

Organizational Structure and Controls

Chapter Eleven

11

Knowledge Objectives

Studying this chapter should provide you with the strategic management knowledge needed to:

1. Define organizational structure and controls and discuss the difference between strategic and financial controls.
2. Describe the relationship between strategy and structure.
3. Discuss the functional structures used to implement business-level strategies.
4. Explain the use of three versions of the multidivisional (M-form) structure to implement different diversification strategies.
5. Discuss the organizational structures used to implement three international strategies.
6. Define strategic networks and strategic center firms.



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The success of Amaze Entertainment, creator of Sony's Playstation2, is partly a function of the match between its corporate-level strategy and organizational structure.

Amaze Entertainment: Bringing Video-Game Excitement Directly to You!

Amaze Entertainment was founded in 1996. It has become one of the world's largest and most successful independent developers of interactive video-game entertainment. The firm believes that it is quite skilled at "creating reliable, solid, interactive experiences for platforms ranging from PCs and Macs to handheld devices and gaming consoles—including next-generation systems like the Nintendo Game Cube, Microsoft X-Box and Sony Playstation2." As this array of products suggests, Microsoft, Mattel, Sony, and Electronic Arts are but a few of Amaze's clients. Designing and producing games linked to Hollywood blockbusters is an important source of the firm's profitable growth. Amaze's games based on *Harry Potter and the Sorcerer's Stone*, *The Lord of the Rings: The Two Towers*, *Finding Nemo*, and *Daredevil*, for example, have been highly successful.

Although relatively small (with approximately 220 employees in mid-2003), Amaze Entertainment is a diversified company with an organizational structure featuring five core business units (called studios) serving different markets. Each specialized studio is guided by a unique vision and has its own culture. However, all the studios rely on technical sophistication and skilled designers to produce their products. The goal of the Adrenium studio is to surprise, amuse, and captivate even the most seasoned gamer. Azurik is one of its popular games. Griptonite is Amaze's handheld entertainment studio. In addition to *Harry Potter*, Griptonite has produced handheld games based on *Star Wars*, Barbie, and Ren and Stimpy, among others. The PC entertainment studio is called KnowWonder. Oriented to family fun, KnowWonder creates digital entertainment products for use on PCs. Titles produced by KnowWonder are intended to educate as well as entertain. The Fizz Factor studio was acquired by Amaze. The "Fizz" unit seeks to be a premiere developer of original character-driven console and handheld titles for customers such as Hasbro and Nickelodeon. Black Ship studios is the newest Amaze business unit. After gaining success in its U.S. domestic market, Amaze decided to expand into what it envisions to be a lucrative Asian market, starting with Japan. The former president of Nintendo Software USA is heading Black Ship, which is focused on developing partnerships and superior products by working with the best publishers in Asia. Amaze believes that Black Ship has the potential to eventually account for as much as 33 percent of the firm's total revenues.

Amaze Entertainment is using a related constrained corporate-level strategy, with each of its five studios implementing a differentiation business-level strategy. The cooperative multidivisional organizational structure (discussed later in the chapter) is used at Amaze to support its related constrained corporate-level strategy. This structure means that while Amaze's studios

work independently, all five of them share the firm's strength in innovative game technologies as well as its ability to share knowledge among its employees regarding their game development skills. The corporate office centralizes strategic planning and marketing efforts to foster cooperation among the five studios. This proper match between corporate-level strategy and structure has contributed to the firm's ability to establish a niche with Hollywood producers. Indeed, as an Amaze executive says, "There really isn't another studio in the world that can do what we do. With one contract, publishers can get a great PC game, a great Game Boy game and a great console game—nobody that I know of offers that." Family-oriented games form the other market niche analysts believe Amaze dominates.

SOURCES: 2003, Amaze Entertainment, <http://www.amazeentertainment.com>, July 7; 2003, One market at a time, *Business Week Online*, <http://www.businessweek.com>, April 15; S. Ernst, Fast-growing Amaze builds on its Hollywood ties, *Puget Sound Business Journal*, 23(41): 12; L. Hawkins, 2003, Computer-game maker puts Fizz back into Austin, Texas, industry, *Austin American-Statesman*, June 23.

As described in Chapter 4, all firms use one or more business-level strategies. In Chapters 6–9, we discuss the other strategies that might be used (corporate-level, international, and cooperative strategies). Once selected, strategies can't be implemented in a vacuum. Organizational structure and controls, this chapter's topic, provide the framework within which strategies are used in both for-profit organizations and not-for-profit agencies.¹ However, as we explain, separate structures and controls are required to successfully implement different strategies. For example, Amaze Entertainment uses a form of the multidivisional structure to support use of its related constrained corporate-level strategy, while each of its business units or studios employs a version of the functional structure to effectively implement the differentiation business-level strategy. Top-level managers have the final responsibility for ensuring that the firm has matched each of its strategies with the appropriate organizational structure and that changes to both take place when needed.² The match or degree of fit between strategy and structure influences the firm's attempts to earn above-average returns.³ Thus, the ability to select an appropriate strategy and match it with the appropriate structure is an important characteristic of effective strategic leadership.⁴

This chapter opens with an introduction to organizational structure and controls. We then provide more details about the need for the firm's strategy and structure to be properly matched. Executives at Amaze Entertainment are aware of this need and are committed to maintaining a proper match between its corporate-level strategy and the structure used to implement it. Affecting firms' efforts to match strategy and structure is the fact that they influence each other.⁵ As we discuss, strategy has a more important influence on structure, although once in place, structure influences strategy.⁶

The chapter then describes the relationship between growth and structural change that successful firms experience. This is followed with discussions of the different organizational structures that firms use to implement the separate business-level, corporate-level, international, and cooperative strategies. A series of figures highlights the different structures firms match with strategies. Across time and based on their experiences, organizations, especially large and complex ones, customize these general structures to meet their unique needs.⁷ Typically, the firm tries to form a structure that is complex enough to facilitate use of its strategies but simple enough for all to effectively implement.⁸ For example, the main priority of the organizational struc-

ture developed by DnB NOR, Norway's largest commercial bank, was "to adapt the functional organization as far as possible to our customer activities, making sure that the chosen structure will enable us to realize potential synergies."⁹

Organizational Structure and Controls

Research shows that organizational structure and the controls that are a part of it affect firm performance.¹⁰ In particular, when the firm's strategy isn't matched with the most appropriate structure and controls, performance declines.¹¹ An ineffective match between strategy and structure is thought to account for Zurich Financial Services' recent performance declines.¹² Recognizing this mismatch, the firm is restructuring its business portfolio to focus on its core non-life insurance programs. Less diversification and a renewed concentration on its core business area are expected to result in a match between corporate-level strategy and structure.¹³ Even though mismatches between strategy and structure do occur, such as the one at Zurich Financial Services, research evidence suggests that managers try to act rationally when forming or changing their firm's structure.¹⁴

Organizational Structure

Organizational structure specifies the firm's formal reporting relationships, procedures, controls, and authority and decision-making processes.¹⁵ Developing an organizational structure that effectively supports the firm's strategy is difficult,¹⁶ especially because of the uncertainty (or unpredictable variation¹⁷) about cause-effect relationships in the global economy's rapidly changing and dynamic competitive environments.¹⁸ When a structure's elements (e.g., reporting relationships, procedures, and so forth) are properly aligned with one another, that structure facilitates effective implementation of the firm's strategies.¹⁹ Thus, organizational structure is a critical component of effective strategy implementation processes.²⁰

A firm's structure specifies the work to be done and how to do it, given the firm's strategy or strategies.²¹ Thus, organizational structure influences how managers work and the decisions resulting from that work.²² Supporting the implementation of strategies,²³ structure is concerned with processes used to complete organizational tasks.²⁴ Effective structures provide the stability a firm needs to successfully implement its strategies and maintain its current competitive advantages, while simultaneously providing the flexibility to develop competitive advantages that will be needed for its future strategies.²⁵ Thus, *structural stability* provides the capacity the firm requires to consistently and predictably manage its daily work routines,²⁶ while *structural flexibility* provides the opportunity to explore competitive possibilities and then allocate resources to activities that will shape the competitive advantages the firm will need to be successful in the future.²⁷ An effective organizational structure allows the firm to *exploit* current competitive advantages while *developing* new ones.²⁸

Modifications to the firm's current strategy or selection of a new strategy call for changes to its organizational structure. However, research shows that once in place, organizational inertia often inhibits efforts to change structure, even when the firm's performance suggests that it is time to do so.²⁹ In his pioneering work, Alfred Chandler found that organizations change their structures only when inefficiencies force them to do so.³⁰ Firms seem to prefer the structural status quo and its familiar working relationships until the firm's performance declines to the point where change is absolutely necessary.³¹ In addition, top-level managers hesitate to conclude that there are problems with the firm's structure (or its strategy, for that matter), in that doing so suggests that their previous choices weren't the best ones.³² Because of these inertial tendencies, structural change is often induced instead by the actions of stakeholders

Organizational structure specifies the firm's formal reporting relationships, procedures, controls, and authority and decision-making processes.

who are no longer willing to tolerate the firm's performance. For example, continuing losses of customers who have become dissatisfied with the value created by the firm's products could force change, as could reactions from capital market stakeholders (see Chapter 2). This appears to be the case for Sears, Roebuck and Co. Because of dissatisfactions expressed by those it tried to serve, Sears recently changed its organizational structure in ways that it believes allows it to better satisfy customers' needs.³³

In spite of the timing of structural change described above, many companies make changes prior to substantial performance declines. Appropriate timing of structural change happens when top-level managers quickly recognize that a current organizational structure no longer provides the coordination and direction needed for the firm to successfully implement its strategies.³⁴ As we discuss in the Strategic Focus, Eastman Chemical Company has made various changes to its organizational structure prior to significant performance declines. Indeed, in commenting about one of the changes to the firm's structure, a company official asserted, "This was not a company that reorganized in response to plummeting sales, laying off thousands of workers to stay afloat. This was restructuring from strength."³⁵

As we discuss next, effective organizational controls help managers recognize when it is time to change the firm's structure. Eastman Chemical Company uses a mixture of strategic and financial controls to judge its overall performance. In addition, the controls in place at Eastman help the firm determine when to make changes to its organizational structure.

Organizational Controls

Organizational controls guide the use of strategy, indicate how to compare actual results with expected results, and suggest corrective actions to take when the difference between actual and expected results is unacceptable.

Strategic controls are largely subjective criteria intended to verify that the firm is using appropriate strategies for the conditions in the external environment and the company's competitive advantages.

Organizational controls are an important aspect of structure.³⁶ **Organizational controls** guide the use of strategy, indicate how to compare actual results with expected results, and suggest corrective actions to take when the difference between actual and expected results is unacceptable. The fewer the differences between actual and expected outcomes, the more effective are the organization's controls.³⁷ It is hard for the company to successfully exploit its competitive advantages without effective organizational controls.³⁸ Properly designed organizational controls provide clear insights regarding behaviors that enhance firm performance.³⁹ Firms rely on strategic controls and financial controls as part of their structures to support use of their strategies.⁴⁰

Strategic controls are largely subjective criteria intended to verify that the firm is using appropriate strategies for the conditions in the external environment and the company's competitive advantages. Thus, strategic controls are concerned with examining the fit between what the firm *might do* (as suggested by opportunities in its external environment) and what it *can do* (as indicated by its competitive advantages; see Figure 3.1). Effective strategic controls help the firm understand what it takes to be successful.⁴¹ Strategic controls demand rich communications between managers responsible for using them to judge the firm's performance and those with primary responsibility for implementing the firm's strategies (such as middle- and first-level managers). These frequent exchanges are both formal and informal in nature.⁴²

Strategic controls are also used to evaluate the degree to which the firm focuses on the requirements to implement its strategies. For a business-level strategy, for example, the strategic controls are used to study primary and support activities (see Tables 3.8 and 3.9) to verify that those critical to successful execution of the business-level strategy are being properly emphasized and executed. With related corporate-level strategies, strategic controls are used to verify the sharing of appropriate strategic factors such as knowledge, markets, and technologies across businesses. To effectively use strategic controls when evaluating related diversification strategies, executives must have a deep understanding of each unit's business-level strategy.⁴³

Partly because strategic controls are difficult to use with extensive diversification,⁴⁴ financial controls are emphasized to evaluate the performance of the firm following the

Effective Timing of Structural Change at Eastman Chemical Company

Strategic Focus

Founded in 1920 to supply basic photographic materials to Eastman Kodak Company, Eastman Chemical Company (ECC) was spun off and became an independently traded public company in 1994. A global firm with sales exceeding \$5 billion annually and with production operations in 17 countries, ECC manufactures and markets more than 1,200 plastics, chemicals, and fibers products. Collectively, this array of products and their success has resulted in ECC becoming the world's largest supplier of polyester plastics for packaging, a leading supplier of coatings, raw materials, specialty chemicals, and plastics, and a major supplier of cellulose acetate fibers and basic chemicals.

