Chapter **11**

Organizational Design: Structure, Culture, and Control

Chapter Outline

Learning Objectives

LO 11-1 Define organizational design and list its three components.

LO 11-2 Explain how organizational inertia can lead established firms to failure.

LO 11-3 Define organizational structure and describe its four elements.

LO 11-4 Compare and contrast mechanistic versus organic organizations.

LO 11-5 Describe different organizational structures and match them with appropriate strategies.

LO 11-6 Describe the elements of organizational culture, and explain where organizational cultures can come from and how they can be changed.

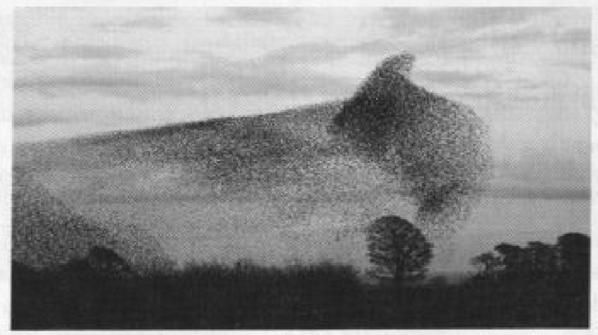
LO 11-7 Compare and contrast different strategic control-and-reward systems.

CHAPTERCASE 11 /

Zappos: From Happiness to Holacracy

DELIVERING HAPPINESS is the title of *The New York Times* bestseller by Tony Hsieh, CEO of Zappos, the online shoe and clothing store (www.zappos.com). Today, Zappos stocks more than 3 million shoes, handbags, clothing items, eyewear, and accessories from over 1,200 brands. Shoes continue to be the main business for Zappos, bringing in some three-quarters of revenues and making it the world's largest shoe store. Delivering happiness is also Zappos' mission. The company is known for "delivering WOW through service," providing a positive online shopping experience including free shipping to and from its customers, including a generous 365-day return policy.

In addition to making customers happy, Zappos has also made its investors happy. In 2008, just 10 years after its founding, Zappos achieved more than $1 billion in annual sales. In 2009, Amazon.com acquired the company for $1.2 billion. Although now a subsidiary of Amazon, Zappos continues to operate as an independent brand, as Amazon maintains a hands-off policy. Instead of top-down management from Amazon, if anything, new ideas flow from Zappos up to its parent. One example is Zappos' novel approach to weed out cultural misfits by paying employees to leave after the orientation program. Amazon recently implemented a similar program for its warehouse workers.



A flock of birds in flight, immediately shifting direction with self-regulating unity, frequently serves as a poetic symbol of holacracy in action.
© greatonmywall / Alamy

Zappos has grown so much—receiving over 20 million unique visitors a month to its website—that it sometimes reorganizes to offer the best customer service possible. At one point, to keep the organization flat and responsive to customers, Zappos restructured into 10 separate business units including Zappos.com, Zappos Gift Cards, Zappos IP, and 6pm.com, among others. This step, however, was not sufficient to accommodate the rapid growth, as employee productivity was declining. To continue to make its customers, employees, and other stakeholders happy, Zappos is redesigning its structure radically to create a unique organization that is even more responsive to its customers' needs as well as external and internal changes. Zappos CEO Tony Hsieh decided to implement a radically new structure called *holacracy*, and explains why:

> Research shows that every time the size of a city doubles, innovation or productivity per resident increases by 15 percent. But when companies get bigger, innovation or productivity per employee generally goes down. So we're trying to figure out how to structure Zappos more like a city and less like a bureaucratic corporation. In a city, people and businesses are self-organizing. We're trying to do the same thing by switching from a normal hierarchical structure to a system called Holacracy, which enables employees to act more like entrepreneurs and self-direct their work instead of reporting to a manager who tells them what to do.[1]

This focus explains why Zappos is implementing holacracy, but what exactly is it? Often compared to a computer's operating system, holacracy provides a new organizational structure for governing and running a company. Because it greatly changes how workers interact, proponents hail it as a "social technology." It was developed by Brian Robertson in the 2000s, who was working from ideas introduced by Arthur Koestler in the 1967 book, *The Ghost in the Machine*, the work in which Koestler coined the term *holacracy*.[2] Rather than relying on a traditional top-down hierarchical management structure, holacracy attempts to achieve control and coordination by distributing power and authority to self-organizing groups (so-called circles) of employees. Circles of employees are meant to self-organize and own a specific task, such as confirming online orders or authorizing a customer's credit card.

At this point of its reorganization, Zappos grouped its over 1,500 employees in some 400 circles, with each employee in two or more circles. Order is supposed to emerge from the bottom up, rather than rely on top-down command and control as in traditional organizational structures.

How? Rules are explicit in a so-called constitution, which defines the power and authority of each circle. For coordination, the employee circles overlap horizontally, and without vertical hierarchy. Teams in circles of employees self-organize and self-govern. The CEO's last act as the highest-ranking person in the organization is to sign the constitution in a symbolic act, relinquishing all executive powers. Thereafter the former leader becomes the "ratifier of the holacracy constitution." All this is done to serve the overarching goal of achieving rapid organizational evolution and adaptation to constantly changing external and internal environments. Exhibit 11.1 provides an overview comparing a traditional organizational structure with holacracy.

As often happens, a new organizational structure sounds great in theory, but proves hard to implement. In fact, Zappos is the first large corporation to try; previously firms adopting the approach tended to be small startups and nonprofits. Robertson, the inventor of holacracy as organizational form, ran a software company of 12 people where he tested his ideas. Twitter co-founder Evan Williams is a fan; he implemented holacracy—not at Twitter, but at his *new* venture, Medium, a blog-publishing platform. With Zappos the first large corporation attempting to make a wholesale switch to this approach, curiosity remains high as to how it will play out.[3]

You will learn more about Zappos by reading this chapter; related questions appear on page 392.

EXHIBIT 11.1 / Traditional Organizational Structure vs. Holacracy

Source: Adapted from Robertson, B. (2015), *Holacracy: The New Management System for a Rapidly Changing World* (New York: Henry Holt).

Traditional Organizational Structure	Holacracy
Static job description	Dynamic roles
Top-down	Self-organizing teams
Hierarchical decision making	Employee senses tension as dissonance between *what is* (current reality) and *what could be* (the purpose). How to resolve tension is worked out in circle meetings.
Formal authority	Distributed authority
Command and control	Employee autonomy
Functional areas	Employee circles
Alignment via politics	Transparent rules defined in constitution
Large scale re-organizations	Rapid, fluid, and constant iterations

ZAPPOS CEO TONY HSIEH believes that about one-half of all retail transactions in the United States will be online soon, and that people will buy from the company with the best customer service and best selection. His strategic intent for Zappos is to be that online store, to differentiate itself from the competition with superior service and selection. Hsieh remains unusually thoughtful about what type of structure, culture, and processes will advance that strategy. He initially designed Zappos as a flat organization to help Zappos provide exceptional service, and he continued to refine its organizational design through trial and error, with transparency, while nurturing a supportive culture by soliciting bottom-up feedback. And he celebrated the emphasis on happiness as noted in his book, with the understanding that happy employees are productive employees.

Yet, a loss of productivity and increased bureaucracy could not be avoided as the company grew and matured. To move Zappos forward, in 2014 Hsieh proposed a new organizational

structure called **holacracy**, a form of social technology that Hsieh believes will allow Zappos to pursue its purpose of delivering happiness and WOW through customer service.

holacracy An organizational structure in which decision-making authority is distributed through loose collections or circles of self-organizing teams.

This chapter opens the final part of the *AFI framework:* strategy implementation. *Strategy implementation* concerns the organization, coordination, and integration of how work gets done. (See discussion in Chapter 2.)

Effective strategy implementation is critical to gaining and sustaining competitive advantage. Although the discussion of *strategy formulation* (what to do) is distinct from *strategy implementation* (how to do it), formulation and implementation must be part of an interdependent, reciprocal process in order to ensure continued success. That need for interdependence explains why the AFI framework is illustrated as a circle, rather than a linear diagram (see page 365). The design of an organization, the matching of strategy and structure, and its control-and-reward systems determine whether or not an organization that has chosen an effective strategy will be able to gain and sustain a competitive advantage. As discussed in the ChapterCase, Zappos pursues a differentiation strategy at the business level, which it is now implementing internally and structurally through holacracy. Whether Zappos' strategy implementation will be successful or not remains to be seen.

In this chapter, we study the three key levers that managers have at their disposal when designing their organizations for competitive advantage: *structure, culture,* and *control.* Managers employ these three levers to coordinate work and motivate employees across different levels, functions, and geographies. How successful they are in this endeavor determines whether they are able to translate their chosen business, corporate, and global strategy into strategic actions and business models, and ultimately whether the firm is able to gain and sustain a competitive advantage.

We begin our discussion with organizational structure. We discuss different types of organizational structures as well as why and how they need to change over time as successful firms grow in size and complexity. We highlight the critical need to match strategy and structure, and then take a closer look at corporate culture. An organization's culture can either support or hinder its quest for competitive advantage.[4] We next study strategic control systems, which allow managers to receive feedback on how well a firm's strategy is being implemented. We conclude our discussion of how to design an organization for competitive advantage with practical "Implications for the Strategist."

11.1 Organizational Design and Competitive Advantage

LO 11-1 Define organizational design and list its three components.

Organizational design is the process of creating, implementing, monitoring, and modifying the structure, processes, and procedures of an organization. The key components of organizational design are structure, culture, and control. The goal is to design an organization that allows managers to effectively translate their chosen strategy into a realized one.

organizational design The process of creating, implementing, monitoring, and modifying the structure, processes, and procedures of an organization.

Not surprisingly, the inability to implement strategy effectively is the number-one reason boards of directors fire CEOs.[5] Yahoo's co-founder and CEO Jerry Yang was ousted in 2008 precisely because he failed to implement necessary strategic changes after Yahoo lost its competitive advantage.[6] In the two years leading up to his exit, Yahoo lost more than 75 percent of its market value. Yang was described as someone who preferred consensus among his managers to making tough strategic decisions needed to change Yahoo's structure. That preference, though, led to bickering and infighting. Yang's failure to make the necessary changes to the Internet firm's organizational structure led to a destruction of billions of dollars in shareholder value and thousands of layoffs. Once a leader in online search, Yahoo is struggling to make a comeback. A number of short-term and interim CEOs followed Yang without much success. Then in 2012, as detailed in ChapterCase 2, Yahoo tapped former Google executive Marissa Mayer as president and CEO; Mayer's turnaround efforts hinge on improving the user experience to drive mobile advertising revenues. Such changes in strategy required changes in structure as well.

Because strategy implementation transforms strategy into actions and business models, it often requires changes within the organization. However, strategy implementation often fails because managers are unable to make the necessary changes due to the effects on resource allocation and power distribution within an organization.[7] Managers are leery to disturb the status quo.

As demonstrated by business historian Alfred Chandler in his seminal book *Strategy and Structure,* organizational structure must follow strategy in order for firms to achieve superior performance: "Structure can be defined as the design of organization through which the enterprise is administered . . . *structure follows strategy*."[8] This tenet implies that to implement a strategy successfully, organizational design must be flexible enough to accommodate the formulated strategy and future growth and expansion.

