Choose an Organizational Structure for Digital Business

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CEOs will often ask CIOs who are digital business leaders to recommend an appropriate organizational structure for the enterprise and its ecosystem. Any alteration in structure should help to change the way work gets done within the appropriate operating model.

Key Challenges

- Digital business requires more speed and flexibility than conventional business. This requirement becomes even more difficult to fulfill when the enterprise must work with partners in an extended digital business ecosystem.

- Many CEOs will often turn to CIOs for advice about the best organizational structure to support digital business.

- Executives look to digital giants such as Google and Facebook or more recent startups like Netflix as models for their organizational structure. However, successful digital businesses encompass a wide variety of structures. There is no obvious answer.

- Each of the main types of organizational structure can support a digital business: hierarchy, heterarchy and holacracy. Any recommendation about a change organizational structure requires trade-offs between the various strengths and weaknesses of these types.

Recommendations

CIOs tasked with building and developing a digital business should:

- Work with the COO, head of HR and business leaders to improve the operating model for digital business before you recommend changing the organizational structure.

- Be prepared to advise changes to the organizational structure when external factors, strategic objectives, the evolution of the business or organizations drive a need for them.

- Assess the current state of the enterprise's digital business efforts. This orientation will help you determine which organizational structure to recommend to the executive committee.

- Choose an organizational structure deliberately, based on digital business requirements such as culture and objectives, rather than trying to emulate digital giants (Amazon, Tencent and so on).

- Avoid superficial reorganizations — for example, moving departments and managers around on the organization chart.

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Introduction

Digital business requires more speed and flexibility than conventional business. This requirement becomes even more difficult to fulfill when the enterprise must work with partners in an extended digital business ecosystem. Accordingly, many enterprises recognize the need to develop new operating models to increase their agility (see "What Is an I&T Operating Model, and How Do You Accelerate Its Design Process?"). They wonder which style of organization to adopt to better support the operating model (see Figure 1). Typically, they expect to move from a hierarchical structure to a flatter and looser one, and they look to digital giants such as Google and Facebook or more recent startups like Netflix as models. However, a scan of successful digital businesses by Gartner's secondary research service shows that they encompass a wide variety of organizational structures, including hierarchical. There is no one single best structure. CEOs will often turn for advice about organizational structure to CIOs who play a leading role in digital business. These CIOs should follow three guidelines when they respond:

- Review the operating model and organizational structure types, but recommend the minimum change at first.

- Advise a change in operating model and organizational structure if the business evolves.

■   Help to organize the whole ecosystem.

"The greatest danger in times of turbulence is not the turbulence; it is to act with yesterday's logic."

Peter Drucker

Figure 1. Three Main Types of Organizational Structure

Three Main Types of Organizational Structure

Hierarchy · Heterarchy · Holacracy

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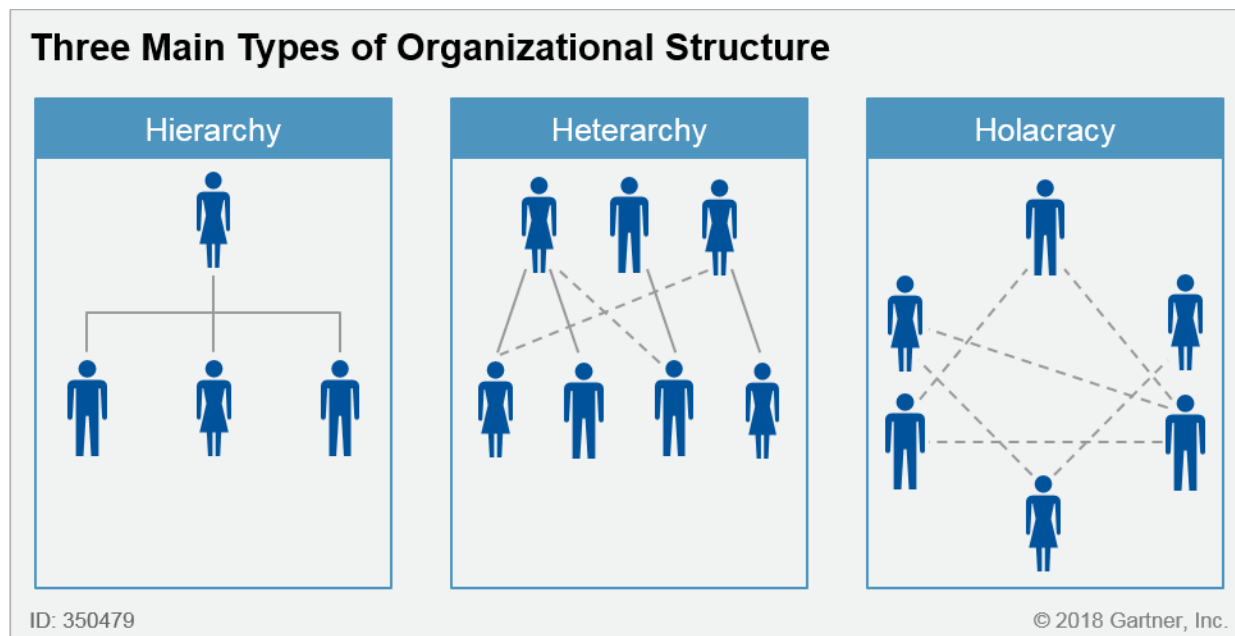
Source: Gartner (April 2018)