On September 1, 1999, ECC announced that it had created two major business groups—one for its polymers business and one for its chemicals business. From 1994 until the 1999 reorganization, ECC had operated through a functional structure. However, the functional structure was no longer capable of dealing with the firm's increasing product and market complexity and diversity. Following analysis of the situation, executives concluded that organizing the firm around two core product divisions would lead to stronger relationships with customers. Increased efficiency, primarily in the form of quicker response to customers' needs, and greater accountability for performance were other benefits expected from the new structure in addition to an enhanced focus on customers. With the new structure, each business group was given direct responsibility for manufacturing, sales, and pricing and product management decisions. Thus, the polymers and chemicals businesses were each to operate with an independent set of organizational functions.

ECC's structure was changed again in 2002. In this instance, 1994's product divisions were changed to create the Eastman Division and the Voridian Division. The purpose of this structural change was to allow ECC to "strategically focus on the unique needs of individual markets." The Eastman Division consists of three product segments—coatings, adhesives, specialty polymers, and inks; specialty plastics; and performance chemicals and intermediates. Polymers and fibers, the product groups formed in 1999, became Voridian's two core segments in 2002. In general, Voridian uses the cost leadership business-level strategy while the differentiation strategy is used in the Eastman Division, primarily to continuously develop innovative products.

In 2003, Developing Businesses became the third division in ECC's multidivisional structure. Soon after its formation, this division had 20 to 30 projects in the pipeline in various stages of development. The purpose of creating this division was to provide a unique environment to "leverage Eastman's technology expertise, intellectual property and know-how into business models that extend to new customers and markets." For the most part, Developing Businesses focuses on service businesses that are less capital intensive compared to the products that are the mainstay of the Eastman and Voridian Divisions.

Eastman Chemical Company was originally a division of Eastman Kodak Company, a supplier of photographic materials. Eastman Chemical now produces a variety of consumer goods, some of which are featured here. The organizational controls that led to Eastman Chemical's independence from its parent company allow each company to better handle its own market complexities and customer needs.



Photo courtesy of the Eastman Chemical Company

SOURCES: 2003, Eastman introduces new business unit, *Chemical Market Reporter*, 263(13): 3; 2003, Eastman Chemical Company, *Standard & Poor's Stock Reports*, <http://www.standardandpoors.com>, June 3; 2003, The company profile, <http://www.eastmanchemicals.com>, July 10; 2003, Eastman facts, <http://www.eastmanchemicals.com>, July 9; 1999, Eastman announces management reorganization, <http://www.eastmanchemicals.com>, July 27.

Financial controls are largely objective criteria used to measure the firm's performance against previously established quantitative standards.

unrelated diversification strategy. The unrelated diversification strategy's focus on financial outcomes (see Chapter 6) requires the use of standardized financial controls to compare performances between units and managers.⁴⁵ **Financial controls** are largely objective criteria used to measure the firm's performance against previously established quantitative standards. Accounting-based measures, such as return on investment and return on assets, and market-based measures, such as economic value added, are examples of financial controls.

When using financial controls, firms evaluate their current performance against previous outcomes as well as their performance compared to competitors and industry averages. In the global economy, technological advances are being used to develop highly sophisticated financial controls, making it possible for firms to more thoroughly analyze their performance results and to assure compliance with regulations. For example, Oracle Corp. developed software tools that automate processes firms can use to meet the financial reporting requirements specified by the Sarbanes-Oxley Act.⁴⁶ (This act requires a firm's principal executive and financial officers to certify corporate financial and related information in quarterly and annual reports submitted to the Securities and Exchange Commission.) Pfizer Inc.'s expectations of sophisticated financial controls are that they will: "(1) safeguard the firm's assets, (2) ensure that transactions are properly authorized, and (3) provide reasonable assurance, at reasonable cost, of the integrity, objectivity, and reliability of the financial information."⁴⁷

Both strategic and financial controls are important aspects of each organizational structure, and any structure's effectiveness is determined by using a combination of strategic and financial controls. However, the relative use of controls varies by type of strategy. For example, companies and business units of large diversified firms using the cost leadership strategy emphasize financial controls (such as quantitative cost goals), while companies and business units using the differentiation strategy emphasize strategic controls (such as subjective measures of the effectiveness of product development teams).⁴⁸ As explained above, a corporate-wide emphasis on sharing among business units (as called for by related diversification strategies) results in an emphasis on strategic controls, while financial controls are emphasized for strategies in which activities or capabilities aren't shared (e.g., in an unrelated diversification).

Relationships between Strategy and Structure

Strategy and structure have a reciprocal relationship.⁴⁹ This relationship highlights the interconnectedness between strategy formulation (Chapter 4 and Chapters 6–9) and strategy implementation (Chapters 10–13). In general, this reciprocal relationship finds structure flowing from or following the selection of the firm's strategy. Once in place, structure can influence current strategic actions as well as choices about future strategies. The general nature of the strategy/structure relationship means that changes to the firm's strategy create the need to change how the organization completes its work. In the "structure influences strategy" direction, firms must be vigilant in their efforts to verify that how their structure calls for work to be completed remains consistent with the implementation requirements of chosen strategies. Research shows, however, that "strategy has a much more important influence on structure than the reverse."⁵⁰

Regardless of the strength of the reciprocal relationships between strategy and structure, those choosing the firm's strategy and structure should be committed to matching each strategy with a structure that provides the stability needed to use current competitive advantages as well as the flexibility required to develop future advantages. This means, for example, that when changing strategies, the firm should simultaneously consider the structure that will be needed to support use of the new strategy. Aware of this mandate, executives at the new Hewlett-Packard continue to adjust the firm's structure in light of the strategies being used following the combining of the former Hewlett-

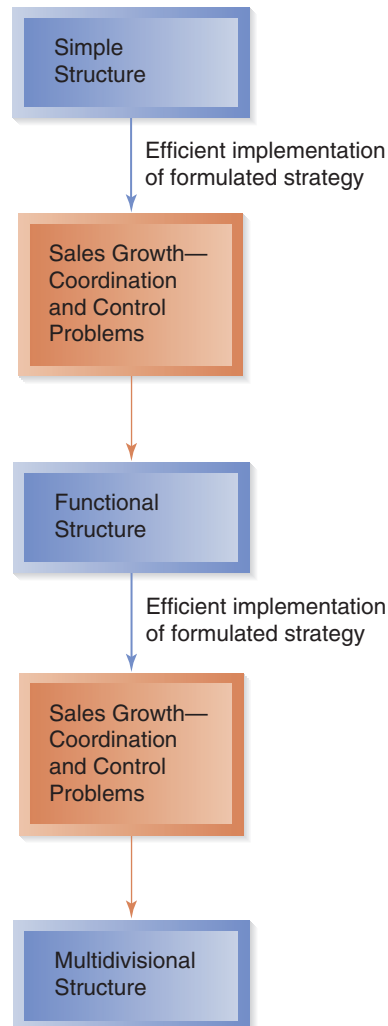
Packard and Compaq Computer Corp.⁵¹ The fact that a proper strategy/structure match can be a competitive advantage⁵² supports actions such as those being taken at Hewlett-Packard. When the firm's strategy/structure combination is a competitive advantage, it contributes to the earning of above-average returns.⁵³

Evolutionary Patterns of Strategy and Organizational Structure

Research suggests that most firms experience a certain pattern of relationships between strategy and structure. Chandler⁵⁴ found that firms tended to grow in somewhat predictable patterns: “first by volume, then by geography, then integration (vertical, horizontal) and finally through product/business diversification”⁵⁵ (see Figure 11.1). Chandler interpreted his findings to indicate that the firm's growth patterns determine its structural form.

As shown in Figure 11.1, sales growth creates coordination and control problems that the existing organizational structure can't efficiently handle. Organizational growth

Strategy and Structure Growth Pattern — Figure 11.1



creates the opportunity for the firm to change its strategy to try to become even more successful. However, the existing structure's formal reporting relationships, procedures, controls, and authority and decision-making processes lack the sophistication required to support use of the new strategy. A new structure is needed to help decision makers gain access to the knowledge and understanding required to effectively integrate and coordinate actions to implement the new strategy.⁵⁶

Three major types of organizational structures are used to implement strategies: simple structure, functional structure, and multidivisional structure.

The **simple structure** is a structure in which the owner-manager makes all major decisions and monitors all activities while the staff serves as an extension of the manager's supervisory authority.

The **functional structure** is a structure consisting of a chief executive officer and a limited corporate staff, with functional line managers in dominant organizational areas, such as production, accounting, marketing, R&D, engineering, and human resources.

Casketfurniture.com may need to change from a simple to a functional structure. MHP Enterprises Ltd. is a good example of a smaller firm that has grown more complex with its success.

Simple Structure

The **simple structure** is a structure in which the owner-manager makes all major decisions and monitors all activities while the staff serves as an extension of the manager's supervisory authority.⁵⁷ Typically, the owner-manager actively works in the business on a daily basis. Informal relationships, few rules, limited task specialization, and unsophisticated information systems describe the simple structure. Frequent and informal communications between the owner-manager and employees make it relatively easy to coordinate the work that is to be done. The simple structure is matched with focus strategies and business-level strategies as firms commonly compete by offering a single product line in a single geographic market. Local restaurants, repair businesses, and other specialized enterprises are examples of firms relying on the simple structure to implement their strategy.

As the small firm grows larger and becomes more complex, managerial and structural challenges emerge. For example, the amount of competitively relevant information requiring analysis substantially increases, placing significant pressure on the owner-manager. Additional growth and success may cause the firm to change its strategy. Even if the strategy remains the same, the firm's larger size dictates the need for more sophisticated workflows and integrating mechanisms. At this evolutionary point, firms tend to move from the simple structure to a functional organizational structure.⁵⁸

Casketfurniture.com, a firm mentioned in Chapter 4 as an example of a company using the focus differentiation strategy, may soon move from the simple structure to a functional structure. Family-owned and managed, this venture is a new part of

MHP Enterprises Ltd.'s operations. As a small family firm, MHP has long been managed through the simple structure. In 1997, MHP decided to expand its distribution by establishing Casketfurniture.com. Using the Internet, this venture sells what it believes are creative products throughout the world. The continuing success of Casketfurniture.com could create coordination and control problems for MHP that may be solved only by the firm changing from the simple to the functional structure.⁵⁹

Functional Structure

The **functional structure** is a structure consisting of a chief executive officer and a limited corporate staff, with

Courtesy of MHP Enterprises, LTD

functional line managers in dominant organizational areas, such as production, accounting, marketing, R&D, engineering, and human resources.⁶⁰ This structure allows for functional specialization,⁶¹ thereby facilitating active sharing of knowledge within each functional area. Knowledge sharing facilitates career paths as well as the professional development of functional specialists. However, a functional orientation can have a negative effect on communication and coordination among those representing different organizational functions. Because of this, the CEO must work hard to verify that the decisions and actions of individual business functions promote the entire firm rather than a single function.⁶² The functional structure supports implementation of business-level strategies and some corporate-level strategies (e.g., single or dominant business) with low levels of diversification.

