and MySpace created an alliance to develop new technologies that will benefit all of the partners. All over corporate America, and particularly in the rapidly changing and uncertain high-tech industry, companies are cheerfully sleeping with the enemy.

A widespread organizational trend today is to reduce boundaries and increase collaboration between companies, sometimes even between competitors. In many industries, the business environment is so complicated that no single company can develop all the expertise and resources needed to stay competitive. Why? Globalization and rapid advances in technology, communications, and transportation have created amazing new opportunities, but they have also raised the cost of doing business and made it increasingly difficult for any company to take advantage of those opportunities on its own. In this new economy, webs of organizations are emerging. Collaboration and partnership is the new way of doing business. Organizations think of themselves as teams that create value jointly rather than as autonomous companies that are in competition with all others.

You can see the results of interorganizational collaboration when a movie like the animated *Star Wars: The Clone Wars* from Lucasfilm Ltd. is launched. More than a month before the movie opened, Toys “R” Us mounted digital clocks in many of its stores, counting down the days until the chain began selling toys and action figures based on the film. Two of the retailer’s flagship stores held midnight costume parties and trivia contests in connection with the opening. McDonald’s teamed up with Lucasfilm to put together a Star Wars Happy Meal promotion, each meal coming with a specially-designed box and one of eighteen exclusive toys. Kids could continue their Star Wars experience online at the Happy Meal Virtual World, where
codes printed on Happy Meal packaging enabled them to unlock top-secret Jedi quests.² For some blockbuster movies, coordinated action among companies can yield millions in addition to box-office and DVD profits.

**Purpose of This Chapter**

This chapter explores the most recent trend in organizing, which is the increasingly dense web of relationships among organizations. Companies have always been dependent on other organizations for supplies, materials, and information. The question is how these relationships are managed. At one time it was a matter of a large, powerful company tightening the screws on small suppliers. Today a company can choose to develop positive, trusting relationships. The notion of horizontal relationships described in Chapter 3 and the understanding of environmental uncertainty in Chapter 4 are leading to the next stage of organizational evolution, which is horizontal relationships across organizations. Organizations can choose to build relationships in many ways, such as appointing preferred suppliers, establishing agreements, business partnering, joint ventures, or even mergers and acquisitions.

Interorganizational research has yielded perspectives such as resource dependence, collaborative networks, population ecology, and institutionalism. The sum total of these ideas can be daunting, because it means managers no longer can rest in the safety of managing a single organization. They have to figure out how to manage a whole set of interorganizational relationships, which is a great deal more challenging and complex.

**ORGANIZATIONAL ECOSYSTEMS**

**Interorganizational relationships** are the relatively enduring resource transactions, flows, and linkages that occur among two or more organizations.³ Traditionally, these transactions and relationships have been seen as a necessary evil to obtain what an organization needs. The presumption has been that the world is composed of distinct businesses that thrive on autonomy and compete for supremacy. A company may be forced into interorganizational relationships depending on its needs and the instability and complexity of the environment.

A new view described by James Moore argues that organizations are now evolving into business ecosystems. An **organizational ecosystem** is a system formed by the interaction of a community of organizations and their environment. An ecosystem cuts across traditional industry lines.⁴ A company can create its own ecosystem. Apple, for instance, travels in several major industries, including consumer electronics, Internet services, mobile phones, personal computers, and entertainment. Its ecosystem also includes hundreds of suppliers and millions of customers across many markets. Google is getting into the entertainment business as well, rolling out dozens of short cartoons by “Family Guy” creator Seth McFarlane and building a role as “middleman to Hollywood talent coming online.”⁵ Cable television companies are offering new forms of phone service, and telephone companies are getting into the television business. Today, successful companies develop relationships with numerous other organizations cutting across traditional business boundaries.
Is Competition Dead?

No company can go it alone under a constant onslaught of international competitors, changing technology, and new regulations. Organizations around the world are embedded in complex networks of confusing relationships—collaborating in some markets, competing fiercely in others. The number of corporate alliances has been increasing at a rate of 25 percent a year, and many of those have been between competitors. These alliances influence organizations’ competitive behavior in varied ways.

Traditional competition, which assumes a distinct company competing for survival and supremacy with other stand-alone businesses, no longer exists because each organization both supports and depends on the others for success, and perhaps for survival. However, most managers recognize that the competitive stakes are higher than ever in a world where market share can crumble overnight and no industry is immune from almost instant obsolescence. In today’s world, a new form of competition is in fact intensifying.

