14.2: Organizational Structure

Learning Objectives

1. Explain the role of formalization, centralization, levels in the hierarchy, and departmentalization for employee attitudes and behaviors.
2. Describe how the elements of organizational structure can be combined to create mechanistic and organic structures.
3. Understand the advantages and disadvantages of mechanistic and organic structures for organizations.
4. Explain what a matrix structure is, and the challenges of working in a structure such as this.
5. Define boundaryless organizations.
6. Define learning organizations and list the steps organizations can take to become learning organizations.

Building Blocks of Structure

What exactly do we mean by organizational structure? In other words, which elements of a company's structure make a difference in how we behave and how work is coordinated? We will review four aspects of structure that have been frequently studied in the literature. We view these four elements as the building blocks, or elements, making up a company's structure. Then we will examine how these building blocks come together to form two different configurations of structures.

Centralization

Centralization is the degree to which decision making authority is concentrated at higher levels in an organization. In centralized companies, many important decisions are made at higher levels of the hierarchy, whereas in decentralized companies, decisions are made and problems are solved at lower levels by employees who are closer to the problem in question.

As an employee, where would you feel more comfortable and productive? If your answer is "decentralized," you are not alone. Decentralized companies give more authority to lower level employees, resulting in a sense of empowerment. Decisions are often faster, and employees believe that decentralized companies provide greater levels of procedural fairness to employees. Job candidates are more likely to be attracted to decentralized organizations. Because centralized organizations assign decision making responsibility to higher level managers, there are greater demands on the mental and physical capabilities of CEOs and other high-level managers. Despite many perceived disadvantages, centralization may lead to more efficient operations, particularly if the company is operating in a stable environment (Ambrose & Cropanzano, 2000; Miller, Droge, & Toulouse, 1988; Oldham & Hackman, 1981; Pierce & Delbecq, 1977; Schminke, Ambrose, & Cropanzano, 2000; Turban & Keon, 1993; Wally & Baum, 1994).

Figure 14.2.2: Changing their decision-making approach to a more decentralized style has helped Caterpillar Inc. compete at the global level. Wikimedia Commons – CC BY-SA 3.0.

Many companies find that the centralization of operations leads to inefficiencies in decision making. For example, in the 1980s, Caterpillar Inc. suffered the consequences of centralized decision making. At the time, all pricing decisions were made in the corporate headquarters in Peoria, Illinois. This meant that when a sales representative working in Africa wanted to give a discount on a product, they needed to check with headquarters. Headquarters did not always have accurate or timely information about the subsidiary markets to make an effective decision. The dramatic reorganization of the company sought to avoid problems such as these (Nelson & Pasternack, 2005). At the other end of the spectrum, organizations can suffer from extreme decentralization. For example, some analysts believe that the Federal Bureau of Investigation (FBI) experiences some problems because all its structure and systems are based on the assumption that crime needs to be caught *after* it happens. Over time, this assumption led to a situation in which, instead of following an overarching strategy, each unit is completely decentralized, and field agents determine how investigations should be pursued. It has been argued that due to the change in the nature of crimes, the FBI's need to gather

accurate intelligence *before* a crime is committed requires more centralized decision making and strategy development (Brazil, 2007).

Hitting the right balance between decentralization and centralization is a challenge for many organizations. At the Home Depot Inc., the retail giant with over 2,000 stores across the United States, Canada, Mexico, and China, one of the major changes their former CEO Robert Nardelli did was to centralize most of its operations. Before the transition, Home Depot store managers made a number of decisions autonomously and each store had an entrepreneurial culture. Nardelli's changes initially saved the company a lot of money. For example, for a company of that size, centralizing purchasing operations led to big cost savings, because the company could negotiate significant discounts from suppliers. At the same time, many analysts think that the centralization went too far, leading to the loss of the service-oriented culture at the stores (Charan, 2006; Marquez, 2007).

Formalization

Formalization is the extent to which policies, procedures, job descriptions, and rules are written and explicitly articulated. In other words, formalized structures are those in which there are many written rules and regulations. These structures control employee behavior using written rules, and employees have little autonomy to make decisions on a case-by-case basis. Formalization makes employee behavior more predictable. Whenever a problem at work arises, employees know to turn to a handbook or a procedure guideline. Therefore, employees respond to problems in a similar way across the organization, which leads to consistency of behavior.

