CHAPTER

11 Organizational Design: Structure, Culture, and Control

Chapter Outline

Learning Objectives

After studying this chapter, you should be able to:

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

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

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

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

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

LO 11-6 Evaluate closed and open innovation, and derive implications for organizational structure.

LO 11-7 Describe the elements of organizational culture, and explain where organizational cultures can come from and how they can be changed.

LO 11-8 Compare and contrast different strategic control-and-reward systems.

CHAPTER CASE 11 Part I

"A" Is for Alphabet and "G" Is for Google

"GOOGLE IS NOT A conventional company. We do not intend to become one,"[1] wrote founders Larry Page and Sergey Brin in 2004 for the company's initial public offering (IPO). These computer science graduate students turned entrepreneurs, best known for creating the world's most successful online search engine, also indicated they would make "smaller bets in areas that might seem very speculative or even strange when compared to our current businesses."[2] Some of these smaller bets seemed crazy at the time, but resulted in Google Maps, YouTube, Chrome, and Android—all of which have more than 1 billion users today. To say that Google has been hugely successful is an understatement. Since listing on the stock market, this online search and advertising company managed to outperform the tech-heavy NASDAQ-100 index by more than 1,700 percentage points. And in 2019, Google reached a market cap of more than $850 billion, becoming one of the three most valuable companies globally, along with Microsoft and Apple.

Pawel Kopczynski/Reuters

Google proved it was not a conventional company yet again when it split itself into several standalone strategic business units (SBUs in 2015). As Google's structure grew increasingly complex and its number of business lines grew increasingly unrelated (think online search and longevity research), it felt the need to transition from a *functional structure* to a *multidivisional structure*. It thus formed Alphabet, a new corporate entity, to act as the parent company in charge of overseeing these varied SBUs, each of which had its own CEO and profit-and-loss responsibilities. Page said he modeled Alphabet's new organizational structure after that of Berkshire Hathaway, a conglomerate led by Warren Buffett. Page had long admired Buffet for effectively managing a set of unrelated businesses. Alphabet's business units, in addition to Google, included Waymo (autonomous vehicles), Google X (R&D lab), Deep Mind (artificial intelligence), Access (internet service provider), Loon (internet balloons), Calico (longevity research), Wing (delivery drones), Google Ventures (early-stage VC fund), and Google Capital (late-stage VC fund). (See Exhibit 11.1.)

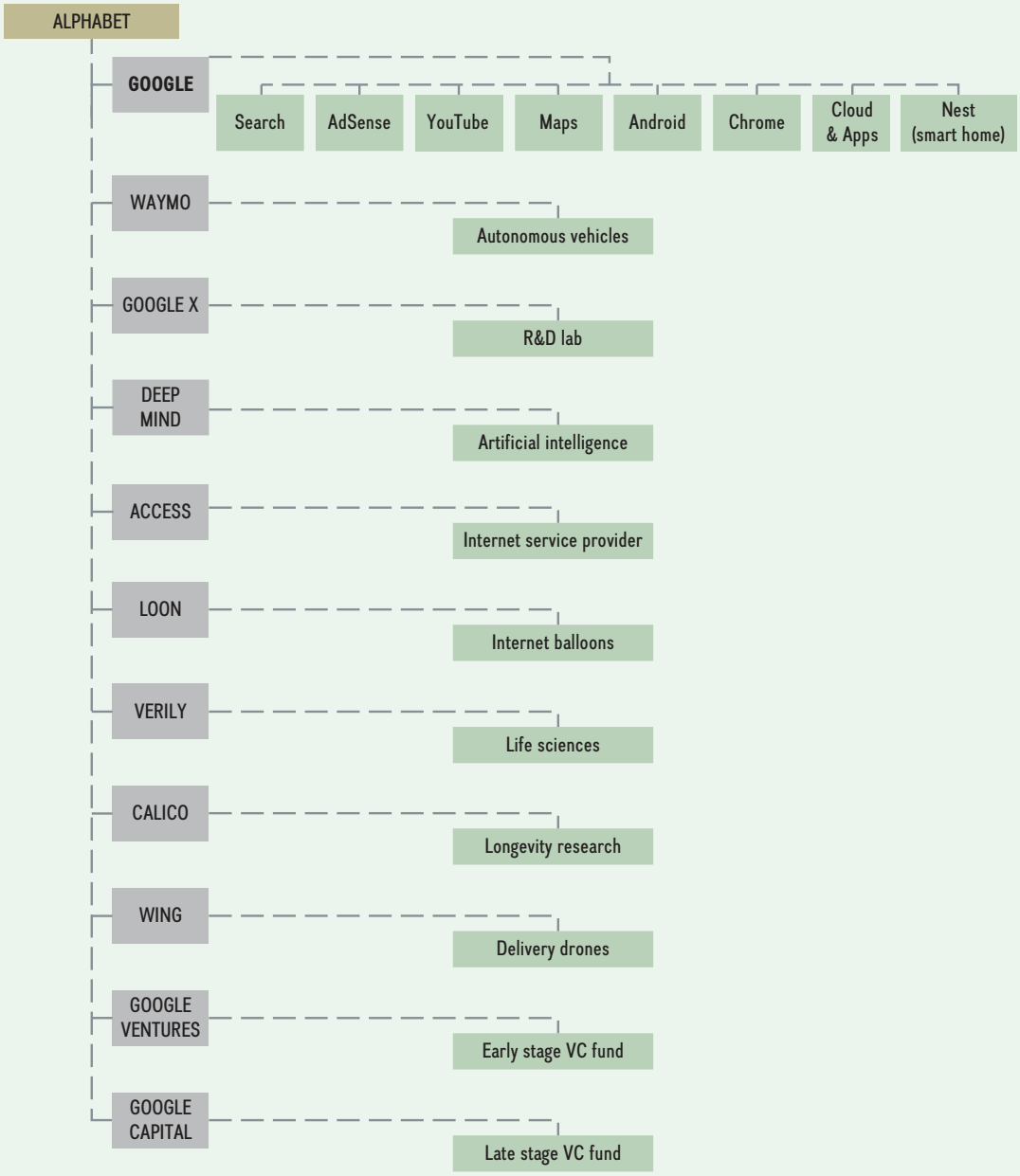
This sweeping restructuring allowed the company to separate its highly profitable search and advertising business from its moon shots, for example, wireless internet connectivity via high-altitude balloons and contact lenses that double as a computer monitor, providing real-time information to the wearer. Furthermore, it created greater financial transparency and accountability.

Perhaps the most notable outcome of Google's restructuring is its pursuit of business opportunities that went far beyond Google's roots in online search—opportunities potentially worth billions of dollars. In his letter to shareholders announcing the restructuring, Larry Page stated that the new structure would prevent Alphabet from becoming complacent and encourage the firm to take a long-term view in pursuing ambitious albeit highly uncertain projects. One of Page's major goals was to ensure that Google would continue to pursue radical innovation, rather than to remain satisfied with incremental innovation only, as is common among other incumbent firms. In keeping with this goal, Alphabet spent over $21 billion in research and development (R&D) in 2018, second only to the $23 billion that Amazon spent.

Alphabet's CEO is Larry Page and its president is Sergey Brin. Alphabet's core business unit, Google, is led by CEO Sundar Pichai. Although slimmer and more focused, Google continues to generate 99 percent of Alphabet's revenues, garnering $140 billion in 2019. Currently, Google's business lines include online search and advertising, YouTube, maps, Android, Chrome, cloud and apps services, and the reintegrated Nest, a smart-home company.

Alphabet houses a number of SBUs that are run by independent CEOs. Besides creating financial transparency and accountability for each SBU, this new organizational structure also allows Alphabet to retain and develop a

EXHIBIT 11.1 Alphabet's Corporate Structure



Source: Author's depiction of publicly available data.

cadre of top-notch executives for the various leadership positions within the conglomerate. YouTube, another of Google's successful companies, is run by CEO Susan Wojcicki. To provide resources for each SBU, Alphabet's head office will oversee a rigorous capital allocation process so that each unit can execute its strategy well.[3]

Part II of this ChapterCase appears in Section 11.6.

THE CHAPTERCASE highlights how much weight Alphabet's strategic leaders place on its organizational structure. Co-founders Larry Page and Sergey Brin feel that getting the organizational structure right will allow Alphabet to continue to innovate with more radical technology breakthroughs, while providing financial transparency, accountability, and leadership development opportunities.

This chapter opens the final part of the *AFI framework:* strategy implementation. *Strategy implementation* concerns the organization, coordination, and integration of how work gets done (see the discussion in Chapter 2). Effective strategy implementation is critical to gaining and sustaining competitive advantage. Although the discussion of *strategy formulation* (what to do) is distinct from *strategy implementation* (how to do it), formulation and implementation must be part of an interdependent, reciprocal process to ensure continued success. That need for interdependence explains why the AFI framework is illustrated as a circle, rather than a linear diagram (see Part 3 Opener). The design of an organization, the matching of strategy and structure, and its control-and-reward systems determine whether or not an organization that has chosen an effective strategy will be able to gain and sustain a competitive advantage.

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

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

11.1 Organizational Design and Competitive Advantage

LO 11-1

Define organizational design and list its three components.

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

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

As discussed in the ChapterCase, Google changed its organizational structure from functional (organized according to domain expertise) to multidivisional or M-form (composed of a number of independent strategic business units). Alphabet's strategic leaders hope this new structure will allow them to drive future radical innovation. Moreover, since each SBU has profit and loss responsibility, the new structure allows Alphabet to provide leadership development opportunities for a number of its executives as they are being groomed for larger roles in the future.

Investors are also happy with this new organizational structure because it provides a cleaner picture of Google's profitability. Before the reorganization, Google subsidized all of the loss-making long shots, which in turn depressed its net income. When all businesses

As CEO of Yahoo, Marissa Mayer attempted a turnaround of the struggling internet company by making changes to Yahoo's organizational structure and culture, among other strategic initiatives. In the end, a successful turnaround of the once-leading internet company remained elusive. Once valued at $125 billion (in 2000), Verizon bought Yahoo for a mere $4.5 billion (in 2017) and later wrote off the acquisition. Julie Jacobson/AP Images

were under Google, it was unclear how much Google invested in R&D to improve its core businesses (online search and advertising) versus how much it spent on moon shots. The new organizational structure freed Google from the huge outlays it had incurred through funding of risky projects over the years, and of which investors had become much less tolerant. Finally, if any of the non-core businesses take off in the same way that Waymo has, then Alphabet could decide to spin Waymo out as an initial public offering (IPO). This would fund future Waymo growth independent of Alphabet, which itself would stand to gain significantly should Waymo go public.

Although Alphabet's strategic leaders have high expectations for their new M-form structure, effective implementation of strategy remains challenging. It is therefore not surprising that the inability to implement strategy effectively is the number-one reason boards of directors fire CEOs.[5] Although Google has been highly successful, Yahoo, once one of Google's main competitors, has struggled, largely due to the lack of an effective organizational design.