Featured in the ChapterCase, Zappos provides an example of a company with flexible organizational structure. When establishing customer service as a core competency, one of the hardest decisions Hsieh made early was to pull the plug on drop-shipment orders. These are orders for which Zappos would be the intermediary, relaying them to particular shoe vendors who then ship directly to the customer. Such orders were profitable because Zappos would not have to stock all the shoes. They were also appealing because the fledgling startup was still losing money. But the problem was twofold. The vendors were slower than Zappos in filling orders. In addition, they did not accomplish the reliability metric that Zappos wanted for exceptional service: 95 percent accuracy was simply not good enough! Instead, Zappos decided to forgo drop shipments and instead built a larger warehouse in Kentucky to stock a full inventory. This move enabled the firm to achieve close to 100 percent accuracy in its shipments, many of which were overnight. Unlike other online retailers, Zappos stocks everything it sells in its own warehouses—this is the only way to get the merchandise as quickly as possible with 100 percent accuracy to the customer. Strategy, therefore, is as much about deciding what to do as it is about deciding what *not* to do.

LO 11-2

Explain how organizational inertia can lead established firms to failure.

ORGANIZATIONAL INERTIA: THE FAILURE OF ESTABLISHED FIRMS

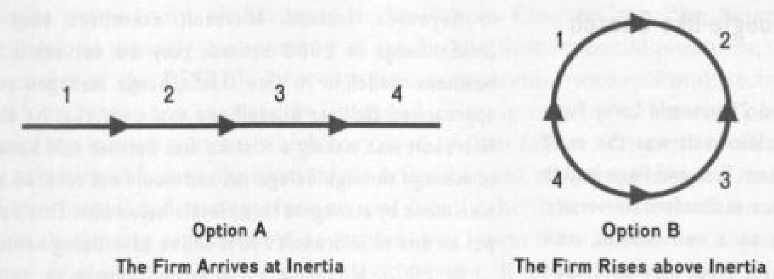
To implement a formulated business strategy successfully, structure must accommodate strategy, not the other way around. In reality, however, a firm's strategy often follows its structure.[9] This reversal implies that some managers consider only strategies that do not change existing organizational structures; they do not want to confront the inertia that often exists in established organizations.[10] **Inertia**, a firm's resistance to change the status quo, can set the stage for the firm's subsequent failure. Successful firms often plant the seed of subsequent failure: They optimize their organizational structure to the current situation. That tightly coupled system can break apart when internal or external pressures occur.

inertia A firm's resistance to change the status quo, which can set the stage for the firm's subsequent failure.

Note that organizational inertia is often the result of success in a particular market during a particular time; it becomes difficult to argue with success. The pattern for successful firms often follows a particular path:

1. Mastery of, and fit with, the current environment.
2. Success, usually measured by financial measurements.
3. Structures, measures, and systems to accommodate and manage size.
4. A resulting organizational inertia that tends to minimize opportunities and challenges created by shifts in the internal and external environment.

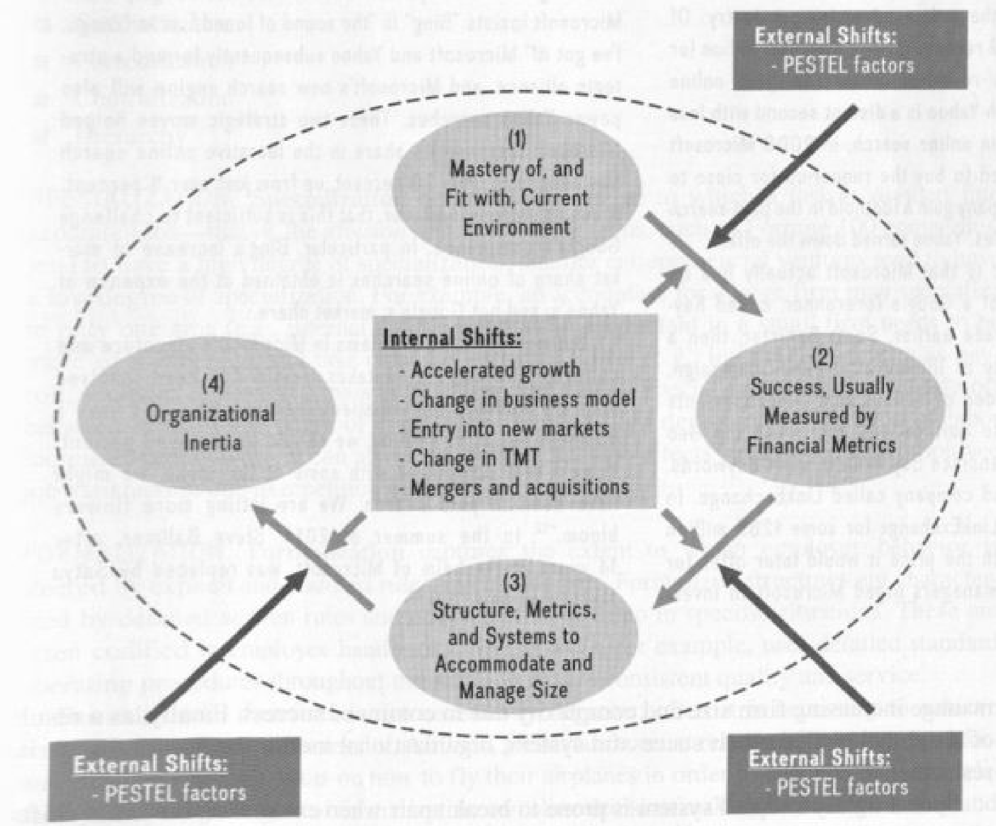
What's missing, of course, is the conscious strategic decision to change the firm's internal environment to fit with the new external environment, turning four steps leading to the endpoint of inertia (Option A) into the kind of a virtual circle where the firm essentially reboots and reinvents itself (Option B).



Consider that the need for structural reorganization can be especially intense in many industries where the rate of change is high and potential disruption frequent. Consider also that business leaders find it much easier to create and manage within developed structures than to restructure their organizations to be where they will need to be in future.

Exhibit 11.2 shows how success in the current environment can lead to a firm's downfall in the future, when the tightly coupled system of strategy and structure experiences internal or external shifts.[11] First, the managers achieve a mastery of, and fit with, the firm's current environment. Second, the firm often defines and measures success by financial metrics, with a focus on short-term performance (see discussion in Chapter 5). Third, the firm puts in place structures, metrics, and systems to accommodate and

EXHIBIT 11.2 Organizational Inertia and the Failure of Established Firms to Respond to Shifts in the External or Internal Environments



Strategy Highlight 11.1

The Premature Death of a Google-like Search Engine at Microsoft

In 1998, 24-year-old Sergey Brin and 25-year-old Larry Page founded Google. At the same time, Microsoft was the most valuable technology company of all time. Brin and Page met as graduate students in computer science at Stanford University, where they began working together on a web crawler, with the goal of improving online searches. What they developed was the PageRank algorithm, which returns the most relevant web pages more or less instantaneously and ranks them by how often they are referenced on other important web pages. A clear improvement over early search engines such as AltaVista, Overture, and Yahoo, all of which indexed by keywords, the PageRank algorithm is able to consider 500 million variables and 3 billion terms. What started as a homework assignment launched the two into an entrepreneurial venture when they set up shop in a garage in Menlo Park, California.

Today, Google is the world's leading online search company with 65 percent market share in the United States and over 90 percent in Europe. It leverages this dominant position into leadership in the online advertising industry: Of some $70 billion in annual revenues, more than $60 billion (or 90 percent) of Google's revenues come from paid online search advertising. Though Yahoo is a distant second with less than a 15 percent share in online search, in 2008 Microsoft CEO Steve Ballmer offered to buy the runner-up for close to $50 billion to help his company gain a foothold in the paid-search business where Google rules. Yahoo turned down the offer.

What haunts Ballmer is that Microsoft actually had its own working prototype of a Google forerunner, called Keywords, more than a decade earlier. Scott Banister, then a student at the University of Illinois at Urbana-Champaign, had come up with the idea of adding paid advertisements to Internet searches. He quit college and drove his Geo hatchback to the San Francisco Bay Area to start Keywords, later joining an online ad company called LinkExchange. In 1998, Microsoft bought LinkExchange for some $265 million (about one two-hundredth the price it would later offer for Yahoo). LinkExchange's managers urged Microsoft to invest in Keywords. Instead, Microsoft executives shut down LinkExchange in 2000 because they did not see a viable business model in it. One LinkExchange manager actually approached Ballmer himself and explained that he thought Microsoft was making a mistake. But Ballmer said he wanted to manage through delegation and would not reverse a decision made by managers three levels below him. This decision put an end to Microsoft's first online advertising venture.

In 2003, Microsoft got a second chance to enter the online advertising business when some mid-level managers proposed buying Overture Services, an innovator in combining Internet searches with advertisements. This time, Ballmer, joined by Microsoft co-founder Bill Gates, decided not to pursue the idea because they thought Overture was overpriced. Shortly thereafter, Yahoo bought Overture for $1.6 billion.

Having missed two huge opportunities to pursue promising strategic initiatives that emerged from lower levels within the firm, Microsoft has been playing catch-up in online search and advertising ever since. In the summer of 2009, it launched its own search engine, Bing. Industry pundits joked that Bing is an acronym for "Because It's Not Google," while Microsoft insists "Bing" is "the sound of found," as in "Bingo, I've got it!" Microsoft and Yahoo subsequently formed a strategic alliance, and Microsoft's new search engine will also power Yahoo searches. These two strategic moves helped Microsoft increase its share in the lucrative online search business to roughly 20 percent, up from just over 8 percent. It seems unlikely, however, that this is sufficient to challenge Google's dominance. In particular, Bing's increase in market share of online searches is obtained at the expense of Yahoo's, and not Google's, market share.

Ballmer admitted problems in Microsoft's structure and culture: "The biggest mistakes I claim I've been involved with are where I was impatient—because we didn't have a business yet in something, we should have stayed patient. If we'd kept consistent with some of the ideas, we might have been in paid search. We are letting more flowers bloom."[12] In the summer of 2014, Steve Ballmer, after 14 years at the helm of Microsoft, was replaced by Satya Nadella as new CEO.[13]

manage increasing firm size and complexity due to continued success. Finally, as a result of a tightly coupled albeit successful system, organizational inertia sets in—and with it, resistance to change.

Such a tightly coupled system is prone to break apart when external and internal shifts put pressure on the system.[14] In Exhibit 11.2, inside the oval, the longer internal arrows show the firm's tightly coupled organizational design over time. The shorter internal arrows indicate pressures radiating from internal shifts such as accelerated growth, a change in the business model, entry into new markets, a change in the top management team (TMT), or mergers and acquisitions. Accelerated growth, for example, was the reason for a decline in employee productivity, as discussed in the Zappos ChapterCase. The longest arrows pointing into and piercing the boundary of the firm indicate external pressures, which can stem from any of the PESTEL forces (political, economic, sociocultural, technological, ecological, and legal, as discussed in Chapter 3). Strong external or internal pressure can break apart the current system, which may lead to firm failure. To avoid inertia and possible organizational failure, the firm needs a flexible and adaptive structure to effectively translate the formulated strategy into action. Ideally the firm would maintain a virtuous cycle of reconsidering organization, as implied by Option B earlier in the chapter.

Strategy Highlight 11.1 provides a case in point. It shows how Microsoft's strategy and decision-making process were negatively affected by organizational inertia due to its success and dominance in the Windows-based PC world.

