

Chapter 10 basic organizational design



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Chapter 10 Basic Organizational Design Once managers are done planning, then what? This is when managers need to begin to “ work the plan. ” And the first step in doing that involves designing an appropriate organizational structure. This chapter covers the decisions involved with designing this structure. Focus on the following learning outcomes as you read and study this chapter. LEARNING OUTCOMES 10. 1 Describe six key elements in organizational design. 10. 2 Contrast mechanistic and organic structures. 10. 3 Discuss the contingency factors that favor either the mechanistic model or the organic model of organizational design. 10. 4 Describe traditional organizational designs. A MANAGER’S DILEMMA How can we design an organizational structure that will help us accomplish our company’s goals? Should our structure be tall or flat? Traditional or contemporary? Will our chosen design enhance our capacity to continuously learn, adapt, and change in a dynamic global environment? As tomorrow’s managers, many of your students will soon face these questions. In Chapter 10, students learn about various elements of organizational structure, the contingency factors that influence organizational design, and traditional and contemporary design.

In addition, they will study design challenges encountered by managers who work in a variety of organizational structures. “ A Manager’s Dilemma” highlights some of the problems in store for Eli Lilly & Company, a major US pharmaceutical company. Eli Lilly & Co. stands to lose \$10 billion in annual revenues between now and 2016 as three of its major drug patents expire. As CEO, John Lechleiter’s job is to find foster new drug development to replace the projected loss revenue. While other pharmaceutical companies

are seeking a merger route to acquire new drugs, Eli Lilly One has decided to revamp the company's operational structure into five global business units and create an improved product research and development center. Students should address other organizational design elements Lechleiter might use to ensure that Lilly achieves its goal of speeding up its product development process? From the information presented here, it appears that Eli Lilly's has adopted a product structure which offers the advantage of being more responsive to changes in the external environment. Eli Lilly may also want to create more teams in their structure as well as take advantage of technology with virtual teams.

CHAPTER OUTLINE INTRODUCTION Designing organizational structure involves the process of organizing (the second management function) and plays an important role in the success of a company. 10. 1 DEFINING ORGANIZATIONAL STRUCTURE Managers need to establish structural designs that will best support and allow employees to do their work effectively and efficiently. Several important terms must be defined in order to understand the elements of organizational structure and design: 1. Organizing is arranging and structuring work to accomplish the organization's goals.

This process has several purposes, as shown in Exhibit 10-1. 2.

Organizational structure is the formal arrangement of jobs within an organization. 3. Organizational design is developing or changing an organization's structure. This process involves decisions about six key elements: work specialization, departmentalization, chain of command, span of control, centralization/ decentralization, and formalization. Chapter 10

examines each of these structural elements. A. Work Specialization. Work specialization is dividing work activities into separate job tasks.

Most of today's managers regard work specialization as an important organizing mechanism, but not as a source of ever-increasing productivity. Exhibit 10-2 illustrates the human diseconomies from division of labor—boredom, fatigue, stress, low productivity, poor quality, increased absenteeism, and high turnover—eventually exceed the economic advantages created by work specialization. B. Departmentalization. When work tasks have been defined, they must be arranged in order to accomplish organizational goals.

This process, known as departmentalization, is the basis by which jobs are grouped. There are five major ways to departmentalize (see Exhibit 10-3): 1. Functional departmentalization groups jobs by functions performed. 2. Product departmentalization groups jobs by product line. 3. Geographical departmentalization groups jobs on the basis of geographical region. 4. Process departmentalization groups jobs on the basis of product or customer flow. 5. Customer departmentalization groups jobs on the basis of specific and unique customers who have common needs. 6.

Popular trends in departmentalization include the following: a. Customer departmentalization continues to be a highly popular approach because it allows better monitoring of customers' needs and responds to changes in the needs of customers. b. Cross-functional teams, which are work teams composed of individuals from various functional specialties, are being used along with traditional departmental arrangements. C. Chain of Command.

The chain of command is the line of authority extending from upper organizational levels to the lowest levels, which clarifies who reports to whom.