Indeed, Yahoo's co-founder and former CEO Jerry Yang was ousted (in 2008) precisely because he failed to implement necessary strategic changes after Yahoo lost its competitive advantage.[6] In the two years leading up to his exit, Yahoo lost more than 75 percent of its market value. Yang was described as someone who preferred consensus among his managers to making tough strategic decisions needed to change Yahoo's structure. That preference, though, led to bickering and infighting. Yang's failure to make the necessary changes to the internet firm's organizational structure led to a destruction of billions of dollars in shareholder value and thousands of layoffs. A number of short-term and interim CEOs followed Yang without much success. Then in 2012, Yahoo hired former Google executive Marissa Mayer as president and CEO. Mayer's turnaround efforts focused on improving the user experience to drive mobile advertising revenues. Such a strategic reorientation required changes in the organizational structure and culture. Despite all these changes, Yahoo was not able to gain significant ground in the online advertising space, which Google and Facebook have dominated, though Amazon is quickly catching up. Eventually, this former leader in online search, which was once valued at $125 billion at the height of the dot-com boom, was acquired by Verizon for $4.5 billion in 2017.[7] In 2018, Verizon wrote off $4.5 billion of the close to $9 billion it spent on acquiring Yahoo and AOL (bought for $4.4 billion in 2015) as Verizon's online search and advertising business faltered.[8]

Because implementation transforms strategy into actions and business models, it often requires changes within the organization. However, strategy implementation often fails because managers are unable to make the necessary changes due to the effects on resource allocation and power distribution within an organization.[9] Strategic leaders are leery about disturbing the status quo. As demonstrated by business historian Alfred Chandler in his seminal book *Strategy and Structure,* organizational structure must follow strategy for firms to achieve superior performance: "Structure can be defined as the design of organization through which the enterprise is administered...*structure follows strategy.*"[10] This tenet implies that to implement a strategy successfully, organizational design must be flexible enough to accommodate the formulated strategy and future growth and expansion.

Zappos (www.zappos.com), the online shoe and clothing retailer (and featured in Strategy Highlight 11.1), exemplifies a company with flexible organizational structure. When

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

ORGANIZATIONAL INERTIA: THE FAILURE OF ESTABLISHED FIRMS

LO 11-2

Explain how organizational inertia can lead established firms to failure.

To implement a formulated business strategy successfully, structure must accommodate strategy, not the other way around. In reality, however, a firm's strategy often follows its structure.[11] This reversal implies that some managers consider only strategies that do not change existing organizational structures; they do not want to confront the inertia that often exists in established organizations.[12] **Inertia**, a firm's resistance to change the status quo, can set the stage for the firm's subsequent failure. Successful firms often plant the seed of subsequent failure: They optimize their organizational structure to the current situation. That tightly coupled system can break apart when internal or external pressures occur.

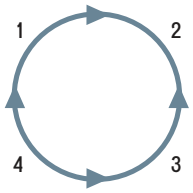
inertia A firm's resistance to change the status quo, which can set the stage for the firm's subsequent failure.

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

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

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

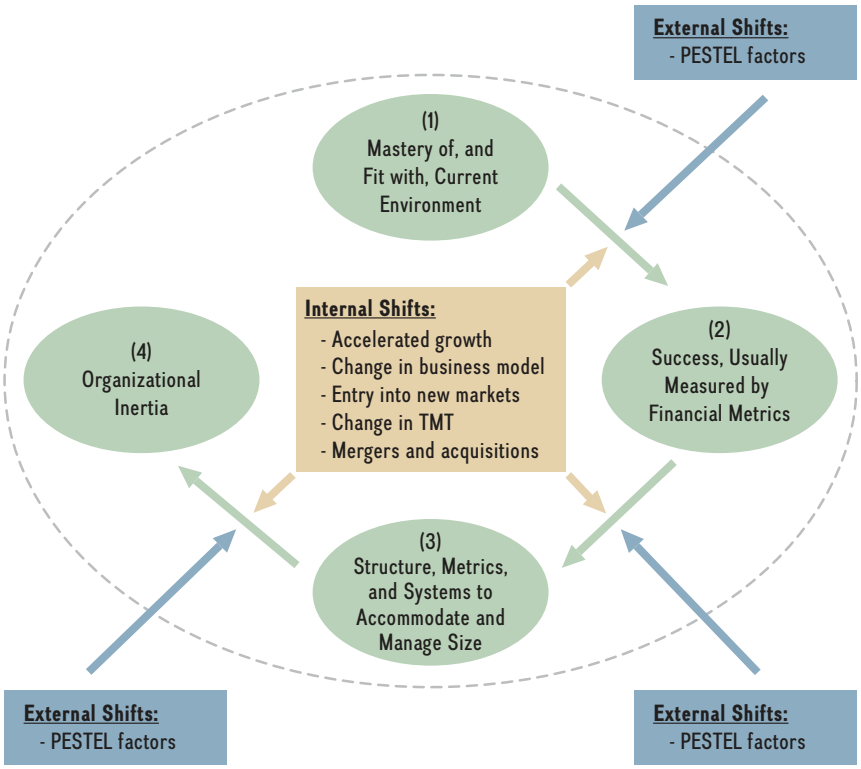
Option A
The Firm Arrives at Inertia



Option B
The Firm Rises above Inertia

EXHIBIT 11.2

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



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

Exhibit 11.2 shows how success in the current environment can lead to a firm's downfall in the future, when the tightly coupled system of strategy and structure experiences internal or external shifts.[13] First, the managers achieve a mastery of, and fit with, the firm's current environment. Second, the firm often defines and measures success by financial metrics, with a focus on short-term performance (see discussion in Chapter 5). Third, the firm puts in place structures, metrics, and systems to accommodate and manage increasing firm size and complexity due to continued success. Finally, as a result of a tightly coupled albeit successful system, organizational inertia sets in—and with it, resistance to change.

Such a tightly coupled system is prone to break apart when external and internal shifts put pressure on the system.[14] In Exhibit 11.2, inside the oval, the longer internal arrows show the firm's tightly coupled organizational design over time. The shorter internal arrows indicate pressures radiating from internal shifts such as accelerated growth, a change in the business model, entry into new markets, a change in the top management team (TMT), or mergers and acquisitions. Accelerated growth, for example, was the reason for a decline in employee productivity at Zappos, as discussed in Strategy Highlight 11.1. The longest arrows pointing into and piercing the boundary of the firm indicate external pressures, which can stem from any of the PESTEL forces (political, economic, sociocultural, technological, ecological, and legal, as discussed in Chapter 3). Strong external or internal pressure can break apart the current system, which may lead to firm failure.

To avoid inertia and possible organizational failure, the firm needs a flexible and adaptive structure to effectively translate the formulated strategy into action. Ideally the firm would maintain a virtual cycle of reorganizing, as implied by Option B discussed earlier in this section. As noted in the ChapterCase, the strategic intent of transitioning Google from a functional to M-form structure was to help Google and its other SBUs rise above inertia, to improve its flexibility and responsiveness in order to promote radical innovations rather than mere incremental innovations. As firms grow in size and complexity, they have a tendency and an incentive to focus on incremental innovation (see Chapter 7); however, this can lead to inertia and subsequent failure.

ORGANIZATIONAL STRUCTURE

LO 11-3

Define organizational structure and describe its four elements.

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

- Specialization
- Formalization
- Centralization
- Hierarchy

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

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

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

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

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

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

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

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

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

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

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

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

LO 11-4

Compare and contrast mechanistic versus organic organizations.

MECHANISTIC VS. ORGANIC ORGANIZATIONS

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

MECHANISTIC ORGANIZATIONS. **Mechanistic organizations** are characterized by a high degree of specialization and formalization and by a tall hierarchy that relies on centralized decision making. The fast food chain McDonald's fits this description quite well. Each step

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

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

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

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

of every job such as deep-frying fries is documented in minute detail (e.g., what kind of vat, the quantity of oil, how many fries, what temperature, how long, and so on). Decision power is centralized at the top of the organization: McDonald's headquarters provides detailed instructions to each of its franchisees so that they provide comparable quality and service across the board although with some local menu variations. Communication and authority lines are top-down and well defined. To ensure standardized operating procedures and consistent food quality throughout the world, McDonald's operates Hamburger University, a state-of-the-art teaching facility in a Chicago suburb, where 50 full-time instructors teach courses in chemistry, food preparation, and marketing. In 2010, McDonald's opened a second Hamburger University campus in Shanghai, China. Mechanistic structures allow for standardization and economies of scale, and often are used when the firm pursues a cost-leadership strategy at the business level.

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

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

For instance, W.L. Gore & Associates, inventors of such path-breaking new products as breathable GORE-TEX fabrics, Glide dental floss, and Elixir guitar strings, use an organic structure to foster continuous innovation.[20] Bill Gore, a former longtime employee of chemical giant DuPont, founded W.L. Gore & Associates (in 1958) with the vision to create an organization "devoted to innovation...where imagination and initiative would flourish, where chronically curious engineers would be free to invent, invest, and succeed."[21] Gore articulated four core values that still guide the company and its associates to this day:

- Fairness to each other and everyone with whom the firm does business.
- Freedom to encourage, help, and allow other associates to grow in knowledge, skill, and scope of responsibility.
- The ability to make one's own commitments and keep them.
- Consultation with other associates before undertaking actions that could cause serious damage to the reputation of the company ("blowing a hole below the waterline").[22]

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

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

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

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

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

Although at first glance organic organizations may appear to be more attractive than mechanistic ones, their relative effectiveness depends on context. McDonald's, with its some 37,000 restaurants across the globe, would not be successful with an organic structure. Similarly, a mechanistic structure would not allow Zappos or W.L. Gore to develop and hone their respective core competencies in customer service and product innovation.

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

LO 11-5

Describe different organizational structures and match them with appropriate strategies.

11.2 Strategy and Structure

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

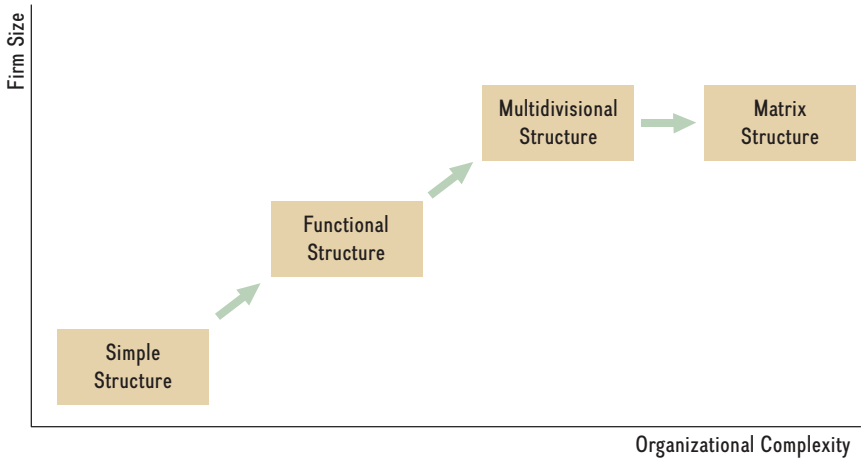


EXHIBIT 11.4
Changing Organizational Structures and Increasing Complexity as Firms Grow

businesses.[23] Different stages in a firm's growth require different organizational structures. This important evolutionary pattern is depicted in Exhibit 11.4. As we discuss next, organizational structures range from simple to functional to multidivisional to matrix.