While formalization reduces ambiguity and provides direction to employees, it is not without disadvantages. A high degree of formalization may actually lead to reduced innovativeness, because employees are used to behaving in a certain manner. In fact, strategic decision making in such organizations often occurs only when there is a crisis. A formalized structure is associated with reduced motivation and job satisfaction as well as a slower pace of decision making (Fredrickson, 1986; Oldham & Hackman, 1981; Pierce & Delbecq, 1977; Wally & Baum, 1994). The service industry is particularly susceptible to problems associated with high levels of formalization. Sometimes employees who are listening to a customer's problems may need to take action, but the answer may not be specified in any procedural guidelines or rulebook. For example, while a handful of airlines such as Southwest Airlines Company do a good job of empowering their employees to handle complaints, in many airlines lower level employees have limited power to resolve a customer problem and are constrained by stringent rules that outline a limited number of acceptable responses.

Hierarchical Levels

Another important element of a company's structure is the number of levels it has in the hierarchy. Keeping the size of the organization constant, tall structures have several layers of management between frontline employees and the top level, while flat structures consist of few layers. A closely related concept is span of control, or the number of employees reporting to a single manager. In tall structures, span of control tends to be smaller, resulting in greater opportunities for managers to supervise and monitor employee activities. In contrast, flat structures involve a wider span of control. In such a structure, managers will be relatively unable to provide close supervision, leading to greater levels of freedom of action for each employee. Research indicates that flat organizations provide greater need satisfaction for employees, and greater levels of self-actualization (Ghiselli & Johnson, 1970; Porter & Siegel, 2006). Companies such as the IKEA Group, the Swedish furniture manufacturer and retailer, are successfully using flat structures to build an employee mentality of job involvement and ownership. At the same time, there may be some challenges associated with flat structures. In flat structures, employees will not have many opportunities to receive supervision and guidance from the manager, making it necessary for employees to be self-reliant. In fact, research shows that when managers supervise a large number of employees, which is more likely to happen in flat structures, employees experience greater levels of role ambiguity (Chonko, 1982). This may be a disadvantage for employees who need closer guidance from their managers. Moreover, in a flat structure, advancement opportunities will be more limited, because there are fewer management layers. Finally, while employees report that flat structures are better at satisfying their higher order needs such as self-actualization, they also report that tall structures are better at satisfying security needs of employees (Porter & Lawler, 1964). Because tall structures are typical of large and well-established companies, it is possible that when working in such organizations, employees feel a greater sense of job security.

Figure 14.2.3: Companies such as IKEA, the Swedish furniture manufacturer and retailer, are successfully using flat structures within stores to build an employee attitude of job involvement and ownership. Wikimedia Commons – CC BY-SA 3.0.

Departmentalization

Organizational structures differ in terms of departmentalization. Organizations using functional structures group jobs based on similarity in functions. Such structures may have departments such as marketing, manufacturing, finance, accounting, human resources, and information technology. In these structures, each person serves a specialized role and handles large volumes of transactions. For example, a marketing employee working in a functional structure may serve as an event planner, planning promotional events for all the products of the company. In organizations using divisional structures, departments represent the unique products, services, customers, or geographic locations the company is serving. In other words, each unique product or service the company is producing will have its own department. Within each department, functions such as marketing, manufacturing, and other roles are replicated. In these structures, employees act like generalists as opposed to specialists. Instead of performing specialized tasks, employees will be in charge of performing many different tasks in the service of the product. For example, a marketing employee working in this structure may be in charge of planning promotions, coordinating relations with advertising agencies, and planning and conducting marketing research.

In reality, many structures are a hybrid of functional and divisional forms. For example, if the company has multiple product lines, departmentalizing by product may increase innovativeness and reduce response times. Each of these departments may have dedicated marketing, manufacturing, and customer service employees serving the specific product, yet the company may also find that centralizing some operations and retaining the functional structure makes sense and is more cost effective for roles such as human resources management and information technology. The same organization may also create geographic departments, if it is serving different countries.

