JAY R. GALBRAITH

DESIGNING ORGANIZATIONS

STRATEGY, STRUCTURE, and PROCESS at the BUSINESS UNIT and ENTERPRISE LEVELS

THIRD EDITION

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Published by Jossey-Bass
A Wiley Imprint
One Montgomery Street, Suite 1200, San Francisco, CA 94104-4594
www.josseybass.com

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Library of Congress Cataloging-in-Publication Data
Galbraith, Jay R.
Designing organizations : strategy, structure, and process at the business unit and enterprise levels / Jay R. Galbraith.—3rd Edition.
pages cm
Includes bibliographical references and index.
ISBN 978-1-118-40995-4 (hardback); ISBN 978-1-118-41729-4 (pdf);
ISBN 978-1-118-46382-6 (epub)
1. Organizational effectiveness. 2. Strategic planning. I. Title.
HD58.9.G35 2014
658.4′012—dc23

2013040235

Printed in the United States of America
THIRD EDITION
HB Printing 10 9 8 7 6 5 4 3 2 1

List of Figures and Tables

Figures

Tables

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Preface

The last revision I did for this book was standard. I updated the examples and references, modified some ideas based on new research, and added a new chapter or two. For this revision, I took more time and substantially rewrote the book. The basics, like the Star Model and lateral forms of organization, remain the same. But the organization design thinking throughout the book is much more driven by strategy. It follows the research and theory that started with Alfred Chandler's *Strategy and Structure* (1962).

The first couple of chapters explain the approach of strategic organization design. It is a top-down approach as opposed to a sociotechnical systems approach, which is bottom up. Sociotech is much more influenced by the actual work of the first level of the organization. The strategic approach to design is based on the Star Model, a holistic framework for combining strategy, structure, processes, rewards, and people. (I am the holder of the copyright and trademark on the Star Model.) In addition to discussing the Star Model, the first chapters set the methodology of growth leading to strategic transformation. I assume that companies pursue growth to attract capital and talent and, for those that are publicly traded, to drive their stock price. However, a company can grow only so far in its core business and home country. As a result, growth drives a diversification strategy from a single business into a multiple business portfolio. These two stages of growth—a single core business strategy and a multiple business portfolio strategy—are covered in this book. Growth also drives companies to expand outside their home country into host countries. These companies take on three-dimensional structures where functions, businesses, and geographies all report to the CEO. I have described these organizations in more detail in *Designing the Global Corporation* (2000).

A fourth-stage organization arises when companies focus on a customer dimension. I discussed these organizations in *Designing the Customer-Centric Organization* (2005). In chapter 13 of this book, I speculate about a fifth dimension that could result from the impacts of analytics and big data. Throughout the book, I refer to "big data," which denotes the greater volume, variety, and velocity of data that are available today.

In chapters 3 through 7, I describe the different types of single-business functional organizations. Chapters 3 and 4 focus on the functional structure and the cross-functional lateral processes that characterize most single-business organizations. In this edition, I highlight the growing interest in social technologies to coordinate work flows, products, and services across the company. I also distinguish between the different types of business strategies and organizations. I follow Treacy and Wiersema's (1997) three organizational types: cost-centric, product-centric, and customer-centric. In chapter 5, I discuss the organizations for each of these strategies along with several case studies to bring them alive. In that same chapter, I present some ideas about the real-time decision processes that are enabled by big data.

Chapter 6 is devoted to the reconfigurable organization. When competitive advantages do not last long, neither do the organizations that implement them. So today we design organizations to be easily and quickly changeable. This capability requires us to become even more adept at lateral forms of organization. The final chapter in this group, chapter 7, focuses on the network organization. Rather than vertical integration, many companies are using virtual integration. That is, companies are using partnerships rather than ownership to coordinate the components of their businesses. This is particularly true for companies using embedded microchips in their products. Such companies are building networked ecosystems of app developers to write applications for their software platforms.

Chapters 8 through 12 examine the variations on the enterprise strategies and organizations. In chapter 8, I review what we know about portfolio strategy and the continuum spanning from related portfolios to unrelated or conglomerate portfolios. Historically, the literature has focused on either pure types of strategies in the related portfolio with its multidivisional structure or on conglomerates with their holding company structures. Chapter 9 elaborates on the mixed model. Chapters 10 and 11 treat the subject of how corporate centers add value to their portfolios. That is, these companies create portfolios that are more valuable than the sum of their stand-alone businesses. I focus on three conglomerates: General Electric, Danaher, and Illinois Tool Works. Finally, chapter 12 examines two different approaches to creating value through synergy. One type leverages intellectual property across business units. Disney and Armani are examples I use to show how companies leverage characters, brands, and fashion designs across diverse portfolios. The other model is the solutions strategy. IBM and medical products companies combine products, software, and services from diverse business units into smart solutions for their customers.