SIMPLE STRUCTURE

A **simple structure** generally is used by small firms with low organizational complexity. In such firms, the founders tend to make all the important strategic decisions and run the day-to-day operations. Examples include entrepreneurial ventures such as Google in 1998, when the startup operated out of Susan Wojcicki's garage in Menlo Park, California (Ms. Wojcicki is now the CEO of YouTube). Other common examples of firms with simple structures are professional service firms such as smaller advertising, consulting, accounting, and law firms, as well as family-owned businesses. Simple structures are flat hierarchies operated in a decentralized fashion. They exhibit a low degree of formalization and specialization. Typically, neither professional managers nor sophisticated systems are in place, which often leads to an overload for the founder and/or CEO when the firms experience growth.

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

FUNCTIONAL STRUCTURE

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

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

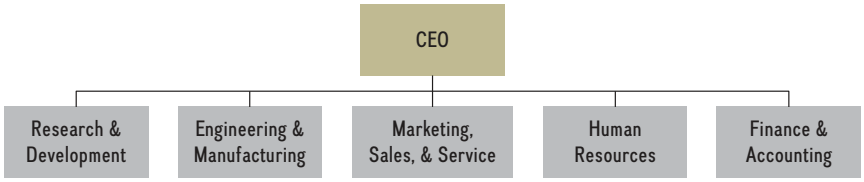


EXHIBIT 11.5
Typical Functional Structure

W.L. Gore & Associates started as a simple structure business operating out of Gore's basement. Two years after its founding, the company received a large manufacturing order for high-tech cable that it could not meet with its ad hoc basement operation. It was at this point when W.L. Gore reorganized into a functional structure. A simple structure would not have provided the effective division, coordination, and integration of work required to accommodate the order, much less future growth.

A functional structure allows for a higher degree of specialization and deeper domain expertise than a simple structure. Higher specialization also allows for a greater division of labor, which is linked to higher productivity.[24] While work in a functional structure tends to be specialized, it is centrally coordinated by the CEO (see Exhibit 11.5). A functional structure allows for an efficient top-down and bottom-up communication chain between the CEO and the functional departments, and thus relies on a relatively flat structure.

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

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

in an attempt to reap economies of scale and scope. All of these challenges make it clear that although a blue ocean strategy is attractive at first glance, it is quite difficult to implement given the range of important trade-offs that must be addressed.

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

The goal for leaders who want to pursue a blue ocean strategy is to build an **ambidextrous organization**, one that enables managers to balance and harness different activities in trade-off situations.[25] Here the trade-offs to be addressed involve the simultaneous pursuit of low-cost and differentiation strategies. Notable management practices that companies use to resolve this trade-off include flexible and lean manufacturing systems, total quality management, just-in-time inventory management, and Six Sigma.[26] Other management techniques that allow firms to reconcile cost and value pressures are the use of teams in the production process, as well as decentralized decision making at the level of the individual customer.

Ambidexterity describes a firm's ability to address trade-offs not only at one point but also over time. It encourages strategic leaders to balance **exploitation**—applying current knowledge to enhance firm performance in the short term—with **exploration**—searching for new knowledge that may enhance a firm's future performance.[27] For example, while Intel focuses on maximizing sales from its *current* cutting-edge microprocessors, it also has several different teams with different time horizons working on *future* generations of microprocessors.[28] In ambidextrous organizations, strategic leaders must constantly analyze their existing business processes and routines, looking for ways to change them in order to resolve trade-offs across internal value chain activities and time.[29]

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

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

To overcome the lack of cross-departmental collaboration in a functional structure, strategic leaders can set up *cross-functional teams*. In these temporary teams, members come from different functional areas to work together on a specific project or product, usually from start to completion. Each team member reports to two supervisors: the team leader and the respective functional department head. Many companies such as Apple, Nike, or W.L. Gore employ cross-functional (project) teams successfully.

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

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

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

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

EXHIBIT 11.6

Matching Business Strategy and Structure

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

A second critical drawback of the functional structure is that it cannot effectively address a higher level of diversification, which often stems from further growth.[30] This is the stage at which firms find it effective to evolve and adopt a multidivisional or matrix structure, both of which we will discuss next.

MULTIDIVISIONAL STRUCTURE

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

Over time, as a firm diversifies into different product lines and geographies, it generally implements a multidivisional or a matrix structure (as shown in Exhibit 11.4 and discussed in the ChapterCase). The **multidivisional structure** (or **M-form**) consists of several distinct strategic business units (SBUs), each with its own profit-and-loss (P&L) responsibility. Each SBU is operated more or less independently from one another, and each is led by a CEO (or equivalent general manager) who is responsible for the unit's business strategy and its day-to-day operations. The CEOs of each division report to the corporate office, which is led by the company's highest-ranking executive (titles vary and include president or CEO for the entire corporation). Because most large firms are diversified to some extent across different product lines and geographies, the M-form is a widely adopted organizational structure.

As featured in the ChapterCase, Google has moved from a functional to an M-form structure by creating the parent company Alphabet. Each unit under Alphabet is an independent SBU, run by a CEO that is responsible for the unit's P&L. The individual CEOs report to Larry Page, who is the CEO of parent company Alphabet, and he oversees capital allocation and strategy execution. As CEO of the holding company, Page also monitors each SBU's performance and adjusts rewards accordingly.

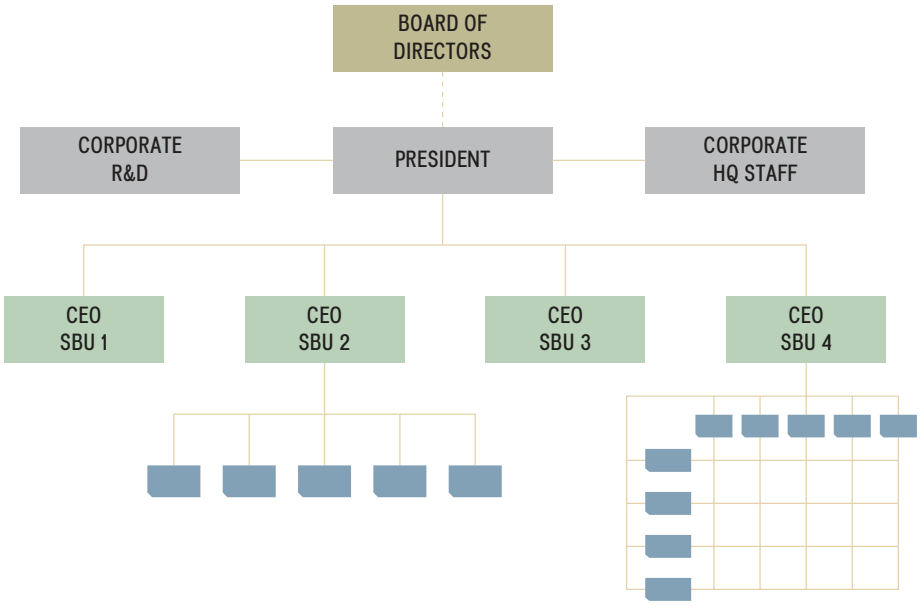


EXHIBIT 11.7

Typical Multidivisional (M-Form) Structure

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

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

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

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

Moreover, corporate executives can also spin off successful strategic business units to grow on their own. For instance, the travel site Expedia was spun out from Microsoft through an initial public offering. In other cases, frustrated employees may leave the parent corporation and start new ventures on their own. Former Fairchild employees started Intel. Likewise, former Xerox employees started Adobe. Ex-Amazon employees started Flipkart, an Indian e-commerce company (in which Walmart in 2018 acquired a majority, valuing the company at $22 billion). All of these spin-offs went on to be largely successful.

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

- Firms that follow a single-business or *dominant-business strategy* at the corporate level gain at least 70 percent of their revenues from their primary activity; they generally employ a *functional structure*.
- For firms that pursue either *related* or *unrelated diversification*, the *M-form* is the preferred organizational structure.
- Firms using the M-form organizational structure to support a *related-diversification* strategy tend to concentrate decision making at the top of the organization. Doing so allows a high level of integration. It also helps corporate headquarters leverage and transfer across different SBUs the core competencies that form the basis for a related diversification.
- Firms using the M-form structure to support an *unrelated-diversification* strategy often decentralize decision making. Doing so allows general managers to respond to specific circumstances, and leads to a low level of integration at corporate headquarters.

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

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

Also, since each SBU in the M-form is evaluated as a standalone profit-and-loss center, SBUs frequently end up competing with each other. A high-performing SBU might be rewarded with greater capital budgets and strategic freedoms; low-performing businesses might be spun off. SBUs compete with one another for resources such as capital and

EXHIBIT 11.8

Matching Corporate Strategy and Structure

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

managerial talent, but they also need to cooperate to share competencies. *Co-opetition*—competition and cooperation at the same time—among the SBUs is both inevitable and necessary. Sometimes, however, it can be detrimental when a corporate process such as resource allocation or transfer pricing between SBUs becomes riddled with corporate politics and turf wars.

In some instances, spinning out SBUs to make them independent companies is beneficial. As discussed in Chapter 8, the BCG growth-share matrix helps corporate executives when making these types of decisions. In the last few years when owned by eBay, PayPal outperformed its parent company. PayPal's executives (and investors) were tired of subsidizing eBay's stagnant business. EBay had bought PayPal in the aftermath of the dot-com stock market crash in 2002 for $1.5 billion. In 2015, eBay and PayPal were de-merged. PayPal was spun off through an initial public offering, and thus became an independent company again. PayPal is now able to fully unlock its value. Investors also liked separating eBay and PayPal, giving PayPal a valuation of more than $130 billion in 2019; eBay's standalone valuation is only about $32 billion.[32]

Strategy Highlight 11.1 discusses how the online retailer Zappos experimented with new organizational forms after realizing the M-form did not yield the expected benefits. Although quite innovative, Zappos' results have been mixed.

Strategy Highlight **11.1**

Zappos: Of Happiness and Holacracy

Zappos (www.zappos.com) made its mark delivering shoes and happiness. When Tony Hsieh, CEO of Zappos, wrote about the company's unique approach in 2010's *Delivering Happiness*, the book joined The *New York Times* bestseller list. Hsieh believes that making customers and employees happy drives success by "delivering WOW through service." The result? The online shoe and clothing store grew from a startup to become a major player in the industry. Service includes easy online shopping with free shipping to and from its customers and a generous 365-day return policy.

Zappos also made its investors happy. In 2008, just 10 years after its founding, Zappos achieved more than $1 billion in annual sales. A year later, Amazon acquired Zappos for $1.2 billion. Although now a subsidiary of Amazon, Zappos continues to operate as an independent business unit, as Amazon maintains a hands-off policy. If anything, new ideas flow up from Zappos to its parent. One example: Zappos weeds out cultural misfits by paying employees to leave after the orientation program. Amazon CEO Jeff Bezos said the "clever people at Zappos" inspired him to offer warehouse workers as much as $5,000 to quit if they were not totally enthusiastic about the importance of their work to Amazon's future.[33]

A flock of birds in flight, immediately shifting direction with self-regulating unity, frequently serves a metaphor of holacracy in action.
Greatonmywall/Alamy Stock Photo

Zappos had grown so much since its founding—receiving over 20 million unique visitors a month to its website—that it sometimes reorganized to ensure it continued to offer the best customer service possible. At one point, to keep the organization flat and responsive to customers, Zappos restructured into 10 separate business units including Zappos.com, Zappos Gift Cards, Zappos IP, and 6pm.com, among others. But to fight the slow bureaucracy that affects larger companies, Hsieh announced (in 2013) an even more radical approach to reorganization—a structure called *holacracy*.