Analysis

Review Organizational Structure Types but Recommend the Minimum Change at First

There is no single best organizational structure for digital business. Most organizational structures can be made to work at different points in time. Therefore, the enterprise may not need to change its structure to support digital business or may need to make only small modifications to its current structure.

The right structure for any enterprise depends on the nature of its business, its strategic ambitions, the development stage its digital business has reached, and the enterprise's organizational culture and capabilities. The vast majority of enterprises start out in digital business by optimizing existing business models. Thus, the organizational structure will often not have to look much different from the one in place to support its conventional business.

Each of the three main types of organizational structure described below can support a digital business. Nevertheless, the types have various strengths and weaknesses, which CIOs should consider before making a recommendation.

Hierarchy:

- Description — Command-and-control or top-down organization. Fixed positions with superior/subordinate relationships and strict lines of reporting up the chain of command.

- Strengths — Distinct lines of authority, clear priority setting and minimization of duplicate work.

- Weaknesses — Slower to adjust to drastic changes in business conditions, a difference between holding a formal positions and the ability to make a decision, and prone to siloed thinking.

- Example — Amazon.[1] Market leaders dictate the terms of the market and therefore do not have to adjust to changes imposed by others.

Heterarchy:

- Description — Matrix or bottom-up organization. Positions with formal responsibilities whose reporting lines vary over time and by situation (see "The CIO's Role in Creating an Adaptive Digital Business").

- Strengths — Ability to adjust to changing circumstances, emphasis on the right decision maker for every situation.

- Weaknesses — Complicated and fluid governance can lead to confusion, potential for conflicting decisions. Resolving conflicts takes time.

- Example — Netflix.[2] Loosely coupled functions support the development of new lines of business.

Holacracy:

- Description — Individuals are responsible for deciding how they will contribute to business objectives, workers organize themselves, no people managers, people change leader and follower roles as the situation requires.[3] More easily applied to domains where goals can be decomposed into subtasks that can be assigned self-reliant units. A 2016 Gartner survey found that 22% of mainstream enterprises and 31% of leaders use holacracy (see "Survey Analysis: What Leading Enterprises Do Differently With Talent and Organization").

- Strengths — Autonomy of execution (once an objective has been delegated to someone, they can decide how to achieve the goal within agreed-to constraints), empowerment of workers. Emphasis on creativity, great flexibility.

- Weaknesses — Harder to deploy, given its potential to alienate people, dependence on the goodwill of workers. Corporate policies such as pay scales harder to determine without formal

roles and reporting lines. No explicit mechanism for setting enterprise level strategy and objectives.

- Example — Zappos.[4] Flexibility and worker empowerment enable fast response to customer problems (see "Zappos Embraces 'Holacracy' to Transform Its Workplace Experience").

Each type of organizational structure offers plenty of scope for adjustment. Many enterprises exhibit qualities of two or three types, including other emergent ones (such as wirearchy, fractal and paradoxical). Even within strict command-and-control organizations, some teams may be given more freedom to spur innovation. Gartner's "2018 CEO Survey: CIOs Should Guide Business Leaders Toward Deep-Discipline Digital Business" found that the average CEO has 10.7 direct reports and 6.5 indirect reports, indicating that a blend of hierarchical and heterarchical organizational structures is common. Enterprises can adjust, even within a given organizational structure. For example, reporting lines can be vertical (more managers with fewer direct reports) or flatter (fewer managers with more direct reports). And organizational structures can place their emphasis in different directions, such as:

- **Function-oriented** organizations stress the importance of corporate functions, such as product, finance, marketing and HR, and smooth operations. This structure offers specialization and efficiency.