For one thing, companies now need to coevolve with others in the ecosystem so that everyone gets stronger. Consider the wolf and the caribou. Wolves cull weaker caribou, which strengthens the herd. A strong herd means that wolves must become stronger themselves. With coevolution, the whole system becomes stronger. In the same way, companies coevolve through discussion with each other, shared visions, alliances, and managing complex relationships.

Exhibit 5.1 illustrates the complexity of an ecosystem by showing the myriad overlapping relationships in which high-tech companies were involved in 1999. Since then, many of these companies have merged, been acquired, or gone out of business. Ecosystems constantly change and evolve, with some relationships growing stronger while others weaken or are terminated. The changing pattern of relationships and interactions in an ecosystem contributes to the health and vitality of the system as an integrated whole.

In an organizational ecosystem, conflict and cooperation exist at the same time. Consider the partnership between rivals Sony and Samsung.

Sony and Samsung illustrate the tangled connections that have developed among consumer electronics firms over the past several years. Many electronics companies that long prided themselves on independence have shifted to an ecosystem approach.

Samsung’s mission has long been clear: knock off Sony as the world’s top electronics maker. Within the past several years, the Korean underdog surpassed giant Sony in market capitalization, revenue, and profits. The two companies continue to battle, along with a few other top electronics makers, for the No. 1 spot in global television sales.

So what possible reason could Samsung have for letting Sony use some of its key technologies for flat-panel televisions before Samsung’s own products used them? Sony’s televisions using those technologies ended up outselling Samsung’s LCD sets by more than three to one in the year they were released. Not such a smart move on Samsung’s part, you would think, but you might be wrong. By working closely with Sony, Samsung engineers and managers knew they were getting a crash course in how to make better LCD televisions. Previously the company had used the technology primarily for computer monitors and cellphones. Samsung engineer Jang Insik and his Sony counterpart Hiroshi Murayama talk by phone several times a day. “If we can learn from Sony,” says Jang, “it will help us in advancing our technology.” (continued)
The largest companies (those with more than 10,000 employees) are, not surprisingly, the hubs of the digital universe: they tend to have the most strategic partnerships (black lines) and investments (red lines).* 

*Smaller companies that have no relationships with the hubs are not featured.
Chapter 5: Interorganizational Relationships

Mutual dependencies and partnerships have become a fact of life. Is competition dead? Companies today may use their strength to achieve victory over competitors, but ultimately cooperation carries the day.

The Changing Role of Management

Within business ecosystems managers learn to move beyond traditional responsibilities of corporate strategy and designing hierarchical structures and control systems. If a top manager looks down to enforce order and uniformity, the company is missing opportunities for new and evolving external relationships. In this new world, managers think about horizontal processes rather than vertical structures. Important initiatives are not just top down; they cut across the boundaries separating organizational units. Moreover, horizontal relationships now include linkages with suppliers and customers, who become part of the team. Business leaders can learn to lead economic coevolution. Managers learn to see and appreciate the rich environment of opportunities that grow from cooperative relationships with other contributors to the ecosystem. Rather than trying to force suppliers into low prices or customers into high prices, managers strive to strengthen the larger system evolving around them, finding ways to understand this big picture and how to contribute.

This is a broader leadership role than ever before. Managers in charge of coordinating with other companies have to learn new executive skills. A study of executive roles by the Hay Group distinguished between operations roles and collaborative roles. Most traditional managers are skilled in handling operations roles, which have traditional vertical authority and are accountable for business results primarily through direct control over people and resources. Collaborative roles, on the other hand, don’t have direct authority over horizontal colleagues or partners, but are nonetheless accountable for specific business results. Managers in collaborative roles have to be highly flexible and proactive. They achieve results through personal communication and assertively seeking out needed information and resources.

The old way of managing relied almost exclusively on operations roles, defending the organization’s boundaries and maintaining direct control over resources. Today, though, collaborative roles are becoming more important for success. When alliances fail, it is usually because of an inability of the partners to develop trusting, collaborative relationships rather than due to the lack of a solid business plan or strategy. In successful alliances, people work together almost as if they were members of the same company. Donovan Neale-May, president of advertising firm Neale-May & Partners, provides an example of the new collaborative management style. Neale-May realized that his agency was having trouble winning accounts because of its lack of international experience. He talked with other ad executives...