UNIT 213 – UPSC - Design of Organization Structure and Control

It is found in abundant of research studies that organizational structure and the controls greatly impact the performance of any firm. Particularly, when the firm' s strategy is not harmonized with the most appropriate structure and controls, performance falloffs. Organization structure is described as the role-responsibility relationships of different personnel in an organization along with their pre-defined interaction patterns. It accelerates the flow of information both vertically and horizontally in an organization.

Organizational structure identifies the firm' s formal reporting relationships, procedures, controls, and authority and decision-making processes. It has been observed that developing an organizational structure that effectively supports the firm' s strategy is difficult, especially because of the ambiguity or unpredictable variation about cause-effect relationships in rapidly changing global economy and dynamic competitive environments. When a structure' s elements such as reporting relationships, procedures are properly allied with one another, that structure enables effective implementation of the firm' s strategies. Thus, organizational structure is a critical component of effective strategy implementation processes.

A firm' s structure also stipulates the work to be done and how to do it, given the firm' s strategy or strategies. Therefore, organizational structure influences the way managers work and the decisions resulting from that work (Schilling & H. K. Steensma, 2001). Supporting the implementation of strategies, structure is concerned with processes used to complete organizational tasks.

Numerous studies have shown that effective structures provide the steadiness in a firm and to successfully implement its strategies and maintain its current competitive advantages, while instantaneously providing the flexibility to develop competitive advantages that will be needed for its future strategies (Ireland, et, al., 2003). Thus, structural stability provides the capacity the firm requires to constantly and predictably manage its regular work, while structural flexibility provides the opportunity to explore competitive possibilities and then allocate resources to activities to gain competitive advantages the firm will need to be successful in the future. An effective organizational structure also enables the firm to exploit current competitive advantages while developing new ones.

Alterations to the firm' s current strategy or selection of a new strategy are done to bring transformation in its organizational structure. However, many researches show that once in place, organizational inertia often hinders efforts to change structure, even when the firm' s performance suggests that it is time to do so. Alfred Chandler found in his original research work that organizations change their structures only when inadequacies force them to do so. 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. Additionally, senior managers stated that there are problems with the firm' s structure (or its strategy, for that matter), in that doing so suggests that their previous choices were not the best ones. Because of these inertial tendencies, structural change is often induced instead by the actions of stakeholders. In brief, organizational structure postulates the firm' s formal reporting relationships, procedures, controls, and authority and decision-making processes.

The structural dimensions of organization design: These are as follows.
- Formalization
- Specialization
- Hierarchy of authority
- Centralization
- Professionalism
- Personnel ratios

Some of the contextual dimensions of organization design are as under:
- Organization size
- The technology it uses
- The environment in which it operates

An organization should be organised in such a way as to go beyond maximizing performance levels and effectiveness of operations. It should boost participation and innovation throughout the organization.

Different types of organization structures:

These include:
- **Functional:** The functional structure is characterized by categorizing people based on their expertise and skills.
- **Divisional:** Divisional structure is described as the divisions formed based on an organization's product range. These are specific markets the organization caters to, or the geographic locations in which it operates.
- **Matrix:** The matrix organization attempts to integrate the desired features of both the functional and divisional structures. In this structure, a worker reports simultaneously to two different supervisors. One of these supervisors represents a functional department and the other represents the division, product, market, geography, or project.
- Horizontal: The horizontal structure averts the rigidity and departmentalization existing in a vertical system by grouping the managers and employees into synergistic teams for problem solving.

Hybrid structures: When firms use a combination of any two structures (for example, functional and divisional or functional and horizontal), the resulting structure is referred as hybrid structure. It combines the strengths of the structures being merged.

A responsibility structure is a gathering of responsibility centres. A responsibility centre is a function, division, or unit of an organization under a specified authority with a specified responsibility. Responsibility accounting can be described as a system of management accounting under which accountability is determined according to the responsibility allotted to various levels of management. In an organizational setting, it is essential that the performance measurement systems are designed to be fair. Two major aspects should be considered that include controllability and goal congruence. According to the controllability principle, each manager should be assessed and rewarded only for those factors that are under his/her control. Goal congruence is accomplished when managers (and employees), while working toward their best self-interest as perceived by themselves, take decisions that are successful in achieving the overall goals of the organization. This occurs when their individual objectives are aligned with the organizational goals. Transfer pricing is a device used in responsibility accounting to assign monetary values to transactions taking place between two or more responsibility centres.

