CHAPTER 8
Organization Structure

LEARNING OBJECTIVES
After studying Chapter 8, you will know:

1. How differentiation and integration influence an organization's structure.
2. How authority operates.
3. The roles of the board of directors and the chief executive officer.
5. How to delegate work effectively.
6. The difference between centralized and decentralized organizations.
7. How to allocate jobs to work units.
8. How to manage the unique challenges of the matrix organization.
9. The nature of important integrative mechanisms.

CHAPTER OUTLINE
Fundamentals of Organizing
   Differentiation
   Integration
The Vertical Structure
   Authority in Organizations
   Hierarchical Levels
   Span of Control
   Delegation
   Decentralization
The Horizontal Structure
   The Functional Organization
   The Divisional Organization
   The Matrix Organization
Organizational Integration
   Coordination by Standardization
   Coordination by Plan
   Coordination by Mutual Adjustment
   Coordination and Communication
Looking Ahead

Take my assets—but leave me my organization and in five years I'll have it all back.
—Alfred P. Sloan, Jr.
ADIDAS ENTERS A THREE-LEGGED RACE

Faced with sagging sales in North America as well as tough competition in Europe, Adidas has been reevaluating its game plan and getting its structure in shape. By trimming the fat of duplicated functions and integrating its U.S. organization into the company’s global structure, Adidas is expected to return to the industry’s “A-team.”

The company has a redesigned, three-divisional approach that veers from the traditional “footwear and apparel” structure of most other sporting goods companies. Each of the three divisions will produce its own footwear and apparel lines in order of the total business and will log double-digit annual growth beginning in 2001.

- The Adidas Equipment division focuses on multifunctional products and is the bridge between the Forever Sport and Original lines. The category uses the new Adidas Equipment logo and eventually will account for 5 to 10 percent of the overall business.

Herbert Hainer, Adidas-Salomon CEO and chairman of the board, concluded, “Our new... organisational structure will revolutionize the way Adidas does business. It will provide us with the dynamic framework that we need to aggressively expand our business and will enable us to deliver significant growth rates in the coming years.”

The onetime professional soccer player is making a major push for the $7.8 billion U.S. market, which accounts for nearly half of global athletic footwear sales. Things seem to be going Hainer’s way; he won high marks for nuts-and-bolts stuff like shortening the product-development cycle and speeding product delivery.

Adidas was the best-performing stock on Germany’s DAX in 2001, rising 26.5 percent even as the index slumped 19.8 percent. Hainer also kept his promise to deliver 15 percent growth in profits for 2001: $182 million on sales of $5.3 billion. But with the U.S. athletic shoe market flat, it will be hard for Adidas’s boss to move closer to his goal of wringing 40 to 50 percent of revenues out of the United States, up from 30 percent now.

Adidas, the world’s number two sporting goods maker after Nike Inc., didn’t have to pay for the use of its trademark three-stripe apparel in the movie The Royal T enenbaums. Hainer could use a few more breaks like that.

Adidas is a company that pretty much all of us know, but the material in “Setting the Stage” gives us some insight into its struggles and plans for the future. Although a quick story such as this doesn’t provide all the details about Adidas’s strategy and structure, it does highlight a few important issues that we want to cover in this chapter. Make no mistake: How a company organizes itself is as important as—if not more important than—its strategy. And Adidas, like many other companies, is working hard to make certain that its strategy and structure are aligned with each other.

This chapter focuses on the vertical and horizontal dimensions of organization structure. We begin by covering basic principles of differentiation and integration. Next, we discuss the vertical structure, which includes issues of authority, hierarchy, delegation, and decentralization. We continue on to describe the horizontal structure, which includes functional, divisional, and matrix forms. Finally, we illustrate the ways in which organizations can integrate their structures: coordination by standardization, coordination by plan, and coordination by mutual adjustment.

In the next chapter, we continue with the topic of organization structure but take a different perspective. In that chapter we will focus on the flexibility and responsiveness of an organization, that is, how capable it is of changing its form and adapting to strategy, technology, the environment, and so on.

**Fundamentals of Organizing**

To get going, let’s start simple. We often begin to describe a firm’s structure by looking at its organization chart. The *organization chart* depicts the positions in the firm and how they are arranged. The chart provides a picture of the reporting structure (who reports to whom) and the various activities that are carried out by different individuals. Most companies have official organizational charts drawn up to give people this information.

Figure 8.1 shows the traditional organization chart. Note the various kinds of information that are conveyed in a very simple way:

1. The boxes represent different work.
2. The titles in the boxes show the work performed by each unit.
3. Reporting and authority relationships are indicated by solid lines showing superior-subordinate connections.
4. Levels of management are indicated by the number of horizontal layers in the chart. All persons or units that are of the same rank and report to the same person are on one level.

Although the organization chart presents some clearly important structural features, there are other design issues related to structure that—while not so obvious—are no less important. Two fundamental concepts around which organizations are structured are differentiation and integration. **Differentiation** means that the organization is composed of many different units that work on different kinds of tasks, using different skills and work methods. **Integration** means that these differentiated units are put back together so that work is coordinated into an overall product.¹

**Differentiation**

Several related concepts underlie the idea of structural differentiation. For example, differentiation is created through division of labor and job specialization. **Division of labor** means that the work of the organization is subdivided into smaller tasks. Various individuals and units throughout the
organization perform different tasks. Specialization, in turn, refers to the fact that different people or groups often perform specific parts of the entire task. The two concepts are, of course, closely related. Secretaries and accountants specialize in, and perform, different jobs; similarly, marketing, finance, and human resources tasks are divided among the respective departments. The numerous tasks that must be carried out in an organization make specialization and division of labor necessities. Otherwise the complexity of the overall work of the organization would be too much for any individual.\(^2\)

Differentiation is high when there are many subunits and many kinds of specialists who think differently. Harvard professors Lawrence and Lorsch found that organizations in complex, dynamic environments (plastics firms in their study) developed a high degree of differentiation in order to cope with the complex challenges. Companies in simple, stable environments (container companies) had low levels of differentiation. Companies in intermediate environments (food companies) had intermediate differentiation.\(^3\)

**Integration**

As organizations differentiate their structures, managers must simultaneously consider issues of integration. All the specialized tasks in an organization cannot be performed completely independently. Because the different units are part of the larger organization, some degree of communication and cooperation must exist among them. Integration and its related concept, coordination, refer to the procedures that link the various parts of the organization to achieve the organization’s overall mission.

Integration is achieved through structural mechanisms that enhance collaboration and coordination. Any job activity that links different work units performs an integrative function. Remember, the more highly differentiated
A disenchanted investor vows to vote in favor of every shareholder resolution he can find. An angry employee says she feels betrayed by bosses who have grown rich on stock options while putting the squeeze on health benefits and salaries. A deal maker trying to close a sale hears yet another buyer grouse: “Who’s to say this guy isn’t lying about the numbers like everyone else?” The latest wave of skepticism may have started with Enron Corp.’s ugly demise, but with each revelation of corporate excess or wrongdoing, the goodwill built up by business during the boom of the last decade has eroded a little more, giving way to widespread suspicion and mistrust.

The sight of Enron employees tearfully testifying before Congress was a watershed moment in American capitalism. Enron added to the sense that no matter how serious their failure or how imperiled the corporation, those in charge always seem to walk away vastly enriched, while employees and shareholders are left to suffer the consequences of the top managers’ ineptitude or malfeasance. When IBM used $290 million from the sale of a business three days before the end of the fourth quarter of 2001 to help it beat Wall Street’s profit forecast, it did what was perfectly legal—yet entirely misleading. Such distortions have become commonplace as companies strive to hit a target even at the cost of clarity and fairness.

The inevitable result is growing outrage among corporate stakeholders. Unchecked, that rising bitterness and distrust could prove costly to business and to society. The loss of trust threatens our ability to create new jobs and reignite the economy. It also leaves a taint on the majority of executives and corporations that act with integrity. Directors who fail to direct and CEOs who fail at moral leadership are arguably the most serious challenge facing corporate America today.