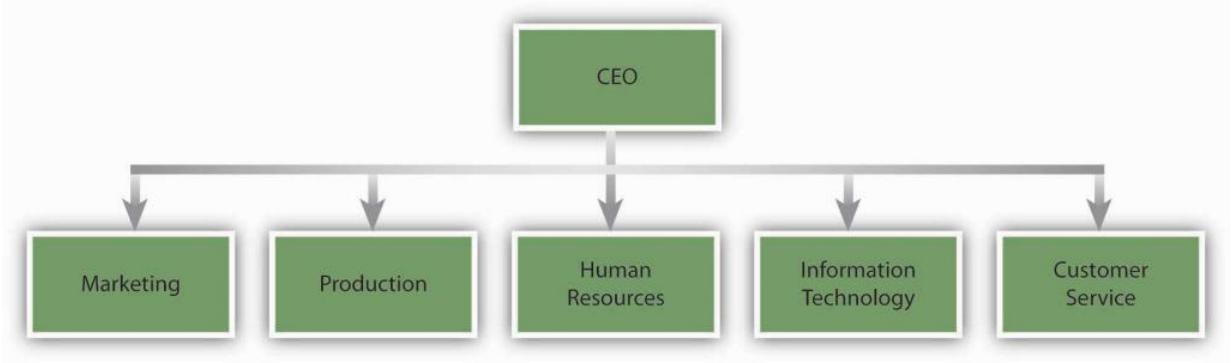

Figure 14.2.4: An Example of a Pharmaceutical Company With Functional Departments

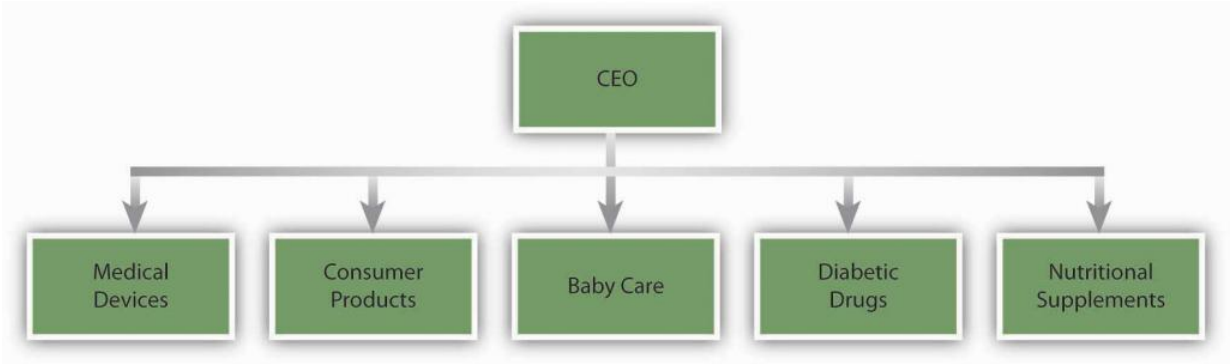

Figure 14.2.5: An Example of a Pharmaceutical Company With Product Departments

Functional structures tend to be effective when an organization does not have a large number of products and services requiring special attention. When a company has a diverse product line, each product will have unique demands, deeming traditional structures less useful for promptly addressing customer demands and anticipating market changes. Functional structures are also more effective in stable environments that are slower to change. In contrast, organizations using product departments are more agile and can perform better in turbulent environments. The type of employee who will succeed under each structure is also different. Research shows that when employees work in product departments in turbulent environments, because activities are diverse and complex, their performance depends on their general mental abilities (Hollenbeck et al., 2002).

Two Configurations: Mechanistic and Organic Structures

The different elements making up organizational structures in the form of formalization, centralization, number of levels in the hierarchy, and departmentalization often coexist. As a result, we can talk about two configurations of organizational structures, depending on how these elements are arranged.