Three concepts related to chain of command are authority, responsibility, and unity of command. 1. Authority is the rights inherent in a managerial position to tell people what to do and to expect them to do it. a. The acceptance theory of authority proposed by Chester Barnard says that authority comes from the willingness of subordinates to accept it. Barnard contended that subordinates will accept orders only if the following conditions are satisfied: 1. They understand the order. 2.

They feel the order is consistent with the organization's purpose. 3. The order does not conflict with their personal beliefs. 4. They are able to perform the task as directed. b. Line authority entitles a manager to direct the work of an employee. It is the employer–employee authority relationship that extends from the top of the organization to the lowest echelon, according to the chain of command, as shown in Exhibit 10-4. c. Staff authority functions to support, assist, advise, and generally reduce some of their informational burdens.

Exhibit 10-5 illustrates line and staff authority. 2. Responsibility is the obligation to perform any assigned duties. 3. Unity of command is the management principle that each person should report to only one manager. D. Span of Control. Span of control is the number of employees a manager can efficiently and effectively manage. 1. The span of control concept is important because it determines how many levels and managers an

organization will have. (See Exhibit 10-6 for an example) 2. What determines the “ ideal” span of control?

Contingency factors such as the skills and abilities of the manager and the employees, the characteristics of the work being done, similarity and complexity of employee tasks, the physical proximity of subordinates, the degree to which standardized procedures are in place, the sophistication of the organization’s information system, the strength of the organization’s culture, and the preferred style of the manager influence the ideal number of subordinates. 3. The trend in recent years has been toward wider (larger) spans of control. E. Centralization and Decentralization.

The concepts of centralization and decentralization address who, where, and how decisions are made in organizations. 1. Centralization is the degree to which decision making is concentrated at upper levels of the organization. 2. Decentralization is the degree to which lower-level employees provide input or actually make decisions. 3. The current trend is toward decentralizing decision making in order to make organizations more flexible and responsive. 4. Employee empowerment is giving employees more authority (power) to make decisions. . A number of factors influence the degree of centralization or decentralization in an organization (see Exhibit 10-7). F. Formalization refers to the degree to which jobs within an organization are standardized and the extent to which employee behavior is guided by rules and procedures. 1. In a highly formalized organization, employees have little discretion, and a high level of consistent and uniform output exists.

Formalized organizations have explicit job descriptions, many organizational rules, and clearly defined procedures. 2.

In a less-formalized organization, employees have much freedom and can exercise discretion in the way they do their work. 3. Formalization not only fosters relatively unstructured job behaviors, but also eliminates the need for employees to consider alternatives. 4. The degree of formalization can vary widely between organizations and even within organizations. 10. 2

MECHANISTIC AND ORGANIC STRUCTURES Organizations do not have identical structures. Even companies of comparable size do not necessarily have similar structures. A. Two Models of Organizational Design. See Exhibit 10-8) 1. A mechanistic organization is an organizational design that is rigid and tightly controlled. It is characterized by high specialization, rigid departmentalization, narrow spans of control, high formalization, a limited information network, and little participation in decision making by lower-level employees. 2. An organic organization is an organizational design that is highly adaptive and flexible. It is characterized by little work specialization, minimal formalization, and little direct supervision of employees. 3.

Under what circumstances is each design favored? It “ depends” on contingency variables. 10. 3 **CONTINGENCY FACTORS** Appropriate organizational structure depends upon four contingency variables: A. Strategy and structure. The organization’s strategy is one of the contingency variables that influences organizational design. 1. Alfred Chandler originated the strategy-structure relationship. His finding that structure follows strategy indicates that as organizations change their strategies, they must change their structure to support that strategy. . Most current strategy/structure frameworks focus on three strategy dimensions: a) Innovation needs the flexibility and free flow of information present in the organic organization. b)

Cost minimization needs the efficiency, stability, and tight controls of the mechanistic organization. c) Imitation uses some of the characteristics of both mechanistic and organic organizations. B. Size and structure.

Considerable historical evidence indicates that an organization's size significantly affects its structure.