More than a half century ago, the Columbia University professors Adolf A. Berle and Gardiner C. Means made clear the divergence between the owners of a corporation and
the professional managers hired to run it. After years of lavish stock-option rewards meant to remedy the problem, this divergence is more extreme than ever. The senior executives of public corporations today are often among the largest individual owners of those enterprises, and board members are far more likely to have major equity stakes as well, whether through actual stock ownership or through option grants. In theory, this ownership was supposed to align the interests of management and directors with those of shareholders. However, executives and directors realized that their personal wealth was so closely tied to the price of the company stock that maintaining the share price became the highest corporate value.

As the market overheated, it became less and less tolerant of even the slightest whiff of bad news, rumors of which could wipe out hundreds of millions of dollars of market value at a stroke. Anita M. McGahan, a Boston University business professor, says, “The stakes in admitting problems were very high, both because the market overvalued their stock and because of executive pay.” A study by J. Richard Finlay, chairman of Canada’s Center for Corporate and Public Governance, showed that many boards devote far more time and energy to compensation than to assuring the integrity of the company’s financial reporting systems. At Oracle Corp., where CEO Laurence J. Ellison’s exercise of stock options just before the company issued an earnings warning led to a record $706.1 million payout in 2001, the full board met on only five occasions and acted by written consent three times. The compensation committee, by contrast, acted 24 times in formal session or by written consent.

In a report filed by William C. Powers, Jr., an Enron board member, he and his colleagues found an almost total collapse in board oversight. The Powers report concluded that the board’s controls were inadequate, that its committees carried out reviews “only in a cursory way,” and that the board failed to appreciate “the significance of some of the specific information that came before it.”

It’s not just the corporation that is at fault. Many of the corporation’s outside professionals fell prey to greed and self-interest as well, from Wall Street analysts and investment bankers to auditors and lawyers and even regulators and lawmakers. These players, who are supposed to provide the crucial checks and balances in a system that favors unfettered capitalism, have in many cases been compromised.

• Many analysts urged investors to buy shares in companies solely because their investment banker colleagues could reap big fees for handling underwriting and merger business.
• Far too many auditors responsible for certifying the accuracy of a company’s accounts looked the other way so that their firms could rake in millions from audit fees and millions more from higher-margin consulting work.
• Some outside lawyers invented justifications for less than pristine practices to win a bigger cut of the legal fees.
• Far too often, CEOs found that they could buy all the influence they wanted or needed.


Authority in Organizations

Authority, the legitimate right to make decisions and to tell other people what to do, is fundamental to the functioning of every organization. For example, a boss has the authority to give an order to a subordinate.

Authority resides in positions rather than in people. Thus, the job of vice president of a particular division has authority over that division, regardless of how many people come and go in that position and who currently holds it.

In private business enterprises, the owners have ultimate authority. In most small, simply structured companies, the owner also acts as manager. Sometimes the owner hires another person to manage the business and its employees. The owner gives this
manager some authority to oversee the operations, but the manager is accountable to—that is, reports and defers to—the owner. Thus, the owner still has the ultimate authority.

Traditionally, authority has been the primary means of running an organization. An order that a boss gives to a lower-level employee usually is carried out. As this occurs throughout the organization day after day, the organization can move forward toward achieving its goals.

We will discuss the authority structure of organizations from the top down, beginning with the board of directors.

**The Board of Directors**  In corporations, the owners are the stockholders. But because there are numerous stockholders and these individuals generally lack timely information, few are directly involved in managing the organization. Stockholders elect a board of directors to oversee the organization. The board, led by the chair, makes major decisions affecting the organization, subject to corporate charter and bylaw provisions. Boards perform at least three major sets of duties: (1) selecting, assessing, rewarding, and perhaps replacing the CEO; (2) determining the firm’s strategic direction and reviewing financial performance; and (3) assuring ethical, socially responsible, and legal conduct.

Some top executives are likely to sit on the board (they are called inside directors). Outside members of the board tend to be executives at other companies. The trend in recent years has been toward reducing the number of insiders and increasing the number of outsiders. Today most companies have a majority of outside directors. Boards made up of strong, independent outsiders are more likely to provide different information and perspectives and to prevent big mistakes. Successful boards tend to be those which are active, critical participants in determining company strategies. Campbell Soup’s board, for example, took control over selecting a new CEO and routinely conducts performance evaluations of board members to make certain they are active contributors.

**The Chief Executive Officer**  The authority officially vested in the board of directors is assigned to a chief executive officer (CEO), who occupies the top of the organizational pyramid. The CEO is personally accountable to the board and to the owners for the organization’s performance.

It is estimated that in 15 percent of Fortune 500 corporations, one person holds all three positions of CEO, chair of the board of directors, and president. More commonly, however, one person holds two of those positions, with the CEO serving also...
as either the chair of the board or the president of the organization. When the CEO is president, the chair may be honorary and may do little more than conduct meetings. In other cases, the chair may be the CEO and the president is second in command.

**The Top Management Team** Increasingly, CEOs share their authority with other key members of the top management team. Top management teams typically are composed of the CEO, president, chief operating officer, chief financial officer, and other key executives. Rather than make critical decisions on their own, CEOs at companies such as Shell, Honeywell, and Merck regularly meet with their top management teams to make decisions as a unit.9

**Hierarchical Levels**

In Chapter 1, we discussed the three broad levels of the organizational pyramid, commonly called the hierarchy. The CEO occupies the top position and is the senior member of top management. The top managerial level also includes presidents and vice presidents. These are the strategic managers in charge of the entire organization. The second broad level is middle management. At this level, managers are in charge of plants or departments. The lowest level is made up of lower management and workers. It includes office managers, sales managers, supervisors, and other first-line managers, as well as the employees who report directly to them. This level is also called the operational level of the organization.

An authority structure is the glue that holds these levels together. Generally (but not always), people at higher levels have the authority to make decisions and tell lower-level people what to do. For example, middle managers can give orders to first-line supervisors; first-line supervisors, in turn, direct operative-level workers.

A powerful trend for U.S. businesses over the past few decades has been to reduce the number of hierarchical layers. General Electric used to have 29 levels; today, after a major reorganization, it has only 5. Most executives today believe that fewer layers create a more efficient, fast-acting, and cost-effective organization. This also holds true for the subunits of major corporations. A study of 234 branches of a financial services company found that branches with fewer layers tended to have higher operating efficiency than did branches with more layers.10

**Span of Control**

The number of people under a manager is an important feature of an organization’s structure. The number of subordinates who report directly to an executive or supervisor is called the span of control. The implications of differences in the span of control for the shape of an organization are straightforward. Holding size constant, narrow spans build a tall organization that has many reporting levels. Wide spans create a flat organization with fewer reporting levels. The span of control can be too narrow or too wide. The optimal span of control maximizes effectiveness because it is (1) narrow enough to permit managers to maintain control over subordinates but (2) not so narrow that it leads to overcontrol and an excessive number of managers who oversee a small number of subordinates.

What is the optimal number of subordinates? Five, according to Napoleon.11 Some managers today still consider five a good number. At one Japanese bank, in contrast, several hundred branch managers report to the same boss.

Actually, the optimal span of control depends on a number of factors. The span should be wider when (1) the work is clearly defined and unambiguous, (2) subordinates are highly trained and have access to information, (3) the manager is highly capable and supportive, (4) jobs are similar and performance measures are comparable, and (5) subordinates prefer autonomy to close supervisory control. If the opposite conditions exist, a narrow span of control may be more appropriate.12
Delegation

As we look at organizations, and recognize that authority is spread out over various levels and spans of control, the issue of delegation becomes paramount. Specifically, delegation is the assignment of authority and responsibility to a subordinate at a lower level. It requires that the subordinate report back to his or her boss in regard to how effectively the assignment was carried out. Delegation is perhaps the most fundamental feature of management, because it entails getting work done through others. Thus, delegation is important at all hierarchical levels. The process can occur between any two individuals in any type of structure with regard to any task.

Some managers are comfortable delegating to subordinates; others are not. Consider the differences between these two office managers and the ways they gave out the same assignment in the following example.

Manager A: “Call Tom Burton at Nittany Office Equipment. Ask him to give you the price list on an upgrade for our personal computers. I want to move up to a Pentium III with 256 megs of RAM and at least a 40-gigabyte hard drive. Ask them to give you a demonstration of Windows 2000 and Office 2000. I want to be able to establish a LAN for the entire group. Invite Cochran and Snow to the demonstration and let them try it out. Have them write up a summary of their needs and the potential applications they see for the new systems. Then prepare me a report with the costs and specifications of the upgrade for the entire department. Oh, yes, be sure to ask for information on service costs.”

