§1 Introduction

An organization does not simply appear on its own; in fact, organizations are contrived social systems that are created by like-minded groups of persons in order to pursue and hopefully achieve a stated goal or purpose. Organizational design is concerned with the factors and issues that must be considered, and the rules and processes that must be implemented, with respect to the design, development, implementation and maintenance of a successful and effective organization. Organizational design is more than simply organizational structure – the boxes and lines that are normally found on a traditional organization chart – and extends outward to include a variety of other factors including information and reward systems; management and decision making processes; organizational culture, including mission, vision, values and norms; strategy, including the goals or purposes for which the organization exists; and the human resources who will do the work necessary for the organization to operate, survive and thrive. The creativity involved in the design process has led some to refer to the field as “organizational architecture”.

The organizational designer is charged with balancing each of the factors mentioned above and determining the best way to bring about coherence or fit among them in order for the organizational design to become and remain a source of competitive advantage. The role of organizational designer generally falls to the chief executive officer (“CEO”) who emerges from the founding group and he or she will rely on the other founders and non-founder members of the executive team to provide input on the key elements of organizational design.¹ For example, the CEO is responsible for strategic planning—setting the business and financial goals for the company and creating and implementing the specific strategies designed to achieve those goals. The senior executive overseeing the human resources function is responsible for developing, recommending and administering rewards systems that motivate managers and employees to effectively execute the chosen strategies. The head of logistical activities, sometimes referred to as the “chief operating officer,” is charged with making sure that vertical business processes are established to ensure communication and collaboration between departments and divisions. Finally, all the members of the executive team should focus on creating and supporting the organizational culture and preferred management/leadership style that are appropriate for the organizational strategy and other elements of the design model.

§2 Models of the organizational design process

¹ For further discussion of the founders’ influence on elements of organizational design, particularly organizational culture, see “Founders” in “Entrepreneurship: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
A wide range of methods have been used to identify and depict the elements that must be considered in the organizational design process. One of the most popular is the “Star Model”, which was first developed by Galbraith in 1977 and which emphasizes the following five major components: tasks, structure, information and decision processes, compensation and reward systems and people (i.e., human resources management). Each component presents the organizational designer with several key choices. With respect to tasks, the organization must decide upon the correct scope of diversity, difficulty and variability to meet its performance objectives. Structural choices include identifying the appropriate division of labor, departmentalization, configuration, and distribution of power. With respect to information and decision processes, the choices include selection of the decision mechanism, the frequency and formalization of information collection and decision making, and design of the database. When focusing on choices regarding the people who will be integrated into the organization, important factors include selection, training and development, promotion and transfer. Finally, the choices with respect to reward systems include the compensation system, basis for promotion, leadership style and job design.

The Star Model is generally depicted as a pentagon that connects each of these components and a star is placed inside the pentagon with the word “fit” to emphasize the interdependence of each of these elements and the need to make sure that each of them is consistent with the business strategy that has been adopted by the organization. The primary driver of each component is the strategy adopted by the organization. If a change in strategy requires a modification to any one element then the designer must check each of the other elements to confirm that they still work in the new circumstances or to determine what changes in those other elements might be necessary and appropriate to accommodate and compliment the initial change. For example, if the organization alters its strategy by targeting a new market the designer must determine if the necessary human resources (i.e., “people”) are available to the organization for the initiative and make sure that the organizational reward systems provide adequate incentive to shift focus toward achieving the revised strategic goals and objectives in the new market.

By 1995 Galbraith himself had modified the five points of the Star Model to include the following: strategy, including vision, governance and comparative advantage; structure, including power and authority, information flow and organizational roles; business processes and lateral linkages; compensation and reward systems; and human resource management, including organizational learning. Several other variations of the Star Model have evolved and been popularized by business consultants and academics. For example, information technology has been added to structure, process, people and culture to form the five points of the star and “strategy” has been placed in the middle of the star to emphasize how the choice made with respect to organizational strategy should be tightly aligned with the other organizational elements. Another version of the Star Model is based on taking a strategic focus toward the following five areas: vision and strategy, with a specific emphasis on identifying a mission and set of goals that go beyond

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3 J. Galbraith, Designing Organizations (San Francisco: Jossey-Bass, 1995).
financial performance; values and culture, including ideas about how the organizational values can be marketed and delivered to customers and other business partners; leadership and management, which include recruitment and motivation of talented human resources similar to the element of “people” in the other variants of the Star Model; business processes, including information technology; and organizational structure, both formal and informal.