Mechanistic structures are similar to bureaucracies, as they are highly formalized and centralized. Communication tends to follow formal channels, and employees are given specific job descriptions delineating their roles and responsibilities. Mechanistic organizations are often rigid and resist change, making them unsuitable for being innovative and taking quick action. These forms have the downside of inhibiting entrepreneurial action and discouraging the use of individual initiative on the part of employees. Not only do mechanistic structures have disadvantages for innovativeness, they also limit individual autonomy and self-determination, which will likely lead to lower levels of intrinsic motivation on the job (Burns & Stalker, 1961; Covin & Slevin, 1988; Schollhammer, 1982; Sherman & Smith, 1984; Slevin & Covin, 1990). Despite these downsides, mechanistic structures have advantages when the environment is more stable. The main advantage of a mechanistic structure is its efficiency. Therefore, in organizations that are trying to maximize efficiency and minimize costs, mechanistic structures provide advantages. For example, McDonald's Corporation has a famously bureaucratic structure in which employee jobs are highly formalized, with clear lines of communication and very specific job descriptions. This structure is an advantage for them, because it allows McDonald's to produce a uniform product around the world at minimum cost. Moreover, mechanistic structures tend to be advantageous for new ventures. New businesses often suffer from a lack of structure, role ambiguity, and uncertainty. The presence of a mechanistic structure has been shown to be related to firm performance in new ventures (Sine, Mitsuhashi, & Kirsch, 2006).

Organic structures are flexible, decentralized structures with low levels of formalization. Communication lines are more fluid and flexible. Employee job descriptions are broader, and employees are asked to perform duties based on the specific needs of the organization at the time as well as their own expertise levels. Organic structures tend to be related to higher levels of job satisfaction on the part of employees. These structures are conducive to entrepreneurial behavior and innovativeness (Burns & Stalker, 1961; Covin & Slevin, 1988). An example of a company that has an organic structure is 3M. The company is strongly committed to decentralization. At 3M, there are close to 100 profit centers, with each division feeling like a small company. Each division manager acts autonomously and is accountable for his or her actions. As operations within each division get too big and a product created by a division becomes profitable, the operation is spun off to create a separate business unit. This is done to protect the agility of the company and the small-company atmosphere (Adair, 2007).

Contemporary Forms of Organizational Structures

Matrix Organizations

Matrix organizations cross a traditional functional structure with a product structure. Specifically, employees reporting to department managers are also pooled together to form project or product teams. As a result, each person reports to a department manager as well as a project or product manager. In this structure, product managers have control and say over product-related matters. Matrix structures are created in response to uncertainty and dynamism of the environment and the need to give particular attention to specific products or projects. Instead of completely switching from a product-based structure, a company may utilize a matrix structure to balance the benefits of product-based and traditional functional structures.

Using the matrix structure as opposed to product departments may increase communication and cooperation among departments, because project managers will need to coordinate their actions with department managers. In fact, research shows that matrix structure increases the frequency of informal and formal communication within the organization (Joyce, 1986). Matrix structures also have the benefit of providing quick responses to technical problems and customer demands. The existence of a project manager keeps the focus on the product or service that is being provided.

Despite these potential benefits, matrix structures are not without costs. In a matrix, each employee reports to at least two or more managers. In other words, the matrix organization violates the unity of command principle that is often prevalent in traditional organizations. In organizations with unity of command, each person reports to a single manager. As a result, communication flows through predictable lines and coordination is easier. Because matrix organizations do not follow unity of command, this is a situation ripe with conflict. Because multiple managers are in charge of guiding the behaviors of each employee, there may be power struggles or turf wars among managers. The managers are more interdependent compared to a traditional or product-based structure, and they will need to spend more effort coordinating their work. From the employee's perspective, there is potential for interpersonal conflict with team members as well as with leaders. The presence of multiple leaders may create role conflict. The necessity to work with a team consisting of employees with different functional backgrounds increases the potential for task conflict at work (Ford & Randolph, 1992). Solving these problems will require a great deal of patience and proactivity on the part of the employee.