(*Continued*)

Here is what we know about holacracy. Brian Robertson developed the concept in the 2000s, working from ideas introduced by Arthur Koestler in the 1967 book, *The Ghost in the Machine*, the work in which Koestler coined the term. Forgoing traditional top-down hierarchy, **holacracy** purports to achieve control and coordination by distributing power and authority to self-organizing groups (so-called circles) of employees. Circles of employees are meant to self-organize and self-govern around a specific task, such as confirming online orders or authorizing a customer's credit card. Often compared to a computer's operating system, holacracy constitutes a new organizational structure for governing and running a company. Because it greatly changes how workers interact, proponents hail it as a "social technology."

Hsieh explains holacracy as follows:

> *Research shows that every time the size of a city doubles, innovation or productivity per resident increases by 15 percent. But when companies get bigger, innovation or productivity per employee generally goes down. So we're trying to figure out how to structure Zappos more like a city and less like a bureaucratic corporation. In a city, people and businesses are self-organizing. We're trying to do the same thing by switching from a normal hierarchical structure to a system called holacracy, which enables employees to act more like entrepreneurs and self-direct their work instead of reporting to a manager who tells them what to do.*[34]

Zappos grouped its more than 1,500 employees in some 400 circles, with each employee in two or more circles. Order is supposed to emerge from the bottom up, rather than rely on top-down command and control. The rules are spelled out explicitly in a so-called constitution, which defines the power and authority of each circle. For coordination, the employee circles overlap horizontally, and without vertical hierarchy. The CEO's last act as the highest-ranking person in the organization is to sign the constitution in a symbolic act, relinquishing all executive powers. Thereafter the former leader becomes the "ratifier of the holacracy constitution."

As often happens, a new concept sounds great in theory but proves hard to implement. Zappos' implementation of holacracy is not going well. As a consequence, employee morale has plummeted, and Zappos employees are no longer as happy. In 2011, Zappos was ranked sixth in Fortune's list of "100 Best Companies to Work For" (one of the highest rankings for a relatively young firm). By 2015, after it started implementing holacracy, Zappos fell to 86. In the three years since (2016 to 2018), Zappos failed to place in Fortune's "100 Best Companies to Work For" list. Note that the ranking is determined by what employees say about their own company in anonymous surveys—not some arbitrary external assessment.

Hsieh was frustrated that by 2015 the transition to holacracy was still not yet complete. To accelerate the process, he offered a three-month severance package to employees not willing to adopt the new structure. More than 200 employees, or some 14 percent of Zappos' work force, accepted the offer and resigned. By 2016, Zappos had lost 18 percent of its work force.

Employees that remained with Zappos have complained that holacracy has removed clear paths for career advancement. They have wondered openly how hiring, firing, and promoting would be done. They are also concerned that relying on employee circles for making decisions will not only induce paralysis, but also make the organization more and not less political. In sum, they find that holacracy forces them to waste time in endless meetings rather than allows them to get the actual work done. That Hsieh made a top-down decision for Zappos to implement a holacracy (or decided a few years prior to selling the company to Amazon), in a company that ostensibly celebrated democracy and participation, was an irony that was not lost upon Zappos' employees.[35]

MATRIX STRUCTURE

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

To reap the benefits of both the M-form and the functional structure, many firms employ a mix of these two organizational forms, called a **matrix structure**. Exhibit 11.9 shows an example. In it, the firm is organized according to SBUs along a horizontal axis (like in the M-form), but also has a second dimension of organizational structure along a vertical axis. In this case, the second dimension consists of different geographic areas, each of which generally would house a full set of functional activities. The idea behind the matrix structure is to combine the benefits of the M-form (domain expertise, economies of scale, and

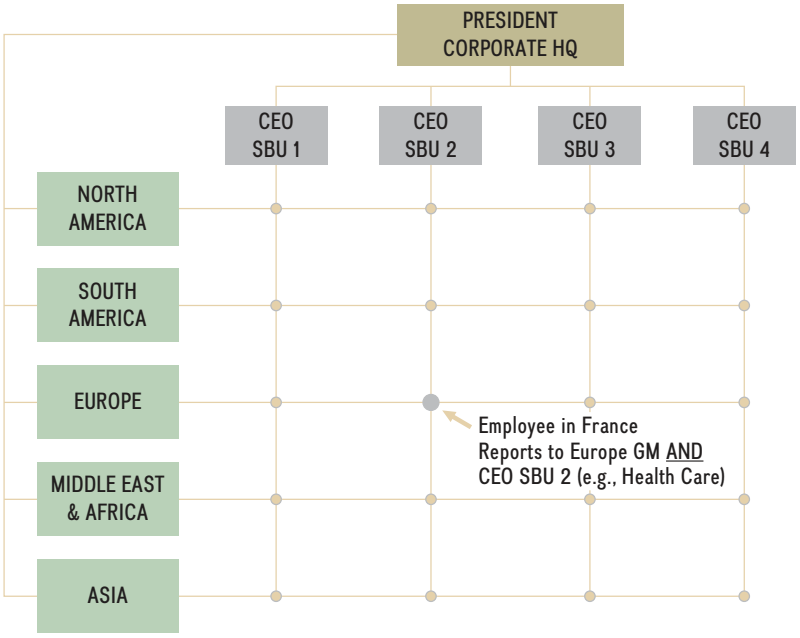


EXHIBIT 11.9
Typical Matrix Structure with Geographic and SBU Divisions

efficient processing of information) with those of the functional structure (responsiveness and decentralized focus).

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

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

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

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

Given the advances in online collaboration tools, some firms have replaced the more rigid matrix structure with a *network structure*. A network structure allows the firm to connect centers of excellence, whatever their global location (see Exhibit 10.4).[36] The firm

EXHIBIT 11.10

Matching Global Strategy and Structure

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

benefits from *communities of practice*, which store important organizational learning and expertise. To avoid undue complexity, these network structures need to be supported by corporate-wide procedures and policies to streamline communication, collaboration, and the allocation of resources.[37]

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

- In an *international strategy*, the company leverages its home-based core competency by moving into foreign markets. An international strategy is advantageous when the company faces low pressure for both local responsiveness and cost reductions. Companies pursue an international strategy through a differentiation strategy at the business level. The best match for an international strategy is a *functional* organizational structure, which allows the company to leverage its core competency most effectively. This approach is similar to matching a business-level differentiation strategy with a functional structure (discussed in detail earlier).
- When a multinational enterprise (MNE) pursues a *multidomestic strategy*, it attempts to maximize local responsiveness in the face of low pressures for cost reductions. An appropriate match for this type of global strategy is the *multidivisional* organizational structure. That structure would enable the MNE to set up different divisions based on geographic regions (e.g., by continent). The different geographic divisions operate more or less as standalone SBUs to maximize local responsiveness. Decision making is decentralized.
- When following a *global-standardization strategy*, the MNE attempts to reap significant economies of scale as well as location economies by pursuing a global division of labor based on wherever best-of-class capabilities reside at the lowest cost. Since the product offered is more or less an undifferentiated commodity, the MNE pursues a cost-leadership strategy. The optimal organizational structure match is, again, a *multidivisional* structure. Rather than focusing on geographic differences as in the multidomestic strategy, the focus is on driving down costs due to consolidation of activities across different geographic areas.

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

As just discussed, the development pattern of how organizational structures tend to change in time as firms grow in size and complexity is fairly predictable: Starting with a simple structure, then moving to functional structure, and finally implementing a multidivisional or matrix structure. Exhibit 11.11 summarizes the advantages and disadvantages of different organizational structures.

EXHIBIT 11.11 Advantages and Disadvantages of Different Organizational Structures

	Advantages	Disadvantages
Simple Structure	• Fast decision making • Nimble and responsive organization • Integration of expertise across areas • Given low bandwidth, organizations with simple structures are easily pushed into "crisis mode," requiring "all hands on deck" (i.e., everyone working long hours until project is completed)	• CEO overload • Lack of domain expertise in distinct business functions (e.g., accounting, finance, marketing, etc.) • Unable to accommodate growth • No separation of strategic and day-to-day decision making
Functional Structure	• Clear, top-down lines of authority and decision making • Deeper domain expertise • Higher productivity due to specialization and division of labor • Responsive organization	• Emergence of silos (i.e., no effective communication across different departments) • Growth is limited • Employee alienation, especially in startups that move from simple structure to functional one
Multidivisional Structure (M-Form)	• Accommodates growth (horizontal, vertical, and geographic) • Clear profit & loss responsibilities at SBU level, run by CEO or equivalent • Efficient processing of information • Allows for different competitive strategies at SBU level, while integration takes place at corporate level	• Additional layer of corporate hierarchy (i.e., corporate headquarters) when moving from functional to M-form structure • SBUs stand in competition to one another • Political infighting • Opportunistic behavior by SBUs
Matrix Structure	• Accommodates growth (horizontal, vertical, and geographic) • Combines advantages of functional structure with M-form	• Two layers of organizational structure create multiple principal–agent relationships • Slow in decision making • Potentially inaccurate performance appraisals • Quite difficult to implement

LO 11-6

Evaluate closed and open innovation, and derive implications for organizational structure.

11.3 Organizing for Innovation

After emphasizing throughout this text (and especially in Chapter 7) that continued innovation is critical to gaining and sustaining competitive advantage in today's fast-moving world, the question arises: *How should firms organize for innovation?* During the 20th century, the *closed innovation* approach was the dominant research and development (R&D) approach for most firms: They focused on discovering, developing, and commercializing new products and services internally.[38] Although this approach was costly and time-consuming, it allowed firms to fully capture the returns made from their R&D investments to generate their own innovations.

Several factors, however, led to a shift in the knowledge landscape from closed innovation to open innovation in recent years. They include

- The increasing supply and mobility of skilled workers.
- The exponential growth of venture capital.
- The increasing availability of external options (such as spinning out new ventures) to commercialize ideas that were previously shelved or insource promising ideas and inventions.
- The increasing capability of external suppliers globally.