A similar analytic tool for looking at the organizational design process is the McKinsey 7S Model that has been widely utilized to analyze and improve the effectiveness of organizations. Like the Star Model, the 7S Model has various elements that are depicted as interdependent elements. These elements can usefully be broken down into “hard” factors, such as strategy, structure and systems, and “soft” factors that are more intangible and imbedded in the culture of the organization, such as skills, shared values and beliefs, staff and style. The notable difference from the Star Model is the inclusion of skills, including the capabilities and competencies within the organization; shared values, which are defined as the values and beliefs of the organization; and style, which calls for taking into account the leadership approach of top management and overall operating approach of the organization.4

§3 Organizational structure

Organizational structure, one of the key issues for the organizational designer5, is the way in which the members of the organization and their job responsibilities are arranged. Organizational structure includes several important components including roles, relationships, responsibilities, authorities and communications channels.6 The organizational structure typically consists of various business units formed around functions, products, markets or customers that are arranged in a hierarchical fashion that identifies how power and authority is formally allocated within the organization. The organizational structure determines how power, authority and accountability is distributed throughout the organization and obviously has a strong influence on how members and business units interact with one another and the degree to which they will share information and collaborate to achieve the overall goals and objectives of the organization. As with the other elements of organizational design, organizational structure must be aligned with strategy. For example, if the strategy is based on identifying and satisfying the needs of a particular target group of customers the human and other resources of the organization should grouped in the way that is most effective for creating and delivering the outputs demanded by the customers.

§4 --Key issues for designing the organizational structure

5 For further discussion of the process of organizational design and the key issues for organizational designers, see “Organizational Design: A Library of Resources for Sustainable Entrepreneurs” prepared and distributed by the Sustainable Entrepreneurship Project (www.seproject.org).
The design of the organizational structure requires answers to several key questions about how the activities of the organization will be carried out. First, the roles and responsibilities of each member of the organization, including executives, managers and employees, must be defined. Second, a hierarchical structure of authority and power must be established in order to identify the locus for decision making within the organization. Third, channels for communication and information flow should be created through the establishment of reporting rules and procedures. Fourth, mechanisms for monitoring and controlling the activities of the members should be established. Fifth, processes for coordinating the work activities of members positioned in different parts of the organizational structure should be developed and implemented. Finally, decisions need to be made about the dimensions that should be used a guide for grouping members of the organization to efficiently collaborate to produce the desired outputs (e.g., functional departments or product-focused business units). Each of these basic questions comes with a myriad of sub-issues. For example, when assessing how control will be exerted decisions must be made about the appropriate degree of centralization, spans of control and complexity of written rules and procedures.

§5 --Evolution of the organizational structure

When an organization has just been launched and only a small number of persons are involved there is generally ample opportunity for face-to-face communication among the members of the group and the need for a formal organizational structure is generally low provided that sufficient attention is paid to strategic planning and setting mutually agreed goals and objectives. At that point the founders and other members of the organization can generally allocate and organize work activities based on their skills, experience and preferences and the organizational structure, to the extent one exists, will generally be organic with a flat hierarchy and strong reliance on informal norms and values to control the activities and interactions of all of the members of the organization. The founders are generally involved in most of the decisions relating to the activities of the organization and other members of the organization can usually count on easy access to the founders to discuss ideas and concerns. In fact, the most popular method for passing along role assignments within top performing smaller organizations is informal conversation. Much less popular, although used with some frequency, is written job descriptions and meetings. The founders are also more directly involved in designing and monitoring role assignments in top performing organizations. If input is needed from other members it can be obtained quickly and efficiently and news of significant events, such as the outcome of a meeting with a new vendor or customer, can be conveyed in real time without the trouble and expense of creating and maintaining formal information and communications processes.

