Chapter 11: Organizational Design: Structure, Culture, and Control

Joe Mahoney
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Chapter Case 11:
Zappos: From Happiness to Holacracy
<table>
<thead>
<tr>
<th>Zappos: From Happiness to Holacracy</th>
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</thead>
<tbody>
<tr>
<td>• An online shoe and clothing store</td>
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<tr>
<td>– The world’s largest shoe store</td>
</tr>
<tr>
<td>– Also offers handbags, clothing items, eyewear, and accessories</td>
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<tr>
<td>– Mission: deliver happiness</td>
</tr>
<tr>
<td>• Zappo’s has also made investors happy</td>
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<tr>
<td>– 10 years after founding, has achieved $1 billion in annual sales</td>
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<tr>
<td>– Amazon.com acquired the company for $1.2 billion</td>
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</table>
Zappos: From Happiness to Holacracy

- Zappo’s has experienced rapid growth.
  - 20 million unique visitors a month
- It is reorganizing to a “Holacracy”
  - To offer the best customer service possible
  - Employees self-direct their work instead of reporting to a manager who tells them what to do.
- This structure can be difficult to implement.
  - Zappo’s is the first large corporation to try it.
Zappos’ Core Values

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

- Zappos – online shoe retailer
- Implementation of holacracy is not going well.
  - Holacracy distributes power to self-managed teams.
- Reasons why the implementation was difficult:
  - Removed paths for clear advancement
  - The grouping of its over 1,500 employees in some 400 circles, with each employee in two or more circles (distributing power and authority) introduced paralysis
  - Made the organization more political
  - 200 employees quit.
Zappos: From Happiness to Holacracy

• What is a holocracy and how does this organizational form differ from more traditional structures?

• Why is Zappos experiencing significant implementation problems with holacracy?

• What else could Zappos do to implement the new organizational structure more effectively?
Organizational Design and Competitive Advantage
The Basic Tasks of Organization

Achieving high levels of productivity requires SPECIALIZATION

Specialization by individuals necessitates COORDINATION

For coordination to be effective requires COOPERATION

But goals of employees $\n$ goals of owners $\n$ THE AGENCY PROBLEM

ORGANIZATIONAL CHALLENGE: design structure & systems that:

- Permit specialization
- Facilitate coordination by grouping individuals & link groups with systems of communication, decision making, & control
- Deploy incentives to align individual & firm goals
How to Organize for Competitive Advantage

• Organizational design
  ➢ Structure
  ➢ Processes
  ➢ Procedures

• Key components:
  ➢ Structure
  ➢ Culture
  ➢ Control

• Structure **follows** strategy (or inefficiency results)
  ➢ Consider the inefficiency of Pepsi Restaurants decentralized structure, which did not follow their related diversification strategy.
Choice Processes in the Carnegie Model

**Uncertainty**
- Information is limited
- Managers have many constraints

**Conflict**
- Managers have diverse goals, opinions, values, experience

**Coalition Formation**
- Hold joint discussion and interpret goals and problems
- Share opinions
- Establish problem priorities
- Obtain social support for problem, solution

**Search**
- Conduct a simple, local search
- Use established procedures if appropriate
- Create a solution if needed

**Satisficing**
- Adopt the first alternative that is acceptable to the coalition
Sources of Bureaucratic Costs

Number of Middle Managers
Motivational Problems
Coordination Problem
Information Distortion

Bureaucratic Costs
Organizational Inertia

• A firm’s resistance to change the status quo
• Can lead to the firm’s subsequent failure
• The pattern of a firm:
  – Mastery of the current environment
  – Success as measured by financial measurements
  – Structures, measures, and systems to manage size
  – Organizational inertia results from shifts in the internal and external environment.
Failure of Firms to Respond to Shifts in the External or Internal Environments

Exhibit 11.2

External Shifts: - PESTEL factors

(1) Mastery of, and Fit with, Current Environment

(2) Success, Usually Measured by Financial Metrics

(3) Structure, Metrics, and Systems to Accommodate and Manage Size

(4) Organizational Inertia

Internal Shifts:
- Accelerated growth
- Change in business model
- Entry into new markets
- Change in TMT
- Mergers and acquisitions

External Shifts: - PESTEL factors
The Premature Death of a Google-like Search Engine at Microsoft

• Microsoft had a prototype called Keywords.
  – More than a decade earlier than Google that was shut down because managers did not see it as a viable business model.