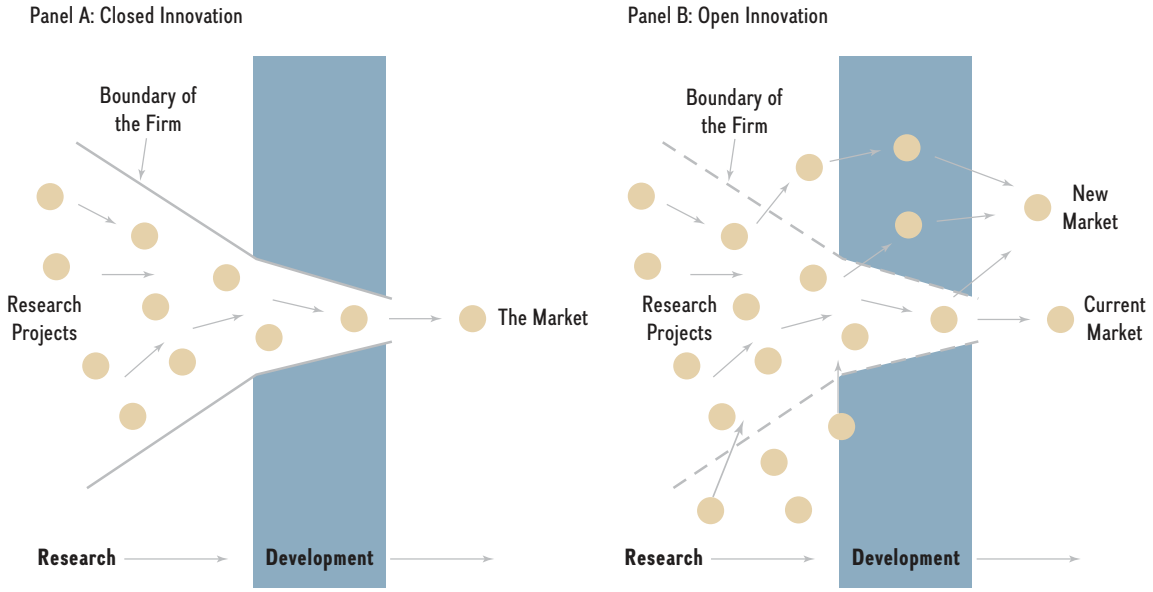
open innovation A framework for R&D that proposes permeable firm boundaries to allow a firm to benefit not only from internal ideas and inventions, but also from external ones. The sharing goes both ways: Some external ideas and inventions are insourced while others are spun out.

These factors have led more and more companies to adopt an open innovation approach to research and development. **Open innovation** is a framework for R&D that proposes permeable firm boundaries to allow a firm to benefit not only from internal ideas and inventions, but also from ideas and innovation from external sources. External sources of knowledge can be customers, suppliers, universities, start-up companies, and even competitors.[39] The sharing goes both ways: Some external R&D is insourced (and further developed in-house) while the firm may spin out internal R&D that does not fit its strategy to allow others to commercialize it. Even the largest companies, such as AT&T, IBM, Siemens, and Pfizer, are shifting their innovation strategy toward a model that blends internal with external knowledge sourcing via licensing agreements, strategic alliances, joint ventures, and acquisitions.[40]

Exhibit 11.12 depicts the closed and open innovation models. In the closed innovation model (Panel A), the firm is conducting all research and development in-house, using a traditional funnel approach. The boundaries of the firm are impenetrable (indicated by the solid lines in Panel A). Outside ideas and projects cannot enter, nor does the firm allow its own research ideas and development projects to leave the firm. Firms in the closed innovation model are extremely protective of their intellectual property. This not only allows the firm to capture all the benefits from its own R&D, but also prevents competitors from benefiting from it. The mind-set of firms in the closed innovation model is that to profit from R&D, the firm must come up with its own discoveries, develop them on its own, and control the distribution channels. Strength in R&D is equated with a high likelihood of benefiting from first-mover advantages. Firms following the closed innovation model, however, are much more likely to fall prone to the *not-invented-here syndrome:*[41] "If the R&D leading to a discovery and a new development project was not conducted in-house, it cannot be good."

As documented, the pharmaceutical company Merck suffers from the *not-invented-here syndrome.*[42] That is, if a product was not created and developed at Merck, it could not be good enough. Merck's culture and organizational systems perpetuate this logic, which assumes that since the company hired the best people, the smartest people in the industry must work for Merck, and so the best discoveries must be made at Merck. The company leads the industry in terms of R&D spending because Merck believes that if it is the first to

EXHIBIT 11.12 Closed Innovation vs. Open Innovation



Source: Adapted from H. Chesbrough (2003), ""The Era of Open Innovation," MIT Sloan Management Review, Spring: 35–41.

discover and develop a new drug, it would be the first to market. Merck is one of the most successful companies by total number of active R&D projects. Perhaps even more important, Merck's researchers have been awarded several Nobel Prizes for their breakthrough research, a considerable point of pride for Merck's personnel.

In the open innovation model, in contrast, a company attempts to commercialize both its own ideas and research from other firms. It also finds external alternatives such as spin-off ventures or strategic alliances to commercialize its internally developed R&D. The boundary of the firm has become porous (as represented by the dashed lines in Panel B in Exhibit 11.12), allowing the firm to spin off some R&D projects while insourcing other promising projects. Companies using an open innovation approach realize that great ideas can come from both inside and outside the company. Significant value can be had by commercializing external R&D and letting others commercialize internal R&D that does not fit with the firm's strategy. The focus is on building a more effective *business model* to commercialize both internal *and* external R&D, rather than focusing on being first to market.

One key assumption underlying the open innovation model is that combining the best of internal *and* external R&D will more likely lead to a competitive advantage. This requires that the company must continuously upgrade its internal R&D capabilities to enhance its **absorptive capacity**—its ability to understand external technology developments, evaluate them, and integrate them into current products or create new ones.[43] Exhibit 11.13 compares and contrasts open innovation and closed innovation principles.

absorptive capacity A firm's ability to understand external technology developments, evaluate them, and integrate them into current products or create new ones.

Strategy Highlight 11.2 provides a detailed account of how Sony's continued use of a closed innovation system led over time to a sustained competitive disadvantage and inferior performance, while Apple leveraged an open innovation model for decade-long superiority, becoming the first company on the planet to be valued over $1 trillion.

EXHIBIT 11.13 Contrasting Principles of Closed and Open Innovation

Closed Innovation Principles	Open Innovation Principles
The smart people in our field work for us.	Not all the smart people work for us. We need to work with smart people inside and outside our company.
To profit from R&D, we must discover it, develop it, and ship it ourselves.	External R&D can create significant value; internal R&D is needed to claim (absorb) some portion of that value.
If we discover it ourselves, we will get it to market first.	We don't have to originate the research to profit from it; we can still be first if we successfully commercialize new research.
The company that gets an innovation to market first will win.	Building a better business model is often more important than getting to market first.
If we create the most and best ideas in the industry, we will win.	If we make the best use of internal and external ideas, we will win.
We should control our intellectual property (IP), so that our competitors don't profit from it.	We should profit from others' use of our IP, and we should buy others' IP whenever it advances our own business model.

Source: Adapted from H.W. Chesbrough (2003), *Open Innovation: The New Imperative for Creating and Profiting from Technology* (Boston: Harvard Business School Press).

Strategy Highlight 11.2

Sony vs. Apple: Whatever Happened to Sony?

Apple's market capitalization in 2001 was $7 billion, while Sony's was $55 billion. In other words, Sony was almost eight times larger than Apple. Then, most people would have picked Sony as the company to revolutionize the mobile device industry given its stellar innovation track record. Instead, that honor went to Apple when it introduced the iPod, a portable digital music player, in October 2001 and 18 months later the iTunes Music Store. Through these two strategic moves Apple redefined the music industry, reinventing itself as not only a mobile-device but also a content-delivery company. Many observers wondered what happened to Sony, the company that created the portable music industry by introducing the Walkman in 1979.

Sony's strategy was to differentiate itself through the vertical integration of content and hardware, driven by its 1988 acquisition of CBS Records (later part of Sony Entertainment) and its 1989 acquisition of Columbia Pictures. This vertical integration strategy contrasted sharply with Sony Music division's desire to protect its lucrative revenue-generating, copyrighted compact discs (CDs). Sony Music's engineers were aggressively combating music piracy by inhibiting the Microsoft Windows media player's ability to rip CDs and by serializing discs (assigning unique ID numbers to discs). The compact disc (CD) became the dominant format for selling music in 1991, replacing analog audiocassettes. The CD had been jointly developed by Sony and European electronics manufacturer Philips.

Media technology, however, soon moved to digital. With the rise of the internet in the 1990s and use of digital music, illegal file sharing on the internet was rampant. Napster allowed peer-to-peer sharing of files, which meant individual users could upload entire albums of music, to be downloaded by anyone, with no payments going to the artists or the record companies. While Sony focused on preventing

Sony created the portable music industry with the Walkman, introduced in 1979.
Chris Willson/Alamy Stock Photo

media players that could rip CDs, Apple was developing a digital rights management (DRM) system to allow for legal downloads of digital music while protecting copyright at the same time. The iTunes Store enabled users to legally download and own individual songs at an attractive 99 cents. Apple's DRM and iTunes succeeded, protecting the music studios' and artists' interests while creating value that enabled consumers to enjoy portable digital music.

Sony had a long history of creating category-defining electronic devices of superior quality and design using a closed innovation approach. It had all the right competencies in-house to launch a successful counterattack to compete with Apple: electronics, software, music, and computer divisions. Sony even supplied the batteries for Apple's iPod. Cooperation among strategic business units had served Sony well in the past, leading to breakthrough innovations such as the Walkman, PlayStation, CD, and VAIO computer line. In digital music, however, the hardware and content divisions each seemed to have its own idea of what needed to be done. Cooperation among the Sony divisions was also hindered by the fact that their centers of operations were spread across the globe: Music operations were located in New York City and electronics design was in Japan, inhibiting face-to-face communications and making real-time interactions more difficult.

Nobuyuki Idei, then CEO of Sony, learned the hard way that the music division managers were focused on the immediate needs of their recordings competing against the consumer-driven market forces. In 2002, Idei shared his frustrations with the cultural differences between the hardware and content divisions:

> *The opposite of soft alliances is hard alliances, which include mergers and acquisitions. Since purchasing the Music and Pictures businesses, more than 10 years have passed, and we have experienced many cultural differences between hardware manufacturing and content businesses.... This experience has taught us that in certain areas where hard alliances would have taken 10 years to succeed, soft alliances can be created more easily. Another advantage of soft alliances is the ability to form partnerships with many different companies. We aim to provide an open and easy-to-access environment where anybody can participate, and we are willing to cooperate with companies that share our vision. Soft alliances offer many possibilities.*[44]

In contrast, Apple organized a small, empowered, cross-functional team to produce the iPod in just a few months. Using open innovation, Apple successfully insourced many of its components from external partners (including from Sony and Samsung), and then integrated them. The phenomenal speed and success of the iPod and iTunes development and the seamless integration of hardware and software became a structural approach that Apple applied to its successful development and launches of other category-defining products such as the iPhone, iPad, and Apple Watch.

Apple's market capitalization grew from a paltry $7 billion in 2001 to over $1 trillion in 2018, making it the most valuable company globally (at the time) and the first company globally to cross this threshold. In contrast, in almost 20 years, Sony's market capitalization has barely moved, from $55 billion in 2001 to $65 billion in 2019. The different ways to organize and implement innovation had a great deal to do with this outcome.[45]

LO 11-7

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

11.4 Organizational Culture: Values, Norms, and Artifacts

Organization design consists of formal and informal building blocks, as shown in Exhibit 11.14. The formal component is a firm's organizational structure (discussed in the previous sections), while the informal building block of organizational design is a firm's culture. Organizational culture is the second key building block when designing organizations for competitive advantage. Just as people have distinctive personalities, so too do organizations have unique cultures that capture "how things get done around here." Culture is an informal and thus an intangible building block of organizational design that unlike the formal structure cannot be easily observed or codified.