According to the nature of monetary inputs and outputs, responsibility centres can be categorized into four types. They are cost centres, revenue centres, profit centres, and investment centres. Cost centres are further divided into standard cost centres and discretionary expense centres.

Organizational Controls:

Organizational controls are significant attribute of structure (Mills & G. R. Ungson, 2003). Organizational controls guide how to use strategy, specify how to compare actual results with expected results, and recommend corrective actions to take when the difference between actual and expected results is undesirable. The fewer the differences between actual and expected outcomes, the more effective are the organization' s controls. It is difficult for the company to successfully exploit its capabilities and resources to gain competitive advantages if there are lack of effective organizational controls. Appropriately designed organizational controls provide clear understandings regarding behaviours that enhance firm performance. Firms depend on on strategic controls and financial controls as part of their structures to support use of their strategies (Harrison, 2002). Strategic controls are mainly subjective criteria intended to confirm that the firm is using appropriate strategies for the conditions in the external environment and the company' s competitive advantages. Consequently, 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. Effective strategic controls help the firm understand what it takes to be Successful (Julian & E. Scifres, 2002). Strategic controls claim smooth and effectual 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 (Hoskisson, et, al., 1994).

Strategic controls are also used to assess the degree to which the firm focuses on the requirements to implement its strategies. For a business-level strategy, the strategic controls are used to study principal and support activities to verify that those critical to successful execution of the business-level strategy are being properly highlighted and executed. For corporate-level strategies, strategic controls are used to confirm the sharing of appropriate strategic factors such as knowledge, markets, and technologies across businesses. In order to effectively use strategic controls when evaluating related diversification strategies, administrators must have a profound understanding of each unit' s business-level strategy (Hitt, 1996). Because strategic controls are difficult to use with extensive diversification, financial controls are emphasized to assess the performance of the firm following the unrelated diversification strategy. The unrelated diversification strategy on financial outcomes requires the use of standardized financial controls to compare performances between units and managers (Collis, 1996). Financial controls are mainly objective criteria used to measure the firm' s performance against formerly 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 few examples of financial controls.

When firm using financial controls, it appraise their current performance against earlier outcomes as well as their performance compared to competitors and industry averages. In the worldwide economy, technological advances are being used to develop highly modern financial controls which enable the firms to more thoroughly analyse their performance results and to assure compliance with regulations. For example, Oracle Corp. developed software tools that automate processes and firms can use to meet the financial reporting requirements specified by the Sarbanes-Oxley Act (Songini, 2003). 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. Sophisticated financial controls of Pfizer Inc. are used to assess

(1) Safeguard the firm' s assets.
(2) Ensure that transactions are properly authorized.
(3) Provide reasonable assurance, at reasonable cost, of the integrity, objectivity, and reliability of the financial information (Pfizer, 2002).

Both strategic and financial controls are vital of each organizational structure, and any structure' s effectiveness is determined by using a combination of strategic and financial controls. Nonetheless, the relative use of controls differs by type of strategy. For example, companies and business units of large diversified firms using the cost leadership strategy to emphasize financial controls (such as quantitative cost goals), while companies and business units using the differentiation strategy to emphasize strategic controls (Barney, 2002). It is established that a corporate-wide emphasis on sharing among business units results in an emphasis on strategic controls, while financial controls are highlighted for strategies in which activities or capabilities are not shared (e.g., in an unrelated diversification).

While designing an optimal management control system, it is necessary to determine the specific control measures to be used and the degree of tightness or looseness of control required to provide the desired level of certainty to accomplish organizational objectives. An organization may choose any one or a combination of action control, results control, and personnel/cultural control. The decision on the choice and degree of tightness of control is made on the basis of a cost-benefit analysis. Costs include the consumption of available resources, harmful behavioural side-effects, and the development of negative attitudes among employees. Benefit refers to the level of certainty that the organization is able to achieve by implementing the control system.

Many theorist have emphasized that complexities and uncertainties in the business environment require to design the organization structure and management control system in such a way that the benefits earned from operating in numerous countries are higher than the costs incurred.

