

FIT - THE KEY TO ORGANIZATIONAL DESIGN

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Abstract: The design of an organization needs to fit its situation. Designs that fit produce higher organizational performance than designs that do not. This article uses the concept of fit to show how to align organizational designs to three important situational factors: competitive strategy, organization size, and task uncertainty.

Keywords: Fit, misfit, organization design, strategy, organization size, task uncertainty, contingency theory, multinational organizational structures

The concept of fit is central to modern organizational design. The core idea is that the design of an organization needs to fit its strategy and other contingency factors. Designs that fit deliver better financial performance; misfit produces disorganization and consequent lower performance (Schlevogt, 2002). As organizations evolve, their existing strategies and structures tend to lose fit and become a drag on performance. Managers have to be alert to emerging misfits and adjust the organization to the changed contingencies in order to restore performance. The objective of this article is to translate research-based organizational design knowledge for managers, specifically to show them how to achieve a fit between structural features and the key contingencies of competitive strategy, organization size, and task uncertainty.

CONTINGENCY 1: COMPETITIVE STRATEGY

The process of achieving fit with competitive strategy is driven by the organization's level of diversification – a continuum that ranges from single business to multiple businesses to multinational. Low diversification, such as a single-business firm with homogeneity in products, services, and customers, is best fitted by a functional structure, in which the managers who report directly to the CEO are specialized by function – engineering, manufacturing, marketing, etc. (Galbraith, 1973). For example, AustralianSuper, a large, successful Australian superannuation (pension) fund, uses a functional structure (see Figure 1). Although AustralianSuper is large, it has only a single product (pensions) and a single geography (Australia), and therefore is best supported by a functional structure.

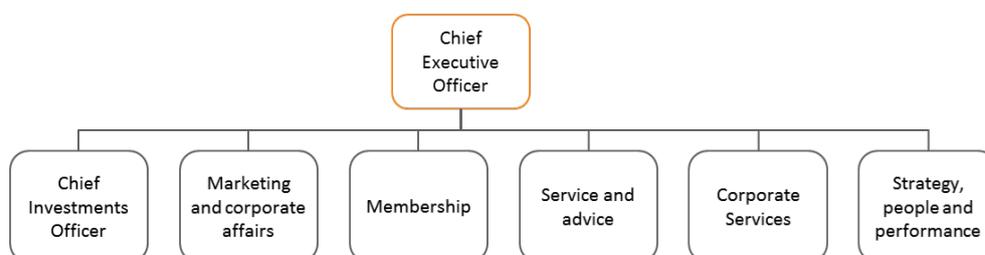


Fig. 1. AustralianSuper: single-business strategy, functional organization structure
Source: www.australiansuper.com

When an organization begins to diversify – to add products, services, production technologies, markets, and geographies – it must adopt a divisional structure (Chandler, 1962). An example is Sony Corporation (see Figure 2). As the firm added entertainment and financial services

to its original line of electronics products, each product category was grouped into its own division. When products or services are unrelated (according to production methods or customers), the fitting structure is for each division to be run as an autonomous business, each with its own set of functions (Hill, Hitt, & Hoskisson, 1992; Rumelt, 1974). Each division is responsible for its own profitability, and division managers may receive bonuses based on divisional profitability. When the products or services are related, however, then some functions and services can be centralized, resulting in increased corporate synergy. In such cases, divisional autonomy declines. In the case of related diversification, collaboration among divisions can be encouraged by having managers and employees receive bonuses based on overall corporate profitability (Rumelt, 1974). When products are vertically integrated, such as in oil companies and other continuous processing firms, the fit is centrally coordinated planning of production rates and inventories across the corporation. The corporate head office, accordingly, is larger and contains more functions. In this structure, upstream divisions are cost centers and downstream divisions are profit centers (Lorsch & Allen, 1973), and general managers' bonuses include more weighting on corporate profitability.