Manager B: “I’d like to do something about our personal computer system. I’ve been getting some complaints that the current systems are too slow, can’t run current software, and don’t allow for networking. Could you evaluate our options and give me a recommendation on what we should do? Our budget is probably around $3,500 per person, but I’d like to stay under that if we can. Feel free to talk to some of the managers to get their input, but we need to have this done as soon as possible.”

Responsibility, Authority, and Accountability

When delegating work, it is helpful to keep in mind the important distinctions among the concepts of authority, responsibility, and accountability.

Responsibility means that a person is assigned a task that he or she is supposed to carry out. When delegating work responsibilities, the manager also should delegate to the subordinate enough authority to get the job done. Authority, recall, means that the person has the power and the right to make decisions, give orders, draw upon resources, and do whatever else is necessary to fulfill the responsibility. Ironically, it is quite common for people to have more responsibility than authority; they must perform as best they can through informal influence tactics instead of relying purely on authority. More will be said about informal power and how to use it in Chapter 12.

As the manager delegates responsibilities, subordinates are held accountable for achieving results. Accountability means that the subordinate’s manager has the right to expect the subordinate to perform the job, and the right to take corrective action if the subordinate fails to do so. The subordinate must report upward on the status and quality of his or her performance of the task.

However, the ultimate responsibility—accountability to higher-ups—lies with the manager doing the delegating. Managers remain responsible
and accountable not only for their own actions but for the actions of their subordinates. Thus, managers should not resort to delegation to others as a means of escaping their own responsibilities. In many cases, however, managers refuse to accept responsibility for subordinates’ actions. Managers often “pass the buck” or take other evasive action to ensure they are not held accountable for mistakes.13

**Advantages of Delegation**  Delegating work offers important advantages. The manager saves time by giving some of his or her own responsibilities to someone else. Then the manager is free to devote energy to important, higher-level activities such as planning, setting objectives, and monitoring performance. Delegation essentially gives the subordinate a more important job. The subordinate acquires an opportunity to develop new skills and to demonstrate potential for additional responsibilities and perhaps promotion. In essence, the subordinate receives a vital form of on-the-job training that could pay off in the future.

The organization also receives payoffs. Allowing managers to devote more time to important managerial functions while lower-level employees carry out assignments means that jobs are done in a more efficient and cost-effective manner.

**How Should Managers Delegate?**  To achieve the advantages just discussed, delegation must be done properly. As Figure 8.2 shows, effective delegation proceeds through several steps.14

The first step in the delegation process, defining the goal, requires that the manager have a clear understanding of the outcome he or she wants. Then the manager should select a person who is capable of performing the task.

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**FIGURE 8.2**  The Steps in Effective Delegation

- Define the goal succinctly
- Select the person for the task
- Solicit the subordinate’s views about suggested approaches
- Give the subordinate the authority, time, and resources (people, money, equipment) to perform the assignment
- Schedule checkpoints for reviewing progress
- Follow through by discussing progress at appropriate intervals
The person who gets the assignment should be given the authority, time, and resources needed to carry out the task successfully. Throughout the delegation process, the manager and the subordinate must work together and communicate about the project. The manager should know the subordinate’s ideas at the beginning and inquire about progress or problems at periodic meetings and review sessions. Thus, even though the subordinate performs the assignment, the manager is available and aware of its current status.

Some tasks, such as disciplining subordinates and conducting performance reviews, should not be delegated. But when managers err, it usually is because they delegated too little rather than too much. The manager who wants to learn how to delegate more effectively should remember this distinction: If you are not delegating, you are merely doing things; but the more you delegate, the more you are truly building and managing an organization.15

Here’s what we look for in evaluating boards:

**INDEPENDENCE**

No more than two directors should be current or former company executives, and none should do business with the company or accept consulting or legal fees from it. The audit, compensation, and nominating committees should be made up solely of independent directors.

**STOCK OWNERSHIP**

Each director should own an equity stake in the company worth at least $150,000, excluding stock options. The only exception: new board members who haven’t had time to build a large stake.

**DIRECTOR QUALITY**

Boards should include at least one independent director with experience in the company’s core business and one who is the CEO of an equivalent-size company. Fully employed directors should sit on no more than four boards, retirees no more than seven. Each director should attend at least 75% of all meetings.

**BOARD ACTIVISM**

Boards should meet regularly without management present and should evaluate their own performance every year. Audit committees should meet at least four times a year. Boards should be frugal on executive pay, decisive when planning a CEO succession, diligent in oversight responsibilities, and quick to act when trouble strikes.

**How We Rated Them:** The BusinessWeek ratings were based on a survey of 51 governance experts conducted for BusinessWeek by Harris Interactive, a proxy analysis by BusinessWeek of companies identified by survey respondents as having the “most effective” and “least effective” boards, and an analysis of overall board performance by BusinessWeek editors. The proxy analysis grades each company on the extent to which it meets 16 governance standards in the areas of independence, accountability, and quality. Performance measures include the board’s handling of strategy, oversight, and executive pay. Data were provided by the Investor Responsibility Research Center, the Corporate Library, and Institutional Shareholder Services.
BEST BOARDS

3M  With just one insider on its nine-member board, the company gets high marks for independence. Outside directors include the CEOs of Lockheed-Martin, Allstate, and Amgen. Audit-committee chairman is the former CFO at Sears. No directors have business ties to the company.

APRIA HEALTHCARE  A favorite among governance experts, the board includes three top shareholder activists and features a separate chairman and CEO, a rarity. It moved quickly to accept the resignation of a former CEO when directors discovered that his wife had been hired for a company job.

COLGATE-PALMOLIVE  Directors are well-invested in the company and sit on few additional boards. The compensation committee has awarded premium-priced options to CEO Reuben Mark, which pay off only if stock appreciates by 10% to 70%. A new section on governance has been added to the latest proxy.

GENERAL ELECTRIC  This talent-packed board, with an unrivaled record of creating shareholder value, remains a favorite with governance experts, although there have been recent revelations of lavish retirement perks for former CEO Jack Welch. The company is improving board independence; it recently added Ralph Larsen, former CEO of Johnson & Johnson (JNJ) and a longtime champion of good governance. The board recently moved to expense options.

HOME DEPOT  With the departure of co-founder Bernard Marcus, the 12-member board now has only two insiders. Independent directors meet regularly without management. Directors are required to visit 20 stores a year.

INTEL  One of the few boards that have a lead director. No insiders sit on the audit, compensation, or nominating committees. The board conducts an annual self-evaluation. Directors have big stakes in the company.

JOHNSON & JOHNSON  The high-powered board includes Delta Air Lines (DAL) CEO Leo Mullin, Lucent Technologies Chairman Henry Schacht, and CSX CEO John Snow. The outside board members own plenty of J&J stock. Only one director sits on more than four boards.

MEDTRONIC  Governance gurus applaud the board’s practice of holding regular meetings without the CEO and its performance evaluations for directors. Members are graded on willingness to “hold management accountable” and “meaningful participation” at meetings.

PFIZER  The board was second only to GE in overall approval by governance experts. Independent directors meet without the CEO. No Pfizer executives sit on the audit, nominating, or compensation committees. Stock transactions for directors and executives are posted on the company Web site.

TEXAS INSTRUMENTS  Making its third appearance on BusinessWeek’s Best Boards list, this highly independent board boasts a roster of well-invested outside directors, including the chief executives of Norfolk Southern, Kimberly-Clark, and Eastman Kodak (EK).

WORST BOARDS

APPLE  Founder Steve Jobs owns just two shares in the company. Recently departed director Larry Ellison had none and had missed more than 25% of meetings in the past five years. The CEO of Micro Warehouse, which accounted for nearly 2.9% of Apple’s net sales in 2001, sits on the compensation committee. Since 2000, the board has awarded Jobs 27.5 million stock options and a $90 million jet. There is an interlocking directorship—with Gap CEO Mickey Drexler and Jobs sitting on each other’s boards.
CONSECO In 2000, the company spent a hefty $45 million to recruit CEO Gary Wendt from GE Capital. Despite the company’s recent slide, in July—with the stock hovering at $1—the board awarded Wendt an $8 million bonus. In August, the shares were delisted from the Big Board and now trade at 7 cents. None is a CEO. The board doesn’t meet without the CEO at present.