Larger organizations tend to have more specialization, departmentalization, centralization, and formalization, although the size-structure relationship is not linear. C. Technology has been shown to affect an organization's choice of structure. 1. Every organization uses some form of technology to transform inputs into outputs. 2. Joan Woodward's study of structure and technology shows that organizations adapt to their technology. She found that three distinct technologies have increasing levels of complexity and sophistication. a) Unit production is the production of items in units or small batches.) Mass production is the production of items in large batches. c) Process production is the production of items in continuous processes. 3. Woodward found in her study of these three groups that distinct relationships exist among these technologies, the subsequent structure of the organization, and the effectiveness of the organization. Exhibit 10-9 and provides a summary of these findings. LEADERS WHO MAKE A DIFFERENCE As the first female CEO of Avon, Andrea Jung has held that position for a decade—the most-tenured female CEO in the Fortune 500. Ms.

Jung clearly understands the importance of organizational design in helping her global company prosper in good times and bad. This part of her job is especially challenging considering that 70 percent of Avon's sales are in developing countries. Ms. Jung has made tough decisions to restructure,

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refocus, and redefine the company's strategies and created an organizational design to help it continue its success as the leading women's beauty products company. D. Environmental uncertainty and structure Environmental uncertainty is the final contingency factor that has been shown to affect organizational structure.

Environmental uncertainty may be managed by making adjustments in the organization's structure. The more uncertain the environment, the more flexible and responsive the organization needs to be. 10. 4 TRADITIONAL ORGANIZATIONAL DESIGNS A number of different organizational designs can be found in today's organizations. Exhibit 10-8 summarizes the strengths and weaknesses of each of these designs. A. A simple structure is an organizational design with low departmentalization, wide spans of control, authority centralized in a single person, and little formalization. . Strengths of the simple structure are its flexibility, speed, clear accountability and low maintenance costs. 2. The major limitation of a simple structure is that it is most effective when used in small organizations. B. As an organization grows, its structure tends to become more specialized and formalized. When contingency factors favor a bureaucratic or mechanistic design, one of the following two options is likely to be used: 1. A functional structure is an organizational design that groups similar or related occupational specialties together. . A divisional structure is an organizational structure made up of separate, semiautonomous units or divisions. LET'S GET REAL: MY RESPONSE Cindy Brewer Customer Contact Channel Manager Sears Holdings Corporation Loves Park, IL Cindy offers several recommendations for Eli Lilly & Company. To better the structure of the organization, she recommends the

use of more flexible structures, i. e. a divisional and organic structure, while at the same time including a mechanistic structure to help speed up certain aspects of the drug approval process.

Her final recommendation, to ‘ create cross-functional teams across the business units to share best practices and key learning to increase the product development process’ is an insightful one in that it leverages the power of teams to aid in the decision making process and at the same time create a learning/innovation based climate. Answers to Review and Discussion Questions 1. Discuss the traditional and contemporary views of each of the six key elements of organizational design. Traditionally, work specialization was viewed as a way to divide work activities into separate job tasks.

Today’s view is that it is an important organizing mechanism but it can lead to problems. The chain of command and its companion concepts—authority, responsibility, and unity of command—were viewed as important ways of maintaining control in organizations. The contemporary view is that they are less relevant in today’s organizations. The traditional view of span of control was that managers should directly supervise no more than five to six individuals. The contemporary view is that the span of control depends on the skills and abilities of the manager and the employees and on the characteristics of the situation. . Can an organization’s structure be changed quickly? Why or why not? Should it be changed quickly? Explain. The speed with which structural changes can be implemented depends partly upon an organization’s size. A small organization is usually able to change its structure more rapidly than a larger one because a smaller company has

fewer employees who are involved in the restructuring process. However, a large organization can change its structure and often does in response to changing environmental conditions and changing strategies. 3. Contrast mechanistic and organic organizations.

A mechanistic organization is a rigid and tightly controlled structure. An organic organization is highly adaptive and flexible. 4. Would you rather work in a mechanistic or an organic organization? Why? Students' answers to this question will vary. Many students prefer the structure provided by a mechanistic organization, whereas others would be less productive in an organization with structural rigidity. Note that SAL #III. A. 1 " What Type of Organization Structure Do I Prefer? " addresses whether each of your students would like to work in a bureaucracy (a mechanistic organization).

Students might want to revisit this assessment in answering this question. 5. Explain the contingency factors that affect organizational design. An organization's structure should support the strategy. If the strategy changes, the structure also should change. An organization's size can affect its structure up to a certain point. Once an organization reaches a certain size (usually around 2, 000 employees), it's fairly mechanistic. An organization's technology can affect its structure. An organic structure is most effective with unit production and process production technology.