• Microsoft almost acquired this capability.
  – But determined Overture Services was overpriced

• Launched their own, Bing, in 2009

• The CEO has admitted impatience.
  – Was replaced in 2014

• How did problems in Microsoft’s structure and culture contribute to strategic mistakes concerning their search engine decisions?
The Key Elements of Organizational Structure

• Organizational structure determines
  ➢ Work efforts of individuals and teams
  ➢ Resource distribution

• Key building blocks
  ➢ Specialization
  ➢ Formalization
  ➢ Centralization
  ➢ Hierarchy
Specialization

• Describes the degree to which a task is divided into separate jobs (i.e., the division of labor)

• Larger firms: high degree of specialization
  – Ex: Large-firm accountant might do internal auditing

• Smaller ventures: low degree of specialization
  – Example: Small-firm accountant might do:
    • Internal auditing
    • Payroll
    • Accounts receivable
    • Financial planning
    • Taxes
Formalization

• Captures the extent to which employee behavior is steered by explicit and codified rules and procedures
• Is not necessarily negative
• Often can be necessary for consistent and predictable results
  – Example. Pilot training
  – Example. Customer service call centers
• Can slow decision making, reduce innovation, and hinder customer service
Centralization

- Refers to the degree to which decision making is concentrated at the top of the organization
- Example: BP oil spill in 2010 (Deepwater Horizon)
  - Decisions made in UK HQ and not on site
  - Centralization reduced response time and led to a prolonged crisis.
- Affects strategic planning:
  - Top-down strategic planning takes place in highly centralized organizations.
  - Planned emergence is found in more decentralized organizations.
Hierarchy

- Determines the formal, position-based reporting lines
- Stipulates who reports to whom
- Span of control:
  - The number of employees who directly report to a manager
  - In tall structures: the span of control is narrow.
  - In flat structures: the span of control is wide.
    - Meaning one manager supervises many employees
Mechanistic vs. Organic Organizations

- **Mechanistic Organization**
  - High degree of specialization and formalization
  - Tall hierarchies
  - Rely on centralized decision making
    - e.g., McDonald’s detailed instructions to franchisees

- **Organic Organization**
  - Low degree of specialization and formalization
  - Flat organizational structure
  - Decentralized decision making
    - e.g., Zappos
W. L. Gore & Associates: Informality and Innovation

- Inventor of path-breaking new products
  - GORE-TEX fabrics, Glide dental floss, and Elixir guitar strings
  - Devoted to innovation, imagination and initiative
  - No formal job titles, job descriptions, chains of command, formal communication channels, written rules or standard operating procedures

- Uses a boundaryless organization form
  - Everyone is empowered
W. L. Gore & Associates: Informality and Innovation

• Organized in project-based teams
  – Led by sponsors, not bosses
  – Peer control enhances productivity
  – Group members evaluate each other’s performance

• This type of culture has been linked to:
  – Greater employee satisfaction and retention
  – Higher personal initiative & creativity
  – Innovation at the firm level
What management lessons can be taken from the W. L. Gore & Associates (informal) organization structure?
# Mechanistic vs. Organic Organizations

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

- Are interdependent
- Impact a firm’s performance
- Changes over time as the firm grows in:
  - Size and complexity
- Successful new ventures generally grow:
  - First by increasing sales
  - Then by obtaining larger geographic reach
  - Finally by diversifying
    - Through vertical integration
    - Entering into related and unrelated businesses
Types of Organizational Structure

- Simple
- Functional
- Multidivisional
- Matrix
Simple Structure

- Generally used by small firms with low organizational complexity
- Founders make all the strategic decisions.
- Founders run day-to-day operations.
- Professional managers/sophisticated systems are not usually in place.
Functional Structure

• Employees are grouped into functional areas.
  – Based on domain expertise
  – Often correspond to distinct stages in the value chain
    • R&D, engineering, manufacturing, marketing, and sales
    • Supporting areas such as HR, finance, and accounting

• Leaders of functional areas report to the CEO.

• Influenced by strategy:
  – Cost leadership: Mechanistic organization
  – Differentiation: Organic organization
  – Blue ocean: Ambidextrous organization
Typical Functional Structure

Exhibit 11.5

- CEO
- Research & Development
- Engineering & Manufacturing
- Marketing, Sales, & Service
- Human Resources
- Finance & Accounting
Business Strategy and Functional Structure

- **Cost Leadership Strategy**
  - Using a functional structure allows the cost leader to:
    - Nurture and constantly upgrade core competencies

- **Differentiation Strategy**
  - Using a functional structure allows a differentiator to:
    - Incorporate decentralized decision making
    - Foster and incentivize continuous innovation and creativity

- **Blue Ocean Strategy**
  - To implement a functional blue ocean strategy:
    - The firm must be both efficient and flexible
    - The firm must control costs and foster creativity
    - Mitigate the disadvantages of this approach
Disadvantages of Functional Structure

• Frequently lacks effective communication channels across departments.

• The top-level manager must take on the coordination and integration work.

• It cannot effectively address a higher level of diversification, which often stems from further growth.
Multidivisional Structure

- Consists of several distinct strategic business units (SBUs)
  - Each with its own profit-and-loss (P&L) responsibility

- Each SBU is operated (quasi-)independently.