Multidivisional Structure

With continuing growth and success, firms often consider greater levels of diversification. However, successful diversification requires analysis of substantially greater amounts of data and information when the firm offers the same products in different markets (market or geographic diversification) or offers different products in several markets (product diversification). In addition, trying to manage high levels of diversification through functional structures creates serious coordination and control problems.⁶³ Thus, greater diversification leads to a new structural form.⁶⁴

The **multidivisional (M-form) structure** consists of operating divisions, each representing a separate business or profit center in which the top corporate officer delegates responsibilities for day-to-day operations and business-unit strategy to division managers. Each division represents a distinct, self-contained business with its own functional hierarchy.⁶⁵ As initially designed, the M-form was thought to have three major benefits: “(1) it enabled corporate officers to more accurately monitor the performance of each business, which simplified the problem of control; (2) it facilitated comparisons between divisions, which improved the resource allocation process; and (3) it stimulated managers of poorly performing divisions to look for ways of improving performance.”⁶⁶ Active monitoring of performance through the M-form increases the likelihood that decisions made by managers heading individual units will be in shareholders’ best interests. Diversification is a dominant corporate-level strategy in the global economy, resulting in extensive use of the M-form.⁶⁷

Used to support implementation of related and unrelated diversification strategies, the M-form helps firms successfully manage the many demands (including those related to processing vast amounts of information) of diversification.⁶⁸ Chandler viewed the M-form as an innovative response to coordination and control problems that surfaced during the 1920s in the functional structures then used by large firms such as DuPont and General Motors.⁶⁹ Research shows that the M-form is appropriate when the firm grows through diversification.⁷⁰ Partly because of its value to diversified corporations, some consider the multidivisional structure to be one of the 20th century’s most significant organizational innovations.⁷¹

No organizational structure (simple, functional, or multidivisional) is inherently superior to the other structures.⁷² In Peter Drucker’s words: “There is no one right organization. . . . Rather, the task . . . is to select the organization for the particular task and mission at hand.”⁷³ In our context, Drucker is saying that the firm must select a structure that is “right” for the particular strategy that has been selected to pursue the firm’s strategic intent and strategic mission. Because no single structure is optimal in all instances, managers concentrate on developing proper matches between strategies and organizational structures rather than searching for an “optimal” structure.

We now describe the strategy/structure matches that evidence shows positively contribute to firm performance.

*The **multidivisional (M-form) structure** consists of operating divisions, each representing a separate business or profit center in which the top corporate officer delegates responsibilities for day-to-day operations and business-unit strategy to division managers.*

Matches between Business-Level Strategies and the Functional Structure

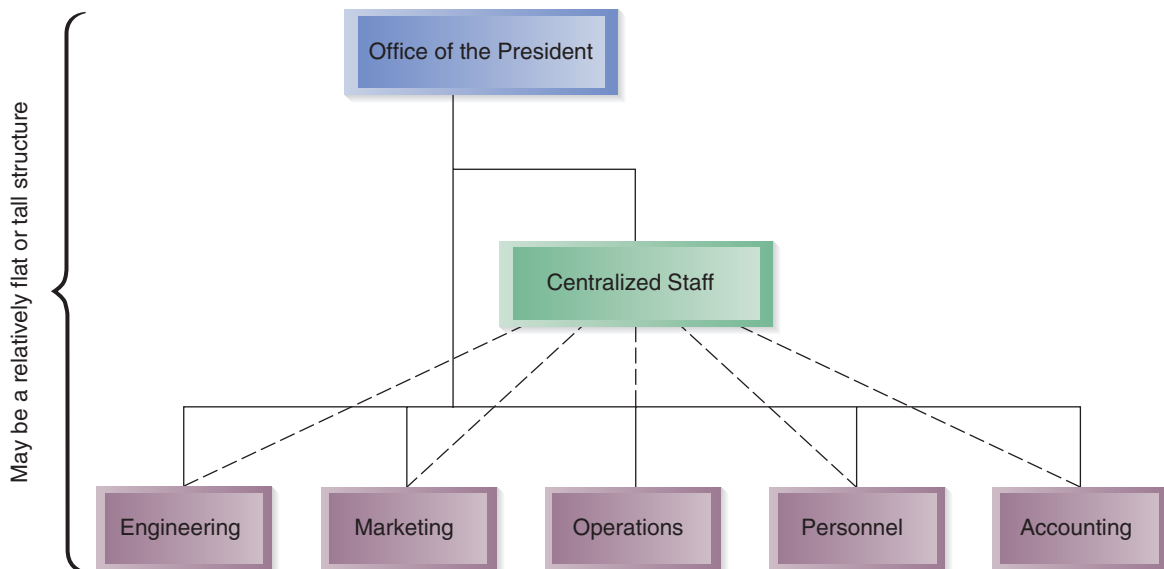
Different forms of the functional organizational structure are used to support implementation of the cost leadership, differentiation, and integrated cost leadership/differentiation strategies. The differences in these forms are accounted for primarily by different uses of three important structural characteristics or dimensions—*specialization* (concerned with the type and number of jobs required to complete work⁷⁴), *centralization* (the degree to which decision-making authority is retained at higher managerial levels⁷⁵), and *formalization* (the degree to which formal rules and procedures govern work⁷⁶).

USING THE FUNCTIONAL STRUCTURE TO IMPLEMENT THE COST LEADERSHIP STRATEGY

Firms using the cost leadership strategy want to sell large quantities of standardized products to an industry's or a segment's typical customer. Simple reporting relationships, few layers in the decision-making and authority structure, a centralized corporate staff, and a strong focus on process improvements through the manufacturing function rather than the development of new products through an emphasis on product R&D characterize the cost leadership form of the functional structure⁷⁷ (see Figure 11.2). This structure contributes to the emergence of a low-cost culture—a culture in which all employees constantly try to find ways to reduce the costs incurred to complete their work.

In terms of centralization, decision-making authority is centralized in a staff function to maintain a cost-reducing emphasis within each organizational function (for example, engineering, marketing, etc.). While encouraging continuous cost reductions, the centralized staff also verifies that further cuts in costs in one function won't adversely affect the productivity levels in other functions.

Figure 11.2 — Functional Structure for Implementation of a Cost Leadership Strategy



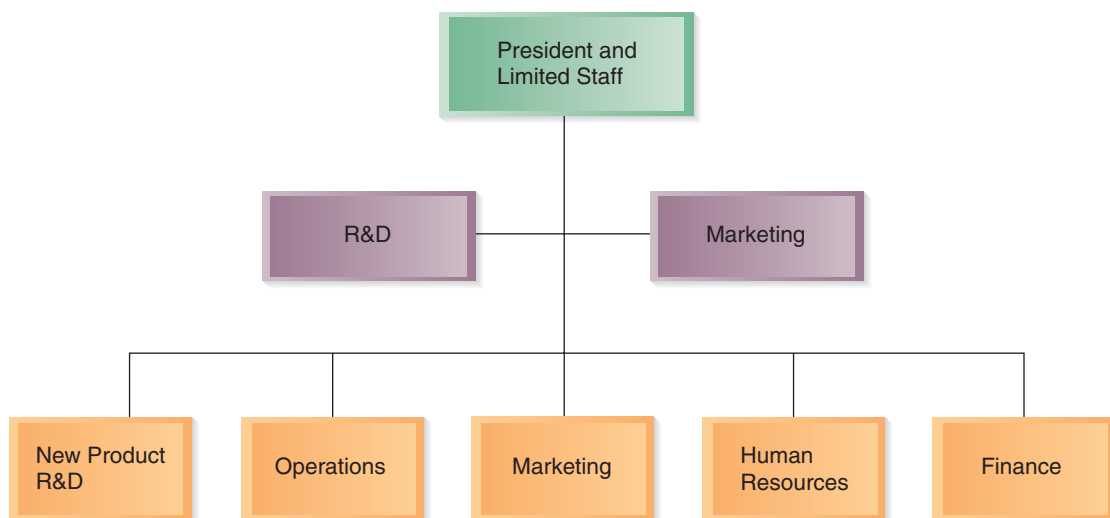
- Notes:
- Operations is the main function
 - Process engineering is emphasized rather than new product R&D
 - Relatively large centralized staff coordinates functions
 - Formalized procedures allow for emergence of a low-cost culture
 - Overall structure is mechanistic; job roles are highly structured

Jobs are highly specialized in the cost leadership functional structure. Job specialization is accomplished by dividing work into homogeneous subgroups. Organizational functions are the most common subgroup, although work is sometimes batched on the basis of products produced or clients served. Specializing in their work allows employees to increase their efficiency, reducing the firm's costs as a result. Highly formalized rules and procedures, often emanating from the centralized staff, guide the work completed in the cost leadership form of the functional structure. Predictably following formal rules and procedures creates cost-reducing efficiencies. Known for its commitment to EDLP ("everyday low price"), Wal-Mart's functional organizational structures in both its retail (e.g., Wal-Mart Stores, Supercenters, Sam's Club) and specialty (e.g., Wal-Mart Vacations, Used Fixture Auctions) divisions are formed to continuously drive costs lower.⁷⁸ As discussed in Chapter 4, competitors' efforts to duplicate the success of Wal-Mart's cost leadership strategies have failed, partly because of the effective strategy/structure matches in Wal-Mart's business units.

USING THE FUNCTIONAL STRUCTURE TO IMPLEMENT THE DIFFERENTIATION STRATEGY

Firms using the differentiation strategy produce products that customers perceive as being different in ways that create value for them. With this strategy, the firm wants to sell nonstandardized products to customers with unique needs. Relatively complex and flexible reporting relationships, frequent use of cross-functional product development teams, and a strong focus on marketing and product R&D rather than manufacturing and process R&D (as with the cost leadership form of the functional structure) characterize the differentiation form of the functional structure (see Figure 11.3). This structure contributes to the emergence of a development-oriented culture—a culture in which employees try to find ways to further differentiate current products and to develop new, highly differentiated products.

Functional Structure for Implementation of a Differentiation Strategy — Figure 11.3



- Notes:
- Marketing is the main function for keeping track of new product ideas
 - New product R&D is emphasized
 - Most functions are decentralized, but R&D and marketing may have centralized staffs that work closely with each other
 - Formalization is limited so that new product ideas can emerge easily and change is more readily accomplished
 - Overall structure is organic; job roles are less structured

Strategic Focus

Thinking Globally, Acting Locally: The Foundations of Procter & Gamble's Multidivisional Structure

Consumer giant Procter & Gamble (P&G) has a bold self-perception, believing that its rightful place in corporate America is as a company that is admired, imitated, and uncommonly profitable. Historical successes suggest that this perception is reasonably consistent with reality. Across time, P&G has been quite profitable while analysts have viewed the firm's management techniques as setting "the gold standard" for others to emulate. Two of the innovations and subsequent skills for which P&G is recognized are brand management and excellence in managerial training. CEOs Jeff Immelt (GE), Meg Whitman (eBay) and W. James McNerney, Jr. (3M) are just a few of the alumni who have achieved great success following their P&G careers.

As with all successful firms, P&G is challenged to continuously reinvent itself while striving to outperform its competitors. Rivals such as Unilever are launching intense campaigns to improve their competitive positions relative to P&G. Unilever began restructuring in 1999 to deliver on the promises of its "Path to Growth" agenda. Unilever's five-year restructuring involves a major overhaul of its portfolio. The firm "has sold low-growth businesses and acquired new-growth drivers, most notably Bestfoods, which it bought for \$24 billion in 2000. The company also snapped up diet brand SlimFast and Ben & Jerry's ice cream."

P&G also restructured its operations in 1999. Framed around the objective of having an organizational structure that would allow the firm to "think globally and act locally," P&G formed a unique version of the cooperative multidivisional structure to support use of its related constrained diversification strategy. This structure, which P&G officials believe is a source of competitive advantage for the firm, features five global business product units (GBUs) (baby, feminine and family care, fabric and home care, food and beverage, and health and beauty care) and seven market development organizations (MDOs), each formed around a region of the world, such as Northeast Asia. Using the five global product units to create strong brand equities through ongoing innovation is how P&G thinks globally; interfacing with customers to ensure that a division's marketing plans fully capitalize on local opportunities is how P&G acts locally. Information is shared between the product-oriented and the marketing-oriented efforts to enhance the corpora-

Well-known CEOs Jeff Immelt, Meg Whitman, and W. James McNerney may owe their current success to the skills acquired during their employment at P&G, which is known for its excellence in managerial training.



