CRISIS OF RED TAPE Achieving growth through coordination is a complex process that has to be managed continuously if organizations are to be successful. When organizations fail to manage this process, they are plunged into a *crisis of red tape.* The number of rules and procedures increases, but this increased bureaucracy does little to increase organizational effectiveness and is likely to reduce it by stifling entrepreneurship and other productive activity. The organization becomes overly bureaucratic and relies too much on the formal organization and not enough on the informal organization to coordinate its activities. How can an organization cut itself free of all the confining red tape so that it can once again function effectively and avoid failure and the fall into the chasm?

Stage 5: Growth through Collaboration

In Greiner's model, *growth through collaboration* becomes the way to solve the crisis of red tape and push the organization up the growth curve. Growth through collaboration emphasizes "greater spontaneity in management action through teams and the skillful confrontation of interpersonal differences. Social control and self-discipline take over from formal control."[33] For organizations at this stage of the growth cycle, Greiner advocates the use of the product team and matrix structures which, as we discussed in Chapter 6, many large companies use to improve their ability to respond to customer needs and introduce new products quickly. Developing the interpersonal linkages that underlie the "matrix in the mind" for managing global linkages is also a part of the collaborative strategy. Collaboration makes an organization more organic by making greater use of mutual adjustment and less use of standardization.

Changing from a mechanistic to an organic structure as an organization grows is a difficult task fraught with problems; hence, many companies do fall into the chasm. Although Xerox and Chrysler moved to a product team structure to streamline their decision making, this change was not made until *after* both companies had experienced huge problems with their structures—problems that increased costs, reduced product quality, and severely reduced their effectiveness. Indeed, both companies came close to bankruptcy.

Managerial Implications

Organizational Birth and Growth

1. Analyze the resources available in an environment to determine whether a niche to be exploited exists.
2. If a niche is discovered, analyze how the population of organizations currently in the environment will compete with you for the resources in the niche.
3. Develop the competences necessary to pursue a specialist strategy in order to attract resources in the niche.
4. Carefully analyze the institutional environment to learn the values and norms that govern the behavior of organizations in the environment. Imitate the qualities and actions of successful organizations, but be careful to differentiate your product from theirs to increase the returns from your specialist strategy.
5. If your organization survives the birth stage, recognize that it will encounter a series of problems as it grows and differentiates.
6. Recognize the importance of creating an effective top-management team and of delegating authority to professional managers in order to build a stable platform for future growth.
7. Then, following principles outlined in earlier chapters, manage the process of organizational design to meet each growth crisis as it emerges. Establish an appropriate balance between centralizing and decentralizing authority, for example, and between standardization and mutual adjustment.

Organizational Decline and Death

Greiner's growth model shows organizations as continuing to grow through collaboration until they encounter some new, unnamed crisis. But, for many organizations, the next stage in the life cycle is not continued growth but organizational decline, as shown by the direction of the dashed line in Figure 11.4. Indeed, Greiner's model suggests that if an organization cannot solve the particular crisis associated with a growth stage, by changing its strategy or structure, this will result in organizational decline.

Organizational decline is the life cycle stage that an organization enters when it fails to "anticipate, recognize, avoid, neutralize, or adapt to external or internal pressures that threaten [its] long-term survival."[34] The liability of newness, for example, threatens young organizations, and the failure to develop a stable structure can cause early decline and failure. Similarly, in Greiner's model, the failure to adapt strategy and structure to match a changing environment can result in crisis and failure. Regardless of whether decline sets in at the birth or the growth stage, the result is a decrease in an organization's ability to obtain resources from its stakeholders.[35] A declining company may be unable to attract financial resources from banks, customers, or human resources because the best managers or employees prefer to work for the most successful organizations.

Organizational decline
The life cycle stage that an organization enters when it fails to anticipate, recognize, avoid, neutralize, or adapt to external or internal pressures that threaten its long-term survival.