- Each is led by a divisional manager
  - Responsible for the unit’s business strategy
  - Responsible for day-to-day operations
Organizing the Diversified Firm

• The multidivisional organization, as documented by Alfred D. Chandler in *Strategy and Structure*, was pioneered in the 1920s by pioneering firms such as:

  ➢ DuPont, General Motors, Sears and Standard Oil;
  ➢ By 1967, two-thirds of Fortune 500 Companies are multidivisional.
The multidivisional structure was an adaptive response to the strategy of diversification.

“Unless (multidivisional) structure follows (diversification) strategy, inefficiency results”

- Alfred D. Chandler, 1962, Strategy and Structure, p. 314

- Dupont --> multi-divisional  <------ General Motors
  family-owned                 holding company
Organizing the Diversified Firm

• Three key features of organizational structure:

➢ 1. The division of tasks;

➢ 2. The depth of the hierarchy (span of control);

➢ 3. The extent of authority delegation (how much decentralization?)
Typical Multidivisional Structure

Exhibit 11.7
Multidivisional Structure

Typical Chemical Company

- Corporate Headquarters Staff
  - CEO

- Oil Division (Functional Structure)
- Pharmaceuticals Division (Product Team Structure)
- Plastics Division (Matrix Structure)
Business Strategy and Multidivisional Structure

• Related Diversification
  – Cooperative M-Form
    • Centralized decision making
    • High level of integration at corporate headquarters
    • Co-opetition among SBUs

• Unrelated Diversification
  – Competitive M-Form
    • Decentralized decision making
    • Low level of integration at corporate headquarters
    • Competition among SBUs for resources
How Hierarchy Economizes on Coordination

(a) Self Organizing Team:
10 interactions

(b) Hierarchy:
4 interactions
Hierarchy Allows Flexible Adaptation

Tightly-coupled, integrated system: Change in any part of the system requires system-wide adaptation

Loose-coupled, modular hierarchy: organizing a complex system into subsystems and components linked by standardized interfaces permits decentralized adaptation
Evolutionary Stability of the Multidivisional Form

• Parable of the Two Watchmakers

➢ 10,000 parts

➢ Watchmaker #1 needs to put all parts together or the watch falls apart and he needs to start all over with his 10,000 parts.

➢ Watchmaker #2 has developed 100 subsystems of 100 parts. This is the “principle of near-decomposability” (i.e., a system that contains localized sub-systems)
Evolutionary Stability of the Multidivisional Form

• Hierarchical systems (containing sub-systems) will evolve much more rapidly from elementary constituents than will non-hierarchic systems containing the same number of elements.

• In organization theory this is called the effectiveness of “loose coupling.”

➢ The advantage of “loose coupling” is that if there is poor performance in division 2 it does not lead to failure of the entire system.
Effectiveness of Multidivisional Form

• Effective Divisionalization involves:

- Identification of separable economic activities within the firm;
- Giving quasi-autonomous standing to each division (usually of a profit center nature);
- Monitoring the efficiency performance of each division;
- Awarding incentives;
- Allocating cash flow to high yield uses; and
- Performing strategic planning (diversification, acquisition, and related activities).
Disadvantages of the Multidivisional Structure

• Dysfunctional Aspects of the Multidivisional:
  ➢ Emphasis on short-term perspective;
  ➢ Loss of economies of scope;
  ➢ Duplication of R&D, marketing, etc.;
  ➢ Divisions can end up (dysfunctionally competing with each other; e.g., Pepsi Restaurants)
  ➢ Emphasis on financial manipulation instead of developing firm capabilities and resources;
  ➢ Large conglomerates may have excessive political power.
Matrix Structure

- Firm is organized according to SBUs
  - Like in the M-form
- Also has a second dimension of organizational structure
  - Consists of different geographic areas
- Purpose:
  - Combine the benefits of the M-form
    - Domain expertise, economies of scale, and the efficient processing of information
  - With benefits of the functional structure
    - Responsiveness and decentralized focus
Typical (Global) Matrix Structure

Exhibit 11.9
Matching Global Strategy and Structure

<table>
<thead>
<tr>
<th>Global Strategy</th>
<th>Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>International</td>
<td>Functional</td>
</tr>
<tr>
<td>Localization (Multidomestic)</td>
<td>Multidivisional</td>
</tr>
<tr>
<td></td>
<td>• Geographic areas</td>
</tr>
<tr>
<td></td>
<td>• Decentralized decision making</td>
</tr>
<tr>
<td>Global standardization</td>
<td>Multidivisional</td>
</tr>
<tr>
<td></td>
<td>• Product divisions</td>
</tr>
<tr>
<td></td>
<td>• Centralized decision making</td>
</tr>
<tr>
<td>Transnational</td>
<td>Global matrix</td>
</tr>
<tr>
<td></td>
<td>• Balance of centralized and decentralized decision making</td>
</tr>
<tr>
<td></td>
<td>• Additional layer of hierarchy to coordinate both:</td>
</tr>
<tr>
<td></td>
<td>• Geographic areas</td>
</tr>
<tr>
<td></td>
<td>• Product divisions</td>
</tr>
</tbody>
</table>
Strengths of Matrix structure

