Chapter 6
Designing Organizational Structure: Specialization and Coordination
Learning Objectives

1. Explain why most organizations initially have a functional structure and why, over time, problems arise with this structure that require a change to a more complex structure.

2. Distinguish between three kinds of divisional structures (product, geographic, and market).
Learning Objectives (cont.)

3. Discuss how the matrix and product team structures differ, and why and when they are chosen to coordinate organizational activities.
4. Identify the unique properties of network structures and the conditions under which they are most likely to be selected as the design of choice.
A functional structure is a design that groups people on the basis of their common skills, expertise, or resources they use.

Functional structure is the bedrock of horizontal differentiation.

An organization groups tasks into functions to increase the effectiveness with which it achieves its goals.
Figure 6.1: Functional Structure

A. This format shows that each function has its own hierarchy.
B. This format shows the position of each function within the organization's hierarchy.
Functional Structure: Advantages

- Provides people with the opportunity to learn from one another and become more specialized and productive.
- People who are grouped together by common skills can supervise one another and control each other’s behavior.
- People develop norms and values that allow them to become more effective at what they do.
Control Problems in a Functional Structure

- Communication Problems: as more organizational functions develop, each with their own hierarchy, they become increasingly distant from one another.

- Measurement Problems: information needed to measure the profitability of any functional group is difficult to obtain.

- Location Problems: an organization must balance the need for centralized decision making and the need to decentralize regional operations.
Control Problems in a Functional Structure (cont.)

- Customer Problems: the ability to identify and satisfy customer needs may fall short and sales are lost.

- Strategic Problems: top managers spend too much time finding ways to improve coordination that they have not time to address the longer term.
Solving the Control Problem

Managers can solve control problems by redesigning the functional structure to increase integration between functions.
Figure 6.2: Improving Integration in a Functional Structure by Combining Sales and Marketing

A. Before

- CEO
  - Sales
  - Marketing

B. After

- CEO
  - Sales and Marketing
From Functional Structure to Divisional Structure

Functional structure is appropriate if the organization:
- Limits itself to producing a small number of similar products
- Produces those products in one or a few locations
- Sells them to only one general type of client or customer
From Functional Structure to Divisional Structure (cont.)

- As organizations grow, they produce more products and serve many different types of customers.
- A new structure is needed that will:
  - Increase manager’s control of individual subunits.
  - Integrate the operation of the whole company and ensure subunits are meeting organizational goals.
Differentiation and Integration

This more complex structure is based on:

- Increasing vertical differentiation
- Increasing horizontal differentiation
- Increasing integration
Figure 6.3: Differentiation and Integration: How Organizations Increase Control Over Their Activities

A. Vertical differentiation:
   Creating a hierarchy of authority to improve coordination *vertically* between subunits

   Horizontal differentiation:
   Creating separate subunits to increase control *within* a subunit
B. Integration:
Creating integrating mechanisms, such as a task force, \textit{laterally} to improve coordination between subunits
Moving to a Divisional Structure

- Organizations most commonly adopt the divisional structure to solve control problems that arise with too many products, regions, or customers.

- The type of divisional structure depends on the problem to be solved.

- Divisional structure creates smaller, more manageable subunits and takes the form:
  - Product structure
  - Geographic structure
  - Market structure
Product Structure

- **Product structure**: a divisional structure in which products (goods or services) are grouped into separate divisions according to their similarities or differences

- Organizations need to decide how to coordinate its product activities with support functions
Product Structure (cont.)

- **Product division structure**: a structure in which a centralized set of support functions service the needs of a number of different product lines
- Each product division uses the services of the central support function
- Support function is divided into product-oriented teams who focus on the needs of one particular product division
Figure 6.4: Product Division Structure

- CEO
  - Vice President Sales and Marketing
  - Vice President Research and Development
  - Vice President Materials Management
  - Vice President Finance

- PDM
  - Canned Soups Division
  - Frozen Vegetables Division
  - Frozen Entrees Division
  - Baked Goods Division

Legend:
- Centralized support functions
- Divisions
Figure 6.5: Assignment of Product-Oriented Functional Teams to Individual Divisions

Research and Development

Team 1
- PDM
- Canned Soups Division

Team 2
- PDM
- Frozen Vegetables Division

Team 3
- PDM
- Frozen Entrees Division

Team 4
- PDM
- Baked Goods Division
Product Structure (cont.)

- **Multidivisional structure:** structure in which support functions are placed in dependent self-contained divisions with its own set of support functions.

- **Corporate headquarters staff:** responsible for overseeing the activities of the managers heading each division.

- Allows a company to operate in many different businesses.
Figure 6.6: Multidivisional Structure

- CEO
- Corporate Headquarters Staff
  - Senior Vice President Marketing
  - Senior Vice President Finance
  - Senior Vice President Materials Management
  - Senior Vice President Research and Development
- Divisional Managers
  - Division A
  - Division B
  - Division C
  - Division D
- Functional Managers
  - Support functions
Advantages of a Multidivisional Structure

- Increased organizational effectiveness: clear division of labor between corporate and divisional managers generally increases organizational effectiveness.

- Increased control: extra control can encourage the stronger pursuit of internal organizational efficiency by divisional managers.
Advantages of a Multidivisional Structure (cont.)

- Profitable growth: when each division is its own profit center, individual profitability can be clearly evaluated.
- Internal labor market: the most able divisional managers are promoted to become corporate managers.
Figure 6.7: Multidivisional Structure in Which Each Division Has a Different Structure

- **Functional Structure**: Automotive Products Division
- **Product Division Structure**: Personal Computers Division
- **Matrix Structure**: Consumer Electronics Division
Disadvantages of a Multidivisional Structure

- Managing the corporate-divisional relationship: finding the balance between centralization and decentralization

- Coordination problems between divisions: divisions start competing for resources and rivalry prevents cooperation
Disadvantages of a Multidivisional Structure (cont.)