DILLARD’S Before his death in February, Chairman William Dillard presided over a board that included seven directors with ties to the company, including four of his children. No nominating committee—allowing the CEO to hand-pick directors. With two-thirds of board elected by holders of privately held Class B shares, Dillard’s is exempt from NYSE governance rules.

GAP Self-dealing includes contracts with the chairman’s brother to build and remodel stores and a consulting deal with the chairman’s wife. Slow to replace outgoing CEO Mickey Drexler as performance declined. Interlocking directorship with Drexler sitting on the Apple board, while Apple’s Steve Jobs sits on Gap’s. Two other directors sit on the Charles Schwab board, while Chuck Schwab sits on Gap’s.

KMART The board’s woes include multiple investigations of company accounting, a $501 million profit restatement, and a federal grand jury probe into pay practices. The board was passive as the company’s performance deteriorated before a bankruptcy filing in January. Meanwhile, the board approved $28 million in retention loans to 25 top executives.

QWEST Founder Philip Anschutz has extensive dealings with the company and sits on compensation and nominating committees. The SEC is probing whether Qwest used “swap” transactions to boost revenue. The compensation committee—described as “comatose” by one expert—awarded ex-CEO Joseph Nacchio an $88 million pay package in 2001, one of the worst years in the company’s history. No outside director has operating experience in the company’s core business.

TYSON FOODS Out of 15 board members, 10 have ties to the company, including seven who have extensive business dealings. CEO John Tyson got a $2.1 million bonus for negotiating the acquisition of meatpacker IBP—which Tyson Foods tried unsuccessfully to back out of—in a year when net income fell 42%. Feds say the company for years conspired to smuggle workers from Mexico for its U.S. poultry-processing plants, a charge Tyson denies.

XEROX The bungled succession of Paul Allaire, accusations of funny accounting, billions in shareholder wealth up in smoke, and a decades-long failure to keep up with changing technology add up to an ineffectual board. With departures of Allaire and CFO Barry Romeril, the board is far more independent. But too many directors sit on too many boards. Director Vernon Jordan’s law firm provides legal services. Two audit committee members had attendance problems last year.

HALL OF SHAME

ADELPHIA COMMUNICATIONS Epic self-dealing by members of the Rigas family went undetected. Board has ousted worst offenders, withheld $4.2 million in severance for founder John Rigas. But for Adelphia shareholders, it’s too little too late.

ENRON Biggest governance failure in modern corporate history. The board twice waived its ethics guidelines to allow the CFO to participate in off-balance-sheet deals. Ignored warnings from auditors concerning “high-risk” accounting. Failed to follow up on allegations from whistle-blower Sherron Watkins. Directors disavowed responsibility for company failure under oath before Congress.

GLOBAL CROSSING Three of seven directors are insiders. Audit committee lacks anyone with hands-on finance or accounting experience. Company is in bankruptcy. Accounting is under investigation. But chairman Gary Winnick is sitting pretty: He sold $735 million in stock before company’s collapse.
METROMEDIA FIBER NETWORK Before a bankruptcy filing in May, three of board’s eight members had ties to Metromedia or affiliated companies. The SEC is investigating accounting problems. The company has announced it will write down $4 billion in assets and restate financials for three quarters in 2001. Several directors sold more than $150 million in stock before the company’s problems became widely known.

TYCO Disgraced CEO Dennis Kozlowski and others are alleged to have illegally siphoned off more than $100 million in corporate assets. An internal probe revealed that at least three directors or their companies for years received undisclosed Tyco payments for aircraft leases and legal services. To its credit, the board booted out director Frank Walsh after he refused to return $20 million he received for facilitating the CIT Group merger. Tyco is suing Kozlowski to recover five years of income and severance. All nine Kozlowski-era directors are leaving next year.

WARNACO Retail downturn plus massive debt and restructuring charges drove Linda Wachner’s once-mighty underwear empire into bankruptcy last year—while the board snoozed. It didn’t ask for Wachner’s resignation until five months after the bankruptcy filing. Meanwhile, accounting errors forced the board to restate three years of financials. The SEC is considering enforcement action against the company. Two steps in the right direction: recruiting a former American Express CFO for board and fighting Wachner’s demand for $25 million in severance.

WORLDCOM The board signed off on financials that had overstated profits by $7.1 billion since 2000. Clifford Alexander Jr., who left the board in January after missing half the meetings in 2001, is chairman of Moody’s Investors Service, which didn’t downgrade WorldCom bonds until April. Chairman Bert Roberts owns a company that was paid $405,000 by WorldCom to provide air-transportation services. Since the bankruptcy filing in July, the board has added three independent directors and initiated a search for a permanent CEO.


### Decentralization

The delegation of responsibility and authority decentralizes decision making. In a centralized organization, important decisions usually are made at the top. In decentralized organizations, more decisions are made at lower levels. Ideally, decision making occurs at the level of the people who are most directly affected and have the most intimate knowledge about the problem. This is particularly important when the business environment is fast-changing and decisions must be made quickly and well. Consider the changes at Harley-Davidson.

Most American executives today understand the advantages of pushing decision-making authority down to the point of the action. The level that deals directly with problems and opportunities has the most relevant information and can best foresee the consequences of decisions. Executives also see how the decentralized approach allows people to take more timely action.16

At AES, the world’s largest global power company (with revenues in excess of $3 billion), all decisions are pushed down to the lowest levels in the organization. Teams in plants have total responsibility for operations and maintenance. According to Cofounder Dennis Bakke and Chairman Roger Sant, giving people the power and responsibility to make important decisions has multiple benefits. It leads to better and faster decisions because decisions are made where the action is. Also, it gives employees a chance to learn and get engaged in the business, turning them into “mini-CEOs.” An extreme example of this decentralized approach occurred when the plant executives let the maintenance staff take a stab at investing the $12 million cash reserve held at the plant. By three months into the process, the team was actually beating the returns of the people in the home office who were investing money for the company’s treasury.17
In the 1980s, Harley-Davidson faced tough competition from Honda, Suzuki, and Yamaha. The company was able to survive under the direction of a very strong hierarchical, centralized leadership group. The key structural concerns at that time were reining in control, getting a firm grasp on manufacturing costs, and producing a quality product at a reasonable price.

Today, that approach alone probably won’t work. The days of controlling leaders and dependent followers are long gone. Harley-Davidson made the transition to a flatter, more empowered organization that decentralizes decision making. In order to support individual growth and excellence, Harley-Davidson replaced hierarchy with collaborative leadership. The changes are built on a philosophy that includes employee empowerment and accountability, mutual trust and respect through education and training, open communications, commitment, and problem solving through consensus. As a consequence of pushing down authority, managers are finding that trust replaces fear-based power. Ultimately the goal is to establish a much more innovative organization that taps into the creativity and resourcefulness of its employees. This is believed to be the type of organization needed to address today’s complex business challenges.

Re-creating itself was a success for Harley-Davidson. The firm celebrates its hundredth birthday in 2003, after 16 consecutive years of earnings increases.


The Horizontal Structure

Up to this point, we’ve talked primarily about vertical aspects of organization structure. Issues of authority, span of control, delegation, and decentralization are important in that they give us an idea of how managers and employees relate to one another at different levels. At the same time, separating vertical differentiation from horizontal differentiation is a bit artificial because the elements work simultaneously.

As the tasks of organizations become increasingly complex, the organization inevitably must be subdivided—that is, departmentalized—into smaller units or departments. One of the first places this can be seen is in the distinction between line and staff departments. **Line departments** are those which have responsibility for the principal activities of the firm. Line units deal directly with the organization’s primary goods or services; they make things, sell things, or provide customer service. At General Motors, for example, line departments include product design, fabrication, assembly, distribution, and the like. Line managers typically have much authority and power in the organization. They have the ultimate responsibility for making major operating decisions. They also are accountable for the “bottom-line” results of their decisions.

**Staff departments** are those which provide specialized or professional skills that support line departments. These would include research, legal, accounting, public relations, and human resources departments. Each of these specialized units often has its own vice president, and some are vested with a great deal of authority, as when accounting or finance groups approve and monitor budgetary activities. But while staff units formerly focused on
monitoring and controlling performance, today most staff units are moving toward a new role focused on strategic support and expert advice.18

As organizations divide work into different units, we can detect patterns in the way departments are clustered and arranged. The three basic approaches to departmentalization are functional, divisional, and matrix. We will talk about each and highlight some of their similarities and differences.