- Achieves coordination necessary to meet dual demands from environment.
- Flexible sharing of human resources across products.
- Suited to complex decisions and frequent changes in unstable environment.
- Provides opportunity for functional and product skill development.
- Best in medium-sized organizations with multiple products.
Weaknesses of Matrix structure

- Causes participants to experience dual authority, which can be frustrating and confusing.
- Participants need to have good interpersonal skills and extensive training.
- Is time-consuming: involves frequent meetings and conflict resolution sessions.
- Will not work unless participants understand it and adopt collegial rather than vertical-type relationships.
- Requires dual pressure from environment to maintain power balance.
Organizational Culture: Values, Norms, and Artifacts
Organizational Culture

• The collectively shared **values** and **norms** of an organization’s members

• Values: define what is considered important

• Norms: define appropriate employee attitudes and behaviors

• Expressed through artifacts:
  – The design and layout of space: cubicles vs. offices
  – Symbols: the type of clothing worn by employees
  – Events: what is celebrated and highlighted
  – Vocabulary: what stories are told
The Elements of Organizational Culture

At Zappos, even under its previous structure, all employees including CEO Tony Hsieh, worked from a cubicle.

Zappos continues to celebrate the norm of happiness; employees are encouraged to promote happiness in the workplace in creative ways.

Zappos turned to the employees themselves to articulate company values, conspicuous in orientation, daily operations, and evaluation reviews.

Exhibit 11.11
Where Do Organizational Cultures Come From?

• Founder imprinting
  – The founder defines and shapes the culture.
  – Can persist for decades after his or her departure.
  – *Examples:* Steve Jobs (Apple), Walt Disney (Disney), Sergey Brin & Larry Page (Google), Michael Dell (Dell), Oprah Winfrey (Harpo), Martha Stewart (Living Omnimedia), Bill Gates (Microsoft), Larry Ellison (Oracle), Herb Kelleher (Southwest Airlines), and Sam Walton (Wal-mart).

• Groupthink
  – When opinions combine.
  – Results when individuals do not critically evaluate and challenge a leader’s opinions and assumptions.

*When all think alike, then no one is thinking.*

- WALTER LIPPMAN-
How Does Organizational Culture Change?

• Culture can turn from core competencies into core rigidities (e.g., GM’s bureaucratic culture).

• A firm must hone, refine, and upgrade.
  – Because the firm and the environment change

• The primary means of cultural change:
  – The board of directors brings in new leadership.
  – Leadership is charged to make changes in strategy and structure.

• Culture is shaped through:
  – Organizational structure
  – Resource allocation and reward systems
Organizational Culture and Competitive Advantage

• Can organizational culture help a firm gain and sustain competitive advantage? Yes, IF:
  – The culture makes a positive contribution to the firm’s economic value creation.
  – If the culture follows the VRIO(N) principles

• It can be an effective lever for new ventures:
  – It is malleable.
  – Firm founders, early-stage CEOs, and venture capitalists should be proactive:
    • Create a culture that supports a firm’s economic value creation
Two Examples of Culture Affecting Employee Behavior

• Example #1: Zappo’s
  – Someone called up Zappo’s to ask where a local pizza could be delivered to her hotel.
  – This type of action can increase the company’s perceived value and economic value creation.
  – Provided “wow” through service!

• Example #2: Southwest Airlines
  – Friendly and highly energized employees (e.g., sing songs)
  – Work across functional and hierarchical levels
  – Turn time between flights is only 15 minutes
Strategic Control-and-Reward Systems
Strategic Control and Reward Systems

• Internal-governance mechanisms

• Put in place to align the incentives of:
  – Principals (shareholders)
  – Agents (employees)

• Allow managers to:
  – Specify goals
  – Measure progress
  – Provide performance feedback
Input Controls

• Seeks to define and direct employee behavior through:
  – Explicit, codified rules
  – Standard operating procedures

• Considered prior to the value-creating activities

• Example: a budget
  – Managers allocate money to R&D projects before they begin.
Output Controls

• Seek to guide employee behavior by:
  – Defining expected results (outputs), but
  – Leaving the means to those results open to individual employees, groups, or SBUs

• “ROWE” = Results Only Work Environment (see e.g., 3M Corporation’s use of ROWE)

• Intrinsic task motivation is highest when an employee has:
  – Autonomy (what to do)
  – Mastery (how to do it)
  – Purpose (why to do it)