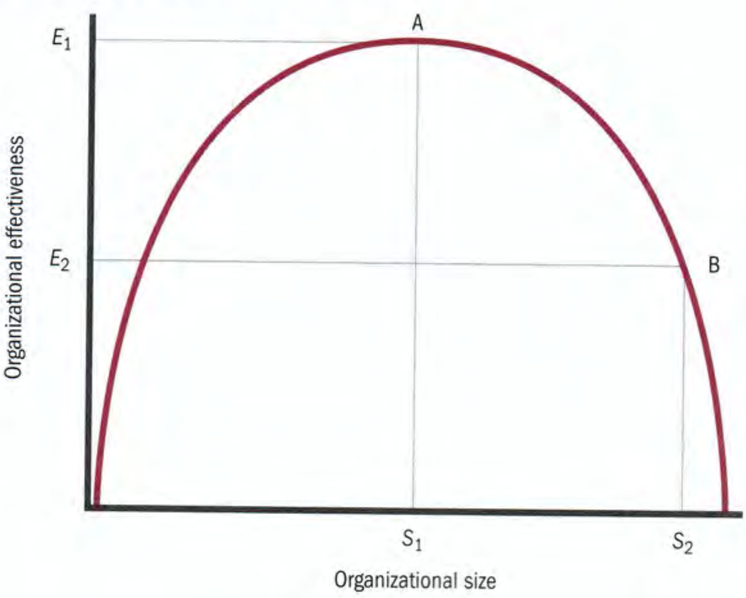
Decline sometimes occurs because organizations grow too fast or too much.[36] The experience of IBM, GM, and Sony suggests that organizations tend to grow past the point that maximizes their effectiveness. Figure 11.5 illustrates the relationship between organizational size and organizational effectiveness. The figure shows that organizational effectiveness is highest at point A, where effectiveness E_1 is associated with organizational size S_1. If an organization grows past this point—for example, to point S_2—effectiveness falls to E_2, and the organization ends up at point B.

Effectiveness and Profitability

An important method stakeholders such as managers and investors employ to assess organizational effectiveness is to compare how well one company in an industry is performing relative to others by measuring its profitability relative to theirs. In evaluating organizational effectiveness, it is crucial to understand the difference between a company *making a profit* and *being profitable*, that is, a company's *profitability*.

Profit is simply the total or absolute monetary difference between a company's sales revenues and operating costs; if its sales are $10 million and costs are $8 million, it has

Figure 11.5 The Relationship between Organizational Size and Organizational Effectiveness



Profitability
A measurement of how well a company is making use of resources relative to its competitors.

made a profit of $2 million. **Profitability** measures how well a company is making use of its resources by investing them in ways that create goods and services that it can sell at prices that generate the most profit.

The important difference between them is that the size of the profit that a company makes in one year says little about how well its managers are making use of resources and its ability to generate future profits. In the car industry, for example, in good economic times, companies like Ford, GM, and Toyota may make billions of dollars of profit each year, but this tells us little about their relative profitability—which company is most effective now and will be in the future. Profitability, in contrast, gives managers and investors much more information to assess how well one company is performing against others in its industry. To see why this is so, consider the following example.

Imagine there are three large companies in an industry and each pursues a different business model. Company A decides to make and sell a no-frills low-priced product; Company B offers customers a state-of-the-art high-priced product; Company C decides to offer a midpriced product targeted at the average customer. The company that has invested its capital in such a way that (1) it is making the most productive use of its resources (which leads to low operating costs) *and* (2) has created a product that customers are clamoring to buy even at a premium price (which leads to high sales revenues) will have the highest profitability.