A mechanistic structure is most effective with mass production technology. The more uncertain an organization's environment, the more it needs the flexibility of an organic design. 6. Contrast the three traditional organizational designs. A simple structure is one with low

departmentalization, wide spans of control, authority centralized in a single person, and little formalization. A functional structure groups similar or related occupational specialties together. A divisional structure is made up of separate business units or divisions. 7.

With the availability of advanced information technology that allows an organization's work to be done anywhere at any time, is organizing still an important managerial function? Why or why not? Although an organization's work may be done anywhere at any time, organizing remains a vital managerial function because the work that must be accomplished still must be divided, grouped, and coordinated. 8. Researchers are now saying that efforts to simplify work tasks actually have negative results for both companies and their employees. Do you agree? Why or why not? Studies as far back as 1924 show that simplified jobs lead to boredom.

In 1950 other researchers found that highly segmented and simplified jobs resulted in lower employee morale and output. Other consequences of low employee motivation include absenteeism and high employee turnover, both very costly for businesses. ETHICS DILEMMA Shortly after the BP oil spill, BP engaged in a campaign to improve their image including buying domain names that referred to terms like 'oil spill' and 'oil spill claims.' A company spokeswoman said "the strategy is to assist those who are most impacted and help them find the right forms and the right people quickly and effectively. Is this an ethical issue? What ethical concerns do students see in BP doing this? What stakeholders might be affected by BP's actions (buying the search terms)? In what ways might these stakeholders be affected?

While some students may not see this as unethical, there is a question as to

whether BP acquired the domain names to better inform the public or to control information access. By controlling information, BP could put their ‘spin’ on events or even keep the domain names idle so that they could not be used by others to distribute negative information about the company actions.

Ultimately, with a disaster as large as this one, there were many stakeholders affected – fisherman, rig workers, hotel owners, management, and employees. Without access to information, these stakeholders may be unaware of their rights to sue or file claims against BP. SKILLS EXERCISE: DEVELOPING YOUR EMPOWERING PEOPLE (DELEGATING) SKILLS A manager’s job is to do things through other people. This requires that a manager learn to trust and empower those they supervise. In this exercise, the author gives five behaviors for effective delegation.

Students are to then to read through the scenario and write a paper describing how they would handle the situation described. In the scenario, Ann is already following several of guidelines given for recommendation, by clarifying the assignment and allowing Ricky to participate. In Ricky’s meeting with Bill, he will have to follow his Boss’s lead and follow the recommendations as well. He should first clarify the assignment and what Bill will be able to include (and not include) in the manual. It will also be a good idea if Ricky and Bill get other employees’ input on the policy manual – since it will be used by everyone in the organization.

Finally, Ricky should establish a feedback channel so that Bill can ask questions and Ricky can keep track of Bill’s progress. WORKING TOGETHER:

TEAM EXERCISE Form groups of three to four students and have each group choose an organization with which students in the group are familiar (where students work, a student organization to which they belong, your college or university, etc.). Have students draw an organization chart of this organization. Students should show departments (or groups) and especially be careful to get the chain of command correct.

Students should be prepared to share their chart with the class. If this is done outside of class as an assignment, it may be a good idea to have students use Microsoft PowerPoint to prepare the chart. PowerPoint has an option to draw organizational charts in the Smartart menu. Your Turn to be a Manager • Find three different examples of organizational charts. In a report, describe each of them. Try to decipher the organization's use of organizational design elements, especially departmentalization, chain of command, centralization–decentralization, and formalization. Survey at least 10 different managers about how many employees they supervise. Also ask them whether they feel they could supervise more employees or whether they feel the number they supervise is too many. Graph your survey results and write a report describing what you found. Draw some conclusions about span of control. • Draw an organizational chart of an organization with which you're familiar (where you work, a student organization to which you belong, your college or university, etc.). Be very careful in showing the departments (or groups) and especially be careful to get the chain of command correct.