AP Photo/Jim McNeight



AP Photo/Jeff Christensen



Getty Images

tion's performance. Indeed, some corporate staff members are responsible for focusing on making certain that knowledge is meaningfully categorized and then rapidly transferred throughout P&G's businesses. Those working to achieve this objective are part of P&G's Global Business Services (GBS) group. Last, the Corporate Functions group is essentially a set of consultants ready to assist those working in the global business units and the market development organizations in their efforts to use "best practices" in terms of organizational functions, such as external relations, information technology management, and human resources practices. In summary, P&G's cooperative structure uses GBUs to define a brand's equity, MDOs to adapt a brand to local preferences, the GBS group to support operations through infrastructure services such as accounting and employee benefits and payroll, and Corporate Functions to assure that the latest and most effective methodologies are being used to conduct the firm's product- and marketing-oriented operations.

SOURCES: 2003, Procter & Gamble Home Page, <http://www.procter&gamble.com>, July 5; 2003, Procter & Gamble corporate structure, <http://www.procter&gamble.com>, July 9; D. Ball, 2003, Unilever cuts sales estimates as U.S. competition stiffens, *Wall Street Journal Online*, <http://www.wsj.com>, June 23; R. Berner, 2003, P&G: New and improved, *Business Week*, July 7, 52–63.

Continuous product innovation demands that people throughout the firm be able to interpret and take action based on information that is often ambiguous, incomplete, and uncertain. With a strong focus on the external environment to identify new opportunities, employees often gather this information from people outside the firm, such as customers and suppliers. Commonly, rapid responses to the possibilities indicated by the collected information are necessary, suggesting the need for decision-making responsibility and authority to be decentralized. To support creativity and the continuous pursuit of new sources of differentiation and new products, jobs in this structure are not highly specialized. This lack of specialization means that workers have a relatively large number of tasks in their job descriptions. Few formal rules and procedures are also characteristics of this structure. Low formalization, decentralization of decision-making authority and responsibility, and low specialization of work tasks combine to create a structure in which people interact frequently to exchange ideas about how to further differentiate current products while developing ideas for new products that can be differentiated to create value for customers.

USING THE FUNCTIONAL STRUCTURE TO IMPLEMENT THE INTEGRATED COST LEADERSHIP/DIFFERENTIATION STRATEGY

Firms using the integrated cost leadership/differentiation strategy want to sell products that create value because of their relatively low cost and reasonable sources of differentiation. The cost of these products is low "relative" to the cost leader's prices while their differentiation is "reasonable" compared to the clearly unique features of the differentiator's products.

The integrated cost leadership/differentiation strategy is used frequently in the global economy, although it is difficult to successfully implement. This difficulty is due largely to the fact that different primary and support activities (see Chapter 3) must be emphasized when using the cost leadership and differentiation strategies. To achieve the cost leadership position, emphasis is placed on production and process engineering, with infrequent product changes. To achieve a differentiated position, marketing and new product R&D are emphasized while production and process engineering are not. Thus, effective use of the integrated strategy results when the firm successfully combines activities intended to reduce costs with activities intended to create additional differentiation features. As a result, the integrated form of the functional structure must have decision-making patterns that are partially centralized and partially

decentralized. Additionally, jobs are semispecialized, and rules and procedures call for some formal and some informal job behavior.

Matches between Corporate-Level Strategies and the Multidivisional Structure

As explained earlier, Chandler's research showed that the firm's continuing success leads to product or market diversification or both.⁷⁹ The firm's level of diversification is a function of decisions about the number and type of businesses in which it will compete as well as how it will manage the businesses (see Chapter 6). Geared to managing individual organizational functions, increasing diversification eventually creates information processing, coordination, and control problems that the functional structure can't handle. Thus, use of a diversification strategy requires the firm to change from the functional structure to the multidivisional structure to develop an appropriate strategy/structure match.

As defined in Figure 6.1 in Chapter 6, corporate-level strategies have different degrees of product and market diversification. The demands created by different levels of diversification highlight the need for each strategy to be implemented through a unique organizational structure (see Figure 11.4).

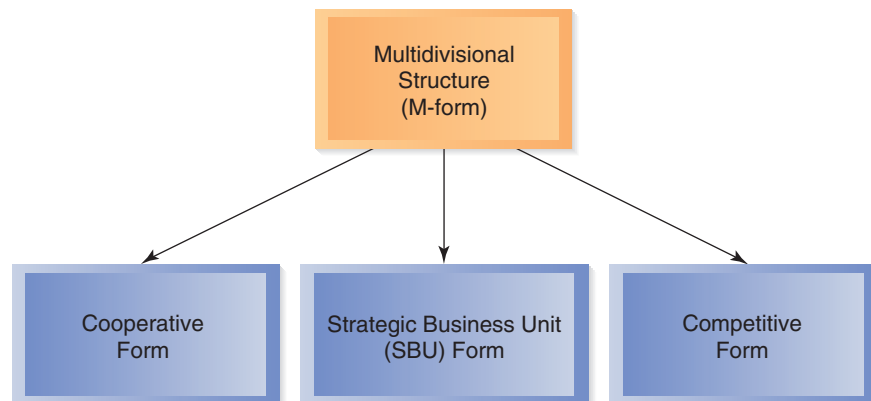
USING THE COOPERATIVE FORM OF THE MULTIDIVISIONAL STRUCTURE TO IMPLEMENT THE RELATED CONSTRAINED STRATEGY

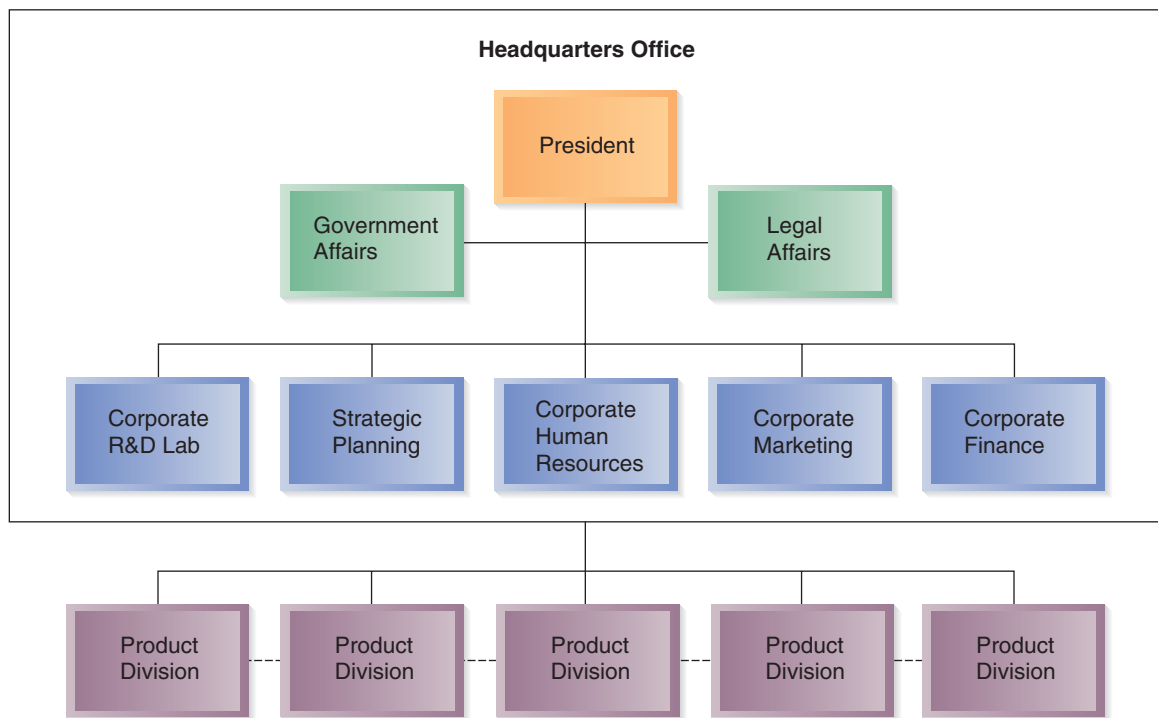
*The **cooperative form** is a structure in which horizontal integration is used to bring about interdivisional cooperation.*

The **cooperative form** is a structure in which horizontal integration is used to bring about interdivisional cooperation. The divisions in the firm using the related constrained diversification strategy commonly are formed around products, markets, or both. We discuss related constrained firm Procter & Gamble's (P&G's) cooperative form of the multidivisional structure in the Strategic Focus. As we explain, P&G's organizational structure is intended to allow the firm to "think globally, yet act locally."

In Figure 11.5, we use product divisions as part of the representation of the cooperative form of the multidivisional structure, although as the P&G example in the Strategic Focus suggests, market divisions could be used instead of or in addition to product divisions to develop the figure. Thus, P&G has modified the core cooperative form of the multidivisional structure to satisfy its unique strategy/structure match requirements.

Figure 11.4 — Three Variations of the Multidivisional Structure





- Notes:
- Structural integration devices create tight links among all divisions
 - Corporate office emphasizes centralized strategic planning, human resources, and marketing to foster cooperation between divisions
 - R&D is likely to be centralized
 - Rewards are subjective and tend to emphasize overall corporate performance in addition to divisional performance
 - Culture emphasizes cooperative sharing

All of the related constrained firm's divisions share one or more corporate strengths. Production competencies, marketing competencies, or channel dominance are examples of strengths that the firm's divisions might share.⁸⁰ Production expertise is one of the strengths shared across P&G's divisions. At Halliburton Co., the world's largest oilfield services company, the firm's competence in the development and application of sophisticated technologies is shared between its two major divisions.⁸¹

The sharing of divisional competencies facilitates the corporation's efforts to develop economies of scope. As explained in Chapter 6, economies of scope (cost savings resulting from the sharing of competencies developed in one division with another division) are linked with successful use of the related constrained strategy. Interdivisional sharing of competencies depends on cooperation, suggesting the use of the cooperative form of the multidivisional structure.⁸² Increasingly, it is important that the links resulting from effective use of integration mechanisms support the cooperative sharing of both intangible resources (such as knowledge) as well as tangible resources (such as facilities and equipment).⁸³

Different characteristics of structure are used as integrating mechanisms by the cooperative structure to facilitate interdivisional cooperation. Defined earlier in the discussion of functional organizational structures, centralization is one of these mechanisms. Centralizing some organizational functions (human resource management, R&D, marketing, and finance) at the corporate level allows the linking of activities

among divisions. Work completed in these centralized functions is managed by the firm's central office with the purpose of exploiting common strengths among divisions by sharing competencies. The intent is to develop a competitive advantage in the divisions as they implement their cost leadership, differentiation, or integrated cost leadership/differentiation business-unit strategies that exceeds the value created by the advantages used by nondiversified rivals' implementation of these strategies.⁸⁴

Frequent, direct contact between division managers, another integrating mechanism, encourages and supports cooperation and the sharing of either competencies or resources that have the possibility of being used to create new advantages. Sometimes, liaison roles are established in each division to reduce the amount of time division managers spend integrating and coordinating their unit's work with the work occurring in other divisions. Temporary teams or task forces may be formed around projects whose success depends on sharing competencies that are embedded within several divisions. Formal integration departments might be established in firms frequently using temporary teams or task forces. Ultimately, a matrix organization may evolve in firms implementing the related constrained strategy. A *matrix organization* is an organizational structure in which there is a dual structure combining both functional specialization and business product or project specialization.⁸⁵ Although complicated, an effective matrix structure can lead to improved coordination among a firm's divisions.⁸⁶