In chapter 13, I speculate about the effects of big data on organization design and whether they will result in a new dimension of organizational structure. Disney and Nike are already creating digital divisions that are generating new sources of revenue.

Therefore, this edition is both an update of the basic content of organizational design and a presentation of a lot of new material. As social networking and big data work their ways through organizations, there will be much more to uncover and analyze in the years to come.

Breckenridge, Colorado Jay R. Galbraith
December 2013

Contents

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1

INTRODUCTION

Organization design, as opposed to organization theory, is a prescriptive body of knowledge. It is intended to inform the choices of how to organize and manage institutions and serve the leaders who have been entrusted with the stewardship of these institutions. These organizations are purposeful: they have been created to accomplish specific goals and objectives. Organization design is therefore focused on creating organizations through which these goals and objectives can be accomplished.

The knowledge base underlying the choice of organization designs has its roots in scientific management and classical management principles. The practitioners and scholars who developed the knowledge in these areas were searching for the one best way to organize. Those early thinkers created many of the principles, like span of control, and much of the useful language, like centralization, that we still use today. However, it was not difficult to find effective organizations that violated many of the principles of classical management. As a result, modern organization design grew out of efforts to explain these exceptional observations.

Modern organization design came out of a variety of work in the 1950s and 1960s. One stream, developed in the United States, is best illustrated by the work of Alfred Chandler in *Strategy and Structure* (1962). He found that the different organizational structures we had observed could be explained by differences in companies' strategies. Therefore, different strategies lead to different organizations. This stream, referred to as strategic organization design, is a top-down design process that begins with the entity's strategy and can be applied at the enterprise, business unit, geographical, and functional levels.

A second stream of thought developed in Europe around the work of Eric Trist and his followers (Trist and Murray, 1993). It was referred to as the sociotechnical systems approach. It was bottom up. It focused on the alignment of the technology involved in doing the work and the social system that could be created to perform that work. Sociotechnical systems' thinking and tools are best at designing organizations at the bottom levels of the structure. The strategic design thinking and tools are best used for designing organizations' top levels. The strategic organization design approach is the one that I follow in this book.

Today's Organization Design

The interest in organization design has been increasing over the past couple of decades. One of the reasons is that our organizations have been increasing in complexity over that time. "Doing what comes naturally" is not a sufficient guide to organizing today's institutions. Most leaders today rose up through a far simpler structure. Nor are the old dismissives relevant: "All you need are good people. They'll make any organization work." And people do make a misaligned organization work, but at a price. The people in an organization that is misaligned with its strategy and stakeholder environment cannot serve its customers and work around the system at the same time. They can perform much more effectively when the system supports them in doing their work. Besides, high-performing companies do not want organizations that just work; they want organizations that excel. The discipline of organization design has evolved along with the increasing organizational complexity and the desire to create high-performing organizations.

In the following chapters, I trace the organizational stages through which companies have progressed from the simple, single-business strategy to the complex multibusiness, multicountry, multicustomer segment strategy. The first organizational stage is the single-business strategy, sometimes called the U form, or unitary form of organizations. Almost all companies start as a single business that is organized around functions, like sales, marketing, operations, product development, finance, and human resources. It is a unitary or one-dimensional form because it is structured only around functions. All people reporting to the CEO are functional leaders. Chapter 3 is devoted to the design of the single business or business unit, I introduce the concept of the lateral or horizontal organization. In order to get anything done, companies have to work across functions to deliver customer orders, new products, and projects. These processes are executed through lateral forms of cross-functional coordination. The functional structure or hierarchy is the vertical form, and the processes are the lateral forms, which vary from informal and self-organizing processes, to formal teams, to the matrix form. Lateral forms are present in all types of organizations, but I present them in a discussion about business units in chapter 3 since they are the principal design challenge facing business unit leaders.

The second stage arrives when a single business diversifies into new business areas. The company then creates a business unit and a profit and loss center for each new business area. Each business unit is another functional organization. The organization design challenge is thus to create a corporate center to govern the various business units. This center typically contains functional staffs to coordinate the functions across business units. The role and size of the center vary with the diversity of the businesses in the corporate portfolio. Since the CEO of the enterprise has both functions and businesses reporting to the center, the company has a two-dimensional organization structure.

