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note on organizational structure and design

Professors Ann Frost and Lyn Purdy wrote this note solely to provide material for class discussion. The authors do not intend to provide legal, tax, accounting or other professional advice. Such advice should be obtained from a qualified professional.

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A rapidly globalizing economy, ongoing technological change, and deregulation have all contributed to intensifying competition. Old sources of competitive advantage are drying up as technology is now easily copied, monopoly positions give way in the wake of deregulation, and barriers to entry fall. Organizational capabilities are one of the few remaining sources of sustainable competitive advantage. These capabilities come from the way an organization structures its work and motivates its people to achieve its strategic objectives.

This section looks at the fundamental components of organizational structure, outlines some basic organizational forms, discusses the costs and benefits associated with each of them, and highlights the conditions for which particular forms are best suited.

The Purpose of Organizational Structure

Organizational structure has two specific purposes: to divide work into various distinct tasks to be performed and to coordinate these tasks to accomplish the organization’s overall objectives. Breaking activities into smaller parts—differentiation—makes the work easier or enables it to be done more efficiently but, ultimately, these smaller parts must be put back together again to complete the activity—integration.

Differentiation

Differentiation occurs at two levels within the organization. Decision-makers must first decide on the extent of horizontal and vertical specialization of an individual job—the breadth of the job in terms of how many separate tasks will be assigned to the job, and the depth of the job in terms of how much planning, conception, execution, and administrative activities are included. Decision-makers must also determine the groupings of jobs that make the most sense for the organization based on the goods and services it produces; the geographic or client markets it serves; and the skills, knowledge, and expertise the organization needs to produce its product. Extreme differentiation or specialization creates greater expertise, builds economies of scale, and focuses attention. However, it tends to produce monotonous work, narrow interests, and the need for higher levels of integration to bring the specialized parts back together to form a whole.

Integration

Differentiation provides the organization with efficiency through the division of labour and aligns group goals within specific areas. However, to make the whole organization effective, various tasks, departments, and subunits must be integrated—the greater the degree of differentiation and the greater the interdependence, the greater the need for integration. Various mechanisms can be used to accomplish this objective. The right one will depend on the amount of integration needed.

As the need for interaction, information flow, and coordination increases, the integration process becomes more resource intensive. At low levels, rules and procedures suffice to coordinate activities. Similarly, planning and hierarchy serve well at fairly low levels. As the need for integration rises, liaison roles, task forces, and teams become necessary to deal with more non-standard integration needs. Finally, at the most extreme level, whole integrating departments may become necessary to oversee the coordination of activities between groups.

Organizational Structure—Basic Forms

The three basic organizational forms are the functional, the divisional, and the matrix.[[1]](#footnote-1) Each is designed to deal with different challenges—size of organization, complexity of environment, multiplicity of markets served, and so on. An organization rarely appears in the pure form of any of these types; however, most organizations basically conform to one of them. Knowing the basic characteristics of these forms can provide a manager with considerable insight.

The Functional Form

When organizations are grouped by function, positions are grouped based on particular skills or processes (see Figure 1). For example, all accountants would be grouped together, all engineers would be grouped together, and all marketing personnel would be grouped together. With this approach, the work of the organization is divided so that a single group handles each part (or function). Each function or department becomes differentiated and adopts similar values, goals, and orientation, encouraging collaboration, innovation, and quality within the department. This differentiation may, however, make coordination with other departments more difficult.

Figure 1: The Functional Form

The activities of all these groups must be put together in order to accomplish the overall goal of the organization. This integration requires information processing among the different functional groups. Procedures need to be developed to coordinate work in order to produce the organization’s final product. In a stable environment, coordination may be relatively easy, but in a rapidly changing environment, it becomes increasingly difficult.

The advantages of grouping by function are the following:

1. Resources are used efficiently (there is no duplication of equipment or efforts).
2. Professional development is promoted (group members can learn from one another and career paths are obvious).
3. Socialization and evaluation take place in a comfortable setting (interaction between people of similar interests and backgrounds is done with ease, and evaluations are conducted by someone knowledgeable in the area).

In grouping by function, some disadvantages that emerge are poor intergroup coordination, the goals of the organization becoming secondary to the goals of the functional group, diffused accountability for the final product or service of the organization, and a tendency for a more formalized and less flexible organization as work is strictly divided between functions. Overall, this form is best suited for small to medium-sized organizations that produce a single or closely related set of products and services.

The Divisional Form

The divisional structure is organized by the outputs the organization produces. Each division is responsible for different products, geographic markets, or clients. Regardless of the basis on which it is organized, the division is a self-contained unit with all the functional areas necessary to serve its specified market (see Figure 2). For example, General Motors Company, a divisional organization based on product market groups, has separate divisions for cars and trucks, each of which has all of the necessary marketing, sales, production, accounting, engineering, and distribution personnel required to produce and sell its set of products.