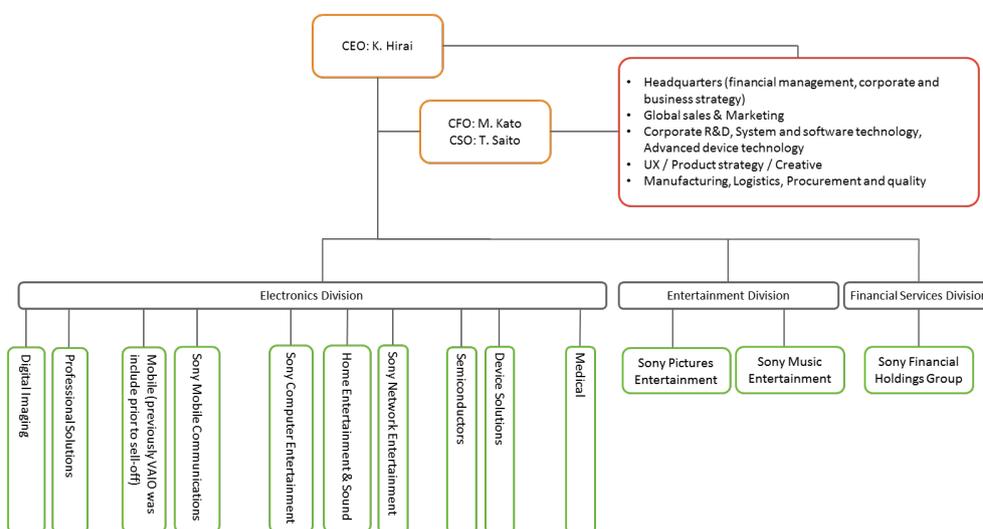


Fig. 2. Sony Corporation: multi-business strategy, divisional organization structure
Source: Sony Group Annual Report 2012 (<http://visiblebusiness.blogspot.com.au/2013/06/sony-organizational-chart-2012.html>)

Much of this strategy-structure fit model has been well researched and is widely understood. Nevertheless, firms sometimes wait more than ten years after diversifying before moving to a divisional structure (Donaldson, 1987), so that they are in misfit for a considerable period, which adversely affects their performance. Hence, there is a need for managers to be more aware of the benefits of moving to a divisional structure as the organization begins to diversify. Moreover, even when the firm has moved to a divisional structure, it may not install the entire suite of structural and process elements that make the divisional model work, such as divisional autonomy, measurement of divisional profitability, and reallocation of capital between divisions (Hill, 1985). Each of these is an element of fit and so adds to performance.

Diversification on Two (or More) Axes

When firms are diversified on two axes – for example, functions and products – the matrix structure becomes the fit, because it is necessary to have a manager responsible for each major diversification dimension (Galbraith, 1973). Matrix structures are complex and may become difficult for managers and employees to operate, so it is important to pre-specify which managers have final decision rights on which decisions (Davis & Lawrence, 1977). In cases where there are diverse projects that draw on shared central functions for resources, a project-functional matrix may offer benefits of speedy innovation and cost containment. Project managers ensure the impetus for speed and innovation while functional managers oversee efficient use of resources shared across projects.

From the original two-dimensional matrices defined by functions and products, matrix structures have become increasingly complex as large multinational companies strive to emphasize multiple diversification dimensions. Three-dimensional matrix structures appeared in the 1970s as multinational companies emphasized country and regional geographies, and four-dimensional matrices appeared in the 1980s as companies put heavy emphasis on customers. Recently, a five-dimensional matrix structure has been predicted, in which companies try to take advantage of the opportunities presented by “big data” (Galbraith, 2014).

Fit for Multinational Corporations

For multinational corporations (MNCs), strategic considerations include not only the level of diversification but also the relative importance to the MNC of local responsiveness (LR) and global integration (GI). High local responsiveness means the MNC responds in-depth to local environments, such as customizing products to local tastes and working cooperatively with the host government. High global integration means the MNC is primarily concerned with global economies of scale, such as standardized products and integrated global supply chains (Bartlett & Ghoshal, 2002). A typology of international strategies and their best-fit organizational structures is shown in Figure 3.

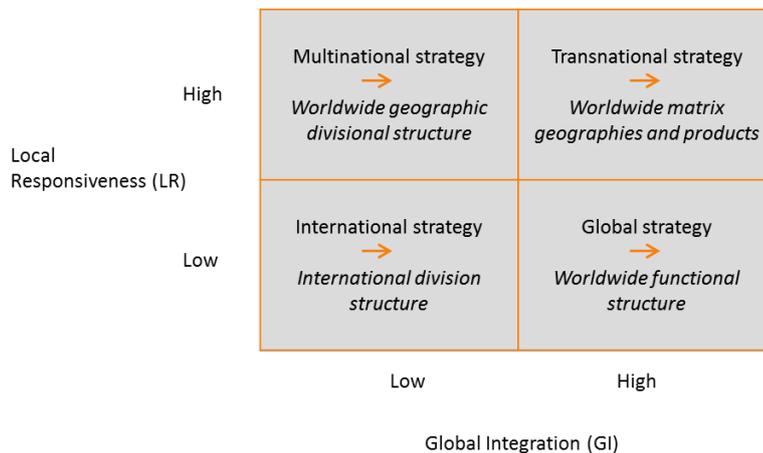


Fig. 3. Multinational strategies and supporting structures

As indicated in the figure:

- An MNC pursuing an international strategy (low LR and low GI) is best fitted with an international division structure (Donaldson, 2009). The international division, housed in the domestic organization, coordinates the foreign subsidiaries. Although this structure has limited cross-national information-processing capacity, it is appropriate for an MNC with limited foreign operations.
- A global strategy (low LR and high GI) is fitted by having a worldwide functional structure which provides detailed coordination among foreign subsidiaries and the domestic organization.
- A multinational strategy (high LR and low GI) is fitted by a worldwide geographic divisional structure, which provides autonomy to foreign subsidiaries so that they can cater to local tastes.
- A transnational strategy (high LR and high GI) is fitted by geographies matrixed with functions; however, if there are diverse products, then the fit is geographies matrixed with product divisions, the functions being within each product division. The transnational strategy requires coordination by the geographies balanced by functions or products.