- Transfer pricing: problems between divisions often revolve around the *transfer price*, i.e., the price at which one division sells a product or information about innovations to another division.

- Bureaucratic costs: multidivisional structures are very expensive to operate.

- Communication problems: tall hierarchies tend to have communication problems, particularly the distortion of information.
Product Structure

- Product team structure: specialists from the support functions are created that specialize in the needs of particular kind of product
  - Focus on the needs of one product (or client) or a few related products
- Each team is a self-contained division headed by a product team manager
Figure 6.8: Product Team Structure

CEO

Functions

- Vice President Research and Development
- Vice President Sales and Marketing
- Vice President Manufacturing
- Vice President Materials Management
- Vice President Finance

Product Development Teams

- PTM
  - Product Division
  - Product Team Manager

- PTM
  - Product Division

- PTM
  - Product Division

* Functional specialist
Divisional Structure II: Geographic Structure

- When the control problems that companies experience are a function of geography, a geographic divisional structure is appropriate.
- Allows the organization to adjust its structure to align its core competences with the needs of customers in different geographic regions.
- Allows some functions to be centralized and others decentralized.
Figure 6.9: Geographic Structure

[Diagram showing a central support functions model with CEO at the center, regional operations on the periphery, and individual stores connected to regional operations.]

- Regional Operations
- Individual stores
- Central Support Functions
A market structure aligns functional skills and activities with the needs of different customer groups

Each customer group has a different marketing focus, and the job of each group is to develop products to suit the needs of its specific customers

Each customer group makes use of centralized support function
Figure 6.11: Market Structure

CEO

Central Support Functions

- Commercial Division
- Consumer Division
- Government Division
- Corporate Division
Matrix Structure

- **Matrix structure**: an organizational design that groups people and resources in two ways simultaneously, by function and product.

- A matrix is a rectangular grid that shows a vertical flow of functional responsibility and a horizontal flow of product responsibility.

- The members of the team are called **two-boss employees** because they report to two superiors: the product team manager and the functional manager.

- The team is the building block and principal coordination and integration mechanism.
Figure 6.12: Matrix Structure

- CEO
  - Vice President Engineering
  - Vice President Sales and Marketing
  - Vice President Finance
  - Vice President Research and Development
  - Vice President Purchasing

Product A Manager
Product B Manager
Product C Manager
Product D Manager

Two-boss employees
Advantages of a Matrix Structure

- The use of cross-functional teams reduces functional barriers and subunit orientation
- Opens communication between functional specialists
- The matrix enables an organization to maximize its use of skilled professionals, who move from product to product as needed
- The dual functional and product focus promotes concern for both cost and quality
Disadvantages of a Matrix Structure

- Matrix lacks a control structure that leads employees to develop stable expectations of one another.
- The lack of a clearly defined hierarchy of authority can also lead to conflict between functions and product teams over the use of resources.
- People are likely to experience a vacuum of authority and responsibility.
  - People then create their own informal organization to provide themselves with some sense of structure and stability.
The Multidivisional Matrix Structure

- Multidivisional matrix structure: a structure that provides for more integration between corporate and divisional managers and between divisional managers.

- Makes it easier for top executives from divisions and corporate headquarters to cooperate and jointly coordinate organizational activities.
Figure 6.13: Multidivisional Matrix Structure

CEO

- Senior Vice President Marketing
- Senior Vice President Finance
- Senior Vice President Research and Development
- Senior Vice President Materials Management

- Automobile Products Division
- Personal Computer Division
- Consumer Electronics Division
Hybrid Structure

- **Hybrid structure:** large complex organizations that have many divisions make use of many different structures.

- Each product division’s manager selects the structure (functional, product, geographic) that best meets the needs of their particular environment and strategy.
Network Structure

- **Network structure:** a cluster of different organizations whose actions are coordinated by contracts and agreements rather than through a formal hierarchy of authority.

- Very complex as companies form agreements with many suppliers, manufacturers, and distributors.

- Such agreements are necessary as the organization outsources many of the value creation activities involved in production and marketing goods and services.
Advantages of Network Structures

- If a network partner can perform a specific functional activity reliably, and at a lower cost, production costs are reduced.
- Avoids the high bureaucratic costs of operating a complex organizational structure.
- Allows an organization to act in an organic way.
- Network partners can be replaced if they do not perform up to standards.
- If network partners fail to perform, they can be easily replaced.
Disadvantages of Network Structures

- A considerable level of mutual adjustment is needed to allow the groups to interact so that they can learn from one another and constantly improve the product.

- Ability to control a complex value-creation process is difficult because managers lack the means to effectively coordinate and motivate the various network partners.
Boundaryless organization: composed of people who are linked by computers, faxes, CAD systems, and video conferencing.

The use of outsourcing and the development of network organization are increasing rapidly as organizations recognize the many opportunities they offer to reduce costs and increase flexibility.
E-commerce

- **E-commerce**: trade that takes place between companies, and between companies and individual customers, using IT and the Internet

- **Business-to-business (B2B)**: trade that takes place between companies that links and coordinates their value chains
  - B2B marketplace: industry-specific trading network connecting buyers and sellers

- **Business-to-customer (B2C)**: trade that takes place between a company and its network of individual customers using IT and the Internet
Figure 6.15: Types of E-Commerce