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

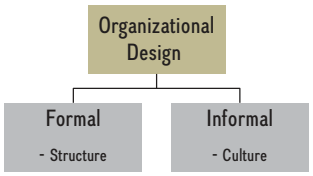
Norms Unwritten rules that define appropriate employee attitudes and behaviors in employees' day-to-day work and interactions.

Organizational culture describes the collectively shared values and norms of an organization's members.[46] *Values* define what is considered important—goals that each organizational member should strive to achieve. As discussed in Chapter 2, an organization's core values are a set of guiding principles to guide employees in achieving an organization's vision and fulfill its mission. **Norms** define appropriate employee attitudes and behaviors in their day-to-day work and interactions.[47]

In a recent survey of almost 2,000 CEOs across the globe, the strategic leaders ranked culture as the most important value driver before operations, marketing, or finance.[48] One clear implication is that a strategic leader must get an organization's culture right. Effective cultures (such as Google's) are credited for being partly responsible for a firm's stellar performance, while ineffective cultures are blamed for corporate failures; consider, for example, Wells Fargo's account fraud scandal and VW's Dieselgate (a more detailed discussion of the latter is found in Strategy Highlight 12.2).

Wells Fargo has been at the center of a number of headline-grabbing scandals over the last few years, with its most recent involving the opening of 3.5 million fake bank accounts by Wells Fargo employees.[49] Other offenses included charging customers for car insurance they did not need or request and overcharging members of the U.S. armed forces when refinancing mortgages. How could this go on at one of the largest banks in the United States? The one common denominator across each of these ethical and legal infractions is Wells Fargo's organizational culture. Known to be hard-driving and demanding, employees faced strict sales quotas around new account openings, insurance sales, mortgage refinancing fees, and so forth. Employees' compensation and bonuses were also directly tied to these super ambitious sales targets. But the problem with these targets was not just that they were overly ambitious, but they also were unrealistic. What do people tend to do when the stakes are high and the pressure is intense? They cut corners. This is precisely what happened in the Wells Fargo case: A culture that valued achieving unrealistic goals took precedence over ethical and legal practice.[50] This slew of scandals has cost the bank dearly. Its stock market valuation fell by 25 percent in 2018, and two CEOs in a row subsequently lost their jobs. Additionally, each of the 5,300 employees involved in opening the fraudulent bank accounts was fired.

EXHIBIT 11.14 Formal and Informal Building Blocks of Organizational Design



Effective cultures allow for smooth execution of strategy, while ineffective cultures can lead to unintended, unethical, and sometimes even illegal outcomes. Interestingly, the researchers conducting the corporate culture survey also found that only 15 percent of the strategic leaders indicated they have an effective culture in their organization, while a bit more than half of strategic leaders indicated their organizational culture needed some work; about one-third said their cultures needed considerable work or a substantial overhaul. Setting the right values and norms, therefore, allows strategic leaders to create an effective culture, which can lay the foundation for competitive advantage.

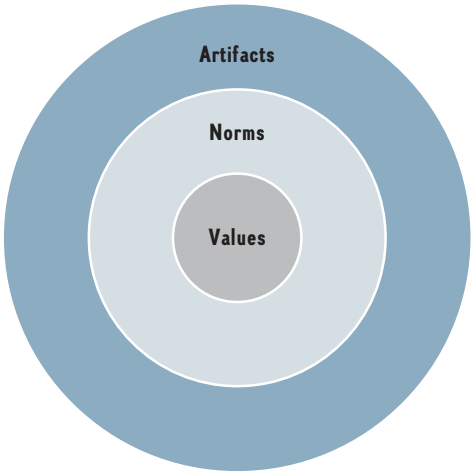
Employees learn about an organization's culture through *socialization,* a process whereby employees internalize an organization's values and norms through immersion in its day-to-day operations.[51] Thus, it is critical that strategic leaders must not only set and refine the corporate cultures, but also live them in their day-to-day activities and thus lead by example. Strategic leaders should strive for buy-in of all employees across all levels. *Strong cultures* emerge when the company's core values are widely shared among the firm's employees and when the norms have been internalized. Corporate culture finds its expression in **artifacts**. Artifacts include elements such as the design and layout of physical space (e.g., cubicles or private offices), symbols (e.g., the type of clothing worn by employees), vocabulary, what stories are told, what events are celebrated and highlighted, and how they are celebrated (e.g., a formal dinner versus a casual barbecue when the firm reaches its sales target).

artifacts Elements that allow corporate culture to be expressed, such as via the design and layout of physical space, symbols, vocabulary, what stories are told, what events are celebrated and highlighted, and how they are celebrated.

Exhibit 11.15 depicts the elements of organizational culture—values, norms, and artifacts—in concentric circles. The most important yet least visible element—values—is in the center. As we move outward in the figure, from values to norms to artifacts, culture becomes more observable. Understanding what organizational culture is, and how it is created, maintained, and changed, can help you be a more effective strategic leader.

Google's Culture. From Google's earliest days in 1998, its quirky co-founders Larry Page and Sergey Brin instilled a set of strong core values, which laid the foundation of the online search company's unique culture. In particular, the co-founders created a tech company that is in many respects strikingly similar to their own personalities. Both Page and Brin suggest that their worldview is shaped by early experiences in Montessori schools as well as their engineering training, especially in computer science.

EXHIBIT 11.15 The Elements of Organizational Culture: Values, Norms, and Artifacts



Page and Brin came up with 10 principles they "know to be true," including some of the best-known Google core values today such as *don't be evil*, *focus on the user first, and profits will follow, you can be serious without a suit*, and *great is just not good enough*.[52] Exhibit 11.16 lists Google's 10 core values.

Eric Schmidt, Google's long-time CEO during its early years (2001–2011), explained how surprised he was that strategic leaders as well as rank-and-file employees believed strongly in their company's core values and made day-to-day decisions based on them. For example, when asked how the core value of not doing evil helped Google, Schmidt recalled:

> When I showed up, I said, "You've got to be kidding." Then one day, very early on, I was in a meeting where an engineer said, "That would be evil." It was as if he'd said there was a murderer in the room. The whole conversation stopped, but then people

EXHIBIT 11.16 Google's 10 Things the Founders Know to Be True

1. Focus on the user and all else will follow.
2. It's best to do one thing really, really well.
3. Fast is better than slow.
4. Democracy on the web works.
5. You don't need to be at your desk to need an answer.
6. You can make money without doing evil.
7. There's always more information out there.
8. The need for information crosses all borders.
9. You can be serious without a suit.
10. Great just isn't good enough.

Source: Excerpted from "Ten things we know to be true," www.google.com/about/philosophy.html.

challenged his assumptions. This had to do with how we would link our advertising system into search. We ultimately decided not to do what was proposed, because it was evil. That kind of story is repeated every hour now with thousands of people. Think of "Don't be evil" as an organizing principle about values.[53]

Some decisions based on the "Don't be evil" credo concern minor decisions such as not accepting ads for hard liquor or guns. Other decisions are far more wide reaching with significant strategic implications. For instance, in 2006, Google entered the Chinese market with a customized search engine (google.cn) to service the then 400 million online customers.[54] This was a self-censored version of its regular search engine (google.com) to comply with China's restrictions on free speech. At that time, Google felt the good that access to its searches, albeit censored, would bring to the Chinese people would outweigh its discomfort with censorship.

But by 2010, Google felt it could no longer continue to provide self-censored searches; it alleged that the firm was the target of sophisticated hacker attacks, accessing some of its users' Gmail accounts, including those of Chinese human rights activists. Google decided it would no longer censor its searches in China, and thus risked having its search engine shut down by the Chinese government. Google's strong values—such as "Democracy on the web works," "You can make money without doing evil," and "The need for information crosses all borders"—guided this decision, which had potentially far-reaching strategic consequences. From 2010 onward, Google ran its China website on a server in Hong Kong (www.google.com.hk).

In the wake of the #MeToo Movement, Google employees also staged a global walkout over the company's handling of sexual harassment. In particular, the Google employees protested a workplace culture that they allege promotes and protects perpetrators of sexual harassment at the tech giant.
Mason Trinca/Getty Images

Yet, Google's exit from mainland China further strengthened Baidu's lead, a domestic Chinese company that had 70 percent market share in 2019. Today, China has more than 800 million internet users, by far the largest online market globally and the fastest growing. In comparison, the United States has 290 million internet users, which makes the Chinese market almost three times the size of the U.S. market.

The size and growth of the Chinese market appeared too alluring for Google's strategic leaders to ignore. In 2018, it was revealed that a team was secretly working on a search project for China, code named Dragonfly, that would adhere to the Chinese government's censoring requirements.[55] Upset Google employees wrote an open protest letter and staged a walkout brandishing signs saying, "Don't be evil" and "OK Google, Don't contribute to Internet censorship in China," while demanding that the clandestine project be shut down. In 2018, during a congressional hearing, Google CEO Sundar Pichai stated the company has no intention of launching a search engine in China at this point.

This example shows how difficult it is to balance deeply held core values with business opportunities, especially since some of Google's strategic leaders argue that providing search services in China—albeit censored—might do more good than harm, while many employees feel otherwise.

WHERE DO ORGANIZATIONAL CULTURES COME FROM?

Often, company founders define and shape an organization's culture, which can persist for many decades after their departure. This phenomenon is called **founder imprinting**.[56] Founders set the initial strategy, structure, and culture of an organization by transforming their vision into reality. We have already seen how the beliefs of Google founders Page and Brin shaped the culture of the internet company. Other famous founders that have left strong imprints on their organizations include Steve Jobs (Apple), Walt Disney (Disney), Michael Dell (Dell), Oprah Winfrey (Harpo Productions and *OWN,* the Oprah Winfrey Network), Martha Stewart (Martha Stewart Living Omnimedia), Bill Gates (Microsoft), Larry Ellison (Oracle), Ralph Lauren (Polo Ralph Lauren), Herb Kelleher (Southwest Airlines), and Elon Musk (Tesla and SpaceX).

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

Walmart founder Sam Walton personified the retailer's cost-leadership strategy. At one time the richest man in America, Sam Walton drove a beat-up Ford pickup truck, got $5 haircuts, went camping for vacations, and lived in a modest ranch home in Bentonville, Arkansas.[57] Everything Walton did was consistent with the low-cost strategy. Walmart stays true to its founder's tradition. Home to one of the largest companies globally, the company's Arkansas headquarters in Bentonville was described by Thomas Friedman in his book *The World Is Flat* as "crammed into a reconfigured warehouse...a large building made of corrugated metal, I figured it was the maintenance shed."[58]

The culture that founders initially imprint is reinforced by their strong preference to recruit, retain, and promote employees who subscribe to the same values. In turn, more people with similar values are attracted to that organization.[59] As the values and norms held by the employees become more similar, the firm's corporate culture becomes stronger and more distinct. This in turn can have a serious negative side-effect: *groupthink*, a situation in which opinions coalesce around a leader without individuals critically evaluating and challenging that leader's opinions and assumptions. Cohesive, non-diverse groups are highly susceptible to groupthink, which in turn can lead to flawed decision making with potentially disastrous consequences.