These designs refer to the enterprise level of the organization, indicating the major building blocks of the organization and the responsibilities of the managers who report directly to the CEO (Qiu & Donaldson, 2010). Accordingly, fitting structure to strategy is

straightforward when strategies change. For example, in an MNC pursuing a global strategy and presently supported by a worldwide functional structure, if its managers decide to change to a multinational strategy, they would attain a new and better fit by changing to a worldwide geographic divisional structure. This would be accomplished by changing the senior managers (or the focus of those senior managers) who report directly to the CEO from functional to geographic. There will be other details to be decided, such as which countries are grouped in the same geographic division, but these issues can be managed by working through the options against agreed criteria.

Fitting Centralization, Formalization, and Shared Values to Strategy

An MNC's competitive strategy will also guide choices regarding centralization, formalization, and shared values as shown in Figure 4 (Ghoshal & Nohria, 1993).

	International	Global	Multinational	Transnational
Enterprise Structure	Domestic	Worldwide functional	Worldwide geographic	Matrix
Degree of Centralization	Low	High	Low	High
Degree of Formalization	Low	High	Low	High
Shared Values	Low	High	Low	High

Fig. 4. How structures and shared values fit MNC strategies

As indicated in the figure:

- An international strategy requires little coordination and so is fitted by minimal structure that avoids unnecessary costs. Therefore, an MNC pursuing an international strategy can be low on centralization, formalization, and shared values.
- Global strategy requires tight control over foreign subsidiaries in order to reap global synergies, so an MNC pursuing this strategy needs to be high on at least one of centralization, formalization, or shared values. Here the challenge is to control lower-level managers, either by the head office making the decisions, or by rules, or by shared values, respectively.
- The multinational strategy seeks local responsiveness and therefore the foreign subsidiaries must fit their local environments, especially the local resources and level of complexity. The degree of centralization, formalization, and shared values is typically low.
- The transnational strategy seeks both global integration and local responsiveness, so it is fitted by high levels of at least one of centralization, formalization, and shared values, while the foreign subsidiaries must also fit their local environments.

It involves a significant amount of work to assess the levels of centralization, formalization, shared values, and foreign subsidiary fits of an MNC and to make appropriate adjustments. However, Ghoshal & Nohria (1993) found that most of the MNCs they studied were in misfit, which resulted in lower profitability and revenue growth (an average of 35% in ROA, 64% in ROA growth, and 31% in revenue growth). Given such magnitudes of lost profitability and lost revenue growth due to misfit, it is clearly worth the effort to assess fit and ensure that the organization structure fits the strategy.

CONTINGENCY 2: ORGANIZATION SIZE

As an organization grows, the fitting structure becomes more complex. The expanding structure has more hierarchical levels, more decentralized decision-making, more functional departments, more specialist jobs, and more standard operating procedures (Child, 1975). An example is the Australian management consulting firm, Nous Group. When the organization had only 10-20 staff in the early 2000s, the Managing Director made most of the important decisions. As the organization grew to approximately 150 people in 2014, more decisions were delegated to lower-level managers and to personnel who made decisions guided by

their job descriptions, policies, standard operating procedures, and norms. The more complex structure included a people and culture team, an IT support team, practice groups, and industry groups.

Some managers fear that greater organizational size may produce structures that are overly complex and costly. Structures, however, become more complex at a lesser rate than size increases. Consider, for example, the growth of hierarchy as size increases. An organization is a pyramid, so there are more people at the bottom than at the top. Adding a level at the bottom accommodates many more people when the organization is large than when it is small. Hence, size growth leads to less of an increase in hierarchy in large organizations than it does in small organizations. If the CEO of a small organization has seven subordinates, then the size is eight and there are two hierarchical levels. If each of these subordinates were to gain seven subordinates, then the size becomes 57 and there are three hierarchical levels. The increase of one hierarchical level, from two to three, is caused by size growth of 49 people, whereas an earlier increase of one level, from one to two, was caused by size growth of only seven people. Similarly, as size grows, specialization and other structural features become more complex, but complexity increases at a lesser rate than size.

This is a hopeful message about fit for managers of growing organizations. Managers should respond to size growth incrementally, adding an additional hierarchical level and a little more delegation, a specialist here and a rule there, as challenges due to growth highlight the need for more sophisticated organizational designs.