The Functional Organization

In a functional organization, jobs (and departments) are specialized and grouped according to business functions and the skills they require: production, marketing, human resources, research and development, finance, accounting, and so forth. At perhaps the most basic level, we can think about a functional structure being organized around a firm’s value chain. A value chain depicts the relationships among separate activities that are performed to create a product or service. Figure 8.3(a) shows a generic value chain, and Figure 8.3(b) shows how it might be translated into an organization’s functional structure.19

Functional departmentalization is common in both large and small organizations. Large companies may organize along several different functional groupings, including groupings unique to their businesses. For example, Carmike Cinemas, which operates 2,275 screens in 312 theaters in 35 states, has vice presidents of finance, real estate, operations, advertising, information systems, technical, and concessions and a vice president who is the head film buyer.

The traditional functional approach to departmentalization has a number of potential advantages for an organization:20

1. **Economies of scale can be realized.** When people with similar skills are grouped, more efficient equipment can be purchased, and discounts for large purchases can be used.
2. **Monitoring of the environment** is more effective. Each functional group is more closely attuned to developments in its own field and therefore can adapt more readily.
3. **Performance standards** are better maintained. People with similar training and interests may develop a shared concern for performance in their jobs.
4. People have greater opportunity for **specialized training** and **in-depth skill development**.
5. Technical specialists are relatively **free of administrative work**.
6. **Decision making** and **lines of communication** are simple and clearly understood.

The functional form has disadvantages as well as advantages. People may care more about their own function than about the company as a whole, and their attention to functional tasks may make them lose focus on overall product quality and customer satisfaction. Managers develop functional expertise but do not acquire knowledge of the other areas of the business; they become specialists, but not generalists. Between functions, conflicts arise, and communication and coordination fall off. In short, while functional differentiation may exist, **functional integration** may not.

As a consequence, the functional structure may be most appropriate in rather simple, stable environments. If the organization becomes fragmented (or dis-integrated), it may be difficult to develop and bring new products to market and difficult to respond quickly to customer demands and other changes. Particularly when companies are growing and business environments are changing, the need arises to integrate work areas more effectively so that the organization can be more flexible and responsive. Other forms of departmentalization can be more flexible and responsive than the functional structure.
Demands for total quality, customer service, innovation, and speed have made clear the shortcomings of the functional form for some firms. Functional organizations are highly differentiated and create barriers to coordination across functions. Cross-functional coordination is essential for total quality, customer service, innovations, and speed. The functional organization will not disappear, in part because functional specialists will always be needed, but functional managers will make fewer decisions. The more important units will be cross-functional teams that have integrative responsibilities for products, processes, or customers.\footnote{21}
The Divisional Organization

The discussion of a functional structure’s weaknesses leads us to the divisional organization. As organizations grow and become increasingly diversified, they find that functional departments have difficulty managing a wide variety of products, customers, and geographic regions. In this case, organizations may restructure in order to group all functions into a single division, and duplicate each of the functions across all the divisions. Division A has its own operations and marketing department, Division B has its own operations and marketing department, and so on. In this regard, separate divisions may act almost as separate businesses or profit centers and work autonomously to accomplish the goals of the entire enterprise. Table 8.1 presents examples of how the same tasks would be organized under functional and divisional structures.

There are several ways to create a divisional structure. It can be created around products, customers, or geographic regions. Each of these is described in the following sections.

Product Divisions In the product organization, all functions that contribute to a given product are organized under one manager. In the product organization, managers in charge of functions for a particular product report to a product manager. Johnson & Johnson is one example of this form. J&J has 168 independent divisions in 33 groups, each responsible for a handful of products worldwide.

The product approach to departmentalization offers a number of advantages:

1. Information needs are managed more easily. Less information is required, because people work closely on one product and need not worry about other products.
2. People have a full-time commitment to a particular product line. They develop a greater awareness of how their jobs fit into the broader scheme.
3. Task responsibilities are clear. When things go wrong in a functional organization, functional managers can “pass the buck” (“That other department is messing up, making it harder for us to do our jobs”). In a product structure, managers are more independent and accountable because they usually have the resources they need to perform their tasks. Also, the performances of different divisions can be compared by contrasting their profits and other measures.
4. People receive broader training. General managers develop a wide variety of skills, and they learn to be judged by results. Many top executives received crucial early experience in product structures.

### TABLE 8.1
Examples of Functional and Divisional Organization

<table>
<thead>
<tr>
<th>Functional Organization</th>
<th>Divisional Organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>A central purchasing department.</td>
<td>Each division has its own purchasing unit.</td>
</tr>
<tr>
<td>Separate companywide marketing, production, design, and engineering departments.</td>
<td>Each product group has experts in marketing, design, production, and engineering.</td>
</tr>
<tr>
<td>A central-city health department.</td>
<td>The school district and the prison have their own health units.</td>
</tr>
<tr>
<td>Plantwide inspection, maintenance, and supply departments.</td>
<td>Production Team Y does its own inspection, maintenance, and supply.</td>
</tr>
<tr>
<td>A university statistics department teaches statistics for the entire university.</td>
<td>Each department hires statisticians to teach its own students.</td>
</tr>
</tbody>
</table>

Because the product structure is more flexible than the functional structure, it is best suited for unstable environments, when an ability to adapt rapidly to change is important. But the product structure also has disadvantages. It is difficult to coordinate across product lines and divisions. And although managers learn to become generalists, they may not acquire the depth of functional expertise that develops in the functional structure.

Furthermore, functions are not centralized at headquarters, where they can be done for all product lines or divisions. Such duplication of effort is expensive. Also, decision making is decentralized in this structure, and so top management can lose some control over decisions made in the divisions. Proper management of all the issues surrounding decentralization and delegation, as discussed earlier, is essential for this structure to be effective.  

**Customer and Geographic Divisions** Some companies build divisions around groups of customers or around geographic distinctions. Adidas, mentioned in “Setting the Stage,” is organized into customer divisions. Similarly, a hospital may organize its services around child, adult, psychiatric, and emergency cases. Bank loan departments commonly allocate assignments on the basis of whether customers are requesting consumer, mortgage, small-business, corporate, or agricultural loans.

In contrast to customers, divisions can be structured around geographic regions. Sears, for example, was a pioneer in creating geographic divisions. Geographic distinctions include district, territory, region, and country. In companies like the industrial wholesaler diagrammed in Figure 8.4, different managers are in charge of the Southwest, Pacific, Midwest, Northeast, and Southeast regions. Seagram International is one of many companies that assign managers to Europe, the Far East, and Latin America.

The primary advantage of both the product and customer/regional approaches to departmentalization is the ability to focus on customer needs and provide faster, better service. But again, duplication of activities across many customer groups and geographic areas is expensive.

**The Matrix Organization**  
A matrix organization is a hybrid form of organization in which functional and divisional forms overlap. Managers and staff personnel report to two bosses—a functional manager...
and a divisional manager. Thus, matrix organizations have a dual rather than a single line of command. Figure 8.5 illustrates the basic matrix structure.

The matrix form originated in the aerospace industry, first with TRW in 1959 and then with NASA. Applications now occur in hospitals and health care agencies, entrepreneurial organizations, government laboratories, financial institutions, and multinational corporations.24 Companies that have used or currently use the matrix form include IBM, Boeing, General Electric, Dow Chemical, Xerox, Shell Oil, Texas Instruments, Bechtel, Phillips Petroleum, and Dow Corning.

**Pros and Cons of the Matrix Form** Like other organization structures, matrix has both strengths and weaknesses. Table 8.2 summarizes the advantages of using a matrix structure. The major potential advantage is a higher degree of flexibility and adaptability.

- Decision making is decentralized to a level where information is processed properly and relevant knowledge is applied.
- Extensive communications networks help process large amounts of information.
- With decisions delegated to appropriate levels, higher management levels are not overloaded with operational decisions.
- Resource utilization is efficient because key resources are shared across several important programs or products at the same time.
- Employees learn the collaborative skills needed to function in an environment characterized by frequent meetings and more informal interactions.
- Dual career ladders are elaborated as more career options become available on both sides of the organization.