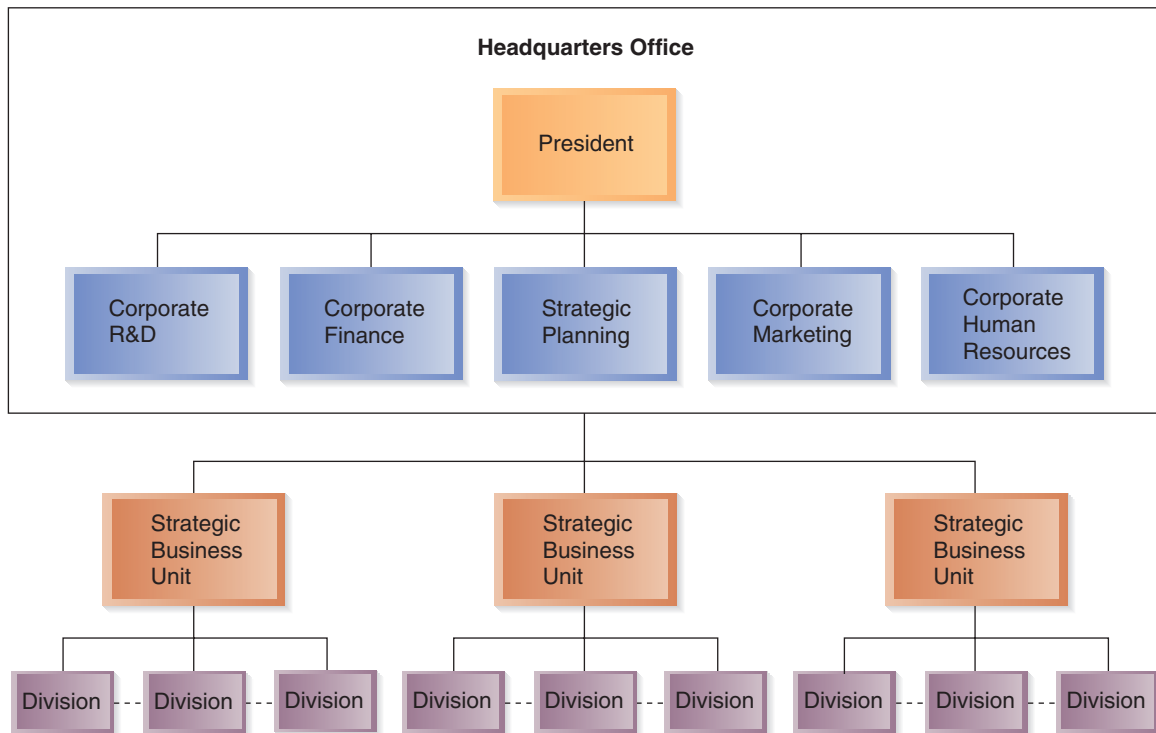
The success of the cooperative multidivisional structure is significantly affected by how well information is processed among divisions. But because cooperation among divisions implies a loss of managerial autonomy, division managers may not readily commit themselves to the type of integrative information-processing activities that this structure demands. Moreover, coordination among divisions sometimes results in an unequal flow of positive outcomes to divisional managers. In other words, when managerial rewards are based at least in part on the performance of individual divisions, the manager of the division that is able to benefit the most by the sharing of corporate competencies might be viewed as receiving relative gains at others' expense. Strategic controls are important in these instances, as divisional managers' performance can be evaluated at least partly on the basis of how well they have facilitated interdivisional cooperative efforts. Furthermore, using reward systems that emphasize overall company performance, besides outcomes achieved by individual divisions, helps overcome problems associated with the cooperative form.

USING THE STRATEGIC BUSINESS UNIT FORM OF THE MULTIDIVISIONAL STRUCTURE TO IMPLEMENT THE RELATED LINKED STRATEGY

When the firm has fewer links or less constrained links among its divisions, the related linked diversification strategy is used. The strategic business unit form of the multidivisional structure supports implementation of this strategy. The **strategic business unit (SBU) form** is a structure consisting of three levels: corporate headquarters, strategic business units (SBUs), and SBU divisions (see Figure 11.6).

The divisions within each SBU are related in terms of shared products or markets or both, but the divisions of one SBU have little in common with the divisions of the other SBUs. Divisions within each SBU share product or market competencies to develop economies of scope and possibly economies of scale. The integration mechanisms used by the divisions in a cooperative structure can be equally well used by the divisions within the individual strategic business units that are part of the SBU form of the multidivisional structure. In the SBU structure, each SBU is a profit center that is controlled and evaluated by the headquarters office. Although both financial and strategic controls are important, on a relative basis, financial controls are vital to headquarters' evaluation of each SBU; strategic controls are critical when the heads of SBUs evaluate their divisions' performance. Strategic controls are also critical to the

The **strategic business unit (SBU) form** is a structure consisting of three levels: corporate headquarters, strategic business units (SBUs), and SBU divisions.



- Notes:
- Structural integration among divisions within SBUs, but independence across SBUs
 - Strategic planning may be the most prominent function in headquarters for managing the strategic planning approval process of SBUs for the president
 - Each SBU may have its own budget for staff to foster integration
 - Corporate headquarters staff serve as consultants to SBUs and divisions, rather than having direct input to product strategy, as in the cooperative form

headquarters' efforts to determine if the company has chosen an effective portfolio of businesses and if those businesses are being successfully managed.

Used by large firms, the SBU structure can be complex, with the complexity reflected by the organization's size and product and market diversity. Related linked firm GE, for example, has over 20 strategic business units, each with multiple divisions. GE Aircraft Engines, Appliances, Power Systems, NBC, and GE Capital are a few of the firm's SBUs. As is frequently the case with large diversified corporations, the scale of GE's business units is striking. GE Aircraft Engines, for example, is the world's leading manufacturer of jet engines for civil and military aircraft. With almost 30 divisions, GE Capital is a diversified financial services company creating comprehensive solutions to increase client productivity and efficiency. The GE Power Systems business unit has 21 divisions, including GE Energy Rentals, GE Distributed Power, and GE Water Technologies.⁸⁷

In many of GE's SBUs, efforts are undertaken to form competencies in services and technology as a source of competitive advantage. Recently, technology was identified as an advantage for the GE Medical Systems SBU, as that unit's divisions share technological competencies to produce an array of sophisticated equipment, including computed tomography (CT) scanners, magnetic resonance imaging (MRI) systems, nuclear medicine cameras, and ultrasound systems.⁸⁸ Once a competence is developed in one of GE Medical Systems' divisions, it is quickly transferred to the other divisions

in that SBU so that the competence can be leveraged to increase the unit's overall performance.⁸⁹ The sharing of competencies among units within an SBU is an important characteristic of the SBU form of the multidivisional structure (see the legend to Figure 11.6).

USING THE COMPETITIVE FORM OF THE MULTIDIVISIONAL STRUCTURE TO IMPLEMENT THE UNRELATED DIVERSIFICATION STRATEGY

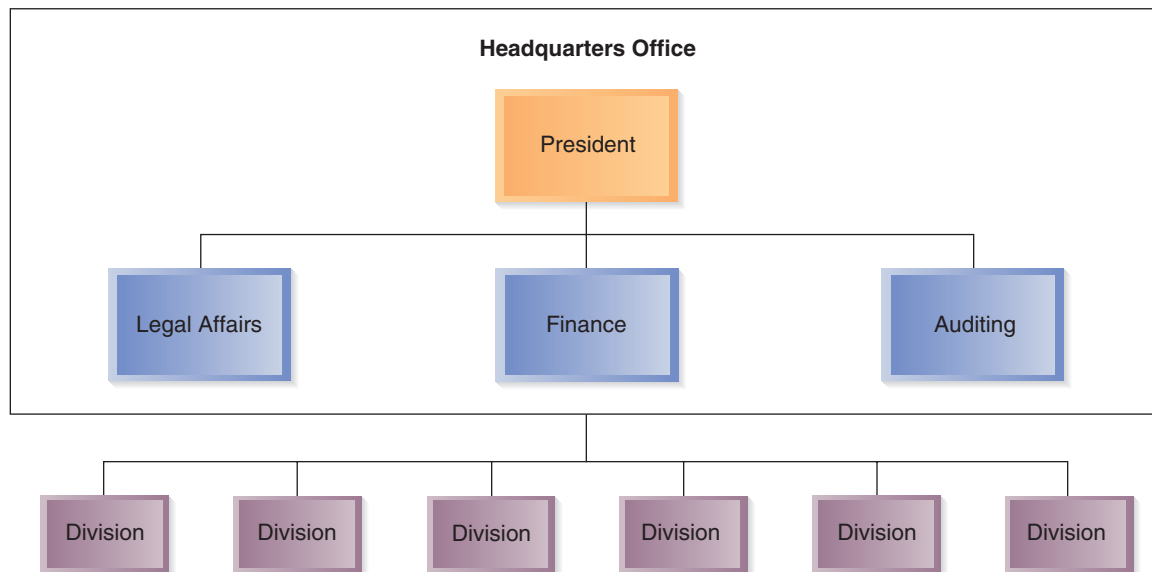
Firms using the unrelated diversification strategy want to create value through efficient internal capital allocations or by restructuring, buying, and selling businesses.⁹⁰ The competitive form of the multidivisional structure supports implementation of this strategy.

The **competitive form** is a structure in which there is complete independence among the firm's divisions (see Figure 11.7). Unlike the divisions included in the cooperative structure, the divisions that are part of the competitive structure do not share common corporate strengths (e.g., marketing competencies or channel dominance). Because strengths aren't shared, integrating devices aren't developed for use by the divisions included in the competitive structure.

The efficient internal capital market that is the foundation for use of the unrelated diversification strategy requires organizational arrangements that emphasize divisional competition rather than cooperation.⁹¹ Three benefits are expected from the internal competition that the competitive form of the multidivisional structure facilitates. First, internal competition creates flexibility—corporate headquarters can have divisions working on different technologies to identify those with the greatest future

*The **competitive form** is a structure in which there is complete independence among the firm's divisions.*

Figure 11.7 Competitive Form of the Multidivisional Structure for Implementation of an Unrelated Strategy



- Notes:
- Corporate headquarters has a small staff
 - Finance and auditing are the most prominent functions in the headquarters office to manage cash flow and assure the accuracy of performance data coming from divisions
 - The legal affairs function becomes important when the firm acquires or divests assets
 - Divisions are independent and separate for financial evaluation purposes
 - Divisions retain strategic control, but cash is managed by the corporate office
 - Divisions compete for corporate resources

United Technologies Corp.: Where Strategy and Structure Are Matched

Strategic Focus

United Technologies is a diversified corporation providing high-technology products to the aerospace and building systems industries throughout the world. Operating in over 180 countries and employing more than 155,000 people worldwide and with annual sales revenue of approximately \$28 billion, the firm's recent market capitalization exceeded \$33 billion. United Technologies' multidivisional structure features six business units (Sikorsky, Pratt & Whitney, Hamilton Sundstrand, UTC Fuel Cells, Otis, and Carrier) as well as a corporate-level research center. Operating independently, these units compete against one another for resources that are allocated from corporate headquarters. The firm spends more than \$2.5 billion annually on R&D, with the clear majority of these funds allocated to the corporate-level research center. This center's primary responsibility is to work individually with the six units to assist in developing product and process innovations that are unique to each unit's operations.

During the 1990s, United Technologies' unrelated diversification strategy was implemented very successfully as demonstrated by the fact that the firm's stock outperformed the S&P 500 index, rising at a ten-year average annual rate of 21 percent versus 15 percent for the index. However, the aftermath of the September 11, 2001 attacks has affected the firm's independent business units. As analysts noted, "Ongoing cuts in Boeing and Airbus commercial aircraft production should continue to temper near-term demand for UTX's Pratt & Whitney jet engines and Hamilton Sundstrand aircraft components." The Otis Elevator business unit has cushioned the firm's bottom line while these other two units continue to be affected by the worst slump in aviation history. Between 2002 and 2003, for example, the percentage of the firm's operating profits accounted for by Otis grew from 24.8 percent to 27.4 percent while Pratt & Whitney's percentage of total operating profits declined from 38.3 percent to 33.2 percent.