CONTINGENCY 3: TASK UNCERTAINTY

Task uncertainty determines how formalized the organization, or parts of the organization, need to be. Uncertainty about how to perform tasks stems from both inside and outside the organization. Generally speaking, organizations in dynamic industries, and organizations that are highly innovative, require less formalized structures so that they can respond quickly to threats and opportunities (Burns & Stalker, 1961). Task uncertainty can be thought of as a continuum. Where task uncertainty is low, the fit is a standard operating procedure. Where the task is somewhat more variable, the ability to plan tasks is the fit. Where the task is of intermediate uncertainty, a manager using his or her information and experience is the fit. Where task uncertainty is high, the fit may require a team of specialists from different functions. They mutually adjust their activities, as each uses their professional expertise to contribute to task accomplishment. In some cases, the fit for high task uncertainty also involves an integrator, who is independent of the functional departments and uses a problem-solving approach to coordinate between the functions (Lawrence & Lorsch, 1967).

Where there is a strong focus on innovation, the fit is for each product or service line to be a division with its own resources. Here co-located functions are focused on one group of products under its own division manager. If there are cross-division opportunities, these can be targeted using cross-division business teams and/or a head office integrator.

FITS TO MULTIPLE CONTINGENCY FACTORS

So far we have considered the fit of organizational designs to the three major contingencies – strategy, size and task uncertainty – separately. But there can be more than one contingency factor that together shape which structure is the fit. For example, strategy and task uncertainty can jointly shape structural fit. In a company with a strategy of related products or services, the best fit for innovation and so high task uncertainty is to have a divisional structure with each division focused on optimizing innovation for its own products and customers. In contrast, if that company had a strategy of related products or services, but had cost containment as its priority, so task uncertainty would be low, the fit would be a functional structure, to achieve economies of scale. Hence for a company with a related strategy, its fitting structure depends upon whether it wants to prioritize innovation or cost containment. Thus, which structure fits it is affected by two contingencies simultaneously: strategy and task uncertainty.

The fit prescribed by one contingency may sometimes differ from that fit prescribed by another contingency. For example, an organization that has a high need for innovation would be fitted by low formalization, yet if the organization were also large that would be

fitted by high formalization. Organizational designs often cope with this through structural differentiation. This means that the R&D department has low formalization, to deal with the high uncertainty of its tasks, while the administrative aspects of the organization (e.g., Accounting) have high formalization to fit the large size of the organization.

This idea of structural differentiation can be carried further to yield the ambidextrous organization (March, 1991; O'Reilly & Tushman, 2004; Tushman & O'Reilly, 1996). A firm with a mature product that also has a related product in the innovation stage may structure them as separate divisions, each with its own distinct internal structure fitted to the task uncertainty of the division. The divisions have their own strategies and are held accountable by the head office on different performance criteria, e.g., profit for the mature product division versus attaining innovation deadlines for the innovative product division. Integration of the two divisions is dealt with by a shared vision of the future under the leadership of the CEO. The main structural differentiation options for ambidextrous organizations are discussed by Carroll (2012).

DEVELOPING FITS

Of course, the environments of organizations can change often. This makes the perfect organizational design elusive and attaining it an unrealistic goal. Organizational design is a dynamic process (Nissen, 2014), in which managers recurrently seek to close the gap between the newly needed organizational design and the existing design. Such reductions in misfit improve organizational performance. To succeed competitively, a firm and its managers only have to do this redesign of their organization in a more effective and timely manner than their competitors.

IDENTIFYING MISFITS

A common question of business owners and managers is how to identify organizational designs that misfit key contingencies. Although it is logically possible that in an organization every design variable could misfit its contingency, in practice there is in an organization often only one or a few large misfits of structural variables and contingencies that is causing most of the performance loss (Burton, Lauridsen, & Obel, 2002). Thus, in the typical organization there is some "low hanging fruit" that a manager can pluck by identifying the big misfit in his or her organization and changing it to a fit. In theory, the search for such a misfit could entail examining all combinations of the structural variables and contingencies in the organization, and identifying those that are mis-fitted to their contingencies. But often the largest misfit in an organization is the result of a change in a contingency (e.g., competitive strategy) that has not yet been accommodated by a new, fitting organizational design. Experienced, vigilant managers are probably aware of the large misfits in their own organizations already and can determine the appropriate adjustments to make.

CONCLUSION

This article provides an application of contingency theory to organizational structures that managers can consider when designing and redesigning their organizations. For managers seeking guidance on the organization design process, see Burton, DeSanctis, and Obel (2011). For those interested in the research base underlying the concept of fit, see Burton and Obel (2004). This book comes with a computer program, *Orgcon*, which analyzes an organization's design and recommends the appropriate fits. By identifying misfits and making the appropriate adjustments, managers can significantly improve the performance of their organizations.

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