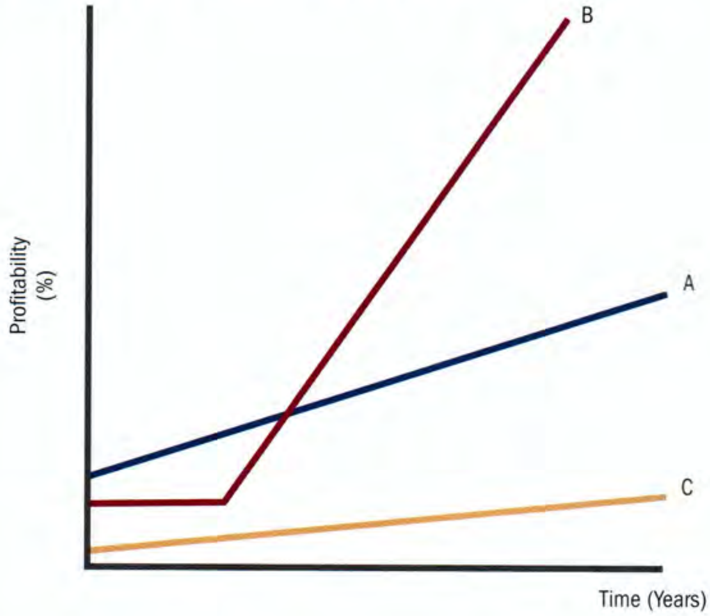
Suppose, for example, that Company A makes a profit of $50 million, B makes $25 million, and Company C makes $10 million. Does this mean Company A has outperformed Company B and C and is generating most returns for its stockholders? To answer this question, we need to calculate their relative profitability. Determining profitability is a two-step process. First, it is necessary to compute a company's profit, which is the difference between sales revenues and operating costs. Second, it is necessary to divide that profit by the total amount of capital invested in productive resources—property, plant, equipment, inventories, and other assets—to make and sell the product. Now we know how much capital each company has invested to generate that profit.

Suppose we find out that Company A has made $50 million profit on $500 million of invested capital, Company B has made $25 million on $100 million of invested capital, and Company C has made $10 million on $300 million. Company A's profitability is 10%, Company B's is 25%, and Company C's is 3%. *Company B is generating profit at two and a half times the rate of A, whereas C is only marginally profitable.* Company B has done the most to create value for stakeholders because its higher level of profitability will have increased the demand for and price of its stock. The importance of considering the relative profitability of companies, rather than differences in their total profit, is clear.

As noted earlier, company profitability is usually considered over time because it is seen as an indicator of a company's ability to generate future profit and capital. Figure 11.6 depicts how the profitability of these three companies has changed over time. Company B's profitability has been increasing rapidly over time, Company A's at a much lower rate, and Company C's has hardly increased at all. As an investor, which company's stock would you buy? Because the stock of a company normally rises as its profitability rises and vice versa, Company B would have been the most profitable company to invest in by far. Company A is also making a respectable return for its investors: It is profitable and holding its own in the industry. However, it needs to reorganize to find new ways to compete with Company B, perhaps by copying or imitating Company B. Company C is making a profit but it is only marginally profitable. Its owners have to decide if the benefits of staying in business outweigh the costs—the falling value of its shares and possible future losses. With such low profitability, it may be very hard to find new ways to make better use of its resources and increase its profitability. At such a competitive disadvantage, however, it might become clear to managers and investors that Company C's capital would be better used in some other business. Company C's managers might decide to sell their company's assets and go out of business.

In any industry, companies are in competition (1) to develop new and improved products to attract customers, and (2) to find ways to make more productive use of their resources to reduce their operating costs. In the supermarket industry, for example, competition from Walmart forced Kroger and Albertson's to find better ways to use their

Figure 11.6 Differences in Profitability



resources to maintain and increase profitability. Kroger, for example, invested its capital to build attractive new stores and install new kinds of IT to allow it to lower its operating costs. Its profit and stock price reached a record level in 2008. Albertson's has not done so well. It continued to decline and was bought by private investors who have been busy selling off thousands of its stores in different regions so it seems likely that the company will soon disappear and die.