In addition to founder imprinting, a firm's culture also flows from its values, especially when they are linked to the company's reward system. For example, Zappos (featured in Strategy Highlight 11.1) established its unique organizational culture through explicitly stated values that are connected to its reward system. To recruit people that fit with the company's values, Hsieh has all new hires go through a four-week training program. It covers such topics as company history, culture, and vision, as well as customer service.[60] New hires also spend two weeks on the phone as customer service reps. What's novel about Zappos' approach is that at the end of the monthlong employee orientation, the company offers an "exit prize": one month's pay plus pay for the time already with Zappos. This allows the company to entice people to leave that are qualified for the job but may not fit with Zappos' culture. Individuals who choose to stay despite the enticing offer tend to fit well with and strengthen Zappos' distinct culture.[61]

HOW DOES ORGANIZATIONAL CULTURE CHANGE?

An organization's culture can be one of its strongest assets, but also its greatest liability. An organization's culture can turn from a core competency into a *core rigidity* if a firm relies too long on the competency without honing, refining, and upgrading as the firm and the environment change.[62] (See the discussion in Chapter 4.) Over time, the original core competency is no longer a good fit and turns from an asset into a liability. This is the time when a culture needs to change.

Mary Barra, General Motors CEO, was appointed with the mandate to fix GM's dysfunctional corporate culture and to make the company competitive again.
Bill Pugliano/Getty Images

GM's bureaucratic culture, combined with its innovative M-form structure, was once hailed as the key to superior efficiency and management.[63] However, that culture became a liability when the external environment changed following the oil-price shocks in the 1970s and the entry of Japanese carmakers into the United States.[64] As a consequence, GM's strong culture led to organizational inertia. This resulted in a failure to adapt to changing customer preferences for more fuel-efficient cars, and it prevented higher quality and more innovative designs. GM lost customers to foreign competitors that offered these features.

More recently, GM's strong culture was again faulted for corporate ineptitude when delaying recalling defective cars.[65] Over 25 million GM cars were recalled for safety defects in 2014, the largest recall ever. In particular, many GM cars were eventually recalled because of a faulty ignition switch, which could turn off the engine while driving and thus disable the airbags. This problem has been linked to more than 120 fatalities in the United States alone.[66] GM is alleged to knowingly have withheld information about the faulty ignition switches and delayed the needed recalls by several years. Indeed, during a U.S. Senate hearing, GM was described as dominated by a "culture of cover-up."[67] In such times of crisis, corporate culture must be changed to avoid such problems in the future and to address a breakdown in the culture-environment fit.

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

Similarly, when Marissa Mayer was appointed CEO of Yahoo (in 2012), one of the first things she did was to change the corporate culture and norms. Yahoo had become overly bureaucratic and lost the zeal characteristic of high-tech startups. Many Yahoo employees worked from home. For those who worked in the office, weekends began Thursday afternoons, leaving empty parking garages at Yahoo's campus in Sunnyvale, California. In response, Mayer withdrew the option to work remotely. All of Yahoo's 12,000 employees would have to come to the office. She also instituted weekly town-hall meetings (called FYI) where she and other executives provided updates and fielded questions. All employees were expected to attend and encouraged to participate in the Q&A. Questions were submitted online during the week, and the employees voted which questions executives should respond to. Although Mayer succeeded in reenergizing the once leading internet firm, in the end, a successful turnaround failed and Yahoo was acquired by Verizon for a fire sale price.

ORGANIZATIONAL CULTURE AND COMPETITIVE ADVANTAGE

Can organizational culture be the basis of a firm's competitive advantage? For this to occur, the firm's unique culture must help it in some way to increase its *economic value creation* (V–C). That is, it must either help in increasing the perceived value of the product/service and/or lower its cost of production/delivery. Moreover, according to the resource-based view of the firm, the resource—in this case, organizational culture—must be *valuable, rare, difficult*

to imitate, and the firm must be *organized* to capture the value created. The VRIO principles (see Chapter 4) must apply even as to organizational culture itself.[68]

Let's look at one well-known example of how culture affects employee behavior and ultimately firm performance. If you have flown with Southwest Airlines (SWA), you may have noticed that things are done a little differently there. Flight attendants might sing a song about the city you're landing in, or they might slide bags of peanuts down the aisle at takeoff. Employees celebrate Halloween in a big way by wearing costumes to work. Some argue that SWA's business strategy—being a cost leader in point-to-point air travel—is fairly simple, and that SWA's competitive advantage actually comes from its unique culture.[69] It's not all fun and games, though: Friendly and highly energized employees work across functional and hierarchical levels. Even Southwest's pilots pitch in to help load baggage quickly when needed. As a result, SWA's turn time between flights is only 15 minutes, whereas competitors frequently take two to three times as long. Taken together, SWA's unique culture helps it keep costs low by turning around its planes faster, thus keeping them flying longer hours (among many other activities that lower SWA's cost structure).[70]

Let's consider how an organization's culture can have a strong influence on employee behavior.[71] A positive culture motivates and energizes employees by appealing to their higher ideals. Internalizing the firm's values and norms, employees feel that they are part of a larger, meaningful community attempting to accomplish important things. When employees are intrinsically motivated this way, the firm can rely on fewer levels of hierarchy; thus, close monitoring and supervision are not needed as much. Motivating through inspiring values allows the firms to tap employees' emotions so they use both their heads and their hearts when making business decisions. Strong organizational cultures that are strategically relevant, therefore, align employees' behaviors more fully with the organization's strategic goals. In doing so, they better coordinate work efforts, and they make cooperation more effective. They also strengthen employee commitment, engagement, and effort. Effective alignment in turn allows the organization to develop and refine its core competencies, which can form the basis for competitive advantage.

Applying the VRIO principles to the SWA example, we see that both cultures are *valuable* (lowering costs for SWA), *rare* (none of their competitors has an identical culture), *nonimitable* (despite attempts by competitors), and *organized* to capture some part of the incremental economic value created due to their unique cultures. It appears that at SWA, a unique organizational culture can provide the basis for a competitive advantage. These cultures, of course, need to be in sync with and in support of the respective business strategies pursued: cost leadership in the case for SWA. Moreover, as the firms grow and external economic environments change, these organizational cultures must be flexible enough to adapt.

Once it becomes clear that a firm's culture is a source of competitive advantage, some competitors will attempt to imitate that culture. Therefore, only a culture that cannot be easily copied can provide a competitive advantage. It can be difficult, at best, to imitate the cultures of successful firms, for two reasons: *causal ambiguity* and *social complexity.* While one can observe that a firm has a unique culture, the causal relationships among values, norms, artifacts, and the firm's performance may be hard to establish, even for people who work within the organization. For example, employees may become aware of the effect culture has on performance only after significant organizational changes occur. Moreover, organizational culture is socially complex. It encompasses not only interactions among employees across layers of hierarchy, but also the firm's outside relationships with its customers and suppliers.[72] Such a wide range of factors is difficult for any competing firm to imitate.

It is best to develop a strong and strategically relevant culture in the first few years of a firm's existence. This is precisely what the Google co-founders did. Strategy scholars have documented that the initial structure, culture, and control mechanisms established in a new

firm can be a significant predictor of later success.[73] In other empirical research, founder CEOs had a stronger positive imprinting effect than non-founder CEOs.[74] This stronger imprinting effect, in turn, resulted in higher performance of firms led by founder CEOs. In addition, consider that the vehicles of cultural change—changing leadership and M&As—do not have a stellar record of success.[75] Indeed, researchers estimate that only about 20 percent of organizational change attempts are successful.[76] Thus, it is even more important to get the culture right from the beginning and then adapt it as the business evolves.

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

LO 11-8

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

11.5 Strategic Control-and-Reward Systems

Strategic control-and-reward systems are the third and final key building block when designing organizations for competitive advantage. **Strategic control-and-reward systems** are internal governance mechanisms put in place to align the incentives of principals (shareholders) and agents (employees). These formal systems allow managers to specify goals, measure progress, and provide performance feedback. Chapter 5 discussed how firms can use the balanced-scorecard framework as a strategic control system. Here, we discuss additional control-and-reward systems: organizational culture, input controls, and output controls.

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

As discussed in the preceding section, *organizational culture* can be a powerful motivator. It also can be an effective control system. Norms, informal and tacit in nature, act as a social control mechanism. Peer control, for example, exerts a powerful force on employee conformity and performance.[77] Values and norms also provide control by helping employees address unpredictable and irregular situations and problems (common in service businesses). In contrast, rules and procedures (e.g., codified in an employee handbook) can address only circumstances that can be predicted.

Google relies on data analysis and the latest findings in behavioral economics and psychology research to motivate its employees and to achieve high productivity.[78] The tech industry in general is plagued by problems of employee attrition, turnover, and confidentiality breaches. In addition, highly capable individuals such as star programmers are in short supply and thus have strong bargaining power. Where Google differs from other employers is in its generous on-the-job perks, which include everything from free gourmet food, beverages, and coffee to onsite child care, car detail services, and educational opportunities. Google also provides relaxation opportunities such as complimentary massages and naps using nap pods. Employees are also invited to play table tennis or foosball. In 2019, Google had 103,000 employees and revenues of $142 billion. This implies that each employee on average generates $1.3 million in revenues, justifying the pricey on-the-job perks.

Less well-known is Google's fine-tuned compensation and reward systems based on pay for performance. Google uses the **Objectives and Key Results (OKRs)** framework as one of its strategic control-and-reward systems; in addition to helping a team and its individual members monitor objectives and outcomes, the OKR framework helps them to set ambitious stretch goals; for example, increase users by 25 percent. The more objective the goal the more easily it can be measured. Google also makes the individual and team OKRs public—doing this puts a degree of peer pressure on those team members who are not carrying their weight. The more public their individual progress, the more likely they will work toward helping their teams achieve their OKRs.

Objectives and Key Results (OKRs) A strategic reward and control system that helps a team and its individual members monitor objectives and outcomes, as well as set ambitious stretch goals.

INPUT CONTROLS

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

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

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

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

OUTPUT CONTROLS

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

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

These days, more and more work requires creativity and innovation, especially in highly developed economies.[79] As a consequence, so-called *results-only-work-environments (ROWEs)* have attracted significant attention. ROWEs are output controls that attempt to tap intrinsic (rather than extrinsic) employee motivation, which is driven by the employee's interest in and the meaning of the work itself. In contrast, extrinsic motivation is driven by external factors such as awards and higher compensation, or punishments like demotions and layoffs (the *carrot-and-stick approach*). According to a recent synthesis of the strategic human resources literature, intrinsic motivation in a task is highest when an employee has

- Autonomy *(about what to do)*.
- Mastery *(how to do it)*.
- Purpose *(why to do it)*.[80]

Today, 3M is best known for its adhesives and other consumer and industrial products.[81] But its full name reflects its origins: 3M stands for Minnesota Mining and Manufacturing Co. Over time, 3M has relied on the ROWE framework and has morphed into a highly science-driven innovation company. At 3M, employees are encouraged to spend 15 percent of

their time on projects of their *own choosing.* If any of these projects look promising, 3M provides financing through an internal venture capital fund and other resources to further develop their commercial potential. In fact, several of 3M's flagship products, including Post-it Notes and Scotch Tape, were the results of serendipity. To foster continued innovation, moreover, 3M requires each of its divisions to derive at least 30 percent of their revenues from products introduced in the past four years.