ORGANIZATIONAL STRUCTURE

LO 11-3
Define organizational structure and describe its four elements.

Some of the key decisions managers must make when designing effective organizations pertain to the firm's **organizational structure.** That structure determines how the work efforts of individuals and teams are orchestrated and how resources are distributed. In particular, an organizational structure defines how jobs and tasks are divided and integrated, delineates the reporting relationships up and down the hierarchy, defines formal communication channels, and prescribes how individuals and teams coordinate their work efforts. The key building blocks of an organizational structure are:

- Specialization
- Formalization
- Centralization
- Hierarchy

organizational structure
A key to determining how the work efforts of individuals and teams are orchestrated and how resources are distributed.

specialization
An organizational element that describes the degree to which a task is divided into separate jobs (i.e., the division of labor).

SPECIALIZATION. **Specialization** describes the degree to which a task is divided into separate jobs—that is, the *division of labor.* Larger firms, such as Fortune 100 companies, tend to have a high degree of specialization; smaller entrepreneurial ventures tend to have a low degree of specialization. For example, an accountant for a large firm may specialize in only one area (e.g., internal audit), whereas an accountant in a small firm needs to be more of a generalist and take on many different things (e.g., internal auditing, plus payroll, accounts receivable, financial planning, and taxes). Specialization requires a trade-off between breadth and depth of knowledge. While a high degree of the division of labor increases productivity, it can also have unintended side-effects such as reduced employee job satisfaction due to repetition of tasks.

formalization
An organizational element that captures the extent to which employee behavior is steered by explicit and codified rules and procedures.

FORMALIZATION. **Formalization** captures the extent to which employee behavior is steered by explicit and codified rules and procedures. Formalized structures are characterized by detailed written rules and policies of what to do in specific situations. These are often codified in employee handbooks. McDonald's, for example, uses detailed standard operating procedures throughout the world to ensure consistent quality and service.

Formalization, therefore, is not necessarily negative; often it is necessary to achieve consistent and predictable results. Airlines, for instance, must rely on a high degree of formalization to instruct pilots on how to fly their airplanes in order to ensure safety and reliability. Yet a high degree of formalization can slow decision making, reduce creativity and innovation, and hinder customer service.[15] Most customer service reps in call centers, for example, follow a detailed script. This is especially true when call centers are outsourced to overseas locations. Zappos deliberately avoided this approach when it made customer service its core competency.

centralization An organizational element that refers to the degree to which decision making is concentrated at the top of the organization.

CENTRALIZATION. **Centralization** refers to the degree to which decision making is concentrated at the top of the organization. Centralized decision making often correlates with slow response time and reduced customer satisfaction. In decentralized organizations such as Zappos, decisions are made and problems solved by empowered lower-level employees who are closer to the sources of issues.

Different strategic management processes (discussed in Chapter 2) match with different degrees of centralization:

- Top-down strategic planning takes place in highly centralized organizations.
- Planned emergence is found in more decentralized organizations.

Whether centralization or decentralization is more effective depends on the specific situation. During the Gulf of Mexico oil spill in 2010, BP's response was slow and cumbersome because key decisions were initially made in its UK headquarters and not onsite. In this case, centralization reduced response time and led to a prolonged crisis. In contrast, the FBI and the CIA were faulted in the 9/11 Commission Report for *not being centralized enough*.[16] The report concluded that although each agency had different types of evidence that a terrorist strike in the United States was imminent, their decentralization made them unable to put together the pieces to prevent the 9/11 attacks.

hierarchy An organizational element that determines the formal, position-based reporting lines and thus stipulates who reports to whom.

HIERARCHY. **Hierarchy** determines the formal, position-based reporting lines and thus stipulates *who reports to whom.* Let's assume two firms of roughly equal size: Firm A and Firm B. If many levels of hierarchy exist between the frontline employee and the CEO in Firm A, it has a *tall structure.* In contrast, if there are few levels of hierarchy in Firm B, it has a *flat structure.*

span of control The number of employees who directly report to a manager.

The number of levels of hierarchy, in turn, determines the managers' **span of control**—how many employees directly report to a manager. In tall organizational structures (Firm A), the span of control is narrow. In flat structures (Firm B), the span of control is wide, meaning one manager supervises many employees. In recent years, firms have de-layered by reducing the headcount (often middle managers), making themselves flatter and more nimble. This, however, puts more pressure on the remaining managers who have to supervise and monitor more direct reports due to an increased span of control.[17] Recent research suggests that managers are most effective at an intermediate point where the span of control is not too narrow or too wide.[18]

LO 11-4 Compare and contrast mechanistic versus organic organizations.

MECHANISTIC VS. ORGANIC ORGANIZATIONS

Several of the building blocks of organizational structure frequently appear together, creating distinct organizational forms—mechanistic or organic organizations.[19]

mechanistic organization Characterized by a high degree of specialization and formalization and by a tall hierarchy that relies on centralized decision making.

MECHANISTIC ORGANIZATIONS. **Mechanistic organizations** are characterized by a high degree of specialization and formalization and by a tall hierarchy that relies on centralized decision making. The fast food chain McDonald's fits this description quite well. Each step of every job such as deep-frying fries is documented in minute detail (e.g., what kind of vat, the quantity of oil, how many fries, what temperature, how long, and so on). Decision power is centralized at the top of the organization: McDonald's headquarters provides detailed instructions to each of its franchisees so that they provide comparable quality and service across the board although with some local menu variations.

Communication and authority lines are top-down and well defined. To ensure standardized operating procedures and consistent food quality throughout the world, McDonald's operates Hamburger University, a state-of-the-art teaching facility in a Chicago suburb, where 50 full-time instructors teach courses in chemistry, food preparation, and marketing. In 2010, McDonald's opened a second Hamburger University campus in Shanghai, China. Mechanistic structures allow for standardization and economies of scale, and often are used when the firm pursues a cost-leadership strategy at the business level.

organic organization Characterized by a low degree of specialization and formalization, a flat organizational structure, and decentralized decision making.

ORGANIC ORGANIZATIONS. **Organic organizations** have a low degree of specialization and formalization, a flat organizational structure, and decentralized decision making. Organic structures tend to be correlated with the following: a fluid and flexible information flow among employees in both horizontal and vertical directions; faster decision making; and higher employee motivation, retention, satisfaction, and creativity. Organic organizations also typically exhibit a higher rate of entrepreneurial behaviors and innovation. Organic structures allow firms to foster R&D and/or marketing, for example, as a core competency. Firms that pursue a differentiation strategy at the business level frequently have an organic structure.

Strategy Highlight 11.2 shows how W.L. Gore & Associates uses an organic structure to foster continuous innovation.

Exhibit 11.3 summarizes the key features of mechanistic and organic structures.

Although at first glance organic organizations may appear to be more attractive than mechanistic ones, their relative effectiveness depends on context. McDonald's, with its over 36,000 restaurants across the globe, would not be successful with an organic structure.

EXHIBIT 11.3 / Mechanistic vs. Organic Organizations: Building Blocks of Organizational Structure

	Mechanistic Organizations	Organic Organizations
Specialization	• High degree of specialization • Rigid division of labor • Employees focus on narrowly defined tasks	• Low degree of specialization • Flexible division of labor • Employees focus on "bigger picture"
Formalization	• Intimate familiarity with rules, policies, and processes necessary • Deep expertise in narrowly defined domain required • Task-specific knowledge valued	• Clear understanding of organization's core competencies and strategic intent • Domain expertise in different areas • Generalized knowledge of how to accomplish strategic goals valued
Centralization	• Decision power centralized at top • Vertical (top-down) communication	• Distributed decision making • Vertical (top-down and bottom-up) as well as horizontal communication
Hierarchy	• Tall structures • Low span of control • Clear lines of authority • Command and control	• Flat structures • High span of control • Horizontal as well as two-way vertical communication • Mutual adjustment
Business Strategy	• Cost-leadership strategy • Examples: McDonald's; Walmart	• Differentiation strategy • Examples: W.L. Gore, Zappos

Strategy Highlight 11.2

W.L. Gore & Associates: Informality and Innovation

W.L. Gore & Associates is the inventor of path-breaking new products such as breathable GORE-TEX fabrics, Glide dental floss, and Elixir guitar strings. Bill Gore, a former longtime employee of chemical giant DuPont, founded the company with the vision to create an organization "devoted to innovation, a company where imagination and initiative would flourish, where chronically curious engineers would be free to invent, invest, and succeed."[20] When founding the company in 1958, Gore articulated four core values that still guide the company and its associates to this day:

1. Fairness to each other and everyone with whom the firm does business.
2. Freedom to encourage, help, and allow other associates to grow in knowledge, skill, and scope of responsibility.
3. The ability to make one's own commitments and keep them.
4. Consultation with other associates before undertaking actions that could cause serious damage to the reputation of the company ("blowing a hole below the waterline").

W.L. Gore & Associates is organized in an informal and decentralized manner: It has no formal job titles, job descriptions, chains of command, formal communication channels, written rules or standard operating procedures. Face-to-face communication is preferred over e-mail. There is no organizational chart. In what is called a *lattice* or *boundaryless* organizational form, everyone is empowered and encouraged to speak to anyone else in the organization. People who work at Gore are called "associates" rather than employees, indicating professional expertise and status. Gore associates organize themselves in project-based teams that are led by sponsors, not bosses. Associates invite other team members based on their expertise and interests in a more or less ad hoc fashion. Peer control in these multidisciplinary teams further enhances associate productivity. Group members evaluate each other's performance annually, and these evaluations determine each associate's level of compensation. Moreover, all associates at W.L. Gore are also shareholders of the company, and thus are part owners sharing in profits and losses.

Gore's freewheeling and informal culture has been linked to greater employee satisfaction and retention, higher personal initiative and creativity, and innovation at the firm level. Although W.L. Gore's organizational structure may look like something you might find in a small, high-tech startup, the company has 10,000 employees and over $3 billion in revenues, making Gore one of the largest privately held companies in the United States. W.L. Gore is consistently ranked in the top 25 of *Fortune*'s "100 Best Companies to Work For" list (number 17 in 2015), and has been included in every edition of that prestigious ranking.[21]

Similarly, a mechanistic structure would not allow Zappos or W.L. Gore to develop and hone their respective core competencies in customer service and product innovation.

The key point is this: To gain and sustain competitive advantage, structure must follow strategy. Moreover, the chosen organizational form must match the firm's business strategy. We will expand further on the required strategy–structure relationship in the next section.

LO 11-5

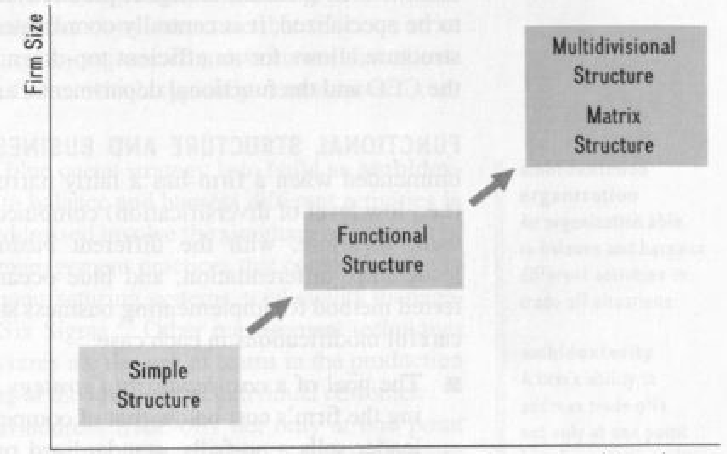
Describe different organizational structures and match them with appropriate strategies.