- **Process-oriented** organizations emphasize getting something done, especially delivering a product or service to customers. This structure focuses on end-to-end responsibility.

- **Product- or service-oriented** organizations concentrate on developing the best possible products and services.

- **Project- or value-oriented** organizations focus on activities that build new offerings and capabilities. This structure extends existing business models (see Level 4 in "ITScore for Strategy and Execution").

An enterprise can adjust its reporting structure or change its emphasis to better support digital business without having to adopt a different type of organization. Instagram's engineering department moved from being organized around different technology domains to being organized around customer-focused processes.[5] The change in structure enabled the organization to overcome roadblocks caused by the various domain teams not knowing what each other was doing.

Figure 2 shows the general suitability of the three organizational types for various strategies and circumstances. Typically, the organizational structure reflects the relative maturity of the business model (third column), with hierarchical organizations having a mature, scalable business model and so on. The strategic focus (second line) often aligns to the emphasis of the organization — function, process and so on. Figure 2 does not offer a definitive statement about which organization type to use when, but serves as a starting point for CIOs to analyze their own enterprise's organizational structure. Any organizational type can be made to work in any situation, but it will take much more effort in some cases.

Figure 2. How Organization Types Fit Various Business Strategies

How Organizational Structures Fit Various Business Models and Emphasis

			Desired Outcome Dictates Emphasis				
			Resource Specialization	End-to-End Focus	Product or Service Excellence		New Offering
		Emphasis on:	Functional	Process	Product	Service	Project/ Value
		Business Model					
Org. Structure Characteristics	Hierarchical	Mature and Scalable	🙂	🙂	🙂	😐	🙁
	Heterarchical	Mature but Evolving	😐	🙂	🙂	🙂	😐
	Holarchical	Immature, Bits and Pieces	🙁	🙁	😐	🙂	🙂

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Source: Gartner (April 2018)

Advise a Change in Organizational Structure If the Business Evolves

CIOs should be prepared to advise that the enterprise change its organizational structure if it doesn't work for digital business, stops working or there's some other change imperative (see "Unleash the Power of Digital Ambition to Realize Your Digital Future"). That is, the weaknesses of the current type start to outweigh the strengths. Some digital businesses change their organizational structure twice or more before getting it right. In 2017, Ford replaced CEO Mark Fields because he was not moving fast enough on digital business and assumed that the existing organization could support it. New CEO Jim Hackett will focus on changing Ford's culture and making the organization less hierarchical.[6]

CIOs should recommend that their enterprise consider switching to a different type of organizational structure if it meets one or more of the following conditions. CIOs should determine whether the new condition has altered the critical success factors for their business model. If it has, the next step is to identify the organizational structure that best supports the new priorities:

- Sudden or foreseen change in external (social, technological, economic, environmental and political) factors, competition, opportunities or regulations drives it. A change to the business strategy, business model or both will affect the operating model and thus the structure (see "Redesign the IT Operating Model to Accelerate Digital Business").

- The strategic objectives (such as business growth, acquisition or divestiture, new product or service lines, and geographic expansion) of the organization change. The more transformative the digital business strategy, the more likely the enterprise will outgrow its organizational structure. A digital business transformation will change fundamental aspects of the business model. For example, the enterprise goes from a product- to a service-focus, which requires changes in finances, delivery tempo and so on. A change in organization structure can reinforce the change in work practices.

- The evolution of the business (such as rising costs, poor performance, talent acquisition and retention, outdated practices, senior leadership changes, organizational culture, operational shifts, and personalities and politics) may require a change in organizational structure. The structure that worked well when the enterprise was a startup may restrict its attempts to scale up. Therefore, the enterprise needs a structure better suited to its size.

- The original organization's culture resists the adoption of the new behaviors that digital business requires, such as risk taking, agile development and rapid decision making. A change of organizational structure may accelerate cultural change by empowering those who champion the new behaviors (see "CIOs Need Organizational Change Management and Change Leadership for Digital Business").

Changing the organizational structure does come with costs. It breaks up some relationships. It hurts productivity during the transition. It may cause some employees to leave. For example, Zappos lost 30% of its workers the year it transitioned to holacracy. However, such a change is probably less risky than most executives imagine. They should weigh the disruptions of change against the lost growth and opportunities if the digital business continues to underperform. Certainly, a number of digital businesses have successfully changed their organizational structure:

- **GitHub —** The company started as a holacracy in which workers could choose their own projects. However, this structure led to duplicated work and a mismatch between these projects and the company's business objectives. In 2014, GitHub switched to a hierarchical organization.[7]

- **Alibaba —** The company changed from a hierarchical organization to a heterarchical organization to speed the development of new digital offerings.[8] The new structure also opened up more opportunities for Alibaba's young managers.