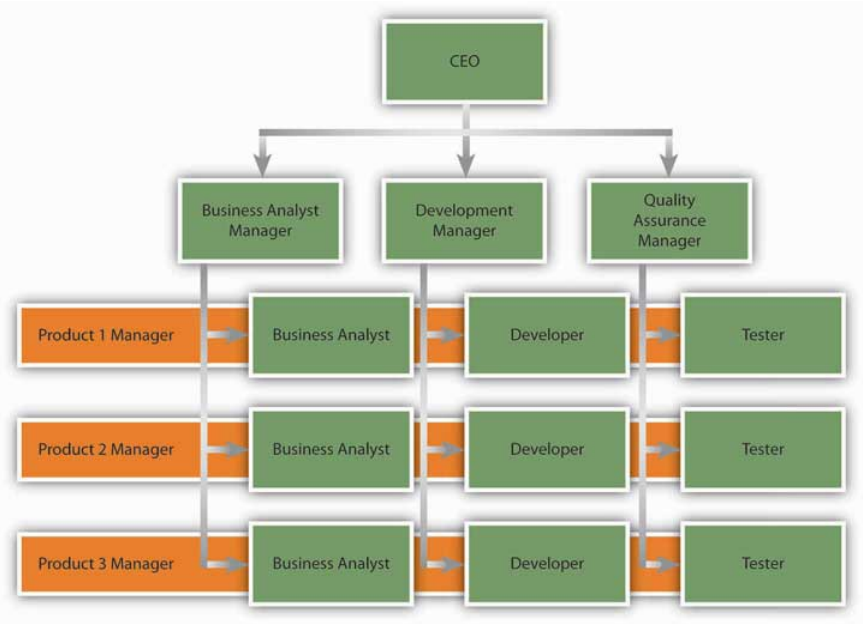

Figure 14.2.6: An example of a matrix structure at a software development company. Business analysts, developers, and testers each report to a functional department manager and to a project manager simultaneously.

The matrix structure is used in many information technology companies engaged in software development. See the example of a matrix structure for an IT company presented in the following figure. Nike Inc. is another company that utilizes the matrix organization successfully. New product introduction is a task shared by regional managers and product managers. While product managers are in charge of deciding how to launch a product, regional managers are allowed to make modifications based on the region (Anand & Daft, 2007).

OB Toolbox: Managed by a Crowd

Due to the widespread use of matrix structures and similar organizational forms, you may find that you are reporting to multiple bosses as opposed to just one. Here is what you can do to make this situation work more smoothly for everyone involved:

- *Do not assume that having multiple bosses is necessarily a bad thing!* Yes, there are more opportunities for role overload and role conflict, but there are also more chances of learning from several senior people. This may turn out to be a great learning experience.
- *Make sure that all your managers are familiar with your overall work load*. One challenge of having multiple bosses is that you may end up with too much work, because they may place expectations on you without checking with each other. For example, you may post your "to do" list on a Web board or on a whiteboard in your office for them to keep track of.
- *Make conflicts known to managers*. Another challenge is the potential for role conflict. If the managers are not coordinating with each other, they may place contradictory expectations on you. Also, keep good records of all e-mails and CC all relevant managers in conversations that are pertinent to them.
- *Do not be afraid to request a meeting with all your managers, and potentially with their own managers if you reach an impasse*. This structure places serious communication and coordination challenges on all those involved, and having meetings may clear the air.
- *Make an effort to establish an effective relation with each manager*. When you have multiple bosses, you will need to manage good relations with each of them.
- *You need to understand the styles of each manager and vary your style with each*. Some may appreciate frequent updates on all you are doing, while others may judge you based solely on ultimate results. Make an effort to understand their styles and do not assume that something that works with one will work with the other.
- *Be cognizant of the relationships among those managers as well*. Never complain about one to the other. Also, be aware that if two managers truly dislike each other, being too friendly with one in the presence of the other may affect your relations with the other.

Sources: Adapted from information in Frings, C. S. (2002, August). Management Q & A: Answering your questions on multiple bosses and not following standard operating procedure. *Medical Laboratory Observer*, *34*(8), 24–25; Hymowitz, C. (2003, August 12). Managers suddenly have to answer to a crowd of bosses. *Wall Street Journal*, B1; McCune, J. (2006, August–September). Multiple bosses multiple directions. *Office Pro*, *66*(6), 10–14.