**TABLE 8.2**

**Advantages of the Matrix Design**

TABLE 8.3
Disadvantages of the Matrix Design

<table>
<thead>
<tr>
<th>Function</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top Executive</td>
<td>Needs to balance power and emphasis between functions and divisions</td>
</tr>
<tr>
<td>Functional Manager</td>
<td>Must collaborate and manage conflicts with product/division manager</td>
</tr>
<tr>
<td>Product Manager</td>
<td>Must collaborate and manage conflicts with functional manager</td>
</tr>
<tr>
<td>“Two-Boss” Manager</td>
<td>Must learn how to respond to two superiors and prioritize multiple demands</td>
</tr>
</tbody>
</table>

Table 8.3 summarizes the potential shortcomings of the matrix form. Many of the disadvantages stem from the matrix’s inherent violation of the **unity-of-command principle**, which states that a person should have only one boss. Reporting to two superiors can create confusion and a difficult interpersonal situation.

**Matrix Survival Skills**

To a large degree, problems can be avoided if the key managers in the matrix learn the behavioral skills demanded in the matrix structure. These skills vary depending on the job in the four-person diamond structure shown in Figure 8.6.

The **top executive**, who heads the matrix, must learn to balance power and emphasis between the product and functional orientations. **Product or division managers** and **functional managers** must learn to collaborate and manage their conflicts constructively. Finally, the **two-boss managers or employees** at the bottom of the diamond must learn how to be responsible to two superiors. This means prioritizing multiple demands and sometimes even reconciling conflicting orders. Some people function poorly under this ambiguous, conflictual circumstance; sometimes this signals the end of their careers with the company. Others learn to be proactive, communicate effectively with both superiors, rise above the difficulties, and manage these work relationships constructively.

**The Matrix Form Today**

The popularity of the matrix form waned during the end of the 1980s, when many companies had difficulty implementing it. But lately, it
has come back strong. Reasons for this resurgence include pressures to consolidate costs and be faster to market, creating a need for better coordination across functions in the business units, and a need for coordination across countries for firms with global business strategies. Many of the challenges created by the matrix are particularly acute in an international context.26

The structure of the matrix hasn’t changed, but our understanding of it has. The key to managing today’s matrix is not the formal structure itself but the realization that the matrix is a process. Companies that have had trouble adopting the matrix form may have been correct in creating such a multidimensional structure to cope with environmental complexity, but they needed to go further than trying to construct a flexible organization simply by changing the structure. The formal structure is merely the organization’s anatomy. Executives must also attend to its physiology—the relationships that allow information to flow through the organization—and its psychology—the norms, values, and attitudes that shape how people think and behave.27 We will address these issues in the next chapter and in Part 4 of the text, which focuses on how to lead and manage people. The issues also arise again in Chapter 16 on control and culture.

Although we have covered both the vertical and the horizontal dimensions of organizational structure, we really have only focused on structural differentiation. At the outset we noted that as organizations differentiate their structures, they also need to be concerned about integration and coordination. Because of specialization and the division of labor, different groups of managers and employees develop different orientations. Depending on whether employees are in a functional department or a divisional group, are line or staff, and so on, they will think and act in ways that are geared toward their particular work units. In short, people working in separate functions, divisions, and business units literally tend to forget about one another. When this happens, it is difficult for managers to combine all their activities into an integrated whole.

There are a variety of approaches available to managers to help them make certain that interdependent units and individuals will work together to achieve a common purpose. Coordination methods include standardization, plans, and mutual adjustment.28

Organizational Integration

Coordination by Standardization

When organizations coordinate activities by establishing routines and standard operating procedures that remain in place over time, we say that work has been standardized. Standardization constrains actions and integrates various units by regulating what people do. People often know how to act—and know how to interact—because there are standard operating procedures that spell out what they should do. Employee manuals and policies, for example, may explain what actions a manager should take to discipline an employee or deal with an unhappy customer.

Organizations also may rely on rules and regulations to govern how people interact (we call this formalization). Simple policies regarding attendance, dress, and decorum, for example, may help eliminate a good deal of uncertainty at work. But an important assumption underlying both standardization and formalization is that the rules and procedures should apply to most (if not all) situations. These approaches, therefore, are most appropriate in situations that are relatively stable and unchanging. In some cases, when the work environment requires flexibility, coordination by standardization may not be very effective. Who hasn’t experienced a time when rules and
Banks are among the most standardized of organizations, from operating procedures through dress codes, reinforcing to their customers and employees that the organization and their dealings with it are stable and reliable.

procedures—frequently associated with a slow bureaucracy—prevented timely action to address a problem? In these instances, we often refer to rules and regulations as “red tape.”

Coordinating by Plan

If it is difficult to lay out the exact rules and procedures by which work should be integrated, organizations may provide more latitude by establishing goals and schedules for interdependent units. Coordination by plan does not require the same high degree of stability and routinization required for coordination by standardization. Interdependent units are free to modify and adapt their actions as long as they meet the deadlines and targets required for working with others.

In writing this textbook, for example, we (the authors) sat down with a publication team that included the editors, the marketing staff, the production group, and support staff. Together we ironed out a schedule for developing this book that covered approximately a two-year period. That development plan included dates and “deliverables” that specified what was to be accomplished and forwarded to the others in the organization. The plan allowed for a good deal of flexibility on each subunit’s part, and the overall approach allowed us to work together effectively.

Coordination by Mutual Adjustment

Ironically, the simplest and most flexible approach to coordination may just be to have interdependent parties talk to one another. Coordination by mutual adjustment involves feedback and discussions to jointly figure out how to approach problems and devise solutions that are agreeable to everyone. The popularity of teams today is in part due to the fact that they allow for flexible coordination; teams can operate under the principle of mutual adjustment.

But the flexibility of mutual adjustment as a coordination device does not come without some cost. “Hashing out” every issue takes a good deal of time and may not be the most expedient approach for organizing work. Imagine how long it would take to accomplish even the most basic tasks if subunits had to
talk through every situation. At the same time, mutual adjustment can be very effective when problems are novel and cannot be programmed in advance with rules, procedures, or plans. Particularly in crisis situations in which rules and procedures don’t apply, mutual adjustment is likely to be the most effective approach to coordination.

Coordination and Communication

Today’s environments tend to be complex, dynamic, and (therefore) uncertain. Huge amounts of information flow from the external environment to the organization and back to the environment. To cope, organizations must acquire, process, and respond to that information. To function effectively, organizations need to develop structures for processing information.

Figure 8.7 shows two general strategies that can help managers cope with high uncertainty and heavy information demands. First, management can act to reduce the need for information. Second, it can increase its capacity to handle more information.30

Option 1: Reducing the Need for Information

Managers can reduce the need for information in two ways: (a) creating slack resources and (b) creating self-contained tasks. Slack resources are simply extra resources on which organizations can rely “in a pinch” so that if they get caught off guard, they can still adjust. Inventory, for example, is a type of slack resource that provides extra stock on hand in case it is needed. With extra inventory, an organization does not have to have as much information about sales demand, lead time, and the like. Employees also can be a type of slack resource. For example, Walden Kayaks, a manufacturer of kayaks, has only eight full-time employees. However, the company has contacts with a crew of 14 part-time employees who come aboard during busy seasons. These part-timers represent a type of slack resource for Walden Paddlers in that the company does not have to perfectly forecast sales peaks, but can rely on supplementary workers to handle irregularities.31

General strategies

Specific techniques

Create slack resources

Create self-contained tasks

Invest in information systems

Create horizontal relationships

FIGURE 8.7
Managing High Information-Processing Demands
Organizing: Building a Dynamic Organization

Like slack resources, creating self-contained tasks allows organizations to reduce the need for some information. Creating self-contained tasks refers to changing from a functional organization to a product or project organization and giving each unit the resources it needs to perform its task. Information-processing problems are reduced because each unit has its own full complement of specialties instead of functional specialties that have to share their expertise among a number of different product teams. Communications then flow within each team rather than among a complex array of interdependent groups.

Option 2: Increasing Information-Processing Capability

Instead of reducing the need for information, an organization may take the approach of increasing its information-processing capability. It can invest in information systems, which usually means employing or expanding computer systems. And it can create horizontal relationships to foster coordination across different units. Such horizontal relationships are effective because they increase integration, which Lawrence and Lorsch suggest is necessary for managing complex environments. As uncertainty increases, the following horizontal processes may be used, ranging from the simplest to the most complex.