11.2 Strategy and Structure

The important and interdependent relationship between strategy and structure directly impacts a firm's performance. Moreover, the relationship is dynamic—changing over time in a somewhat predictable pattern as firms grow in size and complexity. Successful new ventures generally grow first by increasing sales, then by obtaining larger geographic reach, and finally by diversifying through vertical integration and entering into related and unrelated businesses.[22] Different stages in a firm's growth require different

organizational structures. This important evolutionary pattern is depicted in Exhibit 11.4. As we discuss next, organizational structures range from simple to functional to multidivisional to matrix.

EXHIBIT 11.4 / Changing Organizational Structures and Increasing Complexity as Firms Grow



SIMPLE STRUCTURE

A **simple structure** generally is used by small firms with low organizational complexity. In such firms, the founders tend to make all the important strategic decisions and run the day-to-day operations. Examples include entrepreneurial ventures such as Facebook in 2004, when the startup operated out of Mark Zuckerberg's dorm room, and professional service firms such as smaller advertising, consulting, accounting, and law firms, as well as family-owned businesses. Simple structures are flat hierarchies operated in a decentralized fashion. They exhibit a low degree of formalization and specialization. Typically, neither professional managers nor sophisticated systems are in place, which often leads to an overload for the founder and/or CEO when the firms experience growth.

simple structure Organizational structure in which the founders tend to make all the important strategic decisions as well as run the day-to-day operations.

FUNCTIONAL STRUCTURE

As sales increase, firms generally adopt a **functional structure,** which groups employees into distinct functional areas based on domain expertise. These functional areas often correspond to distinct stages in the value chain such as R&D, engineering and manufacturing, and marketing and sales, as well as supporting areas such as human resources, finance, and accounting. Exhibit 11.5 shows a functional structure, with the lines indicating reporting and authority relationships. The department head of each functional area reports to the CEO, who coordinates and integrates the work of each function. A business school student generally majors in one of these functional areas such as finance, accounting, IT, marketing, operations, or human resources, and is then recruited into a corresponding functional group.

functional structure Organizational structure that groups employees into distinct functional areas based on domain expertise.

W.L. Gore began as a company by operating out of Bill Gore's basement and using a simple structure. Two years after its founding, the company received a large manufacturing order for high-tech cable that it could not meet with its ad hoc basement operation. At that point, W.L. Gore reorganized itself into a functional structure. A simple structure could not provide the effective division, coordination, and integration of work required to accommodate future growth.

EXHIBIT 11.5 / Typical Functional Structure

A functional structure allows for a higher degree of specialization and deeper domain expertise than a simple structure. Higher specialization also allows for a greater division of labor, which is linked to higher productivity.[23] While work in a functional structure tends to be specialized, it is centrally coordinated by the CEO (see Exhibit 11.5). A functional structure allows for an efficient top-down and bottom-up communication chain between the CEO and the functional departments, and thus relies on a relatively flat structure.

FUNCTIONAL STRUCTURE AND BUSINESS STRATEGY. A functional structure is recommended when a firm has a fairly narrow focus in terms of product/service offerings (i.e., low level of diversification) combined with a small geographic footprint. It matches well, therefore, with the different *business* strategies discussed in Chapter 6: cost leadership, differentiation, and blue ocean. Although a functional structure is the preferred method for implementing business strategy, different variations and contexts require careful modifications in each case:

- The goal of a *cost-leadership strategy* is to create a competitive advantage by reducing the firm's cost below that of competitors while offering acceptable value. The cost leader sells a no-frills, standardized product or service to the mainstream customer. To effectively implement a cost-leadership strategy, therefore, managers must create a functional structure that contains the organizational elements of a *mechanistic structure*—one that is centralized, with well-defined lines of authority up and down the hierarchy. Using a functional structure allows the cost leader to nurture and constantly upgrade necessary core competencies in manufacturing and logistics. Moreover, the cost leader needs to create incentives to foster process innovation in order to drive down cost. Finally, because the firm services the average customer, and thus targets the largest market segment possible, it should focus on leveraging economies of scale to further drive down costs.
- The goal of a *differentiation strategy* is to create a competitive advantage by offering products or services at a higher perceived value, while controlling costs. The differentiator, therefore, sells a non-standardized product or service to specific market segments in which customers are willing to pay a higher price. To effectively implement a differentiation strategy, managers rely on a functional structure that resembles an *organic organization.* In particular, decision making tends to be decentralized to foster and incentivize continuous innovation and creativity as well as flexibility and mutual adjustment across areas. Using a functional structure with an organic organization allows the differentiator to nurture and constantly upgrade necessary core competencies in R&D, innovation, and marketing. Finally, the functional structure should be set up to allow the firm to reap economies of scope from its core competencies, such as by leveraging its brand name across different products or its technology across different devices.
- A successful *blue ocean strategy* requires reconciliation of the trade-offs between differentiation and low cost. To effectively implement a blue ocean strategy, the firm must be both efficient and flexible. It must balance centralization to control costs with decentralization to foster creativity and innovation. Managers must, therefore, attempt to combine the advantages of the functional-structure variations used for cost leadership and differentiation while mitigating their disadvantages. Moreover, the firm pursuing a blue ocean strategy needs to develop several distinct core competencies to both drive up perceived value and lower cost. It must further pursue both product and process innovations in an attempt to reap economies of scale and scope. All of these challenges make it clear that although a blue ocean strategy is attractive at first glance, it is quite difficult to implement given the range of important trade-offs that must be addressed.

A firm's structure is therefore critical when pursuing a blue ocean strategy. The challenge that managers face is to structure their organizations so that they control cost *and* allow for creativity that can lay the basis for differentiation. Doing both is hard. Achieving a low-cost position requires an organizational structure that relies on strict budget controls, while differentiation requires an organizational structure that allows creativity and customer responsiveness to thrive, which typically necessitates looser organizational structures and controls.

The goal for managers who want to pursue a blue ocean strategy is to build an **ambidextrous organization,** one that enables managers to balance and harness different activities in trade-off situations.[24] Here, the trade-offs to be addressed involve the simultaneous pursuit of low-cost and differentiation strategies. Notable management practices that companies use to resolve this trade-off include flexible and lean manufacturing systems, total quality management, just-in-time inventory management, and Six Sigma.[25] Other management techniques that allow firms to reconcile cost and value pressures are the use of teams in the production process, as well as decentralized decision making at the level of the individual customer.

ambidextrous organization An organization able to balance and harness different activities in trade-off situations.

ambidexterity A firm's ability to address trade-offs not only at one point but also over time. It encourages managers to balance *exploitation* with *exploration.*

exploitation Applying current knowledge to enhance firm performance in the short term.

exploration Searching for new knowledge that may enhance a firm's future performance.

Ambidexterity describes a firm's ability to address trade-offs not only at one point but also over time. It encourages managers to balance **exploitation**—applying current knowledge to enhance firm performance in the short term—with **exploration**—searching for new knowledge that may enhance a firm's future performance.[26] For example, while Intel focuses on maximizing sales from its *current* cutting-edge microprocessors, it also has several different teams with different time horizons working on *future* generations of microprocessors.[27] In ambidextrous organizations, managers must constantly analyze their existing business processes and routines, looking for ways to change them in order to resolve trade-offs across internal value chain activities and time.[28]

Exhibit 11.6 presents a detailed match between different business strategies and their corresponding functional structures.

DISADVANTAGES. While certainly attractive, the functional structure is not without significant drawbacks. Although the functional structure facilitates rich and extensive communication between members of the *same* department, it frequently lacks effective communication channels *across* departments. Notice in Exhibit 11.5 the lack of links between different functions. The lack of linkage between functions is the reason, for example, why R&D managers often do not communicate directly with marketing managers. In an ambidextrous organization, a top-level manager such as the CEO must take on the necessary coordination and integration work.

To overcome the lack of cross-departmental collaboration in a functional structure, a firm can set up *cross-functional teams.* In these temporary teams, members come from different functional areas to work together on a specific project or product, usually from start to completion. Each team member reports to two supervisors: the team leader and the respective functional department head. As we saw in Strategy Highlight 11.2, W.L. Gore employs cross-functional teams successfully.

A second critical drawback of the functional structure is that it cannot effectively address a higher level of diversification, which often stems from further growth.[29] This is the stage at which firms find it effective to evolve and adopt a multidivisional or matrix structure, both of which we will discuss next.

MULTIDIVISIONAL STRUCTURE

multidivisional structure (M-form) Organizational structure that consists of several distinct strategic business units (SBUs), each with its own profit-and-loss (P&L) responsibility.

Over time, as a firm diversifies into different product lines and geographies, it generally implements a multidivisional or a matrix structure (as shown in Exhibit 11.4). The **multidivisional structure** (or **M-form**) consists of several distinct strategic business

EXHIBIT 11.6 /

Matching Business Strategy and Structure

Business Strategy	Structure
Cost leadership	**Functional** • Mechanistic organization • Centralized • Command and control • Core competencies in efficient manufacturing and logistics • Process innovation to drive down cost • Focus on economies of scale
Differentiation	**Functional** • Organic organization • Decentralized • Flexibility and mutual adjustment • Core competencies in R&D, innovation, and marketing • Product innovation • Focus on economies of scope
Blue ocean	**Functional** • Ambidextrous organization • Balancing centralization with decentralization • Multiple core competencies along the value chain required: R&D, manufacturing, logistics, marketing, etc. • Process and product innovations • Focus on economies of scale and scope

units (SBUs), each with its own profit-and-loss (P&L) responsibility. Each SBU is operated more or less independently from one another, and each is led by a CEO (or equivalent general manager) who is responsible for the unit's business strategy and its day-to-day operations. The CEOs of each division report to the corporate office, which is led by the company's highest-ranking executive (titles vary and include president or CEO for the entire corporation). Because most large firms are diversified to some extent across different product lines and geographies, the M-form is a widely adopted organizational structure.

Consider that Zappos is an SBU under Amazon, which employs a multidivisional structure. Also, W.L. Gore uses a multidivisional structure to administer its differentiation and related diversification strategies. It has four product divisions (electronic products, industrial products, medical products, and fabrics division) with manufacturing facilities in the United States, China, Germany, Japan, and Scotland, and business activities in 30 countries across the globe.[30]

A typical M-form is shown in Exhibit 11.7. In this example, the company has four SBUs, each led by a CEO. Corporations may use SBUs to organize around different businesses and product lines or around different geographic regions. Each SBU represents a self-contained business with its own hierarchy and organizational structure. Note that in Exhibit 11.7, SBU 2 is organized using a functional structure, while SBU 4 is organized using a matrix structure. The CEO of each SBU must determine which organizational structure is most appropriate to implement the SBU's business strategy.