Boundaryless Organizations

Boundaryless organization is a term coined by Jack Welch of General Electric Company and refers to an organization that eliminates traditional barriers between departments, as well as barriers between the organization and the external environment. Many different types of boundaryless organizations exist. One form is the modular organization where all the nonessential functions are outsourced. The idea behind this format is to retain only the value-generating and strategic functions in-house, while the rest of the operations are outsourced to many suppliers. An example of a company doing this is Toyota. By managing relationships with hundreds of suppliers, Toyota achieves efficiency and quality in its operations. Strategic alliances constitute another form of boundaryless design. Here, similar to a joint venture, two or more companies find an area of collaboration and combine their efforts to create a partnership that is beneficial for both parties. In this form, the traditional boundaries between two competitors may be broken. As an example, Starbucks Corporation formed a highly successful partnership with PepsiCo Inc. to market its Frappuchino cold drinks. Starbucks has immediate brand name recognition in this cold coffee drink, but its desire to capture shelf space in supermarkets required marketing savvy and experience that Starbucks did not possess at the time. By partnering with PepsiCo, Starbucks gained an important head start in the marketing and distribution of this product. Finally, boundaryless organizations may involve eliminating the barriers separating employees, such as traditional management layers or walls between different departments. Structures such as self-managing teams create an environment where employees coordinate their efforts and change their own roles to suit the demands of the situation, as opposed to insisting that something is "not my job" (Dess et al., 1995; Rosenbloom, 2003).

Learning Organizations

A learning organization is one where acquiring knowledge and changing behavior as a result of the newly gained knowledge are part of an organization's design. In these structures, experimenting, learning new things, and reflecting on new knowledge are the

norms. At the same time, there are many procedures and systems in place that facilitate learning at the organizational level.

In learning organizations, experimentation and testing potentially better operational methods are encouraged. This is true not only in response to environmental threats, but also as a way of identifying future opportunities. 3M is one company that institutionalized experimenting with new ideas in the form of allowing each engineer to spend one day a week working on a personal project. At IBM Corporation, this is achieved by taking highly successful business managers and putting them in charge of emerging business opportunities (EBOs). IBM is a company that has no difficulty coming up with new ideas, as evidenced by the number of patents it holds. Yet commercializing these ideas has been a problem in the past, owing to an emphasis on short-term results. To change this situation, the company began experimenting with the idea of EBOs. By setting up a structure in which failure is tolerated and risk taking is encouraged, the company took a big step toward becoming a learning organization (Deutschman, 2005).

Learning organizations are also good at learning from experience, be it their own or a competitors'. In order to learn from past mistakes, companies conduct a thorough analysis of them. Some companies choose to conduct formal retrospective meetings to analyze the challenges encountered and areas for improvement. In order to learn from others, these companies vigorously study competitors, market leaders in different industries, clients, and customers. By benchmarking against industry best practices, they constantly look for ways of improving their own operations. Learning organizations are also good at studying customer habits to generate ideas. For example, Xerox Corporation uses anthropologists to understand and gain insights into how customers are actually using their office products (Garvin, 1993). By using these techniques, learning organizations facilitate innovativeness and make it easier to achieve organizational change.

Key Takeaways

The degree to which a company is centralized and formalized, the number of levels in the company hierarchy, and the type of departmentalization the company uses are key elements of a company's structure. These elements of structure affect the degree to which the company is effective and innovative as well as employee attitudes and behaviors at work. These elements come together to create mechanistic and organic structures. Rigid and bureaucratic, mechanistic structures help companies achieve efficiency, while organic structures, which are decentralized and flexible, aid companies in achieving innovativeness. The changing environment of organizations creates the need for newer forms of organizing. Matrix structures are a cross between functional and product-based divisional structures. They facilitate information flow and reduce response time to customers but have challenges, because each employee reports to multiple managers. Boundaryless organizations blur the boundaries between departments or the boundaries between the focal organization and others in the environment. These organizations may take the form of a modular organization, strategic alliance, or self-managing teams. Learning organizations institutionalize experimentation and benchmarking.

Exercises

1. What are the advantages and disadvantages of decentralization?
2. All else being equal, would you prefer to work in a tall or flat organization? Why?
3. What are the advantages of departmentalization by product?
4. Have you ever reported to more than one manager? What were the challenges of such a situation?
5. What do you think are the advantages and disadvantages of being employed by a boundaryless organization?
6. What can organizations do to institutionalize organizational learning? What practices and policies would aid in knowledge acquisition and retention?

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