To continue reducing its dependence on the volatile airline industry, United Technologies acquired Chubb PLC for \$1 billion in 2003. Based in the United Kingdom, Chubb specializes in electronic security products (e.g., hotel locks and burglar alarms) and services (e.g., security guards). A cross-border transaction, this strategic acquisition reflects United Technologies' desire to build a portfolio of businesses that are more stable and less cyclical compared to those competing in the aviation industry. In addition to being available at an attractive price, Chubb appealed to United Technologies because electronic security is one of the few sectors of the global economy that emerged stronger after the September 11, 2001 attacks. Company officials anticipate that in the current environment, Chubb will join Otis as a primary contributor to the corporation's operating profits. As part of United Technologies, Chubb will compete with all other business units for corporate resources and will operate independently from them as called for by the competitive form of the multidivisional structure.

SOURCES: J. L. Lunsford, 2003, United Technologies' formula: A powerful lift from elevators, *Wall Street Journal Online*, <http://www.wsj.com>, July 2; A. Raghavan, 2003, U.S. firms are shopping for European M&A deals, *Wall Street Journal Online*, <http://www.wsj.com>, June 30; A. Raghavan & R. Sidel, 2003, United Technologies to buy Chubb PLC for \$1 billion, *Wall Street Journal Online*, <http://www.wjs.com>, June 12; 2003, United Tech gets U.S. clearance to buy Chubb, *Reuters*, <http://www.reuters.com>, July 1; 2003, United Technologies, *Standard & Poor's Stock Reports*, <http://www.standardandpoors.com>, July 3; 2003, UTC Fuel Cells, United Technologies Home Page, <http://www.unitedtechnologies.com>, July 10.

potential, for example. Resources can then be allocated to the division that is working with the most promising technology to fuel the entire firm's success. Second, internal competition challenges the status quo and inertia, because division heads know that future resource allocations are a product of excellent current performance as well as superior positioning of their division in terms of future performance. Last, internal

competition motivates effort. The challenge of competing against internal peers can be as great as the challenge of competing against external marketplace competitors.⁹²

Independence among divisions, as shown by a lack of sharing of corporate strengths and the absence of integrating devices, allows the firm using the unrelated diversification strategy to form specific profit performance expectations for each division to stimulate internal competition for future resources. The benefits of internal capital allocations or restructuring cannot be fully realized unless divisions are held accountable for their own independent performance. In the competitive structure, organizational controls (primarily financial controls) are used to emphasize and support internal competition among separate divisions and as the basis for allocating corporate capital based on divisions' performances. At Textron Inc., for example, return on invested capital is the primary measure used to assess the performance of the firm's unrelated business units. According to the firm, "return on invested capital serves as both a compass to guide every investment decision and a measurement of Textron's success."⁹³

To emphasize competitiveness among divisions, the headquarters office maintains an arms-length relationship with them and does not intervene in divisional affairs, except to audit operations and discipline managers whose divisions perform poorly. In this situation, the headquarters office relies on strategic controls to set rate-of-return targets and financial controls to monitor divisional performance relative to those targets. The headquarters office then allocates cash flow on a competitive basis, rather than automatically returning cash to the division that produced it. Thus, the focus of the headquarters' work is on performance appraisal, resource allocation, and long-range planning to verify that the firm's portfolio of businesses will lead to financial success.⁹⁴

As explained in the Strategic Focus, United Technologies Corp. uses the competitive form of the multidivisional structure to support use of its unrelated diversification strategy.

The three major forms of the multidivisional structure should each be paired with a particular corporate-level strategy. As explained in the Strategic Focus, United Technologies uses the competitive form of the multidivisional structure to implement the unrelated diversification strategy. Table 11.1 shows these structures' characteristics. Differences are seen in the degree of centralization, the focus of the performance appraisal, the horizontal structures (integrating mechanisms), and the incentive compensation schemes. The most centralized and most costly structural form is the cooperative structure. The least centralized, with the lowest bureaucratic costs, is the competitive structure. The SBU structure requires partial centralization and involves some of the mechanisms necessary to implement the relatedness between divisions. Also, the divisional incentive compensation awards are allocated according to both SBUs and corporate performance.

Matches between International Strategies and Worldwide Structures

As explained in Chapter 8, international strategies are becoming increasingly important for long-term competitive success.⁹⁵ Among other benefits, international strategies allow the firm to search for new markets, resources, core competencies, and technologies as part of its efforts to outperform competitors.⁹⁶

As with business-level and corporate-level strategies, unique organizational structures are necessary to successfully implement the different international strategies.⁹⁷ Forming proper matches between international strategies and organizational structures facilitates the firm's efforts to effectively coordinate and control its global operations.⁹⁸ More importantly, recent research findings confirm the validity of the international strategy/structure matches we discuss here.⁹⁹

Characteristics of the Structures Necessary to Implement the Related Constrained, Related Linked, and Unrelated Diversification Strategies

Table 11.1

Structural Characteristics	Overall Structural Form		
	Cooperative M-Form (Related Constrained Strategy) ^a	SBU M-Form (Related Linked Strategy) ^a	Competitive M-Form (Unrelated Diversification Strategy) ^a
Centralization of operations	Centralized at corporate office	Partially centralized (in SBUs)	Decentralized to divisions
Use of integration mechanisms	Extensive	Moderate	Nonexistent
Divisional performance appraisals	Emphasize subjective (strategic) criteria and objective (financial) criteria	Use a mixture of subjective (strategic)	Emphasize objective (financial) criteria
Divisional incentive compensation	Linked to overall corporate performance	Mixed linkage to corporate, SBU, and divisional performance	Linked to divisional performance

^aStrategy implemented with structural form.

USING THE WORLDWIDE GEOGRAPHIC AREA STRUCTURE TO IMPLEMENT THE MULTIDOMESTIC STRATEGY

The *multidomestic strategy* decentralizes the firm's strategic and operating decisions to business units in each country so that product characteristics can be tailored to local preferences. Firms using this strategy try to isolate themselves from global competitive forces by establishing protected market positions or by competing in industry segments that are most affected by differences among local countries. The worldwide geographic area structure is used to implement this strategy. The **worldwide geographic area structure** is a structure emphasizing national interests and facilitating the firm's efforts to satisfy local or cultural differences (see Figure 11.8).

Because using the multidomestic strategy requires little coordination between different country markets, integrating mechanisms among divisions in the worldwide geographic area structure aren't needed. Hence, formalization is low, and coordination among units in a firm's worldwide geographic area structure is often informal.

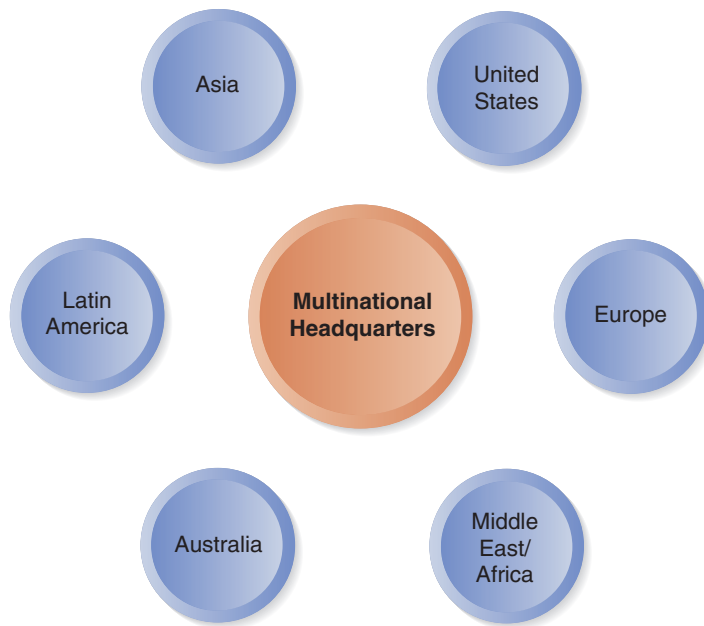
The multidomestic strategy/worldwide geographic area structure match evolved as a natural outgrowth of the multicultural European marketplace. Friends and family members of the main business who were sent as expatriates into foreign countries to develop the independent country subsidiary often implemented this type of structure for the main business. The relationship to corporate headquarters by divisions took place through informal communication among "family members."¹⁰⁰

Unilever, the giant Dutch consumer products firm and major competitor for Procter & Gamble, has refocused its business operations.¹⁰¹ As a result, the firm grouped its worldwide operations into two global divisions—foods, and home and personal care. The firm uses the worldwide geographic area structure. For the foods division (known as Unilever Bestfoods), regional presidents are responsible for results from operations in the region to which they have been assigned. Asia, Europe, North America, Africa, the Middle East and Turkey, and Latin America are the regions of

*The **worldwide geographic area structure** is a structure emphasizing national interests and facilitating the firm's efforts to satisfy local or cultural differences.*

Figure 11.8

Worldwide Geographic Area Structure for Implementation of a Multidomestic Strategy



- Notes:
- The perimeter circles indicate decentralization of operations
 - Emphasis is on differentiation by local demand to fit an area or country culture
 - Corporate headquarters coordinates financial resources among independent subsidiaries
 - The organization is like a decentralized federation

the foods division. The firm describes the match between the multidomestic strategy and Unilever's worldwide geographic structure (in terms of the firm's foods division): "Unilever Bestfoods' strength lies in our ability to tailor products to different markets as well as to anticipate consumer trends and demands. This comes from our deep understanding of the countries in which we operate and our policy of listening to our customers."¹⁰²

A key disadvantage of the multidomestic strategy/worldwide geographic area structure match is the inability to create global efficiency. With an increasing emphasis on lower-cost products in international markets, the need to pursue worldwide economies of scale has also increased. These changes have fostered the use of the global strategy and its structural match, the worldwide product divisional structure.

USING THE WORLDWIDE PRODUCT DIVISIONAL STRUCTURE TO IMPLEMENT THE GLOBAL STRATEGY

With the corporation's home office dictating competitive strategy, the *global strategy* is one through which the firm offers standardized products

Unilever's worldwide geographic structure has regionalized its food division, allowing it to be in better touch with customers in each area.



AP Photo/Greg Baker

across country markets. The firm's success depends on its ability to develop and take advantage of economies of scope and scale on a global level. Decisions to outsource some primary or support activities to the world's best providers are particularly helpful when the firm tries to develop economies of scale.

The worldwide product divisional structure supports use of the global strategy. In the **worldwide product divisional structure**, decision-making authority is centralized in the worldwide division headquarters to coordinate and integrate decisions and actions among divisional business units (see Figure 11.9). This structure is often used in rapidly growing firms seeking to manage their diversified product lines effectively, as in Japan's Kyowa Hakko. With businesses in pharmaceuticals, chemicals, biochemicals, and liquor and food, this company uses the worldwide product divisional structure to facilitate its decisions about how to successfully compete in what it believes are rapidly shifting global competitive environments.¹⁰³

Integrating mechanisms are important to effective use of the worldwide product divisional structure. Direct contact between managers, liaison roles between departments, and temporary task forces as well as permanent teams are examples of these mechanisms. One researcher describes the use of these mechanisms in the worldwide structure: "There is extensive and formal use of task forces and operating committees to supplement communication and coordination of worldwide operations."¹⁰⁴ The evolution of a shared vision of the firm's strategy and how structure supports its implementation is one of the important outcomes resulting from these mechanisms' effective use. The disadvantages of the global strategy/worldwide structure combination are the difficulty involved with coordinating decisions and actions across country borders and the inability to quickly respond to local needs and preferences.

*The **worldwide product divisional structure** is a structure in which decision-making authority is centralized in the worldwide division headquarters to coordinate and integrate decisions and actions among divisional business units.*

Worldwide Product Divisional Structure for Implementation of a Global Strategy

Figure 11.9



- Notes:
- The headquarters' circle indicates centralization to coordinate information flow among worldwide products
 - Corporate headquarters uses many intercoordination devices to facilitate global economies of scale and scope
 - Corporate headquarters also allocates financial resources in a cooperative way
 - The organization is like a centralized federation

USING THE COMBINATION STRUCTURE TO IMPLEMENT THE TRANSNATIONAL STRATEGY

The *transnational strategy* calls for the firm to combine the multidomestic strategy's local responsiveness with the global strategy's efficiency. Thus, firms using this strategy are trying to gain the advantages of both local responsiveness and global efficiency.¹⁰⁵

The combination structure is used to implement the transnational strategy. The **combination structure** is a structure drawing characteristics and mechanisms from both the worldwide geographic area structure and the worldwide product divisional structure.