1. Direct contact (mutual adjustment) among managers who share a problem. In a university, for example, a residence hall adviser might call a meeting to resolve differences between feuding students who live in adjacent rooms.
2. Liaison roles, or specialized jobs to handle communications between two departments. A fraternity representative is a liaison between the fraternity and the interfraternity council, the university, or the local community.
3. Task forces, or groups of representatives from different departments, brought together temporarily to solve a common problem. For example, students, faculty, and administrators may be members of a task force charged with bringing distinguished speakers to campus for a current-events seminar.
4. Teams, or permanent interdepartmental decision-making groups. An executive council made up of department heads might meet regularly to make decisions affecting a college of engineering or liberal arts.
5. Product, program, or project managers who direct interdisciplinary groups with a common task to perform. In a college of business administration, a faculty administrator might head an executive education program of professors from several disciplines.
6. Matrix organizations, composed of dual relationships in which some managers report to two superiors. Your instructors, for example, may report to department heads in their respective disciplines and also to a director of undergraduate or graduate programs.

Several of these processes are discussed further in Chapter 14, where we examine managing teams and intergroup relations.

Looking Ahead

The organization chart, differentiation, integration, authority, delegation, coordination, and the like, convey fundamental information about an organization's structure. However, the information so far has provided only a snapshot. The real organization is more like a motion picture—it moves! More flexible and innovative—even virtual—forms of organizations are evolving.

No organization is merely a set of static work relationships. Because organizations are composed of people, they are hotbeds of social relationships. Networks of individuals cutting across departmental boundaries interact with one another. Various friendship groups or cliques band together to form coalitions—members of the organization who jointly support a particular issue and try to ensure that their viewpoints determine the outcome of policy decisions.
In the corporate world, the word “reorganization” can be chilling. “Did something go wrong?” people ask, “Did somebody lose or win?” Corporate reorganizations may be prompted by failures, but often they are essential elements of success. Done properly, reorganization can move people into new areas where they can be more creative and effective. People often hit plateaus, get too comfortable in their jobs, and no longer come up with new approaches. A realignment presents them with fresh challenges. Great results can happen when people who have worked in product areas get closer to customers, and when people who have been working with customers join the product-development cycle. This mixing helps customer-driven companies conceive and deliver better products.

Whatever the impetus, reorganizations are a lot of work, and they carry risks. For example, if you elect to broaden the experience of an executive by moving him or her from one important job to another, you run the risk that neither job will be performed as well as it was. The new structure may not work as well as the old one. Still, a company unwilling to ever reorganize is rather calcified in terms of how it responds to the marketplace. That is a risk, too. Today any company can find itself driven out of business if it is not adaptive. Sometimes it takes several years for a company to recognize it should have changed, and by then it may be too late.

About every two years, Microsoft undertakes a major reorganization. Even though reorganizations are expected, they still create anxiety for almost everyone, including me. My concern is always whether or not we are making the right decisions, and whether key employees will be enthusiastic about their new roles. I gain confidence about a reorganization when I see that it makes clear what every group is to do, minimizes the dependencies and overlap between groups, and offers developing employees larger responsibilities.

Employees worry about how their careers will be shaped by the new corporate structure. Managers become overly concerned about how their titles or the number of people reporting to them will change. At Microsoft we try to keep titles from carrying too much meaning, simply because descriptive titles encourage inflexibility among people during reorganizations. For example, many people here have the title “product manager.” We give these people significant marketing responsibilities, but some report to others who have the same title. Some of our best people don’t have anyone working for them. Some run large groups, but others are asked to take on a small but important project or even work alone. You must have great people in every corner.

In designing a new structure, you must strike a balance between keeping it logical and keeping executives happy and effective by giving them assignments they want and will handle well. During our most recent change, we asked: What are our goals? How can we move them into practice? What does this imply for our structure? Will our people be excited about their new roles? Over two months our thinking evolved.

How you communicate the news of a reorganization is significant. I’m a big believer in electronic mail, but describing the details of a reorganization to employees is more effective in person. We gathered thousands of employees together, put key executives on stage, and allocated one hour for questions and answers. We welcomed tough questions, and wanted employees to see first-hand how we responded. We wanted to know what employees were thinking.

In any reorganization, some people distinguish themselves by making it succeed. Other people show inflexibility and inability to rise above their views and interests. A few managers choose not to fit into the new structure or actually don’t fit in. It’s okay to lose some managers, but high turnover is damaging. The company must show managers a long-term career plan. Employees who don’t understand how the company values their skills or where those skills can take them, are bound to be restless. And that can mean an unhappy, ineffective organization—whether reorganized or not.

Thus, the formal organization structure does not describe everything about how the company really works. Even if you know departments and authority relationships, there is still much to understand. How do things really get done? Who influences whom, and how? Which managers are the most powerful? How effective is the top leadership? Which groups are most and which are least effective? What is the nature of communication patterns throughout the organization? These issues are discussed throughout the rest of the book.

Now you are familiar with the basic organizing concepts discussed in this chapter. In the next chapter, we will discuss the current challenges of designing the modern organization with which the modern executive constantly grapples.

### KEY TERMS

- Accountability, p. 250
- Authority, p. 247
- Centralized organization, p. 255
- Coordination, p. 245
- Coordination by mutual adjustment, p. 264
- Coordination by plan, p. 264
- Corporate governance, p. 246
- Decentralized organization, p. 255
- Delegation, p. 250
- Departmentalization, p. 257
- Differentiation, p. 244
- Division of labor, p. 244
- Divisional organization, p. 259
- Functional organization, p. 257
- Hierarchy, p. 249
- Integration, p. 244
- Line departments, p. 256
- Matrix organization, p. 261
- Organization chart, p. 244
- Responsibility, p. 250
- Span of control, p. 249
- Specialization, p. 245
- Staff departments, p. 256
- Standardization, p. 263
- Subunits, p. 249
- Unity-of-command principle, p. 262
- Value chain, p. 257

### SUMMARY OF LEARNING OBJECTIVES

**Now that you have studied Chapter 8, you should know:**

**How differentiation and integration influence an organization’s structure.**

Differentiation means that organizations have many parts. Specialization means that various individuals and units throughout the organization perform different tasks. The assignment of tasks to different people or groups often is referred to as the division of labor. But the specialized tasks in an organization cannot all be performed independently of one another. Coordination links the various tasks in order to achieve the organization’s overall mission. When there are many different specialized tasks and work units, the organization is highly differentiated; the more differentiated the organization is, the more integration or coordination is required.

**How authority operates.**

Authority is the legitimate right to make decisions and tell other people what to do. Authority is exercised throughout the hierarchy, as bosses have the authority to give orders to subordinates. Through the day-to-day operation of authority, the organization proceeds toward achieving its goals. Owners or stockholders have ultimate authority.

**The roles of the board of directors and the chief executive officer.**

Boards of directors report to stockholders. The board of directors controls or advises management, considers the firm’s legal and other interests, and protects stockholders’ rights. The chief executive officer reports to the board and is accountable for the organization’s performance.

**How span of control affects structure and managerial effectiveness.**

Span of control is the number of people who report directly to a manager. Narrow spans create tall organizations, and wide spans create flat ones. No single span of control is always appropriate; the optimal span is determined by characteristics of the work, the subordinates, the manager, and the organization.

**How to delegate work effectively.**

Delegation is the assignment of tasks and responsibilities. Delegation has many potential advantages for the manager, subordinate, and the organization. But to be effective, the process must be managed carefully. The manager should define the goal, select the person, solicit opinions, provide resources, schedule checkpoints, and discuss progress periodically.
The difference between centralized and decentralized organizations.
In centralized organizations, most important decisions are made by top managers. In decentralized organizations, many decisions are delegated to lower levels.

How to allocate jobs to work units.
Jobs can be departmentalized on the basis of function, product, customers, or geography. Most organizations use several different types of departmentalization.

How to manage the unique challenges of the matrix organization.
The matrix is a complex structure with a dual authority structure. A well-managed matrix enables organizations to adapt to change. But it can also create confusion and interpersonal difficulties. People in all positions in the matrix—top executives, product and function managers, and two-boss managers—must acquire unique survival skills.