Greiner's model assumes that managers have the ability to identify and solve organizational crises and so can restore company profitability if its performance begins to fall. In today's highly competitive global environment, there are many external and internal forces outside managers' control that prevent a turnaround and so profitability continues to fall. Two factors that often lead to continuing decline and loss in effectiveness are organizational inertia and environmental changes.

Organizational Inertia

An organization may find it difficult to adapt to changes occurring in the environment because of **organizational inertia**—the forces inside an organization that make it resistant to change. Although Greiner and other adaptation theorists believe organizations do have the ability to change and adapt to new conditions in their environments, population ecology theorists are more pessimistic. They believe that organizations are subject to considerable inertia and do not have the ability to quickly or easily change their strategy or structure to avoid decline. Some factors that cause inertia were discussed in the previous chapter. Three more are risk aversion, the desire to maximize rewards, and an overly bureaucratic culture. When these factors operate together, the problems facing managers are greatly compounded.

Organizational inertia
Forces inside an organization that make it resistant to change.

RISK AVERSION As organizations grow, managers often become risk averse—that is, they become unwilling to bear the uncertainty associated with entrepreneurial activities.[37] They prefer to protect the status quo and keep things the way they are, so over time an organization becomes increasingly difficult to change. Risk aversion may set in for several reasons. Managers' overriding concern may be to protect their power and status so they pursue safe courses of action and choose inexpensive projects. Then, if the projects fail, no major damage will have been done. Often, managers try to maximize the chance of success by pursuing new projects similar to those that have already brought the organization success.

THE DESIRE TO MAXIMIZE REWARDS Research suggests that managers' desire for prestige, job security, power, and the strong property rights that bring large rewards often leads them to focus on strategies that increase organizational size, even if this reduces future profitability and organizational effectiveness.[38] The management teams of many large companies such as Goodyear, Kodak, and Anheuser-Busch have been accused of pursuing their own goals at the expense of shareholders, customers, and other stakeholders. Those management teams lacked any incentive to improve organizational effectiveness because they would not gain personally from doing so, and only powerful stakeholders or the threat of takeover can discipline them and force them to streamline operations. The turnarounds achieved at both IBM and Xerox, for example, only came about when new top management teams took control. Of course in companies such as Tyco, Enron, and Arthur Andersen, the pursuit of personal interest led to unethical and illegal acts that resulted in the downfall of these companies.

OVERLY BUREAUCRATIC CULTURE As discussed in Chapter 7, in large organizations, property rights (such as salaries and stock options) can become so strong that managers spend all their time protecting their specific property rights instead of working to advance the organization's interests. Top managers, for example, resist attempts by subordinate managers to take the initiative and act entrepreneurially because subordinates who demonstrate superior skills and abilities may threaten the position of their managers—and thus their managers' property rights.[39] Another bureaucracy-related problem is that, as C. Northcote Parkinson pointed out, in a bureaucracy, managers want to multiply subordinates, not rivals. So to protect their positions, managers limit the autonomy of their subordinates. One way of limiting autonomy is to establish a tall hierarchy so that subordinates have less authority and their behavior can be closely scrutinized. Another way is to develop a bureaucratic culture that emphasizes keeping the status quo and the need for maintaining conformity to organizational procedures. Such a culture might be desirable in the armed forces, but it is not beneficial to a large company fighting for survival in an uncertain environment.

Although the behavior of managers is sometimes a major cause of organizational inertia and decline, it is important to realize that managers may not be deliberately trying to hurt the organization. Bureaucratization and risk aversion may creep up on organizations unexpectedly.

Changes in the Environment

Environmental changes that affect an organization's ability to obtain scarce resources may lead to organizational decline. The major sources of uncertainty in the environment are complexity, the number of different forces that an organization has to manage; dynamism, the degree to which the environment is changing; and richness, the amount of resources available in the environment (see Figure 3.2). The greater the uncertainty in the environment, the more likely that some organizations in a population, especially organizations affected by inertia, will go into decline.