Figure 2: Divisional Form by Product

The divisional structure is excellent when the predominant goal of the organization is to respond effectively to satisfy clients in a particular market segment. Because each division has the necessary complement of skills, it can respond quickly to the changing needs of its market. Moreover, corporate control can be more effectively exerted because each division can be held accountable for its own performance.

The advantages of the divisional form are the following:

1. There is good coordination of activities—everyone who is responsible for a single product is grouped together and the groups are relatively small.
2. Attention is directed more at the organizational goal and less at the individual functional group goals.

There is increased flexibility (organizations can respond to changes in their markets by adding or deleting divisions as required with little negative impact on other parts of the organization).

The divisional form also has drawbacks:

1. There is often duplication of resources across the organization.
2. Professional development is not as clear in terms of career paths and in terms of developing specialized talents.
3. The setting for socialization and evaluation is less comfortable (evaluations may become particularly problematic because individuals may be evaluated by someone with little expertise in their area).

The divisional form works best in medium- or large-sized organizations that operate in heterogeneous environments and produce multiple products, serve different customers, and sell products in different geographic regions.

The Matrix Form

Matrix structures combine both functional and divisional forms (see Figure 3). In some instances, organizations want the benefits of both forms: the deep technological expertise within functions, and the coordination across functions. In a matrix structure, all organizational members maintain a home base in a functional group while working on projects for specific products, regions, or clients. Individuals can be involved with several projects and with tasks for the functional group. As they complete projects, individuals return—either physically or with respect to time—to their functional base for reassignment. The intention of the matrix structure is to reap the advantages of the divisional form and the functional form, and to avoid the pitfalls of either form. The advantages of the matrix structure are the following:

1. It adapts easily to a changing workload (projects are added and deleted as required).
2. Resources are used efficiently (there is no need to duplicate specialists across projects).
3. It provides a home base for specialists (expertise can be pooled).
4. There is flexibility for employees and variety in their task assignments.
5. It promotes innovation (people with diverse backgrounds are drawn together on projects).

The matrix structure does, however, have its own set of drawbacks, including the following:

1. A high degree of dependency on teamwork exists, which may not be the preferred situation for all individuals.
2. Individuals may experience conflict—should one listen to the project manager or the functional manager if priorities conflict?—and uncertainty often exists with regard to evaluation—will the functional manager or the project manager do the evaluation?
3. Power struggles often arise between project groups and between project and functional groups in determining personnel assignments to tasks.
4. A lack of stability in the work environment for individuals exists owing to the constant change of projects and the variation in time demands.
5. The cost for administering these structures (tracking of individuals, constant renegotiation for project assignments, and other administrative tasks) is relatively high.

Figure 3: Matrix Form

The matrix structure is the ideal structure under the following conditions. First, a matrix structure is appropriate when the organization faces environmental pressures from two sources, such as function and product or function and region. In cases such as these, the dual authority structure is needed to balance these pressures. Second, it is well suited to when the firm is in an uncertain and complex task environment. In such instances, the matrix provides the organization with the requisite responsiveness. Finally, the matrix form is well suited to situations in which the firm requires economies of scale in the use of internal resources.

Holacracy

The newest development in organizational design is the advent of holacracy. Emerging from roots in the agile movement in the software development industry, holacracy is a radical departure from the organizational designs of the past century, with their reliance on hierarchy and their need for management. Instead, holacracy distributes authority and decision-making to those doing purpose-driven work using a system of interlocking teams (or “circles”) that form and disband as dictated by the required work. The people in the organization, from the top to the front lines, assume these roles and are then free to make all of the decisions associated with that role, and to propose changes to a role as they individually see fit according to the process rules of holacracy. In the language of holacracy, the philosophy is centred on roles, not souls.[[2]](#footnote-2) Through this, holacracy makes companies more agile and able to better respond to, and benefit more from the ongoing flux in the competitive environment.

Holacracy is the creation of Brian J. Robertson, a serial software entrepreneur who started and sold three companies, yet remained unsatisfied each time with how his company became less efficient as it took on more employees.[[3]](#footnote-3) Robertson spent considerable time experimenting with different versions of traditional organizational designs before realizing that what he was searching for—a way to maintain the autonomy, flexibility, and decision-speed in start-up organizations as they grew larger—did not exist. In the ever-changing, dynamic software environment, traditional organizational designs proved too cumbersome and slow.

Robertson was heavily influenced by the work of philosopher Bertrand Russell and organizational theorist Elliott Jaques. Robertson was drawn to the thinking of Russell, who wrote that “everything is vague to a degree you do not realize until you have tried to make it precise,”[[4]](#footnote-4) and to that of Jaques, who wrote that there is always a tension between the formal organizational-chart structure and the actual or “extant” structure of an organization.[[5]](#footnote-5) Robertson’s experience with his own new ventures was that the solution to scaling the start-up culture to larger, more mature organizations was to create an organizational design based on simple rules for recognizing, articulating, and creating the tasks that needed to be accomplished in an organization, and then giving people the authority to adapt their professional roles to these new tasks at their own discretion.