11.6 Implications for Strategic Leaders

This chapter has a clear practical implication for the strategist: Formulating an effective strategy is a necessary but not sufficient condition for gaining and sustaining competitive advantage; strategy *execution* is at least as important for success.

The key levers for strategic leaders to achieve effective strategy implementation are structure, culture, and control. Successful strategy implementation, therefore, requires leaders to design and shape structure, culture, and control mechanisms. In doing so, they execute a firm's strategy as they put its accompanying business model into action. Strategy formulation and strategy implementation, therefore, are iterative and interdependent activities.

Some argue that strategy implementation is more important than strategy formulation.[82] Often, managers do a good job of analyzing the firm's internal and external environments to formulate a promising business, corporate, and global strategy, but then fail to implement the chosen strategy successfully. That is why some scholars refer to implementation as the "graveyard of strategy."[83] In reality, both strategy formulation *and* strategy implementation are necessary to gain and sustain a competitive advantage.

As a company grows and its operations become more complex, it adopts different organizational structures over time following a generally predictable pattern: beginning with a simple structure, then a functional structure, and followed by a multidivisional or matrix structure. Organizing for competitive advantage, therefore, is a dynamic and not a static process. As seen in the Google example discussed in ChapterCase 11 and throughout the chapter, to maintain competitive advantage, companies need to restructure as they grow and the competitive environment changes.

Organizing for innovation is another area that strategic leaders need to pay careful attention to. Many of the more successful companies have either adopted or are moving toward an open innovation model. Strategic leaders must actively manage a firm's internal and external innovation activities. Internally, one can *induce innovation* through a top-down process or motivate innovation through *autonomous actions,* a bottom-up process.[84] In induced innovation, strategic leaders need to put a structure and system in place to foster innovation. Consider 3M: "A core belief of 3M is that creativity needs freedom. That's why...we've encouraged our employees to spend 15 percent of their working time on their own projects. To take our resources, to build up a unique team, and to follow their own insights in pursuit of problem-solving."[85] We discussed *autonomous actions* in detail in Chapter 2. To not only motivate innovations through autonomous behavior, but also ensure their possible success, *internal champions* need to be willing to support promising projects. In Strategy Highlight 2.2 , we detailed how Howard Behar, at that time a senior executive at Starbucks, was willing to support the bottom-up idea of Frappuccino, which turned out to be a multibillion-dollar business. Externally, strategic leaders must manage innovation through cooperative strategies such as licensing, strategic alliances, joint ventures, and acquisitions. These are the vehicles of *corporate strategy* discussed previously.

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

CHAPTER CASE 11 Part II

Pawel Kopczynski/Reuters

AS OF 2019, Alphabet remains a one-trick pony, with Google's online search and advertising business bringing in basically all the profits (99 percent). Yet, competition in the online advertising space is heating up because Facebook has become a viable alternative to Google, and it's growing fast. In addition, Amazon—a newcomer to the digital ad space—is making strong inroads. Alphabet's profit sanctuary may be under threat. With its new organizational structure, Alphabet CEO Larry Page hopes for more radical innovation that will turn into highly profitable businesses like Google.

Before its reorganization from a functional to M-form structure, implemented to manage a set of unrelated businesses, Google had developed many of its most well-known products and services through planned emergence, wherein the impetus for strategic initiatives emerges from the bottom up through autonomous actions by lower-level employees. Google organized the work of its engineers according to a 70-20-10 rule. The majority of the engineers' time (70 percent) focused on its main business—search and ads. One day a week (20 percent) was spent developing ideas of their own choosing, and the remainder (10 percent) on total wild cards such as Project Loon, an envisioned network of high-altitude balloons that travel on the edge of space to provide wireless internet services to the two-thirds of the world's population that do not yet have internet access—primarily those in rural and remote areas. (Loon is now a standalone unit in the new Alphabet structure.) Google has reported that half of its new products came from the 20 percent rule, including Gmail, Google Maps, Google News, Orkut, and AdSense. AdSense started as an experiment by two Google engineers: They attempted to match Gmail content with targeted ads based on that content. Today, AdSense enables creators of content sites in its network, such as Google bloggers, to serve online ads that are targeted to the site's content.

Although Google has a stellar track record for strategy process as planned emergence, it has fumbled its social networking endeavors multiple times. These missteps left the space open to Facebook, now Google's fiercest competitor in the digital ad space. Google's first attempt in social networking goes back to 2002, two years (eons in internet time) before Facebook was founded. Google engineer Orkut Buyukkokten had developed a social network, called Orkut, using his 20 percent discretionary time. Marissa Mayer, then Google's vice president in charge of the project, liked what she saw and provided initial support. More engineers were eventually added to further Orkut's development. Google was astonished at Orkut's early success: Within the first month after its release, hundreds of thousands of people signed up. By 2014, Orkut had 30 million users mostly in Brazil and India. But this paled in comparison to Facebook's more than 1 billion users worldwide at the time.

Why did Google fumble its lead over Facebook? Google had a huge opportunity to become the leader in social networking because Myspace imploded after it was acquired by News Corp. Despite initial support, Google's top executives felt that social networking did not fit its vision *to organize the world's information and make it universally accessible and useful.* Google relied on highly complex and proprietary algorithms to organize the knowledge available on the internet and serve up targeted search ads. Social networking software, in comparison, is fairly pedestrian. Additionally, Page and Brin, both exceptional computer scientists, looked down on social networking. They felt their PageRank algorithm that accounts for hundreds of variables and considers all available websites was far superior in providing *objective* recommendations to users' search queries than *subjective* endorsements by someone's online friends. As a consequence, they snubbed social networking. Moreover, given the many different projects Google was pursuing at that time, Orkut was ranked as a low priority by Google's top executives. Starved of further resources, the social networking site withered and was eventually shut down in 2014, making Facebook the undisputed leader.

In yet another effort to catch up with Facebook, Google launched Google Plus in 2011. This social networking site integrated all of Google's services— Gmail, YouTube, Chrome, and others—into one user interface. It required users to sign into its portal, even if they were using just one Google product. After a data breach, Google Plus was shut down unceremoniously in 2019. Meanwhile, Facebook has over 2 billion active users on its platform—and Google is unable to access any of the information tied to these users. Not being able to access Facebook users' activities limits Google's ability to serve targeted ads, which, in turn, cuts directly into its main line of business.[86]

Questions

1. Why did Google restructure itself and create Alphabet? What is it hoping to accomplish? For additional insights, see Larry Page's post announcing the restructuring at https://abc.xyz/.
2. Do you think the reorganization is beneficial for Alphabet's moon shots, now housed in their own business unit with profit-and-loss responsibility? Why, or why not? Explain.
3. Why has Google "failed" to develop other profitable businesses? Is Google's strategy process of planned emergence to blame? Why or why not? Will Alphabet's new structure with independent SBUs enable the company to innovate more and to find the next highly profitable business beyond online search and advertising?

mySTRATEGY

For What Type of Organization Are You Best Suited?

As noted in the chapter, firms can have very distinctive cultures. Recall that Zappos has a standing offer to pay any new hire one month's salary to quit the company after orientation. Zappos makes this offer to help ensure that those who stay with the company are comfortable in its "create fun and a little weirdness" environment. (Parts of this "pay to leave" idea were also picked up by owner Amazon more recently.)

You may have taken a personality test such as Myers-Briggs or the Big Five. These tests may be useful in gauging compatibility of career and personality types. They are often available for both graduate and undergraduate students at university career placement centers. In considering the following questions, think about your next job and your longer-term career plans.

1. Review Exhibit 11.11 and circle the organizational characteristics you find appealing. Cross out those factors you think you would not like.
2. Have you been in school or work situations in which your values did not align with those of your peers or colleagues? How did you handle the situation? Are there certain values or norms important enough for you to consider as you look for a new job?
3. As you consider your career after graduation, which control-and-reward system would you find most motivating? Is this different from the controls used at some jobs you have had in the past? How do you think you would perform in a holacracy such as Zappos?

TAKE-AWAY CONCEPTS

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

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

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

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

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

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

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

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

- Organic organizations are characterized by a low degree of specialization and formalization, a flat organizational structure, and decentralized decision making.

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

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

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

LO 11-6 / Evaluate closed and open innovation, and derive implications for organizational structure.

- Closed innovation is a framework for R&D that proposes impenetrable firm boundaries. Key to success in the closed innovation model is that the firm discovers, develops, and commercializes new products internally.
- Open innovation is a framework for R&D that proposes permeable firm boundaries to allow a firm to benefit not only from internal ideas and inventions, but also from external ones. The sharing goes both ways: Some external ideas and inventions are insourced while others are spun off.
- Exhibit 11.12 compares and contrasts principles of closed and open innovation.

LO 11-7 / Describe the elements of organizational culture, and explain where organizational cultures can come from and how they can be changed.

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

LO 11-8 / Compare and contrast different strategic control-and-reward systems.

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

KEY TERMS

Absorptive capacity *(p. 413)*
Ambidexterity *(p. 403)*
Ambidextrous organization *(p. 403)*
Artifacts *(p. 417)*
Centralization *(p. 398)*
Exploitation *(p. 403)*
Exploration *(p. 403)*
Formalization *(p. 397)*
Founder imprinting *(p. 419)*
Functional structure *(p. 401)*
Hierarchy *(p. 398)*
Holacracy *(p. 408)*
Inertia *(p. 395)*
Input controls *(p. 423)*
Matrix structure *(p. 408)*
Mechanistic organization *(p. 398)*
Multidivisional structure (M-form) *(p. 404)*
Norms *(p. 416)*
Objectives and Key Results (OKRs) *(p. 422)*
Open innovation *(p. 412)*
Organic organization *(p. 399)*
Organizational culture *(p. 416)*
Organizational design *(p. 393)*
Organizational structure *(p. 397)*
Output controls *(p. 423)*
Simple structure *(p. 401)*
Span of control *(p. 398)*
Specialization *(p. 397)*
Strategic control-and-reward systems *(p. 422)*

DISCUSSION QUESTIONS

1. Why is it important for an organization to have alignment between its strategy and structure?
2. The chapter describes the role of culture in the successful implementation of strategy. Consider an employment experience of your own or of someone you have observed closely (e.g., a family member). Describe to the best of your ability the values, norms, and artifacts of the organization. What was the socialization process of embedding the culture? Do you consider this to be an example of an effective culture for contributing to the organization's competitive advantage? Why or why not?
3. What makes some strong cultures helpful in gaining and sustaining a competitive advantage, while other strong cultures are a liability to achieving that goal?

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