There are some major aspects which needs to be considered for designing the organization structure of a multinational corporations. These are
- The strategy of international business
- Extent of centralization
- The division of a multinational corporations into subsidiaries based on product, operational location, or function.

Organizations can select from one of the following four strategies to operate in international business:
- International strategy
- Multi-domestic strategy
- Global strategy
- Transnational strategy.

Such strategic choice depends on the pressure on cost competitiveness, pressure for local responsiveness, and the need for worldwide learning. The extent of centralization of decision-making in different areas such as product development, marketing, production depends on the choice of strategy for operating in international business. In terms of organization structure of the multinational corporations, global structures based on area or product, are common. Restrictions in these structures resulted in Multinational Corporation' s adapting the transnational strategy which uses a global matrix structure. A flexible matrix structure can be used to overcome the inflexibilities of a global matrix structure through the use of informal networks between executives.

The controllability of a subsidiary's results goes from high to low as company move from the multi-domestic strategy to international strategy to global strategy to transnational strategy and the interdependencies and the costs of control varies from low to high. For multi-domestic strategy and international strategy, results controls are more appropriate. For global strategy and transnational strategy, it is suitable to use action controls and personnel/cultural controls.

Management control of non-profit organizations is an area different from that in for profit organizations because of the inbuilt difference with respect to source of funds, features of service, the strategies for selling the service, the mode of delivering the services, reward systems for employees. Geert Hofstede stated that there are four criteria that assist in better management control of non-profit organizations. These include clear objectives, quantifiable results, predictable interfaces, and activities that can be repeated. For different combinations of the four criteria, the organization can implement different types of controls such as routine control, expert control, trial and error control, intuitive control, judgmental control, and political control.

It is important that executives must explore ways to inspire employees to be creative and to initiate process improvements, but must still preserve enough control to guarantee that employee creativity help in enhancing the output of the organization. The concept of "levers of control" proposed by Robert Simons is applicable in this respect. The four levers of control are diagnostic control systems, beliefs systems, boundary systems, and interactive control systems. Diagnostic control systems use quantitative data, statistical analyses, and variance analyses to scan for anything unusual that might indicate a potential problem. Diagnostic systems operate effectively if the goals are reasonable and attainable. Beliefs systems are used to communicate the principles of corporate culture to every employee of the organization. Boundary systems are based on the principle that in an age of empowered employees, it is easier to develop the rules regarding what is unsuitable rather than what is appropriate. The effect of this kind of thoughts is to permit employees to create and define new solutions and methods within defined constraints. Interactive control systems are futuristic and involve regular communication between senior managers. The interactive control system helps organizations in positioning themselves strategically in the rapidly changing market.

Steps to establish organizational control:

Managers can establish control systems in following steps:

1. Establish standards to measure performance. Within an organization's overall strategic plan, managers describe goals for organizational departments in specific, operational terms that include standards of performance to compare with organizational activities.
2. Measure actual performance. Most firms prepare formal reports of performance measurements that must be reviewed regularly by managers. These measurements should be related to the standards set in the first step of the control process.
3. Compare performance with the standards. This step compares actual activities to performance standards. When managers evaluate computer reports or walk through their plants, they recognise whether actual performance meets, exceeds, or falls short of standards. Normally, performance reports are simplify such comparison by placing the performance standards for the reporting period alongside the actual performance for the same period and by computing the variance that is, the difference between each actual amount and the associated standard.
4. Take corrective actions. When performance differs from standards, executives must determine what changes, if any, are necessary and how to apply them. In the productivity and quality-centred environment, employees and managers are often authorised to evaluate their own work. After the evaluator determines the cause or causes of deviation, he or she can take the fourth step, corrective action. The most effective course may be set by policies or may be best left up to employees' judgment and initiative. To summarize, Organizational Structure are a firm' s formal role configuration, procedures, governance, and control mechanisms, and authority and decision-making processes. Organizational control are associated with developing rules, guidelines, procedures, limits or other protocols for directing the work and processes of employees and departments. These controls can include establishing rules for financial transactions, employee behaviour and specific practices for all or individual departments. In simple term, the control process involves sensibly collecting information about a system, process, person, or group of people in order to make wise decisions about each element.