Holacracy is organized around a set of interrelated circles or teams devoted to completing a common task or project. Circles are linked, distributing authority throughout the organization, and as circles are formed and disbanded based on what work needs to be done, they keep the organization lean and adaptable. The circles are run democratically and openly with detailed procedures on how decisions are to be made and meetings run. In holacracy, there are no job titles, only roles. There are no managers. Decisions are made by consent, not by consensus, which means that not everyone has to agree before action is taken—no one can bring evidence to persuade the others that such action is a bad idea. The latter is an important distinction, enabling decisions to be made quickly and then altered if need be once disconfirming evidence comes to light. The benefits of holacracy include organizational agility and flexibility, responsiveness to an ever-changing environment, and an ability to adapt as necessary to external demands.

Holacracy is designed to relieve employees of managerial and oversight work that does not directly contribute to getting work done. As such, it has similarities to Lean management systems that focus only on doing what directly contributes to getting work done. By making three key changes to an organization—(1) organizing the work to be done by roles, (2) associating specific accountabilities to those roles, and (3) giving the person assuming the role all authority to make decisions required for that role—holacracy seeks to increase transparency and reduce decision-making time. It is not intended as a way to work more efficiently; it is a system for organizing more efficiently. This means that under holacracy it takes the same amount of time to complete a task like planning a marketing campaign, hiring an employee, or changing how salaries and promotions are calculated. However, it reduces the time it takes to make the decisions involved in those tasks. With clear role assignments and accountability, there are no more of the committee meetings, email inquiries, boss check-ins, or political machinations that have become normal in most organizations.

Holacracy sits in stark contrast to traditional hierarchies in which the organizational structure tends to push accountability upward and requires people who do the work to continually seek authority to make decisions. This results in lost time, a lack of ownership, and low levels of accountability regarding decisions. Such a system can encourage bad habits for both management and employees when the more powerful enjoy the advantages of power and the less powerful are let off the hook by having little or no accountability. Both of these outcomes can be barriers to the successful implementation of holacracy. At the top, senior leaders may be reluctant to let go of their authority over decisions; middle managers may be similarly unwilling to give up their decision-making roles; front-line employees may be unaccustomed to or uncomfortable with assuming full accountability for their decisions and subsequent actions. Together, these factors can prevent an organization from adopting holacracy. Or, perhaps even worse, an organization may face implementation failure by underestimating the scale of change holacracy demands from those in the organization.

To date, holacracy has mainly found a home in technology-oriented start-up firms. In December 2013, however, the online shoe and fashion retailer Zappos.com announced it was eradicating its existing organizational design and replacing it with holacracy. Throughout 2014, Chief Executive Officer Tony Hsieh worked through the implementation of the design at the firm’s 1,500-employee Las Vegas headquarters. Many await a verdict on how well the new organizational design will fare.

Implications of Organizational Structure for Managers

Organizational structure is a key component in creating the unique and difficult to imitate capabilities that organizations now require for sustainable competitive advantage.[[6]](#footnote-6) Organizational structure is important, too, at a more micro level. For individual managers, the redesign or restructuring of their own areas of responsibility has the potential to fundamentally change patterns of performance. Organizational-design decisions define where an organization channels its resources; where and how information flows; and how it defines jobs, shapes work processes, motivates performance, and moulds informal interactions between people over time. A manager will be judged on the basis of how well his or her area performs. An understanding of organizational design helps a manager do his or her job effectively.

1. Ethan S. Bernstein and Nitin Nohria, *Note on Organizational Structure* (Boston, MA: Harvard Business School, 1991). Available from Ivey Publishing, product no. 491083. [↑](#footnote-ref-1)
2. Brian J. Robertson, *Holacracy: The New Management System for a Rapidly Changing World* (New York, NY: Henry Holt and Company, 2015). [↑](#footnote-ref-2)
3. Ibid. [↑](#footnote-ref-3)
4. Bertrand Russell, “Vagueness,” *Australasian Journal of Psychology and Philosophy* 1, no. 2 (June 1923): 84–92, www.tandfonline.com/doi/abs/10.1080/00048402308540623. [↑](#footnote-ref-4)
5. Eliott Jaques, *Requisite Organization: Total System for Effective Managerial Organization and Managerial Leadership for the 21st Century* (London, UK: Gower Publishing Ltd., 1997). [↑](#footnote-ref-5)
6. David A. Nadler and Michael L. Tushman, *Competing by Design: The Power of Organizational Architecture* (New York, NY: Oxford University Press, 1997). [↑](#footnote-ref-6)