Be prepared to share your chart with the class. • Using the organizational chart you just created, redesign the organization's structure. What structural changes might make this organization more efficient and effective? Write a

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report describing what you would do and why. Be sure to include an example of the original organizational chart as well as a chart of your proposed revision of the organizational structure. • Steve's and Mary's suggested readings: Gary Hamel, *The Future of Management* (Harvard Business School Press, 2007); Thomas Friedman, *The World Is Flat 3.0* (Picador, 2007); Harold J. Leavitt, *Top Down: Why Hierarchies Are Here to Stay and How to Manage Them More Effectively* (Harvard Business School Press, 2005); and Thomas W. Malone, *The Future of Work* (Harvard Business School Press, 2004). • Choose one of the three topics discussed in the section on today's organizational design challenges. Research this topic and write a paper about it. Focus on finding current information and current examples of companies dealing with these issues. • In your own words, write down three things you learned in this chapter about being a good manager. Self-knowledge can be a powerful learning tool. Go to mymanagementlab and complete these self-assessment exercises: How Well Do I Handle Ambiguity? What Type of Organizational Structure Do I Prefer? How Good Am I at Playing Politics? How Willing Am I to Delegate? Using the results of your assessments, identify personal strengths and weaknesses. What will you do to reinforce your strengths and improve your weaknesses? Answers to Case Application Questions Ask Chuck 1. Describe and evaluate what Charles Schwab is doing. It is easy for a company to lose sight of their goals.

While other lines of business may be potential money makers, going beyond a firm's core competence can lead a firm into financial trouble. In this case, students should see how Charles Schwab has stayed true to its primary business – making stock trades for investors who make their own financial

decisions. Another goal of Schwab is customer service. In the example of Cheryl Pasquale, we can see how she uses the company's information system to closely monitor her sales representatives to make sure they are meeting the needs of customers. 2.

How might the company's culture of not buying into hype and not taking excessive risks affect its organizational structural design? Schwab's conservative culture would foster a simple structure characterized by low departmentalization, wide spans of control, centralized authority, and little formalization. This structure fast, flexible, inexpensive to maintain and has clear lines of accountability. 3. What structural implications—good and bad—might Schwab's intense focus on customer feedback have? Schwab's focus on customer feedback would indicate a flexible structure that is able to adapt to meet customer demands.

This structure would allow employees to spend more time and energy devoted to improving relationships with customers and possibly provide for exceptions to improve customer satisfaction. On the other hand, building strong customer relationships takes time and money. By paying so much attention to the customer there is the potential loss of efficiency that Schwab has to maintain to keep stock transactions low. 4. Do you think this arrangement would work for other types of organizations? Why or why not? This type of customer focus would not work well for firms that operate on a thin margin.

For example, manufacturing firms that operate in the maturity phase of the industry life cycle focus on keeping production costs as low as possible. This

arrangement may also not work well in situations where organizations are set up around processes. A New Kind of Structure 1. Describe and evaluate what Pfizer is doing. What Jordan Cohen has created at Pfizer is a network organization. It's a form of the boundaryless organization structure where company employees concentrate on the important aspects of the job, i. e. those elements that are related to the company's core competencies, and other tasks are outsourced to another organization. 2. What structural implications—good and bad—does this approach have? (Think in terms of the six organizational design elements.) Have students break into groups and discuss how the advantages and disadvantages of using a network organizational structure from the perspective of: • Work Specialization • Departmentalization • Chain Of Command • Span Of Control • Centralization And Decentralization • Formalization Some groups may be assigned more than one design element.

For more information on Pfizer's new structure, go to the web 3. Do you think this arrangement would work for other types of organizations? Why or why not? The network organization design used by Pfizer has helped to balance recent layoffs the company experienced after a nearly \$4 billion yearly budget cut. According to managers in the Fast Company article, the OOF has cut some project costs by 100%. While this program has been a success for Pfizer, it may not be realistic for other companies that either (a) have not experienced such deep cuts in personnel, or (b) have such high personnel costs. . What role do you think organizational structure plays in an organization's efficiency and effectiveness? Explain. Organizational structure plays a key role in enabling a company to function smoothly, to remain

responsive to its internal and external stakeholders, and to adapt to changes in the marketplace. Innovation is facilitated by fewer layers of management, and students have already learned that the survival and success of a company is usually dependent upon its ability to function as a learning organization that promotes innovation.