The nature of important integrating mechanisms.
Managers can coordinate interdependent units through standardization, plans, and mutual adjustment. Standardization occurs when routines and standard operating procedures are put in place. They typically are accompanied by formalized rules. Coordination by plan is more flexible and allows more freedom in how tasks are carried out but keeps interdependent units focused on schedules and joint goals. Mutual adjustment involves feedback and discussions among related parties to accommodate each other’s needs. It is at once the most flexible and simple to administer, but it is time-consuming.

DISCUSSION QUESTIONS

1. Using the concepts in the chapter, discuss the advantages and disadvantages of the organization structure approach described in “Setting the Stage.”
2. What are some advantages and disadvantages of being in the CEO position?
3. Would you like to sit on a board of directors? Why or why not? If you did serve on a board, what kind of organization would you prefer? As a board member, in what kinds of activities do you think you would most actively engage?
4. Interview a member of a board of directors and discuss that member’s perspectives on his or her role.
5. Pick a job you have held and describe it in terms of span of control, delegation, responsibility, authority, and accountability.
6. Why do you think managers have difficulty delegating? What can be done to overcome these difficulties?
7. Consider an organization in which you have worked, draw its organization chart, and describe it by using terms in this chapter. How did you like working there, and why?
8. Would you rather work in a functional or divisional organization? Why?
9. If you learned that a company had a matrix structure, would you be more or less interested in working there? Explain your answer. How would you prepare yourself to work effectively in a matrix?
10. Brainstorm a list of methods for integrating interdependent work units. Discuss the activities that need to be undertaken and the pros and cons of each approach.

Lucent: Clean Break, Clean Slate?
The company that could seemingly do no wrong in the first three years after it was spun off from AT&T in 1996 seriously lost its way in 2000. Worst of all, it has been completely bested by archrival Nortel Networks Corp. in the key market for optical-fiber telephone switches (see Chapter 2, “At the Speed of Light”).

The contrast with Nortel is what stings Lucent execs the most. It was only a few years ago that Nortel was the industry dog. But today, Nortel has 45 percent of the exploding optical-transmission-switch market. That compares with just 15 percent for Lucent, which decided in 1996 to develop a slower switch precisely because its customers weren’t asking for anything faster. Lucent now rue the decision to settle for less transmission speed. And Chairman Henry Schacht is quick to acknowledge that he is as much at fault as former CEO Richard McGinn. Schacht says he is planning one-on-one meetings with Lucent’s customers and is reviewing all the processes now in place with an eye to streamlining Lucent’s cumbersome structure.

Under McGinn, Lucent embarked on an organizational overhaul in September 2000. To head key divisions, it has appointed some aggressive new outsiders who are not mired in the company’s bureaucratic mindset. One of those, CFO Deborah C. Hopkins, is putting in place a companywide standard for evaluating a product’s profitability, replacing the piecemeal, business-by-business standard used before. The company is also chopping away at management layers, more closely tying compensation to performance, and trying to better integrate its vaunted Bell Labs with product-development teams. But the
world’s largest telecom-equipment maker actually has a more cosmic task: it must remake itself into a company that can be quick to respond to needs, quick to deliver new technology, and far less bureaucratic. And it has to do all of this while suffering from a 20 percent turnover rate that is siphoning off top talent.

Granted, such an overhaul has been prescribed for just about every lumbering old economy behemoth. Lucent is determined to pull itself space with that market. And it may have a secret weapon: In September, Lucent named Jeong Kim to head its optical-networks business. Clearly different from the Lucent lifers around him, Kim has reorganized the group into 17 small divisions based on product lines, with managers closely matched to customers and compensation tied to performance. His goal: to improve time to delivery by 30 percent. “I have a 100-day plan,” he says.

Kim’s entrepreneurial spirit is sorely needed at Lucent, and he is convinced he already has had a positive effect on morale. He recently visited a Lucent plant in North Andover, Massachusetts, and found general managers there very involved in suggesting ways the operation could be improved. “They were really taking ownership of their operation. And morale was running really high. I was very encouraged.”

Lucent also must start regaining the trust of its employees if it wants to stem the flood of talent that started rushing out the door as soon as executives’ pre-IPO options vested on October 1, 1999. And it hasn’t done any better at hanging on to the employees who came on board with its many acquisitions. Adopted employees who have headed for the doors regularly complain that they found themselves stifled by Lucent’s many-layered management. “There are a lot of top-level people trying to get out of Lucent right now,” one Silicon Valley headhunter says.

Lucent’s executives are making all the right turnaround noises. William T. O’Shea, vice president for corporate strategy and business development, is in charge of a massive effort that kicked off in summer 2000 to streamline Lucent’s businesses. The goal: to encourage entrepreneurship. “We are putting new people in charge and organizing groups to focus their energy in small teams,” he says, rather than structuring the company in large, often uncommunicative divisions. And the company is including Bell Lab researchers in these teams, to make sure that their inventions are properly promoted. “We are bringing a much broader collection of people to the table internally to make strategic decisions,” he says.

New chief executive Patricia Russo also is pushing hard to get Lucent back on track. She was named CEO in November 2001 after an eight-month stint as chief operating officer at Eastman Kodak Co. And she has turnaround experience: Before taking her current post, Russo was best known at Lucent for improving the fortunes of the unit that sold communications gear to corporations, now an independent company known as Avaya Inc. “As someone who was with the company and left and came back, I can tell you this is a very different place. Terrific progress has been made,” she says.

There’s no debate there. Staff cuts under former CEO Henry Schacht have eliminated $2 billion in operating expenses. Capital expenses were slashed from $1.9 billion in fiscal 2000 to $1.4 billion in 2001 and were expected to hit a maximum of $750 million in 2002. The company reduced its working capital by $3 billion, beating its target of $2 billion. Schacht also launched new products, which led to the recapture of lost optical share.

Russo says the turnaround will continue even if the markets for telecom equipment don’t rebound much. “There’s lot more we can do that will have huge leverage on the bottom line,” she says. Russo, D’Amelio, and Robert C. Holder, executive vice president for product organizations, are meeting with Lucent’s other managers to size up prospects for the business through 2003. Based on that review, scheduled to conclude within weeks, they are expected to cut up to 5,000 more jobs, lower capital spending and operating expenses, and possibly sell more assets. They believe those steps will boost margins to about 35 percent.

QUESTIONS
1. How would you characterize the changes in Lucent’s vertical and horizontal structures?
2. What are the strategic reasons behind these changes in strategy?
3. What other management issues do you see in this case? How do they combine with issues of structure?


8.1 The Business School Organization Chart

OBJECTIVES
1. To clarify the factors that determine organization structure.
2. To provide insight into the workings of an organization.
3. To examine the working relationships within an organization.

INSTRUCTIONS
1. Draw an organization chart for your school of business. Be sure to identify all the staff and line positions in the school.
8.2 Mechanistic and Organic Structures

OBJECTIVES
1. To think about your own preferences when it comes to working in a particular organizational structure.
2. To examine aspects of organizations by using as an example this class you are a member of.

INSTRUCTIONS
1. Complete the Mechanistic and Organic Worksheet below.
2. Meet in groups of four to six persons. Share your data from the worksheet. Discuss the reasons for your responses, and analyze the factors that probably encouraged your instructor to choose the type of structure that now exists.

Mechanistic and Organic Worksheet

1. Indicate your general preference for working in one of these two organizational structures by circling the appropriate response:

Mechanistic 1 2 3 4 5 6 7 8 9 10 Organic

2. Indicate your perception of the form of organization that is used in this class by circling the appropriate response for each item:

A. Task-role definition Rigid
   1 2 3 4 5 6 7 8 9 10 Flexible

B. Communication Vertical
   1 2 3 4 5 6 7 8 9 10 Multidirectional

C. Decision making Centralized
   1 2 3 4 5 6 7 8 9 10 Decentralized

D. Sensitivity to the environment Closed
   1 2 3 4 5 6 7 8 9 10 Open


DISCUSSION QUESTIONS
1. Is your business school well organized? Why or why not?
2. Is your school’s organization organic or mechanistic? In what ways?
3. In what ways is the school’s structure designed to suit the needs of students, faculty, staff, the administration, and the business community?