The fits between the multidomestic strategy and the worldwide geographic area structure and between the global strategy and the worldwide product divisional structure are apparent. However, when a firm wants to implement both the multidomestic and the global strategies simultaneously through a combination structure, the appropriate integrating mechanisms for the two structures are less obvious. The structure used to implement the transnational strategy must be simultaneously centralized and decentralized; integrated and nonintegrated; formalized and nonformalized. These seemingly opposite characteristics must be managed by an overall structure that is capable of encouraging all employees to understand the effects of cultural diversity on a firm's operations.

This requirement highlights the need for a strong educational component to change the whole culture of the organization. If the cultural change is effective, the combination structure should allow the firm to learn how to gain competitive benefits in local economies by adapting its core competencies, which often have been developed and nurtured in less culturally diverse competitive environments. As firms globalize and move toward the transnational strategy, the idea of a corporate headquarters has become increasingly important in fostering leadership and a shared vision to create a stronger company identity.¹⁰⁶

Matches between Cooperative Strategies and Network Structures

As discussed in Chapter 9, a network strategy exists when partners form several alliances in order to improve the performance of the alliance network itself through cooperative endeavors.¹⁰⁷ The greater levels of environmental complexity and uncertainty companies face in today's competitive environment are causing increasing numbers of firms to use cooperative strategies such as strategic alliances and joint ventures.¹⁰⁸

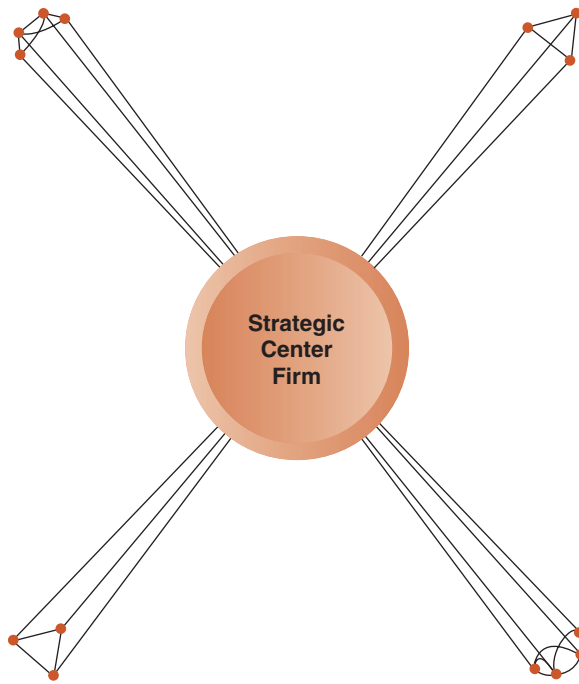
The breadth and scope of firms' operations in the global economy create many opportunities for firms to cooperate.¹⁰⁹ In fact, the firm can develop cooperative relationships with many of its stakeholders, including customers, suppliers, and competitors.¹¹⁰ When the firm becomes involved with combinations of cooperative relationships, it is part of a strategic network, or what others call an alliance constellation.¹¹¹

A *strategic network* is a group of firms that has been formed to create value by participating in multiple cooperative arrangements, such as alliances and joint ventures. An effective strategic network facilitates the discovery of opportunities beyond those identified by individual network participants.¹¹² A strategic network can be a source of competitive advantage for its members when its operations create value that is difficult for competitors to duplicate and that network members can't create by themselves.¹¹³ Strategic networks are used to implement business-level, corporate-level, and international cooperative strategies.

Commonly, a strategic network is a loose federation of partners who participate in the network's operations on a flexible basis. At the core or center of the strategic network, the *strategic center firm* is the one around which the network's cooperative relationships revolve (see Figure 11.10).

Because of its central position, the strategic center firm is the foundation for the strategic network's structure. Concerned with various aspects of organizational struc-

The **combination structure** is a structure drawing characteristics and mechanisms from both the worldwide geographic area structure and the worldwide product divisional structure.



ture, such as formal reporting relationships and procedures, the strategic center firm manages what are often complex, cooperative interactions among network partners. The strategic center firm is engaged in four primary tasks as it manages the strategic network and controls its operations:¹¹⁴

Strategic outsourcing. The strategic center firm outsources and partners with more firms than do other network members. At the same time, the strategic center firm requires network partners to be more than contractors. Members are expected to find opportunities for the network to create value through its cooperative work.

Competencies. To increase network effectiveness, the strategic center firm seeks ways to support each member's efforts to develop core competencies that can benefit the network.

Technology. The strategic center firm is responsible for managing the development and sharing of technology-based ideas among network members. The structural requirement that members submit formal reports detailing the technology-oriented outcomes of their efforts to the strategic center firm facilitates this activity.

Race to learn. The strategic center firm emphasizes that the principal dimensions of competition are between value chains and between networks of value chains. Because of this, the strategic network is only as strong as its weakest value-chain link. With its centralized decision-making authority and responsibility, the strategic center firm guides participants in efforts to form network-specific competitive advantages. The need for each participant to have capabilities that can be the foundation for the network's competitive advantages encourages friendly rivalry among participants seeking to develop the skills needed to quickly form new capabilities that create value for the network.¹¹⁵

Implementing Business-Level Cooperative Strategies

As noted in Chapter 9, there are two types of business-level complementary alliances: vertical and horizontal. Firms with competencies in different stages of the value chain form a vertical alliance to cooperatively integrate their different, but complementary, skills. Firms that agree to combine their competencies to create value in the same stage of the value chain form a horizontal alliance. Vertical complementary strategic alliances, such as those developed by Toyota Motor Company, are formed more frequently than horizontal alliances. Acting as the strategic center firm, Toyota fashioned its lean production system around a network of supplier firms.¹¹⁶

A strategic network of vertical relationships, such as the network in Japan between Toyota and its suppliers, often involves a number of implementation issues.¹¹⁷ First, the strategic center firm encourages subcontractors to modernize their facilities and provides them with technical and financial assistance to do so, if necessary. Second, the strategic center firm reduces its transaction costs by promoting longer-term contracts with subcontractors, so that supplier-partners increase their long-term productivity. This approach is diametrically opposed to that of continually negotiating short-term contracts based on unit pricing. Third, the strategic center firm enables engineers in upstream companies (suppliers) to have better communication with those companies with whom it has contracts for services. As a result, suppliers and the strategic center firm become more interdependent and less independent.¹¹⁸

The lean production system pioneered by Toyota has been diffused throughout the Japanese and U.S. auto industries. However, no auto company has learned how to duplicate the manufacturing effectiveness and efficiency Toyota derives from the cooperative arrangements in its strategic network.¹¹⁹ A key factor accounting for Toyota's manufacturing-based competitive advantage is the cost other firms would incur to imitate the structural form used to support Toyota's application. In part, then, the structure of Toyota's strategic network that it created as the strategic center firm facilitates cooperative actions among network participants that competitors can't fully understand or duplicate.

In vertical complementary strategic alliances, such as the one between Toyota and its suppliers, the strategic center firm is obvious, as is the structure that firm establishes. However, this is not always the case with horizontal complementary strategic alliances where firms try to create value in the same part of the value chain, as with airline alliances that are commonly formed to create value in the marketing and sales primary activity segment of the value chain (see Table 3.6). Because air carriers commonly participate in multiple vertical complementary alliances, it is difficult to select the strategic center firm. Moreover, participation in several alliances can cause firms to question partners' true loyalties and intentions. For these reasons, horizontal complementary alliances are used less frequently than their vertical counterpart.

Strategic networks have been important to Cisco Systems Inc. The worldwide leader in networking for the Internet, Cisco provides a broad line of solutions for transporting data, voice, and video in multiple settings¹²⁰ and has been involved with a number of strategic networks in its pursuit of competitive success. Cisco recently announced that it was changing its organizational structure. Historically, the firm's structure featured three primary business units—enterprise, service provider, and commercial. In late 2001, Cisco changed its structure to create 11 technology areas.¹²¹ Will cooperative strategies be as critical to the firm as it completes its work through the dictates of a new organizational structure? In all likelihood, this will be the case, although the evolution of strategy and structure at Cisco will ultimately decide this issue.

Implementing Corporate-Level Cooperative Strategies

Corporate-level cooperative strategies (such as franchising) are used to facilitate product and market diversification. As a cooperative strategy, franchising allows the firm

to use its competencies to extend or diversify its product or market reach, but without completing a merger or an acquisition. For example, McDonald's, the largest fast-food company in the world, has more than 50 percent of its almost 31,000 restaurants outside the United States and serves more than 46 million customers daily.¹²²

The McDonald's franchising system is a strategic network. McDonald's headquarters office serves as the strategic center firm for the network's franchisees. The headquarters office uses strategic controls and financial controls to verify that the franchisees' operations create the greatest value for the entire network. One strategic control issue is the location of franchisee units. McDonald's believes that its greatest expansion opportunities are outside the United States. Density percentages seem to support this conclusion. "While in the United States there are 22,000 people per McDonald's, in the rest of the world there is only one McDonald's for every 605,000 people."¹²³ As a result, as the strategic center firm, McDonald's is devoting its capital expenditures (over 70 percent in the last three years) primarily to develop units in non-U.S. markets. Financial controls are framed around requirements an interested party must satisfy to become a McDonald's franchisee as well as performance standards that are to be met when operating a unit.¹²⁴

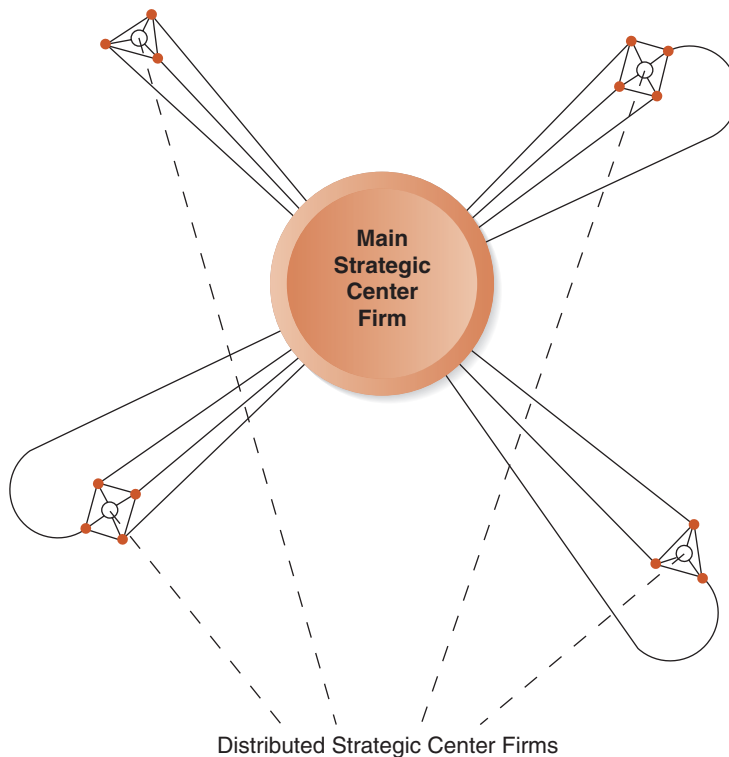
Implementing International Cooperative Strategies

Strategic networks formed to implement international cooperative strategies result in firms competing in several countries.¹²⁵ Differences among countries' regulatory environments increase the challenge of managing international networks and verifying that at a minimum, the network's operations comply with all legal requirements.¹²⁶

Distributed strategic networks are the organizational structure used to manage international cooperative strategies. As shown in Figure 11.11, several regional strategic

A Distributed Strategic Network

Figure 11.11



center firms are included in the distributed network to manage partner firms' multiple cooperative arrangements.¹²⁷ Strategic centers for Ericsson (telecommunications exchange equipment) and Electrolux (white goods, washing machines) are located in countries throughout the world, instead of only in Sweden where the firms are headquartered. Ericsson, for example, is active in more than 140 countries and employs more than 90,000 people. Using the SBU structure, Ericsson has five strategic business units and has formed cooperative agreements with companies throughout the world in each unit. As a founding member of an Ethernet alliance (Intel and Cisco are also members), Ericsson acts as the strategic center firm for this cooperative arrangement, which seeks to solve the wireline access bottleneck by promoting open industry standards.¹²⁸