As organizations grow from very small (i.e., less than 20 employees) to relatively large (i.e., 80 or more employees), one notes significant changes in the management of workflow and structure becomes an important managerial challenge. At some point the range of activities and tasks that need to be performed within the organization expands to the point where the founders no longer have the time and skill to personally oversee all of
them. The founders are forced to delegate responsibilities and decision-making authority to new executives who join the founders as the leaders of the organization, generally focusing on specific functional areas (i.e., an increase in specialization). As new employees join the organization, more managers must also be brought in to provide the direct supervision that the founders and other senior executives can no longer offer and the result is the creation of a traditional chain of command structure accompanied by an inevitable increase in the number of hierarchical levels within the organization structure.

Organizations are typically founded by one person or a small group of persons and, as noted above, there is no need for a formal organizational structure during the early stages of launching the new venture. However, once they reach a certain size and complexity, organizations companies generally begin to departmentalize their activities along one of the axis or dimensions referenced above. In most cases, the initial decision is to distribute activities and people along functional lines (i.e., a “function-based” organizational structure). The main advantage of this approach is that it allows the organization to develop the specialized functional skills and resources that are essential for the development of any business. In addition, a function-based structure is probably the easiest way for the chief executive officer (“CEO”) to retain an overall picture of the business and thus effectively exercise his or her role as the primary decision maker. There are, however, disadvantages to a function-based structure that ultimately lead to changes as the organization grows. For example, departments organized by function tend to focus on internal goals as opposed to the broader goals and objectives of the organization. This “tunnel vision” is fostered by a lack of communication with other business units and establishment of reward systems that are based on functional objectives and achievements as opposed to collaboration with groups in other parts of the organization. As a result, conflicts begin to arise when coordination among business units is required and it becomes necessary for senior management to devote a significant amount of time and effort to ensuring that the various functions learn to work together for common goals.

Eventually, the problems with a functional-based structure lead toward adoption of a new organizational structure built around products or markets as the primary axis or dimension. This has the immediate advantage of dividing the activities and resources of the organization into units, typically divisions or subsidiaries, that are more closely related to its competitive environment and also makes it easier for the organization to align its rewards and incentives with the overall performance goals established by senior management for the organization as a whole. In addition, a product- or market-focus organizational structure reduces the problems that arise when attempts are made to coordinate activities across functions and CEO is able to delegate decision-making responsibility to senior product or market managers and then evaluate their performance using objective criteria. Of course, there are certain disadvantages associated with the new structure that must be considered. The most important is probably the danger that the specialist skills of the organization will be eroded which may adversely impacted what had previously been a competitive advantage of the organization. In addition, launching and maintaining separate organizational units for each product and/or market may result in duplication of functional resources in each unit, a problem that is sometime
eventually addressed by creation of central resource units that offer certain functional services to two or more business units within the organization. Also, while not necessarily a disadvantage, the transition to a new structure means that the CEO must adapt to new ways of tracking the progress of the organization. The former CEO habit of relying on direct knowledge based on detailed involvement in day-to-day decisions must give way to the use of written reports and trust in the judgment, skills and abilities of other managers. In order for the structure to be effective, it must be understood and operated by managers that are highly skilled and committed to the strategic goals and objectives set by the CEO.⁷

Some of the shortcomings associated with an organizational structure grounded in a single axis or dimension may be overcome by implementing a matrix structure that calls for employees to report to managers on two different dimensions. A common form of matrix structure groups employees by product and by function. For example, a marketing specialist may be assigned to a particular product group to provide support on creating and implementing promotional strategies for the product while simultaneously collaborating with colleagues in a headquarters-based marketing department. This individual would have reporting relationships with two managers—one in the product group and one in the marketing department. The matrix structure facilitates the flow of ideas and information across product groups since this individual can share news with colleagues in the marketing department who will then pass them along to the other product groups with which they are affiliated. The matrix structure also allows the organization to build and maintain a functional core competence in marketing while still following a product-focused model for grouping all functional activities. The main challenge of the matrix structure is complexity and most particularly the very real possibility that confusion will arise in the minds of employees as they attempt to serve the needs of two managers.

About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, Business Transactions Solution, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 80 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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