Sometimes the niche that an organization occupies erodes, and managers no longer have the incentive or ability to change strategy to improve the organization's access to resources. That is what happened to AOL and Yahoo! as the demand for new kinds of online applications such as social networking became so popular and users switched to Facebook. Sometimes the environment becomes poorer, and increased competition for resources threatens existing organizations that have not been managing their growth very effectively. For example, rising gas prices have harmed global carmakers that cannot offer price-conscious customers a range of small hybrid or electric fuel-efficient cars. In fact, rising fuel prices are an example of an "environmental jolt," a major change in the environment that precipitates an immediate crisis.[40] Just as global carmakers have been jolted by soaring fuel prices in the 2010s, so such prices have caused life-threatening problems for large U.S. airlines such as Delta and United Continental. Airlines have responded by massive downsizing that has involved the layoff of thousands of employees and the reduction in the number of flights as they shrink their route structure.

Obviously, the combination of an uncertain, changing environment with organizational inertia makes it difficult for managers to anticipate the need for change. It also hampers and limits their ability to adopt new strategies and structures that will allow an organization to adapt to the changing environment. In Chapter 12, we examine how organizations can promote organizational learning, a process that facilitates change and overcomes inertia. Here we discuss a model that charts the main stages of the decline process, just as Greiner's model charted the main stages of the growth process.

Weitzel and Jonsson's Model of Organizational Decline

Organizational decline occurs by degrees. Weitzel and Jonsson have identified five stages of decline.[41] At each stage except the dissolution stage, if managers do take prompt action they can reverse the decline.

STAGE 1: BLINDED In the blinded stage, the first decline stage identified by Weitzel and Jonsson, organizations are unable to recognize the internal or external forces and problems that threaten their long-term survival. The most common reason for this blindness is that organizations do not have in place the monitoring and information systems they need to measure organizational effectiveness and to identify sources of organizational inertia. Internal signals that indicate potential problems are an excessive number of personnel, a slowdown in decision making, a rise in conflict between functions or divisions, and a fall in profits.

At this stage, remedial action to gain access to good information and effective top managers who are able to react quickly and put in place the right strategies and structures can stop the decline and put the organization back on its growth path. Thus to avoid decline in the first place, managers must be able to monitor internal and external factors continuously, so they have the information to take timely corrective action.

STAGE 2: INACTION If an organization does not realize it is in trouble in the blinded stage, its decline advances to the inaction stage. In this stage, despite clear signs of deteriorating performance such as falling sales or profits, top managers make little attempt to correct problems. This failure to act may be because managers are misinterpreting available information. Managers might decide that their problems are owing to a short-term environmental change that the organization can weather, whereas in reality there has been an environmental jolt—a shift in consumer demand from pickups and SUVs to small fuel-efficient cars, for example. Inaction may also occur because managers are focused on the pursuit of goals that benefit them in the short run, even though in the long run this will hurt other stakeholders. Organizational inertia will also slow down managers' response to the situation. Management may follow tried-and-true approaches to solve the organization's problems—approaches that may be inappropriate given the shift in the environment.[42]

As the inaction stage progresses, the gap between acceptable performance and actual performance increases. Now, prompt wide-ranging action by managers is vital to reverse the decline. Managers must take major steps to stop decline, such as by downsizing and laying off employees or by scaling back the scope of their operations. Often a major reorganization and change to a new form of structure is necessary to overcome the inertia that has developed as the organization has become large and complex.

STAGE 3: FAULTY ACTION If managers fail to halt decline at the inaction stage, the organization moves into the faulty action stage. Problems continue to multiply despite corrective action. Managers may have made the wrong decisions because of conflict in the top-management team, or they may have changed too little too late because they feared that a major reorganization might do more harm than good. Often managers fear that radical change may threaten the way the organization operates and put the organization at risk.[43] For example, because of organizational inertia, Kodak's last five CEOs were either unable or unwilling to make the radical structural and strategic changes necessary to turn the company around. Only after Antonio Perez, its present CEO, took over has Kodak committed itself to the competitive reality of digital imaging and slashed its workforce and facilities. By then, however, Kodak was in stage 4, the crisis stage. Very often, an organization reaches the faulty-action stage because managers become overly committed to their present strategy and structure and fear changing them even though they are clearly not working to halt the decline. The incredible turnaround orchestrated by Carlos Ghosn at Nissan is discussed in Organizational Insight 11.2.