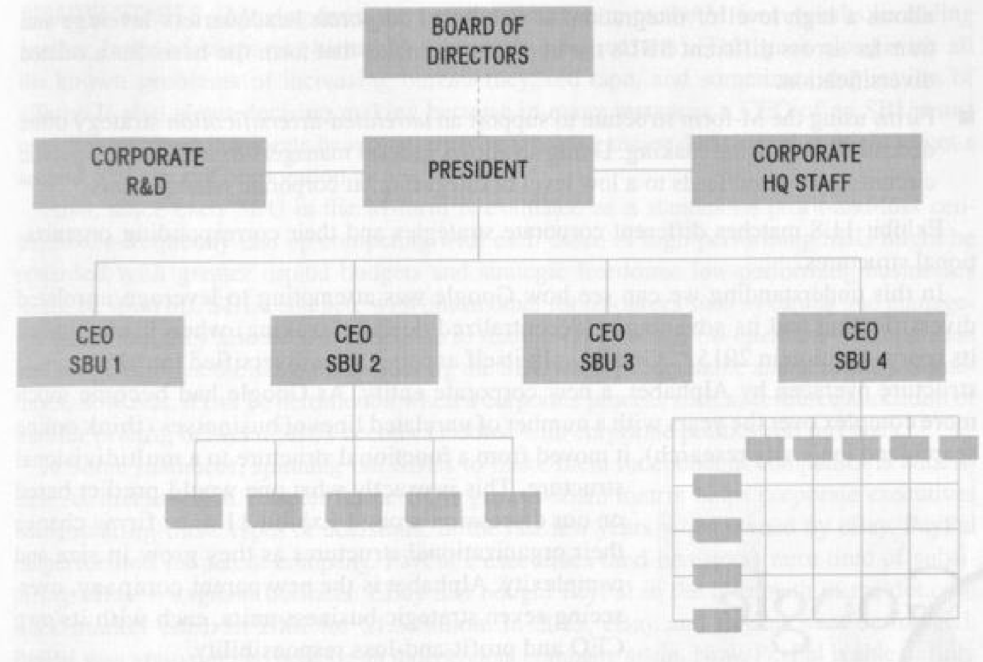


EXHIBIT 11.7 /

Typical Multidivisional (M-Form) Structure

Note that SBU 2 uses a functional structure, and SBU 4 uses a matrix structure.

A firm's corporate office is supported by company-wide staff functions such as human resources, finance, and corporate R&D. These staff functions support all of the company's SBUs, but are centralized at corporate headquarters to benefit from economies of scale and to avoid duplication within each SBU. Since most of the larger enterprises are publicly held stock companies, the president reports to a board of directors who represents the interests of the shareholders, indicated by the dashed line in Exhibit 11.7.

The president, with support from corporate headquarters staff, monitors the performance of each SBU and determines how to allocate resources across units.[31] Corporate headquarters adds value by functioning as an internal capital market. The goal is to be more efficient at allocating capital through its budgeting process than what could be achieved in external capital markets. This can be especially effective if the corporation overall can access capital at a lower cost than competitors due to a favorable (AAA) debt rating. Corporate headquarters can also add value through restructuring the company's portfolio of SBUs by selling low-performing businesses and adding promising businesses through acquisitions.

M-FORM AND CORPORATE STRATEGY. To achieve an optimal match between strategy and structure, different corporate strategies require different organizational structures. In Chapter 8, we identified four types of corporate diversification (see Exhibit 8.8: *single business, dominant business, related diversification,* and *unrelated diversification.* Each is defined by the percentage of revenues obtained from the firm's primary activity.

- Firms that follow a single-business or *dominant-business strategy* at the corporate level gain at least 70 percent of their revenues from their primary activity; they generally employ a *functional structure.*
- For firms that pursue either *related* or *unrelated diversification,* the *M-form* is the preferred organizational structure.
- Firms using the M-form organizational structure to support a *related-diversification* strategy tend to concentrate decision making at the top of the organization. Doing so

allows a high level of integration. It also helps corporate headquarters leverage and transfer across different SBUs the core competencies that form the basis for a related diversification.

- Firms using the M-form structure to support an *unrelated-diversification* strategy often decentralize decision making. Doing so allows general managers to respond to specific circumstances, and leads to a low level of integration at corporate headquarters.

Exhibit 11.8 matches different corporate strategies and their corresponding organizational structures.

In this understanding we can see how Google was attempting to leverage unrelated diversification and its advantages (decentralized decision making) when it announced its reorganization in 2015.[32] Google split itself and created a diversified multidivisional structure overseen by Alphabet, a new corporate entity. As Google had become much more complex over the years with a number of unrelated lines of businesses (think online search and longevity research), it moved from a functional structure to a multidivisional structure. This is exactly what one would predict based on our discussion around Exhibit 11.4, as firms change their organizational structures as they grow in size and complexity. Alphabet is the new parent company, overseeing seven strategic business units, each with its own CEO and profit-and-loss responsibility.

© Pawel Kopczynski/ Reuters/Corbis

The seven business units start with Google's core businesses (search, ads, YouTube, Android, Chrome) in a single unit joined by Google X (self-driving cars, delivery drones, Internet balloons), Nest (smart thermostats), Google Fiber (broadband service), Calico (longevity research), Life Sciences (contact lenses), and Google Ventures (start-up investments). This sweeping restructuring allows the company to separate its highly profitable search and advertising business from its "moon shots" such as providing wireless Internet connectivity via high-altitude balloons or developing contact lenses that double as a "computer monitor" and provide real-time information to the wearer.

EXHIBIT 11.8 / Matching Corporate Strategy and Structure

Corporate Strategy	Structure
Single business	**Functional structure**
Dominant business	**Functional structure**
Related diversification	**Cooperative multidivisional (M-form)** • Centralized decision making • High level of integration at corporate headquarters • Co-opetition among SBUs – Competition for resources – Cooperation in competency sharing
Unrelated diversification	**Competitive multidivisional (M-form)** • Decentralized decision making • Low level of integration at corporate headquarters • Competition among SBUs for resources

DISADVANTAGES. Moving from the functional structure to the M-form results in adding another layer of corporate hierarchy (corporate headquarters). This goes along with all the known problems of increasing bureaucracy, red tape, and sometimes duplication of efforts. It also slows decision making because in many instances a CEO of an SBU must get approval from corporate headquarters when making major decisions that might affect a second SBU or the corporation as a whole.

Also, since each SBU in the M-form is evaluated as a standalone profit-and-loss center, SBUs frequently end up competing with each other. A high-performing SBU might be rewarded with greater capital budgets and strategic freedoms; low-performing businesses might be spun off. SBUs compete with one another for resources such as capital and managerial talent, but they also need to cooperate to share competencies. *Co-opetition*—competition and cooperation at the same time—among the SBUs is both inevitable and necessary. Sometimes, however, it can be detrimental when a corporate process such as resource allocation or transfer pricing between SBUs becomes riddled with corporate politics and turf wars.

In some instances, spinning out SBUs to make them independent companies is beneficial. As discussed in Chapter 8, the BCG growth-share matrix helps corporate executives when making these types of decisions. In the last few years when owned by eBay, PayPal outperformed its parent company. PayPal's executives (and investors) were tired of subsidizing eBay's stagnant business. EBay had bought PayPal in the aftermath of the dot.com stock market crash in 2002 for $1.5 billion. In 2015, eBay and PayPal were de-merged. PayPal was spun out and became an independent company again. Now, PayPal is able to fully unlock its value. Investors also liked separating eBay and PayPal, giving it a valuation that is estimated to be as high as $100 billion; eBay's standalone valuation is about $35 billion.[33]

MATRIX STRUCTURE

matrix structure Organizational structure that combines the functional structure with the M-form.

To reap the benefits of both the M-form and the functional structure, many firms employ a mix of these two organizational forms, called a **matrix structure.** Exhibit 11.9 shows an example. In it, the firm is organized according to SBUs along a horizontal axis (like in the

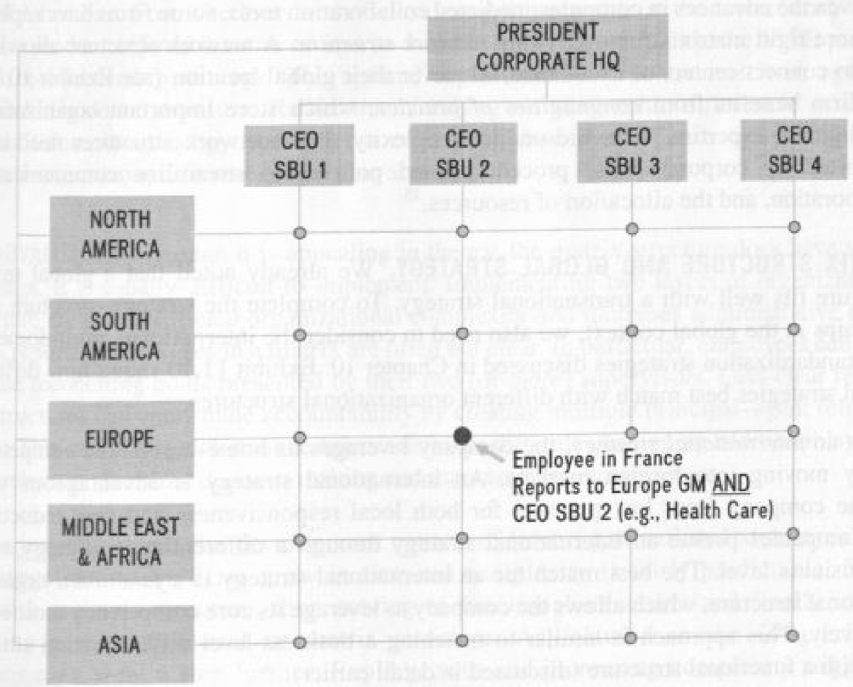


EXHIBIT 11.9 / Typical Matrix Structure with Geographic and SBU Divisions

M-form), but also has a second dimension of organizational structure along a vertical axis. In this case, the second dimension consists of different geographic areas, each of which generally would house a full set of functional activities. The idea behind the matrix structure is to combine the benefits of the M-form (domain expertise, economies of scale, and the efficient processing of information) with those of the functional structure (responsiveness and decentralized focus).

The horizontal and vertical reporting lines between SBUs and geographic areas intersect, creating nodes in the matrix. Exhibit 11.9 highlights one employee, represented by a large dot and called out by an arrow. This employee works in a group with other employees in SBU 2, the company's health care unit for the Europe division in France. This employee has two bosses—the CEO of the health care SBU and the general manager (GM) for the Europe division. Both supervisors report to corporate headquarters, which is led by the president of the corporation (indicated in Exhibit 11.9 by the reporting lines from the SBUs and geographic units to the president).

Firms tend to use a *global matrix structure* to pursue a *transnational strategy*, in which the firm combines the benefits of a multidomestic strategy (high local responsiveness) with those of a global-standardization strategy (lowest-cost position attainable). In a global matrix structure, the geographic divisions are charged with local responsiveness and learning. At the same time, each SBU is charged with driving down costs through economies of scale and other efficiencies. A global matrix structure also allows the firm to feed local learning back to different SBUs and thus diffuse it throughout the organization. The specific organizational configuration depicted in Exhibit 11.9 is a global matrix structure.

The matrix structure is quite versatile, because managers can assign different groupings along the vertical and horizontal axes. A common form of the matrix structure uses different projects or products on the vertical axis and different functional areas on the horizontal axis. In that traditional matrix structure, *cross-functional* teams work together on different projects. In contrast to the cross-functional teams discussed earlier in the W.L. Gore example, the teams in a matrix structure tend to be more permanent rather than project-based with a pre-determined time horizon.