Summary

- Organizational structure specifies the firm's formal reporting relationships, procedures, controls, and authority and decision-making processes. Influencing managerial work, structure essentially details the work to be done and how that work is to be accomplished. Organizational controls guide the use of strategy, indicate how to compare actual and expected results, and suggest actions to take to improve performance when it falls below expectations. When properly matched with the strategy for which they were intended, structure and controls can be a competitive advantage.
- Strategic controls (largely subjective criteria) and financial controls (largely objective criteria) are the two types of organizational controls used to successfully implement the firm's chosen strategy. Both types of controls are critical, although their degree of emphasis varies based on individual matches between strategy and structure.
- Strategy and structure influence each other, although strategy has an overall stronger influence on structure. Research indicates that firms tend to change structure when declining performance forces them to do so. Effective managers anticipate the need for structural change, quickly modifying structure to better accommodate the firm's strategy implementation needs when evidence calls for that action.
- Business-level strategies are implemented through the functional structure. The cost leadership strategy requires a centralized functional structure—one in which manufacturing efficiency and process engineering are emphasized. The differentiation strategy's functional structure decentralizes implementation-related decisions, especially those concerned with marketing, to those involved with individual organizational functions. Focus strategies, often used in small firms, require a simple structure until such time that the firm diversifies in terms of products and/or markets.
- Unique combinations of different forms of the multidivisional structure are matched with different corporate-level diversification strategies to properly implement these strategies. The cooperative M-form, used to implement the related constrained corporate-level strategy, has a centralized corporate office and extensive integrating mechanisms. Divisional incentives are linked to overall corporate performance. The related linked SBU M-form structure establishes separate profit centers within the diversified firm. Each profit center may have divisions offering similar products, but the centers are unrelated to each other. The competitive M-form structure, used to implement the unrelated diversification strategy, is highly decentralized, lacks integrating mechanisms, and utilizes objective financial criteria to evaluate each unit's performance.
- The multidomestic strategy, implemented through the worldwide geographic area structure, emphasizes decentralization and locates all functional activities in the host country or geographic area. The worldwide product divisional structure is used to implement the global strategy. This structure is centralized in order to coordinate and integrate different functions' activities so as to gain global economies of scope and scale. Decision-making authority is centralized in the firm's worldwide division headquarters.
- The transnational strategy—a strategy through which the firm seeks the local responsiveness of the multidomestic strategy and the global efficiency of the global strategy—is implemented through the combination structure. Because it must be simultaneously centralized and decentralized, integrated and nonintegrated, and formalized and nonformalized, the combination structure is difficult to organize and manage successfully.
- Increasingly important to competitive success, cooperative strategies are implemented through organizational structures framed around strategic networks. Strategic center firms are critical to the management of strategic networks.

Review Questions

1. What is organizational structure and what are organizational controls? What are the differences between strategic controls and financial controls?
2. What does it mean to say that strategy and structure have a reciprocal relationship?
3. What are the characteristics of the functional structures that are used to implement the cost leadership, differentiation, integrated cost leadership/differentiation, and focused business-level strategies?
4. What are the differences among the three versions of the multidivisional (M-form) organizational structures that are used to implement the related constrained, related linked, and unrelated corporate-level diversification strategies?
5. What organizational structures are used to implement the multidomestic, global, and transnational international strategies?
6. What is a strategic network? What is a strategic center firm?

Experiential Exercises

Organizational Structure and Controls

As an executive board member for a successful 50-partner firm that provides accounting services to corporate clients, you are interested in expanding to offer management consulting services to these clients. Another possibility for your firm is offering both types of services to smaller clients.

Part One. You are concerned about how your organizational structure may need to change to support these services. Based on the material in the chapter, use the chart to rank each type of organizational structure against the activities—information processing, coordination, and control—that you anticipate will need to be strengthened.

Part Two. You are also very concerned that there may be a potential conflict of interest if your firm provides both accounting and management consulting services to the same client. In small groups, discuss whether it is possible for a firm to use organizational structure and controls to achieve its strategic objectives but also to prevent conflicts of interest among its divisions.

	Information processing	Coordination	Control
Simple structure			
Functional structure			
Multidivisional structure			

Structural Issues of Related Diversification

For years, Kodak used the cooperative form of the multidivisional structure to implement the related-constrained diversification strategy. Following this structure, primary organizational functions such as manufacturing, customer care, and strategic planning were centralized, which allowed such

expertise to be shared among Kodak's seven product divisions. The cooperative structure worked well for Kodak as it used the related-constrained strategy to compete in what for many years had been relatively stable markets. However, innovative technologies and increased competition disrupted these markets, making the sharing of the firm's technologies and related skills across product divisions less competitively valuable. Moreover, sharing key resources and their corresponding costs across many business units with increased competition in unstable markets made it difficult for Kodak to assess the profitability of its product divisions (Consumer Imaging, Digital and Applied Imaging, Kodak Professional, Health Imaging, Document Imaging, Entertainment Imaging) and operational divisions (Commercial and Government, Federal Government Contracts, and Worldwide Transportation).

Analysis of the external environment as well as of Kodak's resources, capabilities, and core competencies resulted in management concluding that the firm should reduce the number of links between its business units and their products and services. Kodak subsequently made two consecutive changes to the SBU structure. First, Kodak moved to a three SBU structure in October 2000 (see Figure 11.12). This combined the previous seven product divisions into two broad customer-oriented SBUs (Consumer and Commercial), while the third (Global Operations) handled Kodak's governmental contracts along with various supply chain and operational needs. The resulting structure was viewed as less than optimal by Kodak executives, who concluded that another form of the SBU structure might be necessary. A new version of the SBU structure was implemented by Kodak in November 2001 (see Figure 11.13).

1. How might these rapid, consecutive, and fundamental changes in the corporate structure both facilitate and hinder Kodak's ability to realistically implement its corporate-level strategy?
2. Do either of the newest Kodak organizational charts match well with the related-constrained or related-linked corporate strategies? Why or why not?

Figure 11.12

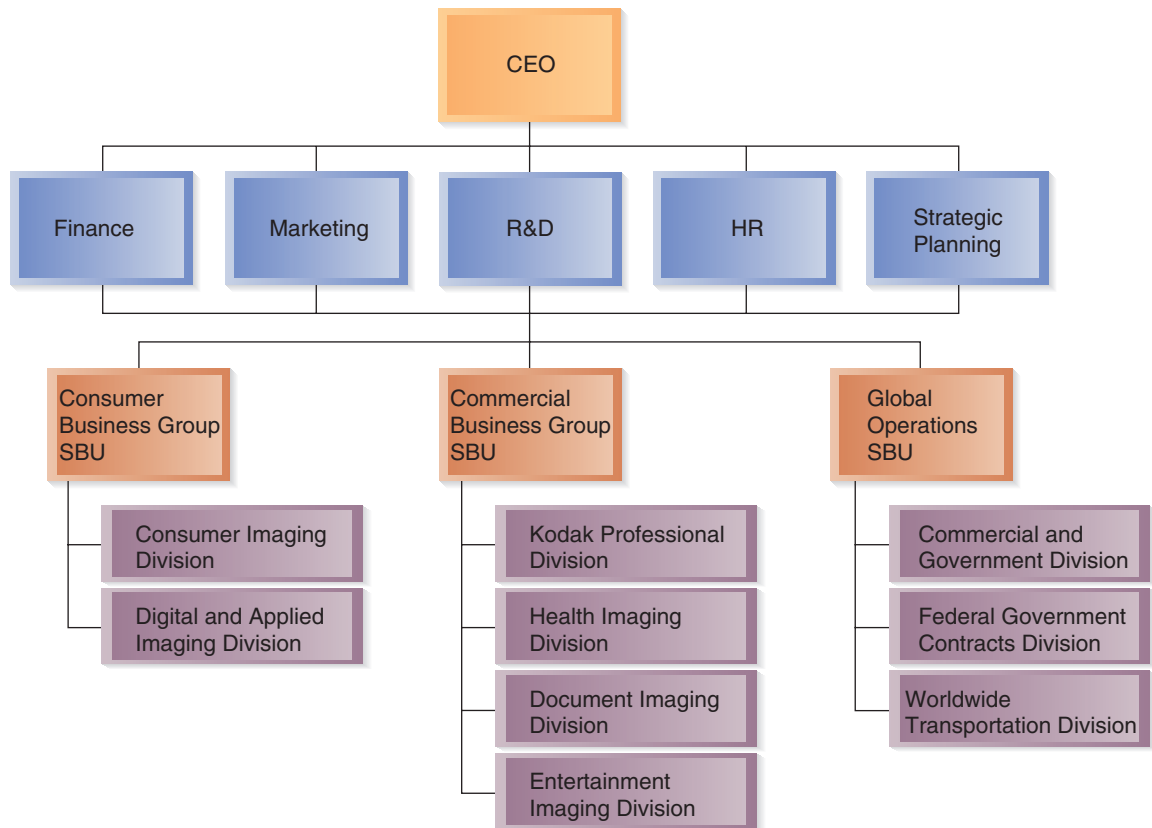
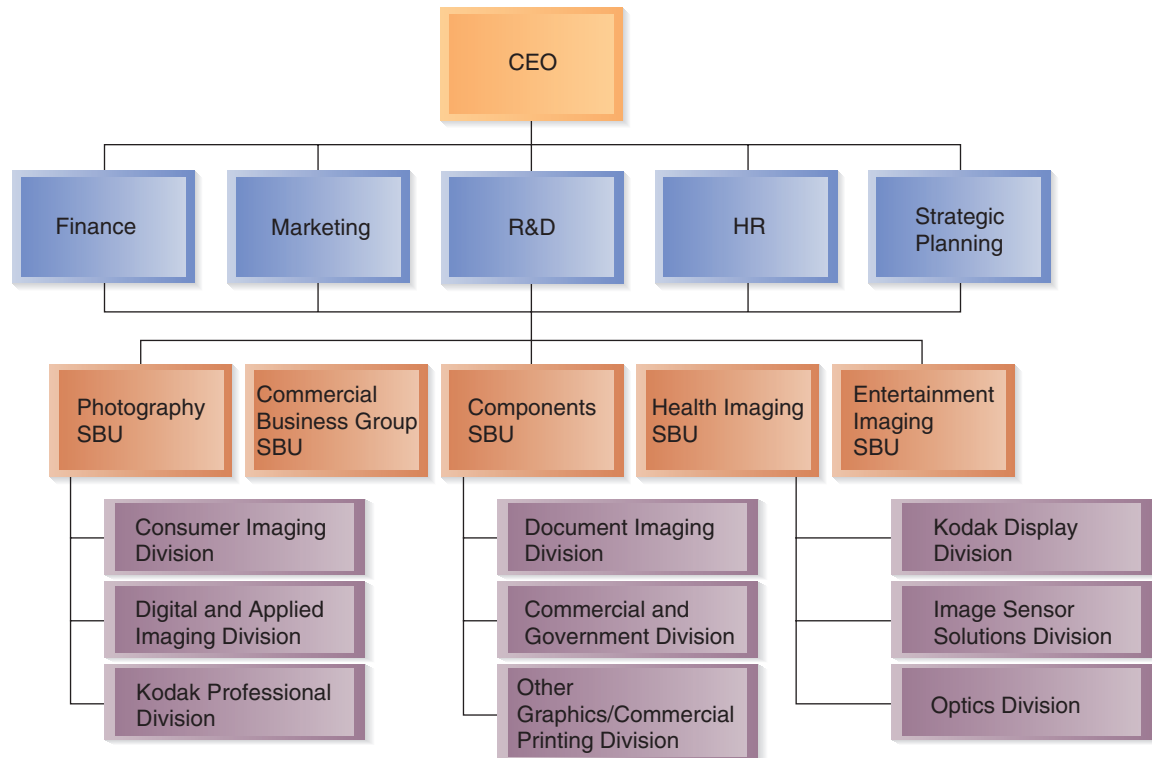


Figure 11.13



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