Organizational Insight 11.2

Carlos Ghosn Shakes Up Nissan

In 1999, Japanese carmaker Nissan was in big trouble: Its performance was rapidly declining. No longer profitable, its debt had soared to over $19 billion, and its market share both at home and in the vital U.S. market was dropping fast. In decline, it welcomed an offer by Renault, the French carmaker, to buy a controlling interest in its operations for $5.4 billion and to pump in money to turn around its performance. Nissan immediately dispatched Carlos Ghosn, an expert in managing turnarounds, to take control of the company. Ghosn had fixed Michelin's U.S. division by ruthless cost cutting. He was then recruited as Renault's COO to turn around that company and cut $4 billion in annual expenses. Now he was poised to do the same at Nissan.

Ghosn was one of the first non-Japanese CEOs of a major Japanese company. His appointment generated considerable resistance from Nissan's Japanese managers, who did not want a foreigner in charge, especially one who seemed likely to shake up the company. Ghosn quickly saw that the problem was that Nissan used 24 different car platforms to produce its cars, which required it to operate with too many expensive factories. Ghosn knew that to reduce costs it would be necessary to close down five factories and eliminate a dozen car platforms to wipe out $5 billion in operating costs. However, this was Japan, where lifetime employment is still widespread, and such a move would shock the company's employees. So operating in great secrecy to push his restructuring through, he waited to tell Nissan's board of directors about his plant-closing plans until the night before his public announcement. He also told them that if they did not back his decision, he would close down seven factories instead.[44]

The stunned Japanese gave in, but a public outcry took place in Japan as a foreign CEO proposed to break long-held Japanese norms. Ghosn was forced to travel with a bodyguard as he went on a tour of inspection of all Nissan's Japanese facilities, in part to share his views on how Nissan must change in the future. He made clear to Nissan's employees that his strategy was not just cost cutting. He also told Nissan engineers and managers that he was going to change Nissan's culture and thus the way they worked. Japanese companies are notoriously bureaucratic and hierarchical. They operate with conservative, cautious values that make subordinates reluctant to make suggestions to their superiors. Top managers are always jockeying to protect their turf—hence the 24 different product platforms—and change is always slow and incremental.

Ghosn destroyed these values by creating strict performance targets for managers, based on reducing costs and introducing innovative new vehicles, which could only be reached if managers reengineered the way the company worked. In particular, its engineers, designers, and other functional experts were instructed to be bold in their approach to new vehicle design and production. He created autonomous product teams empowered to make radical changes to vehicle design; he decentralized control, and the top managers who resisted were retired or moved around. Moreover, he insisted that Nissan's engineers and functional experts cooperate with those from Renault, both to speed innovation and share resources and to transform Nissan's values and norms. His goal quite simply was to transform the company and change the way it operated. One result is that today Nissan operates with only ten global platforms.[45]

iStockphoto.com/joel-t

Ghosn succeeded. Nissan, which also owns Infinity, has introduced a whole stream of futuristic vehicles in the 2000s that have received rave reviews and resulted in soaring sales. Today, Nissan is highly profitable, and in Japan Ghosn became a famous celebrity, even a national hero. He is revered as one foreigner who could show the Japanese how things could be done better. In 2005, Ghosn's success led to his appointment as the CEO of Renault. In 2011, he and the Renault-Nissan board still meet once a month to make the medium- and long-range decisions presented to them by a score of cross-company teams determined to keep the company at the forefront of the ongoing changes in carmaking such as the move to more fuel efficient, safer kinds of vehicles.