Given the advances in computer-mediated collaboration tools, some firms have replaced the more rigid matrix structure with a *network structure*. A network structure allows the firm to connect centers of excellence, whatever their global location (see Exhibit 10.3).[34] The firm benefits from *communities of practice*, which store important organizational learning and expertise. To avoid undue complexity, these network structures need to be supported by corporate-wide procedures and policies to streamline communication, collaboration, and the allocation of resources.[35]

MATRIX STRUCTURE AND GLOBAL STRATEGY. We already noted that a global matrix structure fits well with a transnational strategy. To complete the strategy–structure relationships in the global context, we also need to consider the international, multidomestic, and standardization strategies discussed in Chapter 10. Exhibit 11.10 shows how different global strategies best match with different organizational structures.

- In an *international strategy*, the company leverages its home-based core competency by moving into foreign markets. An international strategy is advantageous when the company faces low pressure for both local responsiveness and cost reductions. Companies pursue an international strategy through a differentiation strategy at the business level. The best match for an international strategy is a *functional* organizational structure, which allows the company to leverage its core competency most effectively. This approach is similar to matching a business-level differentiation strategy with a functional structure (discussed in detail earlier).

EXHIBIT 11.10 / Matching Global Strategy and Structure

Global Strategy	Structure
International	Functional
Multidomestic	Multidivisional • Geographic areas • Decentralized decision making
Global standardization	Multidivisional • Product divisions • Centralized decision making
Transnational	Global matrix • Balance of centralized and decentralized decision making • Additional layer of hierarchy to coordinate both: – Geographic areas – Product divisions

- When a multinational enterprise (MNE) pursues a *multidomestic strategy*, it attempts to maximize local responsiveness in the face of low pressures for cost reductions. An appropriate match for this type of global strategy is the *multidivisional* organizational structure. That structure would enable the MNE to set up different divisions based on geographic regions (e.g., by continent). The different geographic divisions operate more or less as standalone SBUs to maximize local responsiveness. Decision making is decentralized.
- When following a *global-standardization strategy*, the MNE attempts to reap significant economies of scale as well as location economies by pursuing a global division of labor based on wherever best-of-class capabilities reside at the lowest cost. Since the product offered is more or less an undifferentiated commodity, the MNE pursues a cost-leadership strategy. The optimal organizational structure match is, again, a *multidivisional* structure. Rather than focusing on geographic differences as in the multidomestic strategy, the focus is on driving down costs due to consolidation of activities across different geographic areas.

DISADVANTAGES. Though it is appealing in theory, the matrix structure does have shortcomings. It is usually difficult to implement: Implementing two layers of organizational structure creates significant organizational complexity and increases administrative costs. Also, reporting structures in a matrix are often not clear. In particular, employees can have trouble reconciling goals presented by their two (or more) supervisors. Less-clear reporting structures can undermine accountability by creating multiple principal–agent relationships. This can make performance appraisals more difficult. Adding an additional layer of hierarchy can also slow decision making and increase bureaucratic costs.

As just discussed, the development pattern of how organizational structures tend to change in time as firms grow in size and complexity is fairly predictable: Starting with a simple structure, then moving to functional structure, and finally implementing a multidivisional or matrix structure. As featured in the ChapterCase, Zappos even went a step further. Rapid growth and increasing complexity triggered Zappos' move away from a multidivisional structure with different business units to the radically new organizational structure, holacracy, with its nonhierarchical, overlapping employee circles. While the organizational structures shown in Exhibit 11.4 have been around for many decades, holacracy as an organizational structure is new and yet untested in a larger firm.

LO 11-6

Describe the elements of organizational culture, and explain where organizational cultures can come from and how they can be changed.

11.3 Organizational Culture: Values, Norms, and Artifacts

Organizational culture is the second key building block when designing organizations for competitive advantage. Just as people have distinctive personalities, so too do organizations have unique cultures that capture "how things get done around here." **Organizational culture** describes the collectively shared values and norms of an organization's members.[36] *Values* define what is considered important. *Norms* define appropriate employee attitudes and behaviors.[37]

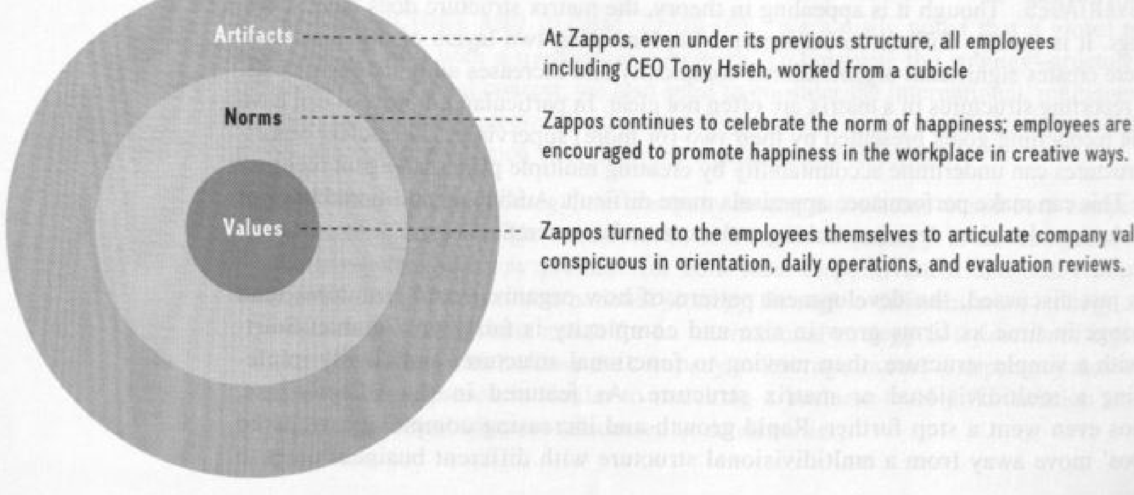
organizational culture
The collectively shared values and norms of an organization's members; a key building block of organizational design.

Employees learn about an organization's culture through *socialization,* a process whereby employees internalize an organization's values and norms through immersion in its day-to-day operations.[38] Zappos' new-employee orientation and immersion is now a four-week extensive course. Successful socialization, in turn, allows employees to function productively and to take on specific roles within the organization. *Strong cultures* emerge when the company's core values are widely shared among the firm's employees and when the norms have been internalized.

Corporate culture finds its expression in *artifacts.* Artifacts include elements such as the design and layout of physical space (e.g., cubicles or private offices); symbols (e.g., the type of clothing worn by employees); vocabulary; what stories are told (see the Zappos pizza-ordering example that follows); what events are celebrated and highlighted; and how they are celebrated (e.g., a formal dinner versus a casual BBQ when the firm reaches its sales target).

Exhibit 11.11 depicts the elements of organizational culture—values, norms, and artifacts—in concentric circles. The most important yet least visible element—values—is in the center. As we move outward in the figure, from values to norms to artifacts, culture becomes more observable. Understanding what organizational culture is, and how

EXHIBIT 11.11 / The Elements of Organizational Culture: Values, Norms, and Artifacts



it is created, maintained, and changed, can help you be a more effective manager. A unique culture that is strategically relevant can also be the basis of a firm's competitive advantage.

As Zappos grew, its managers realized that it was critical to explicitly define a set of core values from which to develop the company's culture, brand, and strategy. Zappos CEO Tony Hsieh wanted to make sure that all employees understood the same set of values and expected behaviors. Zappos' list of 10 core values (see Exhibit 11.12) was crafted through a bottom-up initiative, in which all employees were invited to participate.

EXHIBIT 11.12 / Zappos' 10 Core Values

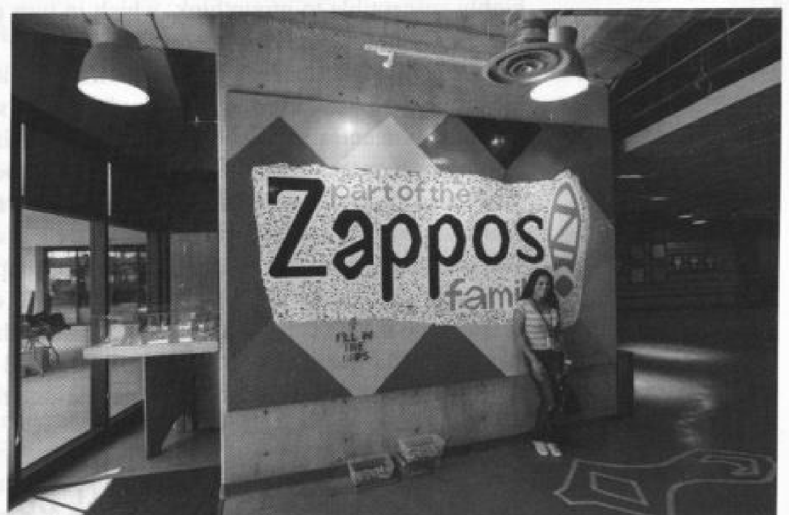
1. Deliver WOW through service.
2. Embrace and drive change.
3. Create fun and a little weirdness.
4. Be adventurous, creative, and open-minded.
5. Pursue growth and learning.
6. Build open and honest relationships with communication.
7. Build a positive team and family spirit.
8. Do more with less.
9. Be passionate and determined.
10. Be humble.

Source: T. Hsieh (2010), *Delivering Happiness: A Path to Profits, Passion, and Purpose* (New York: Business Plus), pp. 157–160.

To live up to its mission of delivering happiness, Zappos decided that exceptional customer service should be its number-one core value. The company put several policies and procedures in place to "deliver WOW through service." For example, shipments to and from customers within the United States are free, allowing customers to order several pairs of shoes and send back (within a liberal 365 days) those that don't fit or are no longer wanted. Repeat customers are automatically upgraded to complimentary express shipping. One of the most important lessons Hsieh learned is "Never outsource your core competency!"[39] Customer service, therefore, is done exclusively in-house.

Perhaps even more importantly, Zappos does not provide a script or measure customer service reps' call times. Rather, the company leaves it up to the individual member of the "Customer Loyalty Team" to deliver exceptional customer service: "We want our reps to let their true personalities shine during each phone call so that they can develop a personal emotional connection with the customer."[40] In fact, one customer service phone call lasted almost six hours! The same trust in the customer service reps applies to e-mail communication. Zappos' official communication policy is to "be real and use your best judgment."[41] Most of Zappos' more than 1,500 employees are in some type of sales function, to maintain constant contact with the customer. The customer call centers are staffed 24/7, seven days a week, 365 days a year.

Zappos third core value, "create fun and a little weirdness," encourages a unique culture based on shared experiences including costume play ("cosplay") at work, parades, fun contests, themed courtyard events, ice cream trucks, Nerf guns, Ping-Pong, live animals, and so on.[42] One of the hardest choices Zapponians need to make each day is choosing which fun event to support, including trivia nights, family picnics, pinewood derby races, talent shows, Foosball, snow sledding, spring break days, pajama days, and karaoke.



This is all just part of another day at the Zappos office.

© James Leynse/Corbis

Besides creating a strong culture that binds employees together through shared fun experiences, Zappos believes that encouraging a little weirdness and fun helps people to think outside the box and thus be more creative and innovative. All this helps to achieve their number-one core value to "deliver WOW through service," but also other core values such as "do more with less." Taken together, employees are more engaged in their work, not only with their hands, but also their minds and hearts, and the company is being more innovative and nimble as a whole.