The third stage develops when a company expands out of its home market into new host countries. This strategy adds a third dimension—a geographical dimension—to the organization. Initially companies simply add a geographical division to their multiple business unit divisions. But when international sales reach around 30 to 40 percent of total sales, the international division disappears. In consumer goods companies, the division is replaced by regional profit centers, one of which is the home country. In the business-to-business (B2B) world, the international division is split and the parts are added to their respective business units, creating global business unit profit and loss centers. However, in the global business unit structure, there is still an international or regional overlay on the global business units. And in the regional structure, there are global business units that are overlaid across the regions. So reporting into the corporate center are functions, business units, and geographies. The organization design challenge is balancing power and authority across the three-dimensional structure. The resulting power distributions will be driven by the global portfolio strategy (Galbraith, 2000).

The fourth strategy stage begins with a focus on the customer (Galbraith, 2005). Driven partly by demands from global customers like Walmart, companies such as Procter & Gamble, IBM, and investment banks are adding global customer or customer segments to their structures. Another contributing factor is the conversion of products and services into digital offerings. In the digital world, everything talks to everything else. Vendors, like IBM and Accenture, can combine digital hardware, software, and services into smart solutions for their customers. They can easily customize and codevelop applications with customers for customer segments, like financial services and utilities. This solutions strategy is best executed by organizing around the customer or customer segments called verticals. So in these solutions-oriented companies, we find customer segments reporting into the corporate center along with business units, countries, and functions. The challenge for organization designers is to integrate four dimensions into a one-company strategy and organization. Integration becomes the task of the company's processes. As we will see, the more complex the structure is, the more important are the processes.

Inevitably, the question that comes up is, "Is there a fifth stage?" In the concluding chapter, I speculate about a fifth stage. It appears that the forces around big data, meaning the increased volume, complexity, variety, and velocity of available data, may very well manifest themselves in a fifth strategy and organizational dimension.

Drivers of New Strategies

It is natural to ask why companies are continually changing their strategies. What is driving this movement through the stages? Usually managers prefer to keep things simple, so why are they moving to ever more complicated strategies? There are at least two reasons. One is the pursuit of growth. Many companies are driven by a growth imperative. And the other is the continuing fragmentation of the stakeholder environment.

Growth

Every publicly traded company wants to grow and drive its stock to trade at a premium price. If there is no growth, the company's stock is flat and trades like a bond. A high stock price makes it easier to attract capital and reward employees. The elevated stock also can serve as a currency to make acquisitions. More important, talented people want to join a growth company that has a bright future. But while growth is desirable, it also faces limits. A firm can grow only so much in its core business and its home country. So when growth in the core business slows, firms diversify into adjacent businesses and become multibusiness companies. When growth slows in the home country, firms expand across borders and become multinationals. This pursuit of new growth opportunities causes firms to change strategies and move through the stages.

Fragmentation of the Stakeholder Environment

The other driver of strategic change is the movement from mass markets to ever smaller market segments. In the twentieth century, businesses used mass production to supply mass merchants to serve the mass market. Now, with ever-increasing data, firms can focus on ever smaller customer segments. Consulting firms can now identify 650 microsegments in the food market. Some of these microsegments are declining, some are flat, and others are growing. So food companies are focusing on these growth microsegments, like Hispanic moms and senior foodies. Both the growth imperative and market fragmentation lead to customer-focused strategies.

So it is largely the growth imperative and market segmentation that drive firms to continually evolve their strategies. But not all companies progress through all of the stages. Some companies, like utilities and defense firms, remain domestic enterprises, and some family-owned companies remain in a single business. Andersen, Marvin, and Pella focus largely on residential windows and doors. Most companies, however, become three-dimensional, multinational enterprises like General Mills, Pfizer, Siemens, Canon, and Johnson & Johnson, while others, like Experian and Nike, progress or are progressing through four or even five stages. My point is that different strategies drive different organization designs. It is not size or industry that is the primary shaper of different organizational forms. Size, industry, and nationality all have their effects, but in this book, I start with strategy to begin the design process.

The other point about strategy stages that is important for organization design is that the strategies are cumulative. Chandler called this feature concatenation. That is, a multibusiness enterprise also has stage 1, single-business strategies that guide its business units. And when the stage 2 enterprise expands across borders, it adds third-stage international strategies to its stage 2 multifunction, multibusiness strategies. This cumulative stage-wise progression is what increases the complexity of organization designs and gives organization design its challenge and its priority to create high-performing enterprises.

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