Chapter 11: Organizational Architecture
The Fundamental Problem

• Important information for profit maximizing decisions is
  – controlled by many individuals
  – may be costly to transfer

• Decision makers may have incompatible incentives

• Organizational architecture helps overcome these limitations
Architecture Within Firms

• Decision-right assignment
  – empowering employees

• Controls
  – Employees are granted authority over resources
  – Incentive may be misaligned

• To align incentives managers must develop a reward and performance evaluation system
# Determinants of Architecture

## Business environment

<table>
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<tr>
<th>Technology</th>
<th>Markets</th>
<th>Regulation</th>
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<tbody>
<tr>
<td>• Computers</td>
<td>• Competitors</td>
<td>• Taxes</td>
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<td>• Telecommunications</td>
<td>• Customers</td>
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<tr>
<td>• Production methods</td>
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<td>• International</td>
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## Strategy

- Choice of industries
- Basis for competition (price, quality, service)

## Organizational architecture

- Decision-right assignment
- Reward system
- Performance-evaluation system

## Incentives and actions

## Firm value
Determinants of Architecture

- Strategy affects architecture and architecture affects strategy
- As the business environment changes, architecture will change with it
Changing Architecture

• Benefits of organizational change must exceed costs

• Costs
  – Direct: resources for design and communication
  – Changes in accounting and information systems
  – Indirect: impact on employee incentives
Changing Architecture

- Organizations are *interdependent* systems, change must be coordinated
- As with three legs of a stool, if one leg changes, the others must change with it
- Likewise for decision rights, reward systems and performance evaluation systems
Corporate Culture

• Culture is the set of explicit and implicit expectations of behavior within the firm
• Communicating culture
  – slogans, rituals, role models
• Architecture shapes employee expectations
• Architecture elements are complements
When Architecture Fails

• Management is at risk of dismissal
• Firm is at risk of takeover
• Rivals are lurking in the wings
Managerial Implications

• Does the strategy fit the business environment?

• Does the current architecture fit the business environment and strategy?
  – Does it effectively link specific knowledge and decision rights?
  – Does it provide incentives to use information productively?
Managerial Implications

• Given the decision rights system, does the control system fit?
• If any of the above questions show a problem, determine what changes in strategy or architecture are appropriate
• Determine problems that will be faces if the firm implements these changes