WHERE DO ORGANIZATIONAL CULTURES COME FROM?

founder imprinting A process by which the founder defines and shapes an organization's culture, which can persist for decades after his or her departure.

Often, company founders define and shape an organization's culture, which can persist for many decades after their departure. This phenomenon is called **founder imprinting**.[43] Founders set the initial strategy, structure, and culture of an organization by transforming their vision into reality. Famous founders who have left strong imprints on their organizations include Steve Jobs (Apple), Walt Disney (Disney), Michael Dell (Dell), Sergey Brin and Larry Page (Google), Oprah Winfrey (Harpo Productions and *OWN*, the Oprah Winfrey Network), Bill Gates (Microsoft), Larry Ellison (Oracle), Ralph Lauren (Polo Ralph Lauren), Martha Stewart (Martha Stewart Living Omnimedia), and Herb Kelleher (Southwest Airlines).

Walmart founder Sam Walton personified the retailer's cost-leadership strategy. At one time the richest man in America, Sam Walton drove a beat-up Ford pickup truck, got $5 haircuts, went camping for vacations, and lived in a modest ranch home in Bentonville, Arkansas.[44] Everything Walton did was consistent with the low-cost strategy. Walmart stays true to its founder's tradition. Home to one of the largest companies on the planet, the company's Arkansas headquarters in Bentonville was described by Thomas Friedman in his book *The World Is Flat* as "crammed into a reconfigured warehouse . . . a large building made of corrugated metal, I figured it was the maintenance shed."[45]

groupthink A situation in which opinions coalesce around a leader without individuals critically evaluating and challenging that leader's opinions and assumptions.

The culture that founders initially imprint is reinforced by their strong preference to recruit, retain, and promote employees who subscribe to the same values. In turn, more people with similar values are attracted to that organization.[46] As the values and norms held by the employees become more similar, the firm's corporate culture becomes stronger and more distinct. This in turn can have a serious negative side-effect: **groupthink**, a situation in which opinions coalesce around a leader without individuals critically evaluating and challenging that leader's opinions and assumptions. Cohesive, non-diverse groups are highly susceptible to groupthink, which in turn can lead to flawed decision making with potentially disastrous consequences.

In addition to founder imprinting, a firm's culture also flows from its values, especially when they are linked to the company's reward system. For example, Zappos established its unique organizational culture through explicitly stated values that are connected to its reward system (see Exhibit 11.12). To recruit people that fit with the company's values, Hsieh has all new hires go through a four-week training program. It covers such topics as company history, culture, and vision, as well as customer service.[47] New hires also spend two weeks on the phone as customer service reps. What's novel about Zappos' approach is that at the end of the monthlong employee orientation, the company offers an "exit prize:" one month's pay plus pay for the time already with Zappos. This allows the company to entice people to leave that are qualified for the job but may not fit with Zappos' culture. Individuals who choose to stay despite the enticing offer tend to fit well with and strengthen Zappos' distinct culture.[48]

HOW DOES ORGANIZATIONAL CULTURE CHANGE?

An organization's culture can be one of its strongest assets, but also its greatest liability. An organization's culture can turn from a core competency into a *core rigidity* if a firm relies too long on the competency without honing, refining, and upgrading as the firm and the

environment change.[49] (See discussion in Chapter 4.) Over time, the original core competency is no longer a good fit and turns from an asset into a liability. This is the time when a culture needs to change.

Mary Barra, CEO, General Motors
© Jeff Kowalsky/Bloomberg/Getty Images

GM's bureaucratic culture, combined with its innovative M-form structure, was once hailed as the key to superior efficiency and management.[50] However, that culture became a liability when the external environment changed following the oil-price shocks in the 1970s and the entry of Japanese carmakers into the United States.[51] As a consequence, GM's strong culture led to organizational inertia. This resulted in a failure to adapt to changing customer preferences for more fuel-efficient cars, and it prevented higher quality and more innovative designs. GM lost customers to foreign competitors that offered these features.

More recently, GM's strong culture was again faulted for corporate ineptitude when delaying recalling defective cars.[52] In 2014, over 25 million GM cars were recalled for safety defects, the largest recall ever. In particular, many GM cars were eventually recalled because of a faulty ignition switch, which could turn off the engine while driving and thus disable the airbags. This problem has been linked to more than 120 fatalities in the United States alone.[53] GM is alleged to knowingly have withheld information about the faulty ignition switches and delayed the needed recalls by several years. Indeed, during a U.S. Senate hearing, GM was described as dominated by a "culture of cover-up."[54] In such times of crisis, corporate culture must be changed to avoid such problems in the future and to address a breakdown in the culture-environment fit.

The primary means of cultural change is for the corporate board of directors to bring in new leadership at the top, which is then charged to make changes in strategy and structure. After all, executives shape corporate culture in their decisions on how to structure the organization and its activities, allocate its resources, and develop its system of rewards (see the discussion on strategic leadership in Chapter 2). In 2014, GM's board of directors appointed Mary Barra as CEO with the charge to fix GM's dysfunctional corporate culture and to make the company competitive again.

ORGANIZATIONAL CULTURE AND COMPETITIVE ADVANTAGE

Can organizational culture be the basis of a firm's competitive advantage? For this to occur, the firm's unique culture must help it in some way to increase its *economic value creation* (*V–C*). That is, it must either help in increasing the perceived value of the product/service and/or lower its cost of production/delivery. Moreover, according to the resource-based view of the firm, the resource—in this case, organizational culture—must be *valuable, rare, difficult to imitate,* and the firm must be *organized* to capture the value created. The VRIO principles (see Chapter 4) must apply even as to organizational culture itself.[55]

Let's look at two examples of how culture affects employee behavior and ultimately firm performance:

- If you have flown with Southwest Airlines (SWA), you may have noticed that things are done a little differently there. Flight attendants might sing a song about the city you're landing in, or they might slide bags of peanuts down the aisle at takeoff. Employees celebrate Halloween in a big way by wearing costumes to work. Some argue that SWA's business strategy—being a cost leader in point-to-point air travel—is fairly simple, and that SWA's competitive advantage actually comes from its unique culture.[56] It's not all fun and games, though: Friendly and highly energized employees work across functional and hierarchical levels. Even Southwest's pilots pitch in to help load baggage quickly when needed. As a result, SWA's turn time between flights is only 15 minutes, whereas competitors frequently take two to three times as long.

- Zappos' number-one core value is to "deliver WOW through service." CEO Hsieh shares the following story to illustrate this core value in action: "I was in Santa Monica, California, a few years ago at a Skechers sales conference. . . . [In the early hours of the morning], a small group of us headed up to someone's hotel room to order some food. My friend from Skechers tried to order a pepperoni pizza from the room-service menu but was disappointed to learn that the hotel did not deliver hot food after 11:00 p.m. We had missed the deadline by several hours. . . . A few of us cajoled her into calling Zappos to try to order a pizza. She took us up on our dare, turned on the speakerphone, and explained to the (very) patient Zappos rep that she was staying in a Santa Monica hotel and really craving a pepperoni pizza, that room service was no longer delivering hot food, and that she wanted to know if there was anything Zappos could do to help. The Zappos rep was initially a bit confused by the request, but she quickly recovered and put us on hold. She returned two minutes later, listing the five closest places in the Santa Monica area that were still open and delivering pizzas at that time."[57]

In the SWA example, the company's unique culture helps it keep costs low by turning around its planes faster, thus keeping them flying longer hours (among many other activities that lower SWA's cost structure).[58] In the Zappos example, providing a "wow" customer experience by "going the extra mile" didn't save Zappos money, but in the long run superior experience does increase the company's perceived value and thereby its economic value creation. Indeed, Hsieh makes it a point to conclude the story with the following statement: "As for my friend from Skechers? After that phone call, she's now a customer for life."[59]

Let's consider how an organization's culture can have a strong influence on employee behavior.[60] A positive culture motivates and energizes employees by appealing to their higher ideals. Internalizing the firm's values and norms, employees feel that they are part of a larger, meaningful community attempting to accomplish important things. When employees are intrinsically motivated this way, the firm can rely on fewer levels of hierarchy; thus close monitoring and supervision are not needed as much. Moreover, motivating through inspiring values allows the firms to tap employees' emotions so they use both their heads and their hearts when making business decisions. Strong organizational cultures that are strategically relevant, therefore, align employees' behaviors more fully with the organization's strategic goals. In doing so, they better coordinate work efforts, and they make cooperation more effective. They also strengthen employee commitment, engagement, and effort. Effective alignment in turn allows the organization to develop and refine its core competencies, which can form the basis for competitive advantage.

Applying the VRIO principles to the SWA and Zappos examples, we see that both cultures are *valuable* (lowering costs for SWA and increasing perceived value created for Zappos), *rare* (none of their competitors has an identical culture), *non-imitable* (despite attempts by competitors), and *organized* to capture some part of the incremental economic value created due to their unique cultures. It appears that at both SWA and Zappos, a unique organizational culture can provide the basis for a competitive advantage. These cultures, of course, need to be in sync with and in support of the respective business

strategies pursued: cost leadership for SWA and differentiation for Zappos. Moreover, as the firms grow and external economic environments change, these cultures must be flexible enough to adapt.

Once it becomes clear that a firm's culture is a source of competitive advantage, some competitors will attempt to imitate that culture. Therefore, only a culture that cannot be easily copied can provide a competitive advantage. It can be difficult, at best, to imitate the cultures of successful firms, for two reasons: *causal ambiguity* and *social complexity*. While one can observe that a firm has a unique culture, the causal relationships among values, norms, artifacts, and the firm's performance may be hard to establish, even for people who work within the organization. For example, employees may become aware of the effect culture has on performance only after significant organizational changes occur. Moreover, organizational culture is socially complex. It encompasses not only interactions among employees across layers of hierarchy, but also the firm's outside relationships with its customers and suppliers.[61] Such a wide range of factors is difficult for any competing firm to imitate.

It is best to develop a strong and strategically relevant culture in the first few years of a firm's existence. Strategy scholars have documented that the initial structure, culture, and control mechanisms established in a new firm can be a significant predictor of later success.[62] In other empirical research, founder CEOs had a stronger positive imprinting effect than non-founder CEOs.[63] This stronger imprinting effect, in turn, resulted in higher performance of firms led by founder CEOs. In addition, consider that the vehicles of cultural change—changing leadership and M&As—do not have a stellar record of success.[64] Indeed, researchers estimate that only about 20 percent of organizational change attempts are successful.[65] Thus, it is even more important to get the culture right from the beginning and then adapt it as the business evolves.

By combining theory and empirical evidence, we can see that organizational culture can help a firm gain and sustain competitive advantage *if* the culture makes a positive contribution to the firm's economic value creation and obeys the VRIO principles. Organizational culture is an especially effective lever for new ventures due to its malleability. Firm founders, early-stage CEOs, and venture capitalists, therefore, should be proactive in attempting to create a culture that supports a firm's economic value creation.

11.4 Strategic Control-and-Reward Systems

LO 11-7

Compare and contrast different strategic control-and-reward systems.

Strategic control-and-reward systems are the third and final key building block when designing organizations for competitive advantage. **Strategic control-and-reward systems** are internal-governance mechanisms put in place to align the incentives of principals (shareholders) and agents (employees). These systems allow managers to specify goals, measure progress, and provide performance feedback.

strategic control-and-reward systems Internal-governance mechanisms put in place to align the incentives of principals (shareholders) and agents (employees).