- **Zappos —** The company changed from heterarchy to holacracy to eliminate conflicts and power struggles.

- **Treehouse —** The company started as a hierarchical organization, implemented holacracy, and then switched back after two years.[9] Treehouse returned to a hierarchy because of worker confusion, unfinished projects and a lack of accountability.

Help to Organize the Whole Ecosystem

Most enterprises will pursue digital business within a larger ecosystem of partners. In fact, enterprises have already been building their digital ecosystems during the past several years (see

"The 2017 CIO Agenda: Seize the Digital Ecosystem Opportunity"). Unlike traditional partnerships that belong to the lead enterprise's supply chain, the partners in most ecosystems will cooperate to build a digital business together. No single enterprise will control it. Different partners will contribute to different functions in different degrees, for example, product development, marketing, sales, HR and finance.

Consequently, each enterprise should not simply organize itself for digital business. It must help to organize the operating model of the whole digital ecosystem. The ecosystem must have all of the functions that a conventional enterprise has, and those functions need to be organized effectively. For example, streaming services like Spotify have revised the structure of the music industry by bringing artists, record companies and listeners together on their platform.[10]

Thus, CIOs who are digital business leaders will also need to advise CEOs on the most appropriate organizational structure for the ecosystems that the enterprise participates in. CIOs should think about an ecosystem as if it were an enterprise that needs to account for all functions and the relationships between them. CIOs should commission enterprise architects to gather information about (see "Best Practices for Modeling Business Ecosystems"):

- Which partners participate
- What resources they make available to the ecosystem
- What roles they play
- How they all work together to create value

The enterprise architects can then build a model for the ecosystem. Figure 3 shows a possible model for a hospital ecosystem.

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Figure 3. Model of a Hospital Ecosystem

Relationships in a Hospital Ecosystem

GP = general practitioner

Source: Gartner (April 2018)

Such a model will build trust among participants, which is a necessary ingredient for an effective organization. Some form of heterarchical structure would probably work best for the amount of trust that can be built within a digital ecosystem of diverse partners. Since no single partner controls the ecosystem in most cases, the partners would likely not agree to a hierarchical organization where they would be in a subordinate position. And a holacracy requires more confidence between workers than can be expected of people in different enterprises, each with different work styles.

Recommendations

- Work with the COO, head of HR and business leaders to improve operations for digital business before you recommend changing the organizational structure. You can make significant changes to goals, metrics, incentives, business processes and culture within the current organizational structure (see "The Art of Culture Hacking").

- Assess the status of the enterprise's digital business efforts (see "A CIO's Guide to Gartner's Digital Business Research"). Determine the development phase it has reached: desire, design,

develop, scale or revise. Identify the ambition — optimization, transformation or a combination. Estimate the scale that digital business has reached. This orientation will help you determine which organizational structure to recommend to the executive committee.

- Choose an organizational structure deliberately, based on digital business requirements of the operating model, such as objectives and culture, rather than trying to emulate digital giants (Amazon, Tencent and so on). For example, flatten the organization if you want faster decision making. Shift to a quality orientation if the digital business strategy revolves around the customer experience. Adopt a heterarchy or even holacracy if you need a dramatic increase in agility.

- Avoid superficial reorganizations — for example, moving departments and managers around on the organization chart. Such reorganizations are tempting because they are visible but not as disruptive as changing the organizational structure and/or the operating model. However, they do not change the jobs of frontline employees. Any organizational change should reinforce a change in the way work gets done, such as what people's tasks are and the style or pace of work.

- Be prepared to advise changes to the organizational structure when external factors, strategic objectives, or the evolution of the business or organizations drive a need for them. Don't keep a structure and try to make it work with a little tinkering just because it is familiar and changing it will be hard. There is a competitive advantage to be gained if your organization can learn how to alter its structure as digitally driven changes in the market warrant.

Gartner Recommended Reading

Some documents may not be available as part of your current Gartner subscription.

"The CIO's Role in Creating an Adaptive Digital Business"

"The 2017 CIO Agenda: Seize the Digital Ecosystem Opportunity"

"A CIO's Guide to Gartner's Digital Business Research"

"Digital Business Transformation in Established Organizations: The Third Wave of Enterprise Agility"

"Six Structural Transition Paths to Digital Business Transformation"

"Five Leaderships Skills CIOs Need to Develop Before M&As"

Evidence

The document is based on secondary research into the organizational structures of digital businesses.

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