Zappos restructured its performance-evaluation system to give these values teeth: The firm rewards employees who apply the values (shown in Exhibit 11.11) well in their day-to-day decision making. It created an open market (referred to internally as OM) based on an online scheduling platform that allows Zappos, customer service employees to select their work hours. The novel tweak in the OM system is that it compensates customer service employees based on a surge-pricing payment model (first popularized by the taxi-hailing service, Uber). Hsieh states, "Ideally, we want all 10 core values to be reflected in everything we do, including how we interact with each other, how we interact with our customers, and how we interact with our vendors and business partners. . . . Our core values should always be the framework from which we make all of our decisions."[66] Zappos' 10 core values are important to its employees; they define their identity of what it means to be working at Zappos.[67]

Chapter 5 discussed how firms can use the balanced-scorecard framework as a strategic control system. Here, we discuss additional control-and-reward systems: organizational culture, input controls, and output controls.

As just demonstrated, *organizational culture* can be a powerful motivator. It also can be an effective control system. Norms, informal and tacit in nature, act as a social control mechanism. Zappos, for example, achieves organizational control partly through an employee's peer group: Each group member's compensation, including the supervisor's, depends in part on the group's overall productivity. Peer control, therefore, exerts a powerful force on employee conformity and performance.[68] Values and norms also provide control by helping employees address unpredictable and irregular situations and problems (common in service businesses). In contrast, rules and procedures (e.g., codified in an employee handbook) can address only circumstances that can be predicted.

INPUT CONTROLS

input controls Mechanisms in a strategic control-and-reward system that seek to define and direct employee behavior through a set of explicit, codified rules and standard operating procedures that are considered prior to the value-creating activities.

Input controls seek to define and direct employee behavior through a set of explicit, codified rules and standard operating procedures. Firms use input controls when the goal is to define the ways and means to reach a strategic goal and to ensure a predictable outcome. They are called input controls because management designs these mechanisms so they are considered *before* employees make any business decisions; thus, they are an input into the value-creating activities.

The use of *budgets* is key to input controls. Managers set budgets before employees define and undertake the actual business activities. For example, managers decide how much money to allocate to a certain R&D project before the project begins. In diversified companies using the M-form, corporate headquarters determines the budgets for each division. Public institutions, like some universities, also operate on budgets that must be balanced each year. Their funding often depends to a large extent on state appropriations and thus fluctuates depending on the economic cycle. During recessions, budgets tend to be cut, and they expand during boom periods.

Standard operating procedures, or policies and rules, are also a frequently used mechanism when relying on input controls. The discussion on formalization described how McDonald's relies on detailed operating procedures to ensure consistent quality and service worldwide. The goal is to specify the conversion process from beginning to end in great detail to guarantee standardization and minimize deviation. This is important when a company operates in different geographies and with different human capital throughout the globe but needs to deliver a standardized product or service.

OUTPUT CONTROLS

output controls Mechanisms in a strategic control-and-reward system that seek to guide employee behavior by defining expected results (outputs), but leave the means to those results open to individual employees, groups, or SBUs.

Output controls seek to guide employee behavior by defining expected results (outputs), but leave the means to those results open to individual employees, groups, or SBUs. Firms frequently tie employee compensation and rewards to predetermined goals, such as a specific sales target or return on invested capital. When factors internal to the firm determine the relationship between effort and expected performance, outcome controls are especially effective. At the corporate level, outcome controls discourage collaboration among different strategic business units. They are best applied when a firm focuses on a single line of business or pursues unrelated diversification.

These days, more and more work requires creativity and innovation, especially in highly developed economies.[69] As a consequence, so-called *results-only-work-environments (ROWEs)* have attracted significant attention. ROWEs are output controls that attempt to tap intrinsic (rather than extrinsic) employee motivation, which is driven by the employee's interest in and the meaning of the work itself. In contrast, extrinsic motivation is driven by external factors such as awards and higher compensation, or punishments like demotions and layoffs (the *carrot-and-stick approach*). According to a recent synthesis of the strategic human resources literature, intrinsic motivation in a task is highest when an employee has:

- Autonomy *(about what to do)*.
- Mastery *(how to do it)*.
- Purpose *(why to do it)*.[70]

Today, 3M is best known for its adhesives and other consumer and industrial products.[71] But its full name reflects its origins: 3M stands for Minnesota Mining and Manufacturing Company. Over time, 3M has relied on the ROWE framework and has morphed into a highly science-driven innovation company. At 3M, employees are encouraged to spend 15 percent of their time on projects of their *own choosing.* If any of these projects look promising, 3M provides financing through an internal venture capital fund and other resources to further develop their commercial potential. In fact, several of 3M's flagship products, including Post-it Notes and Scotch Tape, were the results of serendipity. To foster continued innovation, moreover, 3M requires each of its divisions to derive at least 30 percent of their revenues from products introduced in the past four years.

11.5 ◀▶ Implications for the Strategist

This chapter has a clear practical implication for the strategist: Formulating an effective strategy is a necessary but not sufficient condition for gaining and sustaining competitive advantage; strategy *execution* is at least as important for success. Successful strategy implementation requires managers to design and shape structure, culture, and control mechanisms. In doing so, they execute a firm's strategy as they put its accompanying business model into action. Strategy formulation and strategy implementation, therefore, are iterative and interdependent activities.

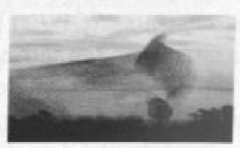
Some argue that strategy implementation is more important than strategy formulation.[72] Often, managers do a good job of analyzing the firm's internal and external environments to formulate a promising business, corporate, and global strategy, but then fail to implement the chosen strategy successfully. That is why some scholars refer to implementation as the "graveyard of strategy."[73]

As a company grows and its operations become more complex, it adopts different organizational structures over time following a generally predictable pattern: beginning with a simple structure, then a functional structure, and followed by a multidivisional or matrix structure.

Organizing for competitive advantage, therefore, is a dynamic and not a static process. As seen in the Zappos example discussed throughout the chapter, in order to maintain competitive advantage, companies need to restructure as they grow and the competitive environment changes.

This concludes our discussion of organizational design. We now move on to our concluding chapter, where we study corporate governance and business ethics.

CHAPTERCASE 11 / Consider This



ZAPPOS' IMPLEMENTION OF holacracy is not going well. As a consequence, employee morale has plummeted, and Zappos employees are no longer as happy. In 2014, Zappos was ranked seventh in *Fortune*'s "100 Best Companies to Work For" list (one of the highest ranking for a relatively young firm). By 2015, after it started implementing holacracy, Zappos had dropped to rank 86! In addition, more than 200 employees, or some 14 percent of Zappos' work force, accepted the offer of a three-month severance package if they didn't like the switch to holacracy and quit. Employees that remain with Zappos complain that the holacracy implementation removes clear career paths for advancement and wonder openly how hiring, firing, and promoting will now be done. They are concerned that relying on employee circles for making decisions will not only induce paralysis, but also make the organization more and not less political. In sum, they find that holacracy forces them to waste time in meetings rather than getting the actual work done.

After the initial implementation struggle, Hsieh remains committed and is doubling down on holacracy implementation. He expressed his frustration about the slow process and lack of productivity gains in a lengthy e-mail to all Zappos employees, which was subsequently leaked to the business press. At the same time, the irony that Hsieh decreed top-down that Zappos would be implementing holacracy (or decided a few years earlier to sell the company to Amazon.com) wasn't lost on the company's workers.

Questions

1. What elements of an organic organization are apparent from the chapter material on Zappos? (Refer to Exhibit 11.3.)
2. What is holacracy, and how does this organizational structure differ from the more traditional ones discussed in this chapter?
3. Why is Zappos experiencing significant implementation problems with holacracy? What else could Zappos do to help implement the new structure more effectively?
4. Do you think that holacracy is a good match with Zappos' business strategy? Why or why not? Explain.

TAKE-AWAY CONCEPTS

This chapter explored the three key levers that managers have at their disposal when designing their firms for competitive advantage—structure, culture, and control—as summarized by the following learning objectives and related take-away concepts.

LO 11-1 / Define organizational design and list its three components.

- Organizational design is the process of creating, implementing, monitoring, and modifying the structure, processes, and procedures of an organization.
- The key components of organizational design are structure, culture, and control.
- The goal is to design an organization that allows managers to effectively translate their chosen strategy into a realized one.

LO 11-2 / Explain how organizational inertia can lead established firms to failure.

- Organizational inertia can lead to the failure of established firms when a tightly coupled system of strategy and structure experiences internal or external shifts.
- Firm failure happens through a dynamic, four-step process (see Exhibit 11.2).

LO 11-3 / Define organizational structure and describe its four elements.

- An organizational structure determines how firms orchestrate employees' work efforts and distribute resources. It defines how firms divide and integrate tasks, delineates the reporting relationships up and down the hierarchy, defines formal communication channels, and prescribes how employees coordinate work efforts.
- The four building blocks of an organizational structure are specialization, formalization, centralization, and hierarchy (see Exhibit 11.3).

LO 11-4 / Compare and contrast mechanistic versus organic organizations.

- Organic organizations are characterized by a low degree of specialization and formalization, a flat organizational structure, and decentralized decision making.
- Mechanistic organizations are described by a high degree of specialization and formalization, and a tall hierarchy that relies on centralized decision making.
- The comparative effectiveness of mechanistic versus organic organizational forms depends on the context.

LO 11-5 / Describe different organizational structures and match them with appropriate strategies.

- To gain and sustain competitive advantage, not only must structure follow strategy, but also the chosen organizational form must match the firm's business strategy.
- The strategy–structure relationship is dynamic, changing in a predictable pattern—from simple to functional structure, then to multidivisional (M-form) and matrix structure—as firms grow in size and complexity.
- In a simple structure, the founder tends to make all the important strategic decisions as well as run the day-to-day operations.
- A functional structure groups employees into distinct functional areas based on domain expertise. Its different variations are matched with different business strategies: cost leadership, differentiation, and blue ocean (see Exhibit 11.6).
- The multidivisional (M-form) structure consists of several distinct SBUs, each with its own profit-and-loss responsibility. Each SBU operates more or less independently from one another, led by a CEO responsible for the business strategy of the unit and its day-to-day operations (see Exhibit 11.7).
- The matrix structure is a mixture of two organizational forms: the M-form and the functional structure (see Exhibit 11.9).
- Exhibits 11.8 and 11.10 show how best to match different corporate and global strategies with respective organizational structures.

LO 11-6 / Describe the elements of organizational culture, and explain where organizational cultures can come from and how they can be changed.

- Organizational culture describes the collectively shared values and norms of its members.
- Values define what is considered important, and norms define appropriate employee attitudes and behaviors.
- Corporate culture finds its expression in artifacts, which are observable expressions of an organization's culture.

LO 11-7 / Compare and contrast different strategic control-and-reward systems.

- Strategic control-and-reward systems are internal governance mechanisms put in place to align the incentives of principals (shareholders) and agents (employees).
- Strategic control-and-reward systems allow managers to specify goals, measure progress, and provide performance feedback.
- In addition to the balanced-scorecard framework, managers can use organizational culture, input controls, and output controls as part of the firm's strategic control-and-reward systems.
- Input controls define and direct employee behavior through explicit and codified rules and standard operating procedures.
- Output controls guide employee behavior by defining expected results, but leave the means to those results open to